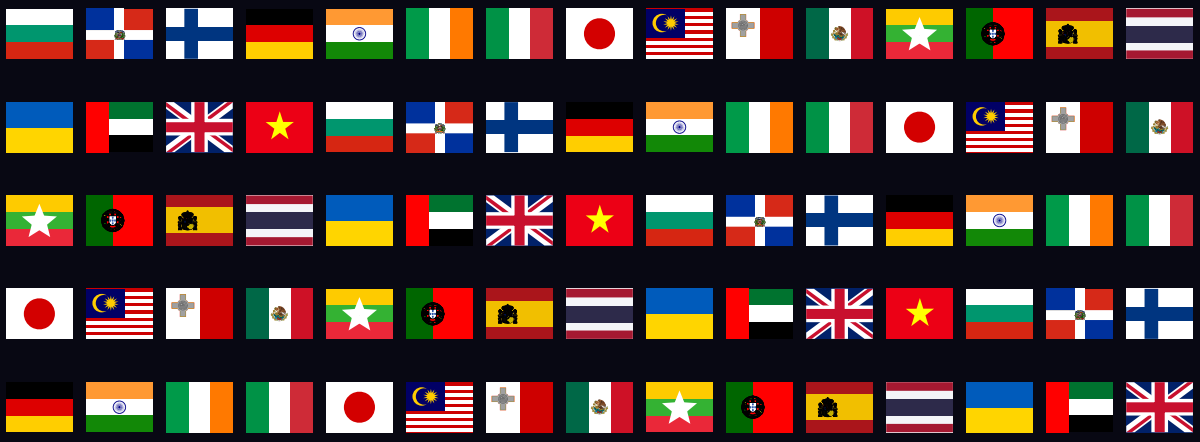
REAL ESTATE

United Kingdom - England & Wales



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Getting The Deal Through

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Quick reference guide enabling side-by-side comparison of local insights, including an overview of the legal system; registration and recording; treatment of foreign owners and tenants and of commercial versus residential property; planning and land use; compulsory purchase or condemnation of real estate; bankruptcy and insolvency; use of investment vehicles; acquisitions and leases, including environmental considerations; financing; and recent trends.

Generated 28 November 2022

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GENERAL

Legal system

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

The United Kingdom has three separate legal systems: one each for England and Wales, Scotland and Northern Ireland. As the significantly largest of the three, this chapter deals with the legal system of England and Wales.

England and Wales has a common law legal system. The laws governing real estate are predominantly statute-based, and these are constantly developed through case law. Investing in England and Wales is highly favoured from a legal perspective given its system of compulsory land registration and its just legal system.

International law is relevant to a limited extent (eg, matters concerning merger control are dealt with by international treaties that the United Kingdom is a part of) but the relevant provisions are implemented into English law, rather than being directly enforceable. Following the UK's exit from the European Union on 31 January 2020, EU law continued to apply for a transitional period but that expired on 31 December 2020. Certain EU laws were, however, retained in the UK legal framework pursuant to domestic statute.

In England and Wales, land contracts need to be in writing, incorporate all relevant terms of sale, and be signed by both seller and buyer as a deed. Oral contracts for the sale of land are usually unenforceable, however more recently courts have been open to recognising oral contracts for the sale of land and oral contracts to enter written contracts for the sale of land at a later date, on a case-by-case basis.

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.

Law stated - 03 October 2022

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?

His Majesty's Land Registry (the Land Registry) is the government department responsible for managing the public register of property ownership in England and Wales. Its online database has a complete record of all registered properties, with each property given a unique code called the 'Title Number'. There is no centralised record of details for unregistered land but a specific third-party interest in such land may be recorded at the Land Charges Department at the Land Registry. With almost all transactions of land interests triggering compulsory registration since 1990, the likelihood of unregistered land is ever decreasing.

The title registers obtainable from the Land Registry provide a snapshot at a given time of the matters affecting registered property, including any fixed security interests, easements or leases. A search at the Land Charges Department will reveal any interests recorded with them against unregistered land.

Law stated - 03 October 2022

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 at law and, until it is formally registered,

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the property is held by the seller on trust for the buyer (ie, the buyer only has an equitable interest until registration is completed).

The following leases are registrable at the Land Registry: (1) leases for a term of more than seven years; and (2) leases which term commences more than three months from the date of the lease (irrespective of the term). While there is no legal requirement to register security interests in a property with the Land Registry, the beneficiary of such security interests will want to do so to perfect its interest and ensure it takes priority to any claims by unsecured creditors.

By 30 November 2022, the Land Registry will have moved away from paper applications (including electronic copies of paper applications) and the application process will be fully digital, which the Land Registry hopes will be quicker and reduce requisitions due to automatic error checking. The process is relatively simple and requires a digital application form to be completed with evidence of the relevant documents to be uploaded (for example, evidence of payment of stamp duty land tax (SDLT)) and payment of the appropriate application fee (which is automatically calculated by the system).

Law stated - 03 October 2022

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 the United Kingdom;
- the Annual Tax on Enveloped Dwellings is payable by companies and other 'non-natural persons' that own UK residential property valued at £500,000 or more, subject to certain reliefs and exemptions;
- a higher rate of 15 per cent SDLT applies to the acquisition of high-value UK residential property for companies and other 'non-natural persons', subject to certain reliefs;
- in addition, non-residents may also be subject to an additional 2 per cent SDLT surcharge for acquisitions of UK residential property, taking the possible maximum rate of SDLT to 17 per cent;
- a legal opinion from local counsel speaking to capacity, due execution and enforceability in England and Wales is likely to be required; and
- from 5 September 2022, the Economic Crime (Transparency and Enforcement) Act 2022 provides that all legal entities incorporated outside of the UK which own, dispose of or acquire UK land, grant a lease for a term of more than seven years or grant a charge over such land, will need to apply to Companies House to be on the overseas entities register and update the register annually. The obligation is retrospective and the purpose of the register is to require foreign entities to be transparent about their beneficial owners, with a requirement for such information to be verified by a UK regulated agent prior to obtaining a unique ID, which will allow for a restriction on title to be satisfied. Failure to comply could result in the Land Registry failing to process an application, as well as criminal sanctions for the entity and its management.

For disposals of real property (and of certain assets deriving value from real property) non-residents (both natural and non-natural persons) are within the scope of UK tax on chargeable gains. Other UK tax charges may apply for non-residents engaged in trading activities in relation to UK real estate.

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Value added tax (VAT) at 20 per cent may in some circumstances be due in respect of property sales and leases. A non-resident investor may be liable to pay, or collect and account for, VAT arising in respect of a UK real estate transaction.

Law stated - 03 October 2022

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, obligations to declare cash and anti-money laundering legislation.

Law stated - 03 October 2022

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?

An owner or tenant of real estate could potentially face liability from:

- dangerous or defective land and buildings;
- title, contractual or statutory obligations;
- environmental liability (as the polluter or as the owner/occupier if the original polluter cannot be found). There are also strict liability sanctions under criminal law for some environmental breaches;
- damage or destruction to the property where the actions of the tenant invalidate a buildings insurance policy; and
- personal injury accidents (whether by the tenant or members of the public) that occur on the property that may lead to claims in tort.

Lenders are unlikely to be exposed to liability of the type described above unless they had knowledge of the borrower's breach of environmental laws and exercised control over the borrower's conduct or they enforce their security over the property asset and become a mortgagee in possession, which is relatively uncommon owing to the risk of liability that a lender may incur as a result.

Law stated - 03 October 2022

Protection against liability

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

The nature of the liability that needs to be insured is largely subject to the nature of the property. Both residential and commercial landlords need adequate property owners' liability insurance to meet their duty of care and potential liability to tenants or members of the public injured on their property. Building and contents insurance protects owners against destruction or damage to the property and loss of contents. Freehold owners of a property will typically procure the buildings insurance and recover the cost proportionately from tenants, while occupiers will typically maintain the contents insurance.

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The market position in leases is that the tenant's obligation to pay the rent is suspended (usually for up to three years) where the property is unusable following insured damage, with landlords insuring against this loss of rent and recharging the cost proportionately to tenants. A point of contention often arises regarding who takes the risk for damage that is not insured against. The largely accepted market position is now that the landlord will take the risk.

Title insurers offer indemnity insurance to cover defects in title to the property. Title insurance, as well as warranty and indemnity insurance, are becoming more popular on transactions from a risk mitigation perspective—particularly where debt is involved—to ensure a seller can achieve a 'clean break' and walk away without risk of residual liability.

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.

Law stated - 03 October 2022

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. Note that different rules apply to land in Scotland and Northern Ireland (which are not addressed in this publication).

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.

Law stated - 03 October 2022

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?

The court in which a real estate dispute will be heard will depend on a number of factors, including whether the matter relates to residential property or commercial property.

The First-Tier Tribunal (Property Chamber) handles applications, appeals and references relating to disputes over property and land, including residential property disputes such as rent increases for 'fair' or 'market' rates and other leasehold disputes.

The Property, Trusts and Probate List (which is a specialist division of the Business and Property Courts, an umbrella term for a number of the specialist jurisdictions of the High Court of England and Wales) addresses claims, whether between individuals or businesses, relating to:

- title to land;
- restrictive covenants affecting land;
- landlord and tenant matters;
- business tenancies; and
- adverse possession and squatters matters.

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There are also a number of alternative dispute resolution methods available in England and Wales, including expert determination and arbitration.

Law stated - 03 October 2022

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 because of the importance of home ownership. Business tenants in England and Wales 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 where a business operates from the premises at the expiry of the lease.

Investors should be mindful of the difference in SDLT treatment between commercial and residential property transactions, with residential properties generally being subject to higher rates. The VAT treatment of commercial and residential property transactions can also differ.

There is no substantive difference in how commercial and residential properties can be financed. However, providing financing to individuals secured on real estate assets is a regulated activity in the United Kingdom, which, unless an exemption applies, requires appropriate authorisations from the financial regulator and compliance with applicable consumer protection legislation in the United Kingdom.

Law stated - 03 October 2022

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?

Planning legislation governs the use and development of land, as well as the protection of historic buildings. Planning permission is required from the local planning authority to develop land, carry out building works and change the use of property. The planning regime is complex and, due to the reliance on local authority cooperation, varies from region to region.

If planning permission is issued, and it is later discovered that this needs to be varied, this can be done through varying forms of applications to the council, including an application for a non-material amendment (which avoids the usual bureaucratic process of a formal variation).

A planning decision can be appealed if either the individual disagrees with it or the decision was not made within eight weeks (or 13 weeks for a major development). An appeal must be made to the planning inspectorate within six months of the date of the decision notice and the local planning authority must tell anyone who has commented on the original application that there is an appeal. The decision may also be appealed in the High Court if the Planning Inspectorate made a legal mistake.

The local planning authority may serve enforcement notices where a building has been built or altered without planning permission. This can be appealed in certain circumstances.

If a building has significant architectural importance and has been designated by the government as having historical

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value (in some cases referred to as a 'listed building'), there are more stringent controls over its development and use.

Building works must also comply with strict local government surveyor building standards, known as building regulations, and at the end of the build process a certificate will be issued to confirm that the building has the requisite consents.

Law stated - 03 October 2022

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.

Law stated - 03 October 2022

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?

In certain circumstances the government has powers to freeze property, which it suspects may have been acquired through proceeds of crime. The owner(s) of the property will then have to prove in court that the funds used to purchase the property were obtained legally. The government may seize property that has been acquired through proceeds of crime.

The government has the power to sanction individuals and organisations with links to oppressive regimes. Sanctions often include the freezing of the sanctioned person's property within the UK.

The government may also 'claim' ownerless goods or property (bona vacantia), which by law passes to the Crown.

Law stated - 03 October 2022

Bankruptcy and insolvency

Briefly describe the bankruptcy and insolvency system in your jurisdiction.

Bankruptcy and insolvency in the United Kingdom are governed by the Insolvency Act 1986 (IA).

For a company, the key UK insolvency options are as follows:

1. Administration: an insolvency practitioner(s) can be appointed as administrator to manage the affairs of the company in order to achieve the following statutory purposes set out in the IA (and in the same order): (a) rescuing the company as a going concern; or (b) achieving a better result for the company's creditors as a whole than would have been the case had the company been wound up without first being in administration; or (c) realising the company's assets and making distributions to certain classes of creditors. An administration can be

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commenced by a court order, or an out-of-court procedure (such as a directors' resolution or by a charge holder holding a floating charge over all the assets of the company). Once the administration commences, it imposes a moratorium on all claims against the company and can prevent a landlord/tenant from enforcing its rights against the insolvent tenant/landlord entity in administration without the consent of the administrator or the courts.

2. Liquidation: A liquidator can be appointed to realise the company's assets and make distributions to creditors. Following this process, the company is wound up and dissolved. The liquidation process can be commenced either voluntarily (by the company's members passing the relevant resolution) or compulsorily (by way of a court order following the presentation of a winding-up petition against the company). Note that certain temporary measures that were introduced to respond to the covid-19 pandemic and limit the winding up of companies have now been lifted.
3. Company voluntary arrangement (CVA). The CVA is a process by which a company can achieve a compromise with its unsecured creditors provided that statutory voting majorities are met. Unlike an administration or liquidation, the directors remain in control of the company and the purpose of the CVA is typically to restructure liabilities of the company so it can continue to trade. CVAs have often been used to compromise rent arrears and modify leases.

Under the UK regime it is also possible to restructure a company with the use of a scheme of arrangement or restructuring plan under the Companies Act 2006. These processes are not insolvency proceedings and so fall outside the scope of this section.

Additionally, on 24 March 2022, the Commercial Rent (Coronavirus) Act 2022 was passed, which had the effect of: (1) ring-fencing 'pure rent' debts accrued as a consequence of mandated business closures during the covid-19 pandemic (between 21 March 2020 and ending at or before 18 July 2021 in England); and (2) introduced a new arbitration process designed to resolve landlord/tenant disputes in respect of such rent debts. For parties that referred a dispute to arbitration prior to 23 September 2022 in respect of a protected rent debt, the landlord will be unable to take customary remedial action (such as start a debt claim, enforce a right of re-entry or forfeiture, apply rent deposit towards unpaid protected rent debts or present winding up petitions against the tenants) in relation to such protected rent debts. In the absence of any referrals being made by 23 September 2022, no further applications can be made and any arrears can be collected by landlords in all the usual ways including commercial rent arrears recovery and forfeiture.

Law stated - 03 October 2022

INVESTMENT VEHICLES

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 may be bought and sold in England and Wales by individuals and through trust corporations, partnerships and limited partnerships (including private fund limited partnerships, which are limited partnerships that are subject to a simpler company law regime as compared with funds that are not private fund limited partnerships), limited liability partnerships (LLPs), real estate investment trusts (REITs), property authorised investment funds (PAIFs), offshore vehicles (including unit trusts) and companies. The entity used for specific transactions will depend on the type of asset, market value, the intended use of the real estate, financing structure, the investors, exit options and tax-efficient structuring.

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Tax considerations may dictate the manner of investment (including the entity used), given:

- value added tax and stamp duty land tax (SDLT) are commonly payable on asset sales, whereas if real estate assets are held by a corporate entity, SDLT is not payable on a transfer of shares and depending on the holding structure used stamp duty on shares may not apply (and investors should note that there is potentially a 3 per cent SDLT surcharge on residential property acquisitions where an investor holds more than one such property);
- individuals (including individuals investing via tax transparent entities such as partnerships) commonly pay income tax on rental receipts, capital gains tax on any (direct or indirect) disposal gain and inheritance tax UK real estate (and, depending on the domicile of the individual, certain other assets) on death; and
- corporations commonly pay corporation tax on rental income and on any (direct or indirect) disposal gain.

REITs benefit from UK tax exemptions subject to strict incorporation requirements and operating restrictions, such as:

- ring-fencing property investments;
- holding a minimum number of properties;
- distributing 90 per cent of income profits, which are subject to tax as UK property income; and
- ensuring that property rental business forms 75 per cent of the REIT's total profits.

PAIFs also benefit from UK tax exemptions, but again are subject to strict incorporation requirements and operating restrictions. The choice between the REIT and the PAIF regimes will be driven by the nature of investors and by investment strategy.

Offshore unit trusts can offer UK income tax transparency for investors, but are typically (although not universally) opaque for capital gains purposes, with units in the trust potentially not subject to SDLT on transfer.

Law stated - 03 October 2022

Foreign investors

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

Commercial property in England and Wales is commonly acquired through UK and non-UK corporate entities, and where non-UK resident entities are used, these are often corporate entities incorporated in the Channel Islands, Cayman Islands or the British Virgin Islands (owing to there being no or minimal stamp duty on the transfer of shares or units in such entities, in contrast with a transfer of shares in a company incorporated in the UK which attracts UK stamp duty). Offshore trust structures are also common, as (among other things) they can have the tax characteristics noted above, which can be useful depending on the nature of the investors.

Commercial property may also be acquired through structures involving limited partnerships (often seen in private equity transactions), which are attractive to investors who are not actively involved in the day-to-day operations of the real estate asset (which remain with the general partner) and, as a result, have limited liability up to their amount of equity investment.

The UK government has now implemented plans to establish a beneficial ownership register to ensure transparency in UK property ownership as a direct reaction to the use of offshore shell companies from jurisdictions with opaque ownership reporting requirements.

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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, limited partnerships and LLPs formed in England and Wales must 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.

Partnerships and limited partnerships are governed by the Partnership Act 1890 and the Limited Partnership Act 1907. The filing requirements for partnerships and limited partnerships are less onerous than for companies and LLPs, but there are also requirements for certain notices to be filed and published in the London Gazette.

An overview of certain tax consequences for foreign investors of using certain types of entity is described above. Whether a particular type of entity is or is not advantageous from a tax perspective will depend on various factors including the type of real estate asset, the characteristics of the investor(s), any financing structure and exit options.

Law stated - 03 October 2022

ACQUISITIONS AND LEASES

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.

The two main types of property ownership in England and Wales are freehold and leasehold.

Freehold demonstrates absolute ownership. The Land Registry will register freehold land with various qualities of title, depending on the level of evidence of ownership provided to them, with Title Absolute being the best.

Leasehold creates a contractual right granted by the lease for a tenant to exclusively occupy a property for a fixed period of time, with such possession subject to the payment of a premium or rent and compliance with the covenants set out in the lease.

There are other land interests (such as easements and commonhold) that may be relevant to land ownership and will be found on the title to the property.

There are different formalities to follow for the grant or transfer of the relevant interests, and to adequately protect the relevant interests, they must usually be registered or noted at the Land Registry.

Law stated - 03 October 2022

Pre-contract

What are the typical pre-contractual steps?

The specific pre-contractual arrangements vary on a case-by case-basis but they typically include the following steps (albeit that the due diligence process is arguably the only essential step):

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- heads of terms (or a term sheet) – sets out the principal commercial terms for the transaction, including purchase price, transaction timetable, exclusivity periods and any conditionality. These are typically non-binding save for the costs provisions;
- non-disclosure/confidentiality agreement – which can alternatively be included as a legally binding provision in the heads of terms;
- lock-out agreement – ensures legally binding exclusivity and is often executed prior to contractual negotiations getting underway; and
- due diligence – the doctrine of 'buyer beware' applies on property transactions so a buyer will undertake extensive due diligence in matters such as registered title, public searches, planning, construction, environmental and structural condition.

In more complex corporate real estate transactions, the property agents (on both the sell-side and buy-side) are more involved with the transaction process, assisting with addressing commercial issues, as well as with matters such as transaction deliverables and the due diligence process. All brokers in England and Wales must be accredited by the Royal Institution of Chartered Surveyors, which is the leading professional body for standards in property matters.

Law stated - 03 October 2022

Contract of sale

What are typical provisions in a contract of sale?

Residential transactions commonly use the Law Society's Standard Conditions of Sale, with very little negotiation of those terms.

Commercial and corporate transactions normally incorporate elements of the Law Society's Standard Commercial Property Conditions into a bespoke contract, typically covering the following matters:

- deposit arrangements;
- conditions to be satisfied for completion of the acquisition of the property to occur (eg, obtaining planning permission, obtaining a third-party consent);
- the conduct of the parties between exchange and completion (where applicable);
- apportionment of liability (eg, for title matters, environmental liability);
- any termination rights; and
- completion deliverables and mechanics.<!--EndFragment-->

Law stated - 03 October 2022

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?

Local government has an obligation through a statutory regime to investigate the full extent of any contamination, and arrange for any remediation if necessary. The primary responsibility in England and Wales for contamination lies with the original polluter. However, if the polluter cannot be found, liability for clean-up can fall on the non-polluting current

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landowner, or even the non-polluting current occupier. In practice, most contamination is discovered when a property is redeveloped and local government will typically use the planning regime to arrange for remediation as a condition to granting planning consent.

On the sale of a property, the extent to which parties include environmental provisions in the contract largely depends on relative bargaining strength and the specific risk profile of the property by reference to buyer surveys and known historic uses. Where specific concerns arise, it is relatively common to see an agreement in the contract to allocate liability, which may be backed by an indemnity if the specific risk requires it. However, ultimately the government has discretion whether to accept those terms.

Law stated - 03 October 2022

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?

The doctrine of 'buyer beware' applies on property transactions, meaning that the onus is on the buyer to undertake adequate due diligence of the property. The market position is for the seller to provide replies to a market standard set of enquiries known as the Commercial Property Standard Enquiries or the Law Society standard residential enquiries (as applicable). These are likely to be the only representations the seller provides (save for, potentially, tax representations in corporate transactions).

Between exchange and completion, the seller is likely to be restricted from making any major decisions regarding the property without the buyer's consent.

Post-exchange and pre-completion, the buyer will raise standard pre-completion enquiries, asking the seller to confirm that nothing has changed since the initial replies were provided. This is important, as estoppel certificates are not customary in England and Wales.

Law stated - 03 October 2022

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 a tenant 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.

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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?

As a commercial decision, a 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. There is no requirement to register a rent deposit deed with the Land Registry or Companies House.

A sale contract should specify how the transfer of any rent deposit deeds are to be dealt with. A well-drafted rent deposit deed will detail the actions the tenant or landlord must take if they are seeking to transfer their respective interest in the property.

Rent reviews are market standard in the United Kingdom, and can take various different forms: annually or every five years, retail or consumer price index-linked, or simply open market value of the premises at a time. While upward-only rent reviews remain the norm in commercial office leases, there is an increasing trend to turnover rent leases in the retail market. Not only was this trend accelerated by the covid-19 pandemic but we have seen many tenants pushing for variations to existing leases in order to convert to turnover rents.

Rent deposits customarily require the deposited amount to be topped up following a rent review.

Law stated - 03 October 2022

Due diligence

What due diligence should be conducted before executing a contract? Is any due diligence customarily permitted or conducted after contract but before closing? 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?

The doctrine of 'buyer beware' operates in England and Wales, making due diligence particularly important. Asset-level due diligence by a buyer's solicitor generally comprises: title review, searches, planning and construction materials (if applicable) and pre-contract enquiries.

The buyer's solicitor will review a title pack provided by the seller's solicitors containing a copy of the registered title for the property from the Land Registry, copies of all documents listed on that title (known as the title documents), any planning and construction materials disclosed and replies to the standard form enquiries (supported by ancillary information such as service charge, insurance and supply contract details). The buyer's solicitor is required to submit property searches with the local authority (for matters regarding land use and other local authority restrictions affecting the property) and all relevant utility companies. The buyer's solicitor will then typically raise any further enquiries with the seller's solicitor to clarify any matters flagged by its due diligence.

Following an exchange of contracts, the buyer's solicitor should 'note' the sale agreement on the registered title to the property at the Land Registry and prior to completion obtain a priority search to 'freeze' the property register for a period of 30 days so that no third party can deal with the property or register any interest. This gives the buyer time to register itself as the new owner at the Land Registry.

The usual practice in England and Wales is for all due diligence to be completed prior to the signing of contracts; however, the climate is changing and this may not always be the case. Buyers may seek to exchange contracts subject

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to due diligence, especially where the sellers are yet to acquire the property interest or if the property is subject to development. A buyer can require the seller to answer pre-completion 'requisitions on title', which will include a statement that all replies to enquiries remain accurate, but there is no liability on the seller pursuant to the requisitions on title if circumstances have changed.

Law stated - 03 October 2022

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 not customary for a seller to give any such representations so a buyer or tenant typically carry out technical and site surveys as part of the due diligence process prior to any purchase or lease, including a site inspection. Formal reports include:

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

Indemnities are rare and will only be provided in relation to a specific risk.

Law stated - 03 October 2022

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 negotiations. In England and Wales, there are broadly recognised standard market positions (such as the guidance given in the Code for Leasing Business Premises), yet they can still be heavily negotiated and site-specific. 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 consider include:

- the term;
- security of tenure (the right to renew at the end of the term);
- restrictions on the use of the premises;
- the ability to dispose of the premises (by way of assignment or underletting) and any conditions that may be applied;
- the standard of tenant repair obligation;
- the tenant's obligation to yield up at the end of the term;
- break/early termination rights;
- rent review provisions;

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- rights granted to tenant and reserved to landlord;
- 'green lease' obligations; and
- service charge provisions.

Where there is a property management agreement in place, it is likely to have been lender approved, with a direct duty of care owed to the lender. Tenants do not always have access to such agreements, as their direct relationship is with the landlord.

Law stated - 03 October 2022

Other agreements

What other agreements does a lawyer customarily review?

As well as the sale contract (and any ancillaries) and standard due diligence materials, the buyer's solicitor may also be required to review:

- planning agreements;
- management company agreements;
- 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.<!--EndFragment-->

Law stated - 03 October 2022

Closing preparations

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

A well-drafted contract will have the completion mechanics clearly set out, with a timetable allocation for each item. 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 required to be produced at the closing meeting and actions that need to be taken to complete the transaction, including procuring any legal opinions from overseas counsel when overseas entities are involved. Timing between signing and closing will vary on a case-by-case basis depending on the financing of the transaction and other conditionality.

It is customary to undertake pre-closing insolvency searches, submit pre-closing requisitions on title and agree a completion statement setting out the funds flow.

Law stated - 03 October 2022

Closing formalities

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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, or closing, is the final step in the process of transferring ownership of a property. The balance of the purchase price is paid and the transfer deed (being a Land Registry form TR1) is 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. Where there is debt involved in the transaction, the closing mechanics for a transaction will be controlled by the requirements of the lender. Solicitor undertakings may need to be agreed upon between lawyers to deal with the movement of monies.

Law stated - 03 October 2022

Contract breach

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

The most common legal remedy in English law for breach of contract is damages, providing 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 of the contract, 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 separate contractual right for the non-defaulting party to terminate the contract. Often, where a deposit has been paid, this may have been paid to a seller on a non-refundable basis, entitling the seller to hold on to the deposit following a failure to complete the transaction for the buyer's default.

Law stated - 03 October 2022

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.

However, most commercial leases will include a right for the landlord to forfeit or end the lease by re-entering the property following a breach of a lease covenant by the tenant (including non-payment of rent or tenant insolvency). The tenant can apply to court for relief to have the forfeiture set aside and the court has discretion to grant or withhold relief (which is generally exercised in favour of the tenant if the tenant acts quickly, pays any arrears, remedies any breaches of covenant and pays the landlord's costs).

Law stated - 03 October 2022

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FINANCING

Secured lending

Discuss the types of real estate security instruments available to lenders in your jurisdiction. Who are the typical providers of real estate financing in your country? Are there any restrictions on who may provide financing?

Most commonly, a lender in a commercial lending transaction will seek to take a charge by way of legal mortgage over real property situated in England that is being financed. A legal mortgage (involving a transfer of title) can only be taken over a property that the mortgagor currently owns. Equitable mortgages (involving the transfer of the beneficial interest) and fixed or floating charges can be taken over property that the mortgagor currently owns or may own in the future. A charge by way of a legal mortgage is now most commonly used in real estate finance transactions, giving the lender equivalent rights as a legal mortgage without transferring title. For a security interest to take effect as a legal mortgage, it must be executed by way of deed and registered at the Land Registry in England. The mortgage is usually protected at the Land Registry by way of a restriction on title, which prevents the owner of the property from dealing with the property without the consent of the lender. If the security interest is granted by an English company or limited liability partnership, it must also be registered at Companies House within 21 days of the creation of the security interest.

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 and can create other security interests, such as legal assignments or fixed charges over specific other assets of the borrower. Depending on the type of financing (eg, development financing or investment financing) the lenders may require different security over different classes of assets to take into account the collateral assets available in the context of the financing.

National and international financial institutions have traditionally been the primary providers of funding in the real estate finance market in the United Kingdom, together with insurance companies, which often look to provide support for long-term investments. In recent years, private credit funds, asset managers and other institutional investors have established credit platforms that offer a variety of funding products and liquidity solutions to borrowers in the commercial lending market (including the real estate finance market) as an alternative to traditional bank lending. Providing financing to individuals secured on real estate assets is a regulated activity in the United Kingdom, which requires, unless an exemption applies, appropriate authorisations from the financial regulator and compliance with applicable consumer protection legislation in the United Kingdom.

Law stated - 03 October 2022

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 therefore may require additional mortgagee protections; and
- alienation provisions: limitations on the lender to deal with the asset freely may impact the lender's ability to

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exercise its rights of enforcement.

Security over freehold and leasehold property is granted in the same way, by creating a charge by way of legal mortgage and registering it at the Land Registry.

Law stated - 03 October 2022

Form of security

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

The most common form of security seen on real estate assets is a charge by way of a legal mortgage. For a security interest to take effect as a legal mortgage, it must be executed by way of deed and registered at the Land Registry. If the security interest is granted by an English company or limited liability partnership, it must also be registered at Companies House within 21 days of the creation of the security interest.

In real estate finance transactions, security will in addition often be granted over:

- the borrower's bank accounts;
- any rental income due to the borrower by any tenants in the property;
- the equity interests of the borrower; and
- any material contracts relating to the property entered into by the borrower.<!--EndFragment-->

Law stated - 03 October 2022

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 of the credit risk. An accredited valuer appointed by the lender will typically be required to prepare a report highlighting key factors and risks relevant to evaluating the financing risk for the lender. The valuer will also review any property reports to ensure that there are no matters that are disclosed in the report that would affect the underlying value of the asset. The financing documentation may require that new valuations are obtained at regular intervals during the life of the loan.

Law stated - 03 October 2022

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?

A non-UK based lender making a loan secured on UK real estate will be required to comply with applicable UK legislation and anti-money laundering legislation. In particular, providing financing to an individual secured on real estate assets is a regulated activity in the United Kingdom, which requires, unless an exemption applies, appropriate authorisations from the financial regulator and compliance with applicable consumer protection legislation in the

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United Kingdom. There are no restrictions on foreign ownership or the occupation of real estate in England. Certain tax considerations (and, in particular, withholding tax on interest considerations) may be relevant and should be considered on a case-by-case basis.

Depending on the nature of the asset over which security is to be enforced, anti-trust approvals, filings with respect to the National Security Investment Act 2021 and/or the Economic Crime (Transparency and Enforcement) Act may need to be considered in the context of the exercise enforcement rights over real estate assets or their owners.

Law stated - 03 October 2022

Loan interest rates

How are interest rates on commercial and high-value property loans commonly set (with reference to common benchmark interest rates (eg, SOFR, Ameribor), 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?

Depending on the underlying currency of the loan, interest rates in real estate financings in the London market entered into from the beginning of 2022 are typically based on the Sterling Overnight Interbank Average Rate, EURIBOR or any other appropriate benchmark rate for the relevant currency, although some products use an alternative base rate or fixed rate. There is no strict rule on the amount of interest that may be charged on a loan. However, applicable consumer protection legislation and unfair contract terms legislation may limit the amount of interest that can be charged. English courts have wide powers to remedy unfair credit relationships. In addition, under English law, an interest clause relating to default interest on overdue sums that is held to be a penalty is unenforceable.

Law stated - 03 October 2022

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?

Loan agreements will typically contain a number of trigger events pursuant to which a lender may take certain actions, ranging from placing the debt on-demand to enforcing its security. The type of security interest that a lender holds will determine how it can enforce its security and whether it can do so without a court order. Certain methods of enforcement are only available to the holders of specific types of security interests. Certain security interests carry an implied power of sale at common law, whereas mortgages or charges created by deed benefit from a statutory power of sale under the Law of Property Act 1925.

The two most typical processes for enforcing security over real estate assets in England and Wales are the appointment of a receiver by the lender over specific assets (such as a particular property or shares in a property-owning company) or the appointment of an administrator in respect of a corporate borrower. This can be done by way of an 'out of court' process where the relevant security document contains a qualifying floating charge over all, or substantially all, of the assets of the borrower, or otherwise by an application to the court. The role of a receiver is to realise assets in favour of the creditor who appointed the receiver, allowing a lender to enforce its security over specific assets, rather than the borrower entity as a whole. An administrator, on the other hand, upon appointment, will take over the management and conduct of the borrower and its business from the directors and will conduct the administration

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in accordance with the statutory objectives (being in order of priority, (1) the rescue of the borrower as a going concern, (2) achieving a better result for the borrower's creditors as a whole than would be likely if the borrower was wound up, or (3) the realisation of its assets to make a distribution to the borrower's secured or preferential creditors) and proposals that the administrator puts to creditors for their approval. An administrator will act as agent of the borrower and as an officer of the court, and, although the lender who appoints the administrator will not have the power to direct the actions of the administrator, the administrator will, nonetheless, owe his or her duties to the interests of the creditors of the borrower as a whole and must act accordingly.

The lender may also use a default under the facility agreement as an opportunity to open negotiations with the borrower to facilitate renegotiations of the debt terms or an overall restructuring of the debt or the underlying asset.

Law stated - 03 October 2022

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?

Unless the financing is limited recourse to specific assets of the borrower, in a situation where the value of the secured assets is insufficient to discharge the outstanding debt, the lender would continue to have an unsecured claim against the borrower.

Law stated - 03 October 2022

Protection of collateral

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

Prior to enforcement, the underlying finance documents will contain restrictive covenants and a negative pledge to protect and prevent dealing by the security provider of, the collateral. If enforcing a legal mortgage over property, the lender may elect to take possession of the property. However, a mortgagee in possession may be exposed to certain liabilities and risks that a property owner ordinarily would be exposed to. Accordingly, upon enforcement, lenders may appoint an insolvency practitioner to act as receiver and deal with the property. If the lender has taken an assignment by way of security over the right to receive rental income, the lender can (subject to the terms of the security documents) retain the rent monies for application against the outstanding loan following a default.

Law stated - 03 October 2022

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-asset debenture is likely to take security over all of the assets of a borrower, be it in the form of a fixed or floating

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charge (depending on the nature of the asset). The type of security granted will determine the options for the enforcement strategy. Share charges over the shares of the borrower may be granted to the lender to provide an additional layer of security and enable the lender to sell the borrower as well as its assets. Cross-guarantees from other entities within the group structure may further complement the security package.

Law stated - 03 October 2022

Cash management and reserves

Is it typical to require a 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 finance transactions. Controlled accounts and collections, cash trap triggers, payment waterfalls and cash sweeps are common features in real estate financings, to enable a lender to exercise the desired degree of control over the cashflows of the underlying asset or development. Reserves are frequently required by lenders for less creditworthy borrowers or special purpose vehicles to mitigate against an early term default or to protect against uncertainties during the early stages of ownership by the borrower of the assets. The reserves may, for example, be required to cover capital expenditure requirements or debt service obligations under the finance documents.

Law stated - 03 October 2022

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 or reserves, letters of credit and insurance, as well as certain duty of care arrangements with respect to the managers. Guarantees are commonly provided in lending transactions by subsidiaries or immediate holding companies of the borrower – 'bad boy' guarantees by the ultimate owner are not typical. A lender can usually make a 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.

Law stated - 03 October 2022

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 to maintain the value of the property, as well as ensuring that the borrower is not permitted to make substantial changes to the property or the occupational leases that run with 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 cost control and project-managing the development properly under the supervision of the lender's project monitor. In addition, financing documentation will typically include a broad range of information covenants requiring the borrower to provide updates as to financial information and material events affecting the property or the corporate structure.

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Financial covenants

What are typical financial covenants required by lenders?

A typical investment finance facility may 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 received or receivable against the interest payable; or
- a debt service ratio, which measures the rental income received or receivable against the loan repayments and interest payments.

A typical development finance facility may in addition include a loan-to-cost ratio, which measures the cost of development against the outstanding debt.

Ongoing information covenants and financial reporting covenants are customary, as is the requirement to provide a valuation at regular pre-agreed intervals.

Law stated - 03 October 2022

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?

Security over movable property may be taken by way of a fixed or floating charge. The debenture will usually create a floating charge over all of the borrower's assets, which allows the borrower to deal with the assets before such charge is crystallised. Whether a security interest expressed as a fixed charge will take effect as a fixed or a floating charge will depend on the degree of control the beneficiary of the security interest exercises over the underlying asset.

Depending on the type of asset, perfection requirements may vary from registering the security interest with the Registrar of Companies or other specialist registries or the service of notice on the relevant counterparty or account bank.

Law stated - 03 October 2022

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 for a borrower to be an SPE, although lenders in real estate transactions often require that borrowing entities limit their liabilities and 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, minimise liabilities and create options for companies to raise capital and structure debt in a more efficient manner.

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UPDATE AND TRENDS

International and national regulation

Are there any emerging trends, international regulatory schemes, national government or regulatory changes, or other hot topics in real estate regulation in your jurisdiction? (eg, transition to a new alternative benchmark rate upon cessation of LIBOR as benchmark rate?)

UK government covid-19-related regulations have played a defining role in managing the relationship between landlords and tenants since the start of the covid-19 pandemic. With changes to those regulations on the horizon, we are likely to see the culmination of pandemic-related debts and liabilities in 2022.

In the long term, as the UK government focuses on the green agenda in the wake of the COP26 summit, we can expect the tightening of existing – as well as the introduction of new – property-specific ESG-focused regulations. Investors will need to seriously consider the impact of these changes across their portfolios.

Sterling LIBOR has been discontinued at the end of 2021 (along with certain quoted tenors of certain other currencies). As an alternative to sterling LIBOR, the Working Group on Sterling Risk-Free Reference Rates has recommended the Sterling Overnight Index Average implemented via a compounded in arrears methodology. The European lending market has so far adopted a fairly uniform approach to the transition, often based on the wording and methodology recommended by the Loan Market Association.

As noted at section 1.4, the Economic Crime (Transparency and Enforcement) Act 2022 introduces requirements on foreign owners of property in the UK. Accordingly, (1) all non-UK entities that own or acquire real property in the UK will need to register the entity's beneficial owners, (2) the requirement to register will apply retrospectively (from 1999 in England and Wales and from 2014 in Scotland), and (3) failure to comply will result in (a) limitations in subsequent transfer/security rights applications at Land Registry, as well as (b) criminal sanctions for the entity and its management.

Relevant to investments into corporate entities, the National Security and Investment Act 2021 has widened the scope of reportable transactions under previous merger regulations. Notification under the Act is mandatory for certain transactions involving entities (both UK and non-UK) carrying out qualifying activities in the UK, including those with control over land assets. Investors should be aware in the event that assets acquired relate to in-scope industries that may be subject to the filing requirements under the Act.

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