

Real Estate

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GETTING THE
DEAL THROUGH

England & Wales

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General

1 Legal system

How would you explain your jurisdiction's legal system to an investor?

England and Wales has a common law legal system. Investing in England and Wales is highly favoured given its system of compulsory land registration, fair and just legal system and maintenance of returns on investment.

The laws governing real estate are predominantly statute based, and these are constantly being developed through case law. International law is relevant to a limited extent (eg, matters concerning merger control are dealt with by EU law or international treaties that the UK is a part of). It is unclear how Brexit will impact on this.

The formalities of land contract in England and Wales require contracts for land to be in writing, to incorporate all relevant terms of sale, and to be signed by both seller and buyer. Oral contracts for the sale of land are usually unenforceable.

Contracts for land are 'exchanged', with the legal transfer of ownership taking place on completion of either a deed of transfer or grant of a lease.

2 Land records

Does your jurisdiction have a system for registration or recording of ownership, leasehold and security interests in real estate? Must interests be registered or recorded?

HM Land Registry (Land Registry) is a government department responsible for managing the public register of property ownership. Its online database has a composite record of all registered properties. Details of unregistered land may be available at the Land Charges Department.

The title registers obtainable from the Land Registry provide a snapshot of the matters affecting the property, including any charges, easements or leases, with the priority of the charges being noted on the title.

3 Registration and recording

What are the legal requirements for registration or recording conveyances, leases and real estate security interests?

The transfer of property must be registered at the Land Registry to be effective and, until it is formally registered, the property is held by the seller on trust (ie, the buyer only has an equitable interest until registration is completed).

The application process (which can be completed electronically) is relatively simple and requires an application form (AP1) to be lodged alongside certified copies of the relevant documents, evidence of payment of stamp duty land tax (SDLT) and payment of the appropriate application fee.

4 Foreign owners and tenants

What are the requirements for non-resident entities and individuals to own or lease real estate in your jurisdiction? What other factors should a foreign investor take into account in considering an investment in your jurisdiction?

There are no specific legal restrictions on non-residents owning freehold or leasehold interests in real estate. However, non-resident entities should be aware that:

- the Non-resident Landlord Scheme taxes the UK rental income of persons whose 'usual place of abode' is outside of the UK;
- Annual Tax on Enveloped Dwellings is payable by companies that own UK residential property valued at £500,000 or more;
- from April 2019, the government has proposed extending capital gains tax to gains arising to non-residents holding UK real estate; and
- the government has announced proposals for an SDLT surcharge of 1 or 3 per cent on foreign buyers.

5 Exchange control

If a non-resident invests in a property in your jurisdiction, are there exchange control issues?

There are no exchange controls and no restrictions on the repatriation of funds, subject to international sanctions and UK anti-money laundering legislation.

6 Legal liability

What types of liability does an owner or tenant of, or a lender on, real estate face? Is there a standard of strict liability and can there be liability to subsequent owners and tenants including foreclosing lenders? What about tort liability?

Residential landlords need adequate property owners' liability insurance to meet their duty of care and potential liability to tenants injured on their property. Commercial landlords need adequate building insurance, with tenants commonly being responsible for their contents. All landlords should protect themselves from liability for:

- dangerous or defective land and buildings;
- contractual and statutory obligations when divesting of their interest in the property so that they walk away from the asset without residual liability;
- environmental liability; if the polluter cannot be found an owner of a property can be liable; and
- personal injury accidents that occur on the property may lead to claims in tort.

Lenders are not exposed to liability unless they enforce their security over the property asset and become a mortgagee in possession, which is highly uncommon owing to the exposure this places on a lender.

7 Protection against liability

How can owners protect themselves from liability and what types of insurance can they obtain?

Building and contents insurance protects owners against destruction or damage to the property and loss of contents. It is market practice for a commercial landlord to take out three to five years' loss of rent cover.

Title insurers offer indemnity insurance to cover defects in title to the property or where a restriction is breached.

Although environmental insurance is available, the premiums are often expensive given the difficulty in quantifying contamination and it is therefore not often deemed a desirable alternative.

8 Choice of law

How is the governing law of a transaction involving properties in two jurisdictions chosen? What are the conflict of laws rules in your jurisdiction? Are contractual choice of law provisions enforceable?

In England and Wales, the laws of the country where the property is located govern the transaction.

If the parties choose to apply foreign law, English courts will generally recognise an express choice of law provision. However, English courts may elect to ignore the choice of law provision if the court deems that all other elements of the dispute or transaction are associated with a jurisdiction other than the jurisdiction chosen by the parties.

9 Jurisdiction

Which courts or other tribunals have subject-matter jurisdiction over real estate disputes? Which parties must be joined to a claim before it can proceed? What is required for out-of-jurisdiction service? Must a party be qualified to do business in your jurisdiction to enforce remedies in your jurisdiction?

Property cases must be commenced in either the County Court or the High Court, as applicable to the terms of the dispute. Additionally, the Lands Tribunal is an expert tribunal that deals with:

- restrictive covenants affecting land;
- landlords and business tenants;
- rating valuations;
- compensation relating to compulsorily acquired land; and
- arbitration of rents and values of business properties.

The Lands Tribunal forms part of the judicial system of England and Wales. Although it is a court, the Lands Tribunal includes valuers as well as legal members.

10 Commercial versus residential property

How do the laws in your jurisdiction regarding real estate ownership, tenancy and financing, or the enforcement of those interests in real estate, differ between commercial and residential properties?

English law does not differentiate between commercial and residential property ownership, but there is more protection afforded to residential tenants. Business tenants in England are protected by the security of tenure provisions, which offer a statutory right to apply for a new lease after the expiration of the current lease.

Investors should be mindful of the different tax treatment between commercial and residential properties under SDLT. Residential property owners are subject to a lower SDLT threshold but may also have to pay a tax surcharge for second homes.

11 Planning and land use

How does your jurisdiction control or limit development, construction, or use of real estate or protect existing structures? Is there a planning process or zoning regime in place for real estate?

There is a legal regime that governs land use and the development and protection of buildings. Planning permission is required from the

relevant public authority in order to develop land, carry out building works and change the use of property. The government has allowed certain exemptions to these planning laws, but these are limited in relation to commercial property.

If a building has significant architectural importance and has been designated by the government as having historical value, there are more stringent controls over its development and use and a second regime is in place.

Any building works also have to comply with strict local government surveyor building standards, known as building regulations.

12 Government appropriation of real estate

Does your jurisdiction have a legal regime for compulsory purchase or condemnation of real estate? Do owners, tenants and lenders receive compensation for a compulsory appropriation?

In England and Wales there is a legal regime for the compulsory purchase of land by both central and local government (subject to strict controls) and the government body must set out its justification for any compulsory purchase. There is a complex statutory system available to compensate those who have been dispossessed of their land and property. Compensation will generally include land value and associated relocation and disturbance costs. The system allows for private agreements and settlements to be made between the parties prior to any government order for compulsory purchase.

13 Forfeiture

Are there any circumstances when real estate can be forfeited to or seized by the government for illegal activities or for any other legal reason without compensation?

The government may:

- seize property that has been acquired through proceeds of crime; and
- 'claim' ownerless property (*bona vacantia*), which passes to the Crown.

14 Bankruptcy and insolvency

Briefly describe the bankruptcy and insolvency system in your jurisdiction.

Bankruptcy and insolvency is governed by the Insolvency Act 1986 (as updated by the Enterprise Act 2002), and the relevant legislation is triggered when individuals or corporations, respectively, have insufficient assets to cover their debts, or is unable to pay their debts when debts become due. Different regimes apply to individuals as opposed to corporations.

In real estate financing, the borrower usually triggers an event of default if it becomes insolvent. The lender will reserve the right to step into the borrower's shoes in the case of the borrower's insolvency in order to:

- minimise the negative impact; and
- ensure that the underlying real estate asset (investment property or a construction project) does not suffer from the borrower's insolvency.

Investment vehicles

15 Investment entities

What legal forms can investment entities take in your jurisdiction? Which entities are not required to pay tax for transactions that pass through them (pass-through entities) and what entities best shield ultimate owners from liability?

Real estate is bought and sold in England and Wales through individuals, trust corporations, partnerships, limited liability partnerships, real estate investment trusts (REITs) and offshore vehicles. The entity used will depend on the type of asset, market value and intended use of the real estate.

Efficient tax structuring will also dictate the investment entity given:

- value added tax and SDLT are commonly payable on asset sales and purchases;

- individuals commonly pay income tax on rental receipts, capital gains tax on any disposal gain and inheritance tax liability on death;
- UK corporations commonly pay corporation tax on rental income and on any disposal gain;
- REITs offer tax transparency for investors subject to strict incorporation requirements and operating restrictions, such as:
 - ring fencing property investments;
 - distributing 90 per cent of income profits; and
 - ensuring that property rental business forms 75 per cent of the REIT's total profits; and
- offshore entities commonly pay income tax on rent, but no capital gains tax (CGT) on commercial real estate. However, the government has announced plans to extend CGT to such gains from April 2019.

16 Foreign investors

What forms of entity do foreign investors customarily use in your jurisdiction?

Commercial property in England and Wales is typically acquired through non-UK resident corporate entities, often incorporated in the Channel Islands, Cayman Islands or the British Virgin Islands owing to there being no CGT liability on disposals. Offshore trust structures are also an option as they are tax transparent for income tax purposes.

There is a growing trend of offshore entities migrating to Luxembourg since the triggering of article 50 (Brexit).

The government continues its desire to harmonise the tax treatment for onshore and offshore entities.

17 Organisational formalities

What are the organisational formalities for creating and maintaining the above entities? What requirements does your jurisdiction impose on a foreign entity? Does failure to comply incur monetary or other penalties? What are the tax consequences for a foreign investor in the use of any particular type of entity, and which type is most advantageous?

Companies, partnerships and limited liability partnerships formed in England and Wales need to be incorporated and registered with Companies House (the company registry in England and Wales). Directors are subject to various obligations codified in the Companies Act 2006, and there are strict reporting requirements. Failure to file accounts and reports on time will result in a strict automatic financial penalty being applied.

The government has recently introduced new rules applying for financial years beginning on or after 1 January 2019, which require large private and public companies to comply with more stringent corporate governance requirements, including more onerous reporting obligations, with a view to restoring trust in big businesses.

Acquisitions and leases

18 Ownership and occupancy

Describe the various categories of legal ownership, leasehold or other occupancy interests in real estate customarily used and recognised in your jurisdiction.

Property ownership can be divided into three categories:

- Freehold: demonstrates absolute ownership. The Land Registry will register such land with various qualities of title, depending on the level of evidence of ownership provided to them, with Title Absolute being the best.
- Leasehold: leases create a contractual right for a tenant to exclusively occupy property for a fixed period of time, with such possession subject to the payment of a premium and/or rent and compliance with the covenants set out in the lease.
- Commonhold: allows ownership of a freehold unit – such as that within a building – and at the same time membership of the company that manages the shared common areas and buildings.

Depending on the nature of the interest, there are different formalities to follow (eg, easements must be created by deed) and, in order

to adequately protect such interests, they must usually be registered or noted at the Land Registry.

19 Pre-contract

Is it customary in your jurisdiction to execute a form of non-binding agreement before the execution of a binding contract of sale? Will the courts in your jurisdiction enforce a non-binding agreement or will the courts confirm that a non-binding agreement is not a binding contract? Is it customary in your jurisdiction to negotiate and agree on a term sheet rather than a letter of intent? Is it customary to take the property off the market while the negotiation of a contract is ongoing?

Heads of terms set out the terms of a commercial transaction agreed in principle between parties, including purchase price, a transaction timetable, exclusivity periods and confidentiality arrangements. They are likely to be non-binding.

Lock-out agreements and non-disclosure agreements are often executed prior to contractual negotiations getting under way, and these agreements are likely to be binding.

20 Contract of sale

What are typical provisions in a contract of sale?

Residential transactions usually utilise the Law Society's Standard Conditions of Sale. In commercial and corporate transactions, the Law Society's Standard Commercial Property Conditions are usually incorporated into a bespoke contract, which, alongside the basic details such as the buyer, the seller and the details of the property, will include additional contractual provisions such as:

- deposit arrangements;
- conditions for acquisition of the property;
- delineation of liability; and
- completion deliverables and mechanics.

21 Environmental clean-up

Who takes responsibility for a future environmental clean-up? Are clauses regarding long-term environmental liability and indemnity that survive the term of a contract common? What are typical general covenants? What remedies do the seller and buyer have for breach?

Primary responsibility in England and Wales for contamination lies with the original polluter. However, if the polluter cannot be found, liability can be the responsibility of the current landowner and, in some circumstances, the current occupier can be held liable by the regulatory authorities for clean-up of historic contamination and pollution that it did not cause. Local government has an obligation, through a statutory regime, to investigate all of the land in its geographical area to confirm whether the land is contaminated and to arrange for any remediation if necessary. Practically, local government will use the planning regime to impose environmental conditions to ensure that remediation takes place prior to development.

On the sale of a site, the parties may agree an environmental indemnity and a transfer of environmental liability. The terms of any such clauses are private and a matter of negotiation. A government authority has discretion to accept these terms.

22 Lease covenants and representation

What are typical representations made by sellers of property regarding existing leases? What are typical covenants made by sellers of property concerning leases between contract date and closing date? Do they cover brokerage agreements and do they survive after property sale is completed? Are estoppel certificates from tenants customarily required as a condition to the obligation of the buyer to close under a contract of sale?

In a property contract, the seller is unlikely to provide many representations because of the concept of 'buyer beware', whereby the onus is on the buyer to undertake adequate due diligence. It is market

standard in either a freehold or leasehold acquisition for the seller to provide certain replies to enquiries, which are the only representations the seller provides. For residential properties, these are governed by the Conveyancing Quality Scheme, while Commercial Property Standard Enquiries are sets of questionnaires that apply for various commercial transactions. Post-exchange and pre-completion, the buyer will usually raise standard pre-completion enquiries, asking the seller to confirm nothing has changed since the initial replies were provided. This is important as estoppel certificates are not customary in England and Wales.

In commercial transactions, both parties may provide each other with tax representations and warranties.

In the period between exchange and completion, the seller is restricted from making any major decisions regarding the property without the buyer's consent.

23 Leases and real estate security instruments

Is a lease generally subordinate to a security instrument pursuant to the provisions of the lease? What are the legal consequences of a lease being superior in priority to a security instrument upon foreclosure? Do lenders typically require subordination and non-disturbance agreements from tenants? Are ground (or head) leases treated differently from other commercial leases?

A lease and a security instrument are not comparable, as a lease is a property interest. Most leases are capable of forfeiture: the right for the landlord to bring a lease to an end due to breach of the lease. This is the case whether or not the leasehold interest has debt secured against it. Normally, where there is a forfeiture provision in the lease, a lender will often require mortgagee cure provisions or mortgagee protection insurance.

24 Delivery of security deposits

What steps are taken to ensure delivery of tenant security deposits to a buyer? How common are security deposits under a lease? Do leases customarily have periodic rent resets or reviews?

The landlord may require a tenant to enter into a security deposit, known in England and Wales as a rent deposit deed. These are relatively common, especially for newly incorporated entities, or entities with no trading history.

A sale contract should set out how the transfer of any rent deposit deeds should be dealt with. A well-drafted rent deposit deed will contain provisions setting out what action a tenant has to take if assigning its lease or where the landlord is assigning its rights under the rent deposit deed.

Rent reviews are market standard in the UK, and can take various different forms, such as annually or every five years, retail/consumer price index linked or simply open market value of the premises at a time. Upward-only rent reviews remain the norm in commercial office leases, while turnover rent leases are relatively common in the retail market.

25 Due diligence

What is the typical method of title searches and are they customary? How and to what extent may acquirers protect themselves against bad title? Discuss the priority among the various interests in the estate. Is it customary to obtain government confirmation, a zoning report or legal opinion regarding legal use and occupancy?

Asset-level due diligence to be undertaken by a buyer's solicitor is divided into three limbs:

- title review;
- searches; and
- pre-contract enquiries.

The buyer's solicitor will review the title pack provided by the seller's solicitors. Title packs include Land Registry official copies, copies of all documents listed in the Land Registry office copies (known as the title

documents) and replies to enquiries (including ancillary information such as service charge and supply contract details). It is then the buyer's solicitor's role to raise property searches with the local authority (which inform the buyer about land use and other local authority restrictions that affect the property) and all relevant utility companies, while raising further enquiries of the seller's solicitor.

Following exchange of contracts, the buyer's solicitor should 'note' the sale agreement on the seller's title and submit a priority search to 'freeze' the property register for a period of 30 days so that no third party can deal with the property. This gives the buyer time to submit an application to register its interest at the Land Registry.

26 Structural and environmental reviews

Is it customary to arrange an engineering or environmental review? What are the typical requirements of such reviews? Is it customary to get representations or an indemnity? Is environmental insurance available?

It is customary for a buyer or tenant to carry out due diligence prior to any purchase or lease, including a site inspection. Formal reports include:

- a building survey;
- a valuation; and
- desk-based environmental search of available environmental databases, with a follow-up intrusive investigation if necessary.

27 Review of leases

Do lawyers usually review leases or are they reviewed on the business side? What are the lease issues you point out to your clients?

Lawyers tend to review and lead lease transactions. In England and Wales, there are broadly recognised standard market positions (such as the guidance in the Code for Leasing Business Premises), yet they can still be heavily negotiated. It is important to ensure a balance in the lease drafting that allows the tenant's business to operate freely without undue restrictions while protecting the landlord's interest.

Key matters to flag to tenants are any restrictions on their use of the premises, ability to dispose of the property, termination rights, rent review provisions and limitations on dealing with the premises.

28 Other agreements

What other agreements does a lawyer customarily review?

Together with the documents referred to in question 25, the buyer's solicitor may also be required to review:

- planning agreements;
- management company agreements;
- structural reports;
- construction reports and underlying building contracts, professional team and consultant appointments and warranties;
- environmental reports;
- rights of light reports;
- asset management agreements;
- development management agreements; and
- property management agreements.

29 Closing preparations

How does a lawyer customarily prepare for a closing of an acquisition, leasing or financing?

The key to a well-organised closing is planning from the outset of a transaction. The parties' lawyers often prepare a closing checklist, so that all parties are aware of any conditions that may need to be fulfilled, the documents (including any engrossments) required to be produced at the closing meeting and actions that need to be taken to complete the transaction. If overseas entities are involved, an opinion letter may be required to evidence the validity and enforceability of that entity's entry into the transaction documents.

In addition, pre-closing searches will need to be carried out, pre-closing requisitions submitted and a completion statement setting out the funds due agreed. Pre-closing, the lawyers will need to check that they are in funds and that they have the client's authority to close.

30 Closing formalities

Is the closing of the transfer, leasing or financing done in person with all parties present? Is it necessary for any agency or representative of the government or specially licensed agent to be in attendance to approve or verify and confirm the transaction?

Completion is typically the final step in the process of transferring ownership of a property. The purchase price is paid and transfer documents dated. Transactions are typically 'closed' or 'completed' remotely by lawyers representing the buyer and seller on a conference call without the parties or any licensed agents required to be present.

31 Contract breach

What are the remedies for breach of a contract to sell or finance real estate?

The most common contractual remedy in English law for breach of contract is damages, provided the non-defaulting party can prove that a loss has been suffered. However, where a contract relates to real estate, the non-defaulting party may not be able to produce evidence of significant monetary losses and may prefer to pursue an alternative remedy, such as specific performance, which has historically been used in England and Wales as the remedy for a contracting party's breach of contract for the sale of land.

There may also be a right for the non-defaulting party to terminate the contract.

32 Breach of lease terms

What remedies are available to tenants and landlords for breach of the terms of the lease? Is there a customary procedure to evict a defaulting tenant and can a tenant claim damages from a landlord? Do general contract or special real estate rules apply? Are the remedies available to landlords different for commercial and residential leases?

The nature of the premises and the provisions of the lease will dictate the remedies available for breach.

In residential tenancies and leases, there is a great deal of statutory protection available to tenants, both in cases of landlord breaches and where the landlord is trying to take action for a tenant breach of covenant.

For commercial premises, the negotiated position in the lease is usually more balanced. Most leases of commercial premises will include a right for the landlord to forfeit the lease in the case of tenant breach. Where the tenant has failed to pay rent due, the landlord can instigate court proceedings to recover rent. Where the breach relates to matters such as the repairing covenant, the landlord can bring an action against the tenant, and the tenant has remedies available to it, such as seeking 'relief from forfeiture'.

Financing**33 Secured lending**

Discuss the types of real estate security instruments available to lenders in your jurisdiction.

For a charge to be legally binding on property, it must be in the form of a legal mortgage executed by deed, and properly registered at the Land Registry. If entered into by a UK company, the mortgage must also be registered at Companies House. The mortgage is usually protected by way of a restriction on title, which prevents the owner of the property dealing with the property without the consent of the lender.

In most commercial lending transactions, the mortgage is contained within a debenture, which also contains a floating charge over all of the assets of the borrower.

34 Leasehold financing

Is financing available for ground (or head) leases in your jurisdiction? How does the financing differ from financing for land ownership transactions?

It is possible to secure debt against a lease in England and Wales, although there are additional due diligence considerations for the lender, such as:

- lease term: leases are depreciating assets, so the longer the term, the better;
- consents: required from the landlord or to comply with any prohibitions in the lease;
- forfeiture: in long leases lenders do not expect to see any forfeiture provisions; and
- alienation provisions: limitations on the lender dealing with the asset freely are not ideal from an enforcement position.

Mortgages against freehold and leasehold property are secured in the same way, by entering into a mortgage deed and registering it at the Land Registry.

35 Form of security

What is the method of creating and perfecting a security interest in real estate?

The most standard form of security seen on real estate assets is a mortgage. In order to satisfy the requirements of a legal mortgage, the mortgage needs to be executed as a deed and registered against the title to the property.

In real estate finance transactions, there will also be additional security, such as:

- security over the borrower's bank accounts;
- a share charge over the borrower;
- security over the material contracts relating to the property entered into by the borrower; and
- a duty of care deed from the managing agent.

36 Valuation

Are third-party real estate appraisals required by lenders for their underwriting of loans? Are there government or industry standards for appraisals? Must appraisers have specific qualifications or required government or industry certifications? Who is required to order the appraisal?

In real estate finance transactions, property valuations form a key part of the lender's evaluation and security package. An accredited valuer will prepare a report highlighting key factors that are important for the financing. The valuer will also review any property reports to ensure there are no matters that are disclosed in the report that would affect the underlying value.

37 Legal requirements

What would be the ramifications of a lender from another jurisdiction making a loan secured by collateral in your jurisdiction? What is the form of lien documents in your jurisdiction? What other issues would you note for your clients?

There is no difference in England and Wales between the treatment of a foreign lender as opposed to a UK-based lender. Obviously, any foreign lender will need to comply with UK legislation in respect of financial regulation, as well as strict money-laundering legislation.

38 Loan interest rates

How are interest rates on commercial and high-value property loans commonly set (with reference to Libor, central bank rates, etc)? What rate of interest is legally impermissible in your jurisdiction and what are the consequences if a loan exceeds the legally permissible rate?

Interest rates have historically been linked to the Bank of England base rate or to Libor. Libor is an average interest rate based on submissions

by major banks of what they expect to pay if they borrow from other banks, and differs depending on currencies and durations, which is where a number of issues have arisen in recent times; hence the decision to scrap the rate. Replacing it, however, has been challenging, and no formal method has as yet been agreed.

Case law has shown that there are strict penalties likely to be issued by the courts where an interest provision is considered 'penalty interest', so it is important that any agreed positions be deemed reasonable.

39 Loan default and enforcement

How are remedies against a debtor in default enforced in your jurisdiction? Is one action sufficient to realise all types of collateral? What is the time frame for foreclosure and in what circumstances can a lender bring a foreclosure proceeding?

Are there restrictions on the types of legal actions that may be brought by lenders?

The Loan Market Association (LMA) standardised documentation means that there is a 'standard' approach to enforcement against a borrower, and there are multiple options that a lender has open to it, alongside the possibility of open negotiations when a borrower is in trouble.

Lenders will look to their appointed insolvency practitioner who will then represent the lender/security agent in matters of insolvency in order to realise their security.

40 Loan deficiency claims

Are lenders entitled to recover a money judgment against the borrower or guarantor for any deficiency between the outstanding loan balance and the amount recovered in the foreclosure? Are there time limits on a lender seeking a deficiency judgment? Are there any limitations on the amount or method of calculation of the deficiency?

Where there is a shortfall in its recovery, the lender may look to other options to recover any outstanding debt, such as guarantors. Ultimately, the remits of the lender's ability to recover debt will be set out in the loan documentation and will be the position agreed between the parties on entering into the loan.

41 Protection of collateral

What actions can a lender take to protect its collateral until it has possession of the property?

As part of the fixed charge over the property, the lender may elect to take ownership of the property, but this is not ideal as the lender will be exposed to the risks that a property owner would be exposed to. Accordingly, lenders are likely to appoint an insolvency practitioner to deal with the property, and the right to such appointment is usually documented in the charging document or governed by statute.

42 Recourse

May security documents provide for recourse to all of the assets of the borrower? Is recourse typically limited to the collateral and does that have significance in a bankruptcy or insolvency filing? Is personal recourse to guarantors limited to actions such as bankruptcy filing, sale of the mortgaged or hypothecated property or additional financing encumbering the mortgaged or hypothecated property or ownership interests in the borrower?

An all-encompassing debenture is likely to take security over all of the assets of a borrower, be it in the form of a fixed or floating charge (depending on the nature of the asset), each of which allows a different insolvency practitioner to be appointed.

Share charges are often granted to the lender to provide an additional layer of security and enable the lender to sell the company as well as its assets. The lender may also be given guarantees from other entities within the group structure upon which it may be able to call.

Update and trends

One of the biggest trends in commercial real estate investment transactions is the increasing use of warranty and indemnity (W&I) insurance to support the seller warranties and indemnities. With individual assets commonly held through SPE structures and the deal size where a corporate disposal route is viable from a costs perspective reducing to around £20 million, insurers have needed to adapt rapidly to be competitive and reflect this in the levels of premium charged, which have decreased enormously in the past three years. The benefits W&I offers to both sides in terms of a clean break for the seller and substance behind the seller warranties for the buyer will lead to this becoming an increasingly standard part of the transaction process.

43 Cash management and reserves

Is it typical to require cash management system and do lenders typically take reserves? For what purposes are reserves usually required?

Depending on the type of transaction, cash management systems and reserves may be used in real estate transactions. Reserves are frequently required by lenders for less creditworthy borrowers in order to mitigate against early term default.

44 Credit enhancements

What other types of credit enhancements are common? What about forms of guarantee?

Common credit enhancements required by a lender include cash deposits, letters of credit and insurance.

Guarantees are commonly used in lending transactions and need to be in writing and signed by a guarantor in order to be enforceable. A lender can usually demand under a guarantee as soon as the borrower fails to pay any guaranteed obligation that is due, such claim being limited to the overdue amount, with a full claim generally only being available if the loan is accelerated.

45 Loan covenants

What covenants are commonly required by the lender in loan documents?

Investment facilities will have a focus on maintaining the underlying value of the property by requiring the borrower to adhere to strict maintenance covenants, as well as ensuring the borrower is not permitted to make substantial changes to the occupational interests in the property. This is fundamentally different from a development facility, where the lender is looking to ensure that the borrower (who will be responsible for developing the property) is complying with the terms of the development documents, actively enforcing third-party obligations, ensuring no cost overrun and project-managing the development properly in accordance with the lender's project monitor.

46 Financial covenants

What are typical financial covenants required by lenders?

In a standard investment real estate finance LMA facility, typical financial covenants include:

- a loan-to-value ratio, which measures the value of the property against the outstanding debt;
- an interest ratio cover, which measures the rental income stream against the interest payable;
- a debt service ratio, which measures the rental income stream against the total loan repayments; and
- information covenants keeping the lender informed about the asset.

47 Secured movable (personal) property

What are the requirements for creation and perfection of a security interest in movable (personal) property? Is a 'control' agreement necessary to perfect a security interest and, if so, what is required?

The debenture will usually create a floating charge over all of the borrower's assets, which allows the borrower to keep dealing with the assets while the borrower's business is liquid. The debenture will be registered at Companies House where the borrower is a UK-based company.

Where security is taken over key contracts of the borrower (such as construction documents), notice is served to the other parties to the documents.

48 Single purpose entity (SPE)

Do lenders require that each borrower be an SPE? What are the requirements to create and maintain an SPE? Is there a concept of an independent director of SPEs and, if so, what is the purpose? If the independent director is in place to prevent a bankruptcy or insolvency filing, has the concept been upheld?

It is not an absolute requirement that a borrower be an SPE, although lenders in real estate transactions often require that borrowing entities limit their activities to that of ownership of a single asset, typically being the real property that secures the loan. SPEs are typically used by companies to isolate risk and create options for companies to raise capital and structure debt in a more efficient manner.

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