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Coalition Budget and Spending Review Round-up

This article takes a look at what the coalition government's first Budget and Spending Review will mean for the commercial property sector.

The stated aims of the coalition government's first Budget in June were to increase tax revenues whilst at the same time making the UK a more attractive place in which to do business.

Main changes affecting the property sector

Change of VAT standard rate

Legislation has been introduced to increase the standard rate of VAT from 17.5% to 20% with effect from 4 January 2011. Zero rated and exempt supplies are unaffected by the change.

Anti-forestalling legislation will counter arrangements that purport to apply the 17.5% VAT rate to goods or services to be delivered or performed on or after 4 January 2011. In certain circumstances there will be a supplementary charge to VAT of 2.5% where only 17.5% VAT has been declared.

Capital gains tax ("CGT")

A new higher CGT rate of 28% has been introduced with effect from 23 June 2010. For individuals, the rate remains at 18% where total taxable gains and income are under the upper limit of the income tax basic rate band (£37,400 for 2010-11). The new 28% rate will apply to

gains, or any parts of gains, above that limit. For trustees and personal representatives, the rate will be increased to 28% from 18%. There will be no change in the annual exempt amount, which will remain at £10,100 for 2010-11.

The new higher rate will particularly affect owners of second homes, some but not all holiday homes and buy-to-let landlords.

Stamp Duty Land Tax

The Government announced that it will examine whether the SDLT rules for high value property transactions need to be changed to combat tax avoidance in this area. This forms part of an overall drive by the Government, to tackle stamp duty land tax avoidance. Be careful if you are offered a "SDLT Scheme" as many have failed in recent years.

Business rates

The Government has confirmed that it will implement a temporary increase in the level of small business rate relief in England, as announced by the former Labour government in the March 2010 Budget. This increase will apply for one year from October 2010 and will give full relief for eligible businesses occupying premises with a rateable value of up to £6,000, and tapering relief for businesses occupying premises with a rateable value of up to £12,000.

Insurance Premium Tax

On 4 January 2011, the standard rate of Insurance Premium Tax (IPT), currently 5%, will increase to 6%. The standard rate of IPT applies to property insurance.

Also on 4 January 2011, the higher rate of IPT will rise to 20% from the current rate of 17.5%, matching the increase in the standard rate of VAT that takes effect on the same day.

The new rates of IPT will apply to premiums received or written by an insurer on, or after, 4 January 2011.

What Next?

The Budget left a lot of issues unresolved. Regeneration was not mentioned by the Chancellor, but a lot of projects which had been supported by the previous government since the beginning of the year have now been cancelled.

The Government proposes to introduce a simple, consolidated national planning framework covering all forms of development and setting out national economic, environmental and social priorities. Greater powers are to be devolved to councils. Neighbourhoods and local communities will be given control over housing and planning decisions. Whilst planning policy will continue to support the maintenance of the green belt, a presumption in favour of sustainable development will be created. As a result, local authorities will be incentivised to deliver sustainable development including new development initiatives for new homes and businesses.

As the private sector grows and the public sector reduces in size, this will affect commercial property use. However, as the economy comes out of recession new demands will be placed on commercial property and those developers and investors within the sector that can identify and adapt to the new demands of post recession economy have every chance of prospering.

Commercial Leases - New Government, new approach?

• Green shoots of recovery?

Whilst there is more optimism in the commercial market than we have seen for some time there remains a degree of caution. Landlords remain wary of offering large rental concessions (or financing expensive fit-out costs) to attract tenants. Conversely, tenants remain reluctant to take on long-term lease commitments, particularly if they are required to provide security (such as personal guarantees and/or rental deposits).

Increasingly we are seeing the emergence of canny landlords and tenants who are seizing the opportunity to review their relationships and to forge new tenancy agreements that better reflect today's marketplace.

• Flexible new leases

Today's property market requires leases that are much more flexible (both in terms of duration and rent arrangements). Increasingly, prospective tenants are looking for shorter commitment periods and are unwilling to accept fixed contractual terms (at a fixed level of rent).

Shorter term leases lasting 12 to 18 months or licences of no more than 6 months are becoming more common. Where longer term leases are granted, tenants are more likely to insist on the inclusion of break rights to allow them to exit the arrangement early. However, break rights are not the exclusive domain of the tenant; they are being utilised by Landlords to allow them to grant leases at a "knock-down" rent on an "excluded" basis (meaning the lease is excluded from the security of tenure provisions of the Landlord & Tenant Act 1954), which can then be terminated when rent levels improve. Shorter term leases or licence arrangements may also have an advantage in reducing the amount of Stamp Duty Land Tax payable in the short-term on the grant of leases.

• Diversification

Many tenants are also seeking to diversify their operations to maximise profitability/reduce premises costs. They may want to potentially share the property with someone else who may

• Introduction

There is a growing consensus that now may be an opportune moment for both landlords and tenants to take a fresh look at their leases to see how these can be reshaped (or "re-gearred") to fit in with the new business environment in which we now find ourselves.

be able to “add value” to their business or contribute to rent. Careful drafting can allow such arrangements to take place without risk to the landlord and without the need for cumbersome applications by a tenant for landlords' consent.

- **Rental incentives**

Current market conditions require that landlords consider methods to incentivise new tenants to take on new leases and to allow existing tenants some breathing space if they are struggling to meet their lease payments. The most common rent incentive, particularly in new leases, is to offer a rent-free period at the commencement of a lease. For existing tenants, a temporary rent suspension or reduction may also be considered. Alternatively, capital incentives (such as a contribution to the costs of a tenant fit-out) can be considered.

Where short-term leases are being used, many landlords are now moving towards “inclusive rent” letting models (rather than attempting to levy a separate management / service charge or ‘top – up’, type rents based on turnover etc). The use of inclusive “all-in” rents greatly simplifies the documentation required and allows both landlord and tenant to evaluate the cost or profitability of the lease for the entire term with greater certainty.

- **Restructuring existing leases**

An increasing number of tenants are seeking to restructure their current arrangements to allow them to trade in today's changed conditions. Leases entered into at the height of the property boom are increasingly regarded as out of touch with the market conditions of today. Consequently, many tenants are looking at the possibility of re-structuring their existing leases (either on a temporary or permanent basis) to re-gear them to today's changed trading conditions.

The return to “traditional” Banking

It does not seem like too long ago since Bank financing for property purchases or business loans secured against property was commonplace and easy to obtain. Indeed, at the height of the property boom making secured loans was big business for the Banks, with them aggressively chasing business on terms and rates that would have seemed ludicrous in the past. Property values and the financial environment were such that Banks took the risk of lending significant amounts at high loan to value ratios, and at low margins. Banks lent more and more supposedly safe in the knowledge that interest rates would remain buoyant and if a borrower defaulted they would be able to recover the full amount they lent by repossession and sale of property over which they held security. Then came a different kind of crunch.

The “credit crunch” saw base rate along with property values plummet. Banks with loan books full of property backed funding found themselves in trouble. Many loan to value covenants were breached and Banks faced the prospect that repossession and sale of properties taken as security may not cover the whole of the loans issued. In addition, the base rate fell so low that low margin term loans that had been so attractive to customers were in many cases unprofitable for the Banks.

As a result Banks have wanted to reduce their overall exposure to property. They have done this by trying to call in loans, extracting more from loans already advanced and by being more cautious about making new loans. Where they are prepared to advance new loans they tend to now only do so at higher margins with higher arrangement fees. They also normally impose more stringent vetting, reporting and monitoring requirements.

How should customers manage their banking arrangements?

As regards existing loans, Banks have often been looking for an opportunity to renegotiate terms or to call in loans (to increase their liquidity ratios).

It should be remembered that Banks can only operate within the existing agreed terms of the loan agreements they have with their customers. Where a customer moves outside of these terms, the Banks can and normally do use this as an excuse to:

- require more security to reduce its risk,
- increase the margins of an existing loan and/or increase arrangement fees,
- freeze any revolving loans, or
- require customers to repay their loans completely.

With regard to new loans, both businesses and individuals are, in many circumstances, finding it much more difficult to obtain Bank finance. Problems with their existing loan books are influencing Banks' view on new loans, with some refusing to make further loans in the property sector altogether.

In a nutshell, all of this spells problems for those seeking new finance. Businesses need to make sure that they are fully aware of and do not breach the terms if they are to avoid new terms being imposed by their Bank.

You should review loan documentation and make yourself aware of terms that you agreed that might put you at risk, for example, covenants regarding the value of assets provided as security, provisions

making a loan potentially repayable on demand, and the nature of any personal security that has been given. By being aware of these terms and managing your business accordingly you can reduce the Bank's opportunities to use an unwitting breach to change the terms of your loan arrangement or call your loan in.

As for those seeking new finance, Banks argue that the fall in the amount of loans being made is due to a lack of demand for credit, as businesses scale back investment and cut costs in difficult times. However, the picture that the Federation of Small Businesses ("FSB") is getting from businesses is very different, with many saying they are still struggling to obtain credit from the big Banks and the FSB arguing that "even if credit is available the terms are often unattractive"

The future

Following the measures that Banks have been taking over the last 2 years, they are now returning to profitability. They also say that they are allocating more money to lending as a result of pressure from Government.

As a result, the chief executives of the UK's largest Banks have joined together to create a taskforce in an attempt to increase lending to credit-starved small businesses. The aim of the taskforce is to examine various industry-led proposals to stimulate lending and drive the private sector recovery.

In addition to the taskforce, the new Commission on Banking is to spend the next 12 months assessing the structure of the UK Banking industry, focusing on the issue of lending.

Whether the Bank taskforce or the Commission's findings will make a difference remains to be seen. Until then, all businesses can do is try their best to weather the storm and, where you do have to deal with Bank finance issues, be prepared!

Key Contacts



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