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# Room with a View

## - Perspectives on Property

Issue One Spring 2010

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## Welcome to the first issue of **Room with a View** – Perspectives on Property

**In this issue we aim to highlight topical areas of interest for the property industry.**

The events affecting the global economy in the last couple of years still reverberate and are likely to continue to impact on the property market for some time to come. It will come as no surprise, therefore, that the articles in this edition have focussed on the kinds of issues likely to be faced by occupiers and investors and offering strategies to cope with these issues.

First, Louise Langley takes a look at the use of indemnity policies to transform property deals to ensure swift completions and she questions whether they provide adequate cover against risk. Will Stokes then offers tips for commercial landlords and tenants during the economic downturn and urges landlords to remain proactive in a tough marketplace.

Richard Eaton considers what happens to land contracts in a slow down and what a seller can do to uphold the contract. We end with John Scannell's outline of break clauses and their use as an invaluable method of mitigating a tenant's lease liabilities.

In keeping with our commitment to keep you up to date with the latest developments (and reduce our carbon footprint) we will be circulating future updates electronically as we come across matters of interest. Enclosed is a form for you to return to us to confirm your email details and ensure our information is up to date.

We hope you find this edition interesting and useful and would welcome your feedback, along with any suggestions of subjects you would like covered in the future.

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# Defective title indemnity insurance

## – how well are you covered?

**Purchasers are increasingly under pressure to complete transactions swiftly either to secure a ‘bargain’; or because they are purchasing at auction where sellers are in financial difficulty or mortgage lenders have repossessed the property.**

If a problem presents itself which cannot be resolved quickly and easily, obtaining an indemnity policy is seen as a quick fix to enable the deal to go ahead. Indemnity policies can transform transactions that are about to fall through into ones which can quickly get back underway, but do they deal with the risks involved?

The answer to this question depends on the facts of the transaction but before pursuing an indemnity policy, thought should be given to the consequences of accepting the risks.

An indemnity policy is designed to cover the insured against specified costs or losses which may be incurred in the future as a result of the problem in question. Each policy is priced according to the risk covered and the sum insured (which should as a minimum be the value of the property or the expected value if development works are to be undertaken). The premium is usually a one off fee, and the intention is that the insurance company will pay out if loss is suffered due to the risk.



The policy is an indemnity, i.e. compensation from a third party against loss. It does not insure the marketability of the property. If the actual loss is lower than the amount insured, the insurance company will only pay out the amount of loss. Inflation-proofing for policies can be purchased at the outset but this may involve a top-up payment. This is important particularly if the purchaser intends to keep the property for a long period of time. If the risk has been under-insured or the property has increased in value, the pay-out by the insurers will be reduced accordingly.

As with any insurance policy, all material information needs to be disclosed to the insurance company at the outset and throughout the policy term, otherwise the policy will be invalidated.

On receipt of a draft policy wording parties should:

- review the terms to check they cover the risks and provide the greatest protection for the commercial needs taking into account the cover proposed, the cost of the premium, and any limitations;
- think about the commercial position. In the event of a claim, would a payout actually deal with the problem? If not, then alternatives should be considered. To put this into context, if a shop is sold with 30 parking spaces but a covenant restricts use to 10 cars, what happens at some future point when the beneficiary of the covenant comes forward to enforce it? The insurer may choose simply to compensate for the difference in the value of the property rather than pay the covenant holder for a right to park 30 cars. Clearly this may not be satisfactory.

by  
**Louise Langley**  
Solicitor



Where there are indemnity policies already in existence parties are advised to review them regularly to ensure they offer the correct level of protection.

The advantage of indemnity policies is that they do provide comfort in the form of financial protection allowing purchasers and their lenders to accept the risks involved and deals to proceed. However, the protection is one of indemnity and not one of guarantee and there are no guarantees of success in a claim.

So the moral of the story? Indemnity policies can provide effective protection, but for best results they should be treated as an important part of the decision making process. Taking time to step back from the excitement of the deal to consider the consequences of not being able to enjoy the property as anticipated may mean that indemnity cover will not necessarily be the answer. Risk taking is part of everyday life but the risks taken need to be calculated, not disproportionate, and certainly not ones which have been masked by an inadequate indemnity policy.

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# The need for pro-activity in a tough marketplace

## - tips for commercial landlords and tenants during the economic downturn



**In the current climate, landlords cannot afford to passively manage their tenants. If a landlord suspects a tenant is experiencing financial difficulties, it is important that it evaluates its options and devises a strategy early on. Equally, tenants may find themselves in a stronger negotiating position than they think.**

Commercial leases generally contain a clause to end or 'forfeit' the lease for non-payment of rent. Forfeiture is often considered the landlord's strongest weapon against a defaulting tenant, but not always. An empty property means a rental void, possible refurbishment costs to bring the premises into a lettable condition and following recent tax changes, a potential rates liability. It also may prove difficult to re-let the premises and any re-letting could well be at a lower rental value. Landlords should always therefore consider other available options first.

The landlord may hold a rent deposit which will cover some rental shortfall. Alternatively it may be possible to claim against a guarantor, if one was provided when the tenant took the lease, or against former

tenants and their guarantors. If an existing sublease is in place, a landlord may also be able to serve a rent diversion notice on the sub-tenant requiring the payment directly to the landlord until the tenant's arrears are discharged. Finally, the landlord could resort to the 'self-help' remedy of distress, to seize goods from the premises to the value of the arrears. However, it should be exercised with caution as entry must be effected 'peaceably' and without force.

From a tenant's perspective, bearing in mind the current pressure on landlords to preserve rental income, those lease terms that landlords would normally insist on should be strongly resisted. This applies firstly to new leases, where conditions attached to a tenant's break right, upwards only rent review and onerous assignment or sub-letting provisions should be avoided. It is also of relevance to tenants seeking to restructure existing lease arrangements where it may be possible to obtain a rent free period, a switch to monthly rental payments or some other concession from the landlord.

Traditionally re-structuring negotiations would take place as a break right approaches or towards the end of the term, but landlords are now increasingly willing

to listen at any point so long as restructuring is of mutual benefit. Of course a tenant with a break right approaching or nearing the end of its term can use these as leverage to secure better terms before the end of the lease or, more riskily, exercising the break right to force negotiations. Tenants should, however, take early advice (see John Scannell's article later to see how it can go wrong if you do not!).

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by  
**William Stokes**  
Senior Solicitor



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# When push comes to shove

## - what happens to land contracts in a slow down?



Contracts for the purchase of land are often made on a conditional basis and it may be several years before the conditions are expected to be fulfilled. Contracts conditional upon obtaining a grant of 'satisfactory' or 'acceptable' planning consent are common and should contain detailed provisions as to the meaning of such terms. Given the slow down in the market, it may well be that the seller and purchasers take different views on whether such conditions have been fulfilled, and accordingly whether the sale must proceed. So what happens then?

### Interpretation

The terms of the contracts often provide scope for competing interpretations. For example, the drafting may not take into account economic circumstances when assessing what is a 'satisfactory' planning consent. Is it the economic conditions at the time of the contract, or the circumstances at the time of the grant of consent? The difference could be critical in the current market. Similar considerations might apply to planning conditions attached to the permission itself. The contract might protect purchasers against 'onerous' or 'unacceptable' conditions. How the contract provides for the assessment of such conditions becomes crucial. The relationship between the conditions and any S.106 agreement should also be explored. An onerous obligation in any S.106 agreement might not be treated in the contract in the same way as if it had been a condition.

### Improving the planning consent

Alongside negotiations with a seller, a purchaser might also seek to mitigate its position by squeezing maximum advantage out of the ongoing planning process. A review of the scope of reserved matters and planning obligations is vital. A developer might also explore what scope there is for hard bargaining on the S.106

agreement when the delivery of a much needed development might be at serious risk. The conduct of the planning process should be provided for in the contract and will require the seller to be informed of and to agree any revised strategy. The purchaser is usually obliged to use 'best' or 'reasonable' endeavours to achieve an 'acceptable' consent, a task made more difficult when the parties to the agreement are taking different views on what this means!

### Remedies

What can the seller do to uphold the contract? Generally the remedy for breach of contract is damages, being the losses suffered by the seller as a result of the purchaser's failure to complete. It is also possible to apply to the court to require the purchaser to perform the contract and complete the purchase. However, the court is not obliged to do so, and any litigation costs need to be balanced against whether the purchaser can actually afford to complete - even if ordered to do so.

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by  
**Richard Eaton**  
Partner



# Breaking out

## - it's all in the detail!

by  
John Scannell  
Partner



A break clause can be an essential lifeline for commercial tenants who are suffering rent on a property that is surplus to their needs. A break clause enables tenants to end a lease at specified dates before the contractual term has expired. However, operating a break clause can be difficult. There are often conditions that must be strictly fulfilled or the break will fail, often with serious consequences. The tenants in *Osborne Assets Ltd v Britannia Life Ltd* were left paying rent on an unwanted property for 20 years because they had decorated the premises with only two coats of paint when the lease required three. A warning that attention to the detail is essential! If considering operating a break clause tenants should consider the following:

**Review the lease** – The lease and all supplemental documents (i.e. schedule of condition, deeds of variation) should be reviewed at the earliest opportunity and at the latest 18 months before the break date and a checklist of the break clause conditions and critical dates prepared.

**The break notice** – This will usually be a written notice. The time limits for service are strict so a notice should be drafted carefully to ensure that it will expire on the correct date. Importantly, the landlord and tenant must be correctly identified; a mistake here can be catastrophic. Notices must be served in accordance with the service provisions contained in the lease. For certainty, have notices served personally on the landlord or by a process server. This is more costly but will prevent issues arising over whether the notice was served in time.



**The conditions** – Conditions are specific to each lease, but can include; a break payment; repairing; redecoration and reinstatement works. If a break payment is required, an invoice should be obtained from the landlord and payment should be made by bank transfer by the correct date.

The most difficult conditions are those requiring works to be undertaken. An independent surveyor should be instructed to prepare a schedule of works with critical dates factoring in time for delays and errors. This should be sent to the landlord for agreement, and gives them the opportunity to identify any further works and/or specify materials. Although tempting as it is to take shortcuts to save costs, be warned it could lead to the break failing. On completion of the works the landlord should be invited to inspect the premises to confirm that the works meet the required standards. In the event of disagreement, a surveyor should be instructed to prepare a compliance report supported by photographs and videos. This will be of assistance if court proceedings are brought.

**Leaving the property** – The rent must be fully paid prior to the break date, and it is advisable to obtain a statement from the landlord showing all monies due. And finally... the property must be completely vacated by the break date. This includes the removal of all belongings and in some circumstances fixtures and fittings. If the property is vacated prior to the break date security at the premises must be maintained until the break date if this was a responsibility under the lease.

Break clauses are an invaluable method of ending a lease, but failure to pay appropriate attention to the detail of the clause can lead to the break failing and the tenant being left paying rent on an unwanted property.

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