REAL NEWS

SUMMER 2016

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In the summer edition of Real News:

Peter Fletcher explores the decision in *Britel Fund Trustees Limited -v- B & Q Plc* and the impact on **rental valuation** of rent frees and break options (pg. 03);

Following guidance published in the summer 2015 edition of Real News, **Michelle Eyre** takes a closer look at **MEES** (pg. 05);

Alasdair Thomas looks at the recent case of *Lynn Shellfish Limited -v- Loose* and considers the impact on the **renewable energy** sector (pg. 09);

Corinne McCarthy reports on **insurance** of existing buildings in which construction works are to take place (pg. 12); and

In the autumn 2015 edition of Real News **Sophie Stewart** reported on the demise of **vacant building credit and the small site exemption** from affordable housing. In this edition Sophie comments on its return following reinstatement of guidance (pg. 14).

As ever if you have any suggestions for future content please do get in touch.

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RENT VALUATION UNDER THE 1954 ACT – RENT FREES AND BREAK OPTIONS

In the recent lease renewal decision of *Britel Fund Trustees Ltd v B&Q plc* [2016] the court considered the various factors that had to be taken into account when determining the rent pursuant to s34 of the Landlord and Tenant Act 1954 (the "**Act**").

Facts

The case concerned a lease renewal of a 37,000 square foot purpose built DIY warehouse in Tottenham Hale Retail Park, London. The parties had agreed all the terms for the new lease except for the rent, including, importantly, the insertion of an early mutual rolling break on or after 30 June 2018 (on six months' notice).

The passing rent was £776,139 per annum. The landlord and tenant differed dramatically as to what should be the new level of rent. The landlord's expert considered the market rent to be £698,500 per annum, whereas the tenant's expert was of the view that it should be £281,000.

Key issues

The court had two main issues to consider in order to determine the rent correctly:

1. Should allowance be made for a three month so called 'Rental Holiday'?
2. What impact would the early mutual break option have on the level of open market rent?

Should allowance be made for a three month so called 'Rental Holiday'?

Noting the conflicting County Court decisions in relation to rent free periods, His Honour Judge John Mitchell ruled that, as the rent was being ascertained for a lease to be taken by a prospective lessee who was not already in occupation, it followed that there must be an element of logic when determining the benefit of a rent free period.

The Judge was satisfied that any retailer who operated out of premises such as this would require a fit out period in order to trade, and so, in the absence of special circumstances, a rent free holiday of three months would be granted.

The Judge then determined that it would be logical to apply the three month rent free period over the entirety of the term (120 months), meaning a rental discount of 2.5 per cent over the term of the renewal lease.

What impact would the early mutual break option have on the level of open market rent?

The parties agreed that the early mutual break clause significantly complicated the determination of the open market rent. There were also several other factors put forward by the experts which would have an effect but are not discussed in this article.

The approach initially agreed between the parties' experts was that the market rent would be agreed, with a discount then applied to take into account the mutual

break clause. The landlord's expert argued for a discount of 10 per cent in the rent, the tenant's expert believed the appropriate amount to be a 50 per cent deduction.

This approach was deemed artificial and dropped during the trial as both sides conceded that no DIY retailer would take a lease with such an early break clause, especially when the costs of fitting out and the potential length of the lease before the break was operated (2.5 years only) were taken into account. Instead, the approach adopted by the court was that the most likely tenant for a lease with the proposed mutual break option would be a discounter, a company that was willing to trade for a short term and carry out a cheap fitting/stripping out. Therefore a discounter would be used as the hypothetical tenant in this instance.

The court held that the market rent payable by a DIY retailer was £603,100 per annum, and for a discounter £466,940 per annum. The appropriate discount in light of the mutual break clause would be 22.5 per cent for a DIY retailer and 20 per cent for a discounter.

Both valuers agreed that if another DIY retailer was looking for premises, they would not take the property with the break clause. Therefore the court accepted that the hypothetical tenant would be a discounter, and found the rent to be £373,700 per annum (£10.10 per square foot).

Key points to note

1. As this is a County Court decision, it will not be binding on other County Courts (or any superior court). That said, it is a reasoned judgment that adopts a logical approach to the implementation of s34 of the Act and so may be judged to be of "persuasive" value in decisions going forward.
2. The court has the power to, and is likely to, address market rent to take into account any rent free period. Accurate comparables are also very important.
3. Each case will turn on its own facts, however, it is clear from this judgment that an early mutual break clause will have an impact on the market rent. The court's approach to a hypothetical tenant should also be noted, as the court decided that the hypothetical tenant originally considered by the experts (a DIY retailer), would not be a "willing" tenant of a lease with such an early mutual break clause.

The judgment provides a useful analysis of the factors to be considered and suggests adjustments to be take into account when the court is left to determine the market rent.

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A CLOSER LOOK AT MEES

The Energy Act 2011 required the introduction of measures to improve the energy efficiency of both domestic (residential) and non-domestic (commercial) private rented buildings in England and Wales.

The Minimum Energy Efficiency Standards (MEES) are implemented in England and Wales by the Energy Efficiency (Private Rented Property) (England and Wales) Regulations 2015 ("**Regulations**"). Parts 1 and 2 of the Regulations came into force on 1 April 2016 and Part 3 comes into force on 1 October 2016.

The two key measures introduced by the Regulations are:

(a) If a property is sub-standard because its energy performance falls below the minimum level of energy efficiency of a band E EPC (that is band F or G), a landlord may not:

- Grant a new tenancy, extend or renew an existing tenancy of a domestic or non-domestic private rented property on or after 1 April 2018;
- Continue to let a domestic private rented property on or after 1 April 2020; or
- Continue to let a non-domestic private rented property on or after 1 April 2023.

Note that there is always the possibility that overall standards may become tighter in the future and the band E threshold could be raised.

(b) A tenant of a domestic private rented property is able to request the landlord's consent to make energy efficiency improvements to the property despite any restrictions that may be contained in its lease. Such consent is not to be unreasonably withheld, subject to certain exemptions.

The Regulations do not impose a positive obligation on landlords to carry out energy efficiency improvement works. However, a landlord who wishes to let a sub-standard property (whether domestic or non-domestic) must undertake "relevant energy efficiency improvements" or obtain and register an exemption. Many investors' strategies look set to be founded on claiming and renewing exemptions.

The Regulations do give the landlord some flexibility and if the landlord pays for the works itself, it can try to recover the cost of doing those works by charging the tenant a higher rent or service charge (assuming the lease wording permits this). This will depend on the state of the relevant property market and whether it is the landlord that has the bargaining strength.

Once the landlord has undertaken the relevant energy efficiency improvements for a sub-standard property, or if there are no relevant energy efficiency improvements that can be made, the property is treated as being compliant for a period of five years from the registering of their completion.

Is the lease valid if a sub-standard property is let?

The validity or enforceability of a lease is not affected by a landlord letting, or continuing to let, a domestic or non-domestic property in breach of the MEES requirement. Neither can a landlord terminate the tenancy or require the tenant to vacate because the landlord has failed to achieve the MEES requirement. However, the landlord will be in breach and liable to enforcement action.

Key exemptions

The Regulations do provide for some key 5 year exemptions (none of which last indefinitely) which are likely to form part of the overall strategy for investors:

- improvement works have been done – If all cost-effective energy improvement works have been done but the EPC remains below E rating – the works will be cost effective if the cost of carrying out the works is less than what the predicted energy savings will be over 7 years.
- consent exemption – If a landlord has been unable to obtain the necessary consents for energy improvement works (such as planning permission or any consents required under the lease).
- devaluation exemption – If the landlord has obtained a report from an independent surveyor which states that making the relevant improvements would devalue the property (or the building of which it forms part) by more than 5 per cent of the market value.

There are also some "mini-exemptions" which postpone the prohibition on letting for six months where a landlord has no choice as to whether or not to grant a lease, for example:

- where a landlord is contractually obliged to grant a lease (such as under a preceding agreement for lease);
- where a lease is granted by operation of law (such as where there is a deemed surrender and re-grant);
- where an overriding lease is granted under sections 19 and 20 of the Landlord and Tenant Act 1995; or
- where a renewal lease is granted under part II of the Landlord and Tenant Act 1954.

In addition, there is also a six month "mini-exemption" from the obligation not to continue to let sub-standard property where a party becomes a landlord by purchasing a property subject to a pre-existing tenancy. This applies to existing lettings of residential property from 1 April 2020 and to other property from 1 April 2023. The successor landlord will either need to bring the property up to standard within six months or establish a new exemption.

Landlords may only rely on the above exemptions where they have registered the information concerning the exemption in the private rented sector exemptions register, which is open to public inspection, in accordance with the Regulations.

Tenant's request for landlord's consent

A tenant's notice requesting consent to make relevant energy efficiency improvements must contain certain information, to include:

- the relevant energy efficiency improvements for which the landlord's consent is sought;
- a copy of any recommendation report;
- evidence that funding is free of charge under an energy suppliers' obligation, or written confirmation where the tenant is funding;
- specify what works, if any, the tenant will undertake to make good the property after the relevant energy efficiency improvements are made, as well as confirming that any such works will be carried out at the tenant's expense.

Penalty notice

From 1 April 2018 an enforcement authority can serve either a financial penalty, publication penalty, or both, on a landlord if at any time in the preceding 18 months, the landlord has been letting a sub-standard domestic or non-domestic property in breach of the Regulations.

Financial penalties

	Domestic Property	Non-Domestic Property
Letting a sub-standard property for less than 3 months from service of a penalty notice	Fine not exceeding £2,000	The greater of £5,000 or 10 per cent of the rateable value up to £50,000
Letting a sub-standard property for 3 months or more from service of a penalty notice	Fine not exceeding £4,000	The greater of £10,000 or 20 per cent of the rateable value up to £150,000
Registering false or misleading information on the PRS exemption register	Fine not exceeding £1,000	Fine not exceeding £5,000
Failing to comply with a compliance notice	Publication penalty plus fine not exceeding £2,000	Publication penalty plus fine not exceeding £5,000
Total financial penalty which could be payable	**Must not exceed £5,000 for a combination of the breaches**	**No cap**

Publication penalty

An enforcement authority will publish information in relation to a penalty notice on the private rented sector exemptions register for at least 12 months. The landlord can appeal on the grounds that the issue of the penalty notice is based on an error of fact or law; does not comply with the requirements in the Regulations; or should not have been served in the circumstances of the case. The penalty notice will be suspended pending the outcome of the appeal.

Potential amendment?

On 14 April 2016 the draft Energy Efficiency (Private Rented Property) (England and Wales) (Amendment) Regulations 2016 were introduced into Parliament to amend the Regulations. If approved, the 2016 Regulations will delay the dates from which landlords may register an exemption from minimum energy efficiency requirements to 1 April 2017 for non-domestic properties and 1 October 2017 for domestic properties.

Final thought

As the EPC rules are EU-driven, it will be interesting to see whether there is any impact now that the UK has voted to leave the EU.

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SUPREME COURT IS ALIVE ALIVE-O TO THE POSSIBILITY OF VARIABLE PRESCRIPTIVE RIGHTS

The recent case of *Lynn Shellfish Ltd and others v. Loose and others* [2016] UKSC has seen the Supreme Court take a practical approach to the law of prescription. Those involved in the development of facilities for renewable energy may already be familiar with the need to work around other manorial rights, such as mineral rights and rights to shoot game. It is not difficult to imagine a scenario in which facilities for the generation of tidal power, or even wind turbines, could similarly impinge upon foreshore fishing rights.

In this case the Supreme Court ruled that the extent of an exclusive prescriptive right to take cockles and mussels from the sandy foreshore of the Wash (in Norfolk) depends, not on some fictitious presumed historical grant of that right, but on its actual use by the party entitled to it. Such rights can exist over areas of variable extent, provided that it is possible to ascertain the extent of the area at any given point. On the other hand, the court also decided that the right did not extend to sandbanks that had become attached to the foreshore when the channels between them and the foreshore silted up. The court's reasoning was that the sandbanks had become attached at a specific moment in time, rather than gradually, and prior to the attachment they had been subject to public fishing rights.

The Lord of the Manor and Mr Loose

One of the co-respondents to the appeal was Michael LeStrange Meakin, Lord of the Manors of Snettisham and Heacham. He is the proprietor of an ancient and exclusive right to collect cockles and mussels from a section of the foreshore of the Wash adjoining his land to the east, otherwise known as a 'profit a prendre' (or just a 'profit'). The Lord of the Manors had, in turn, granted this right to another co-respondent, Mr Loose, who was holding over following an initial 3-year lease of the right, granted in 1970 and never subsequently terminated. The existence of the right was not in dispute, nor for that matter was Mr Loose's claim to exercise the right exclusively under the terms of the lease. It was the extent of the area covered by the right that led to the litigation, which eventually made its way to the Supreme Court.

The dispute arose because Lynn Shellfish Ltd, who is an operator of a commercial fishing businesses in the Wash, had been using modern, boat-based suction dredging techniques to fish for the cockles and mussels in areas that Mr Loose claimed were covered by his exclusive right to pick the cockles and mussels on foot. They were doing this because inshore waters such as the Wash are subject to public fishing rights, and the best cockle and mussel fishing grounds were in areas that were only uncovered by the sea at low tide, making it possible to fish the areas by boat for long periods each day.

The questions before the court were how far the low tide mark should extend for the purposes of determining the area covered by Mr Loose's right to fish on foot, and whether certain sandbanks that had become attached to the foreshore by the action of the tides – silting up the channels in between – formed part of the area covered by Mr Loose's right.

...since time immemorial

Prescriptive rights are those which a party acquires, not by formal written grant, but by means of carrying out a particular activity on somebody else's land as if it had the right to do so. Centuries of case law and some questionable legislation have produced various legal principles for the justification of these rights, prompting the Supreme Court to remark that:

"The law in that connection is a mixture of inconsistent and archaic legal fictions, practical if sometimes haphazard judge-made rules and (in the case of easements and some profits but not profits in gross) well-meaning but ineptly drafted statutory provisions".

The right to collect cockles and mussels on foot was, in this case, said to be based on 'common law prescription', which meant that because the right had been exercised further back than anyone could remember, it raised a presumption that it had been so exercised since before legal memory began (with the accession of Richard I, in 1189), otherwise known as 'since time immemorial'.

The variable area

The Supreme Court clarified that a common law prescriptive right such as this is based, not on some imagined long-lost document, but on a history of actual use 'as of right', so as to demonstrate to the owner of the land on which the right is being exercised that the right is being asserted against him. In this case the owner of the land (as with all foreshore) was the Crown, and the person presumed to have been picking up cockles and mussels along the foreshore as of right since time immemorial was the Lord of the Manors (or, presumably, his serfs or vassals, there not being many recorded instances in history of cockle-picking gentry). Having thereby acquired the right, he was able to demise it to Mr Loose under a lease. The court saw no reason why the right could not apply to an area of variable extent, provided that it was possible to determine that extent from time to time. Express rights can be granted on those terms, and the same should apply to prescriptive rights.

The fundamental point, though, was that the extent of the right was determined by its use. This led the Supreme Court to reject Lynn Shellfish's reasoning that the extent should be confined by reference to a fixed low tide mark, based on average low tides, and rule that the appropriate boundary should fluctuate over time, according to the location of the lowest astronomical tide mark. Even though the lowest astronomical tide was only reached, on average, every 18.6 years, the court considered that this was the only way to give proper effect to the right as it would have been exercised in reality, namely by taking cockles from everywhere that it was possible to reach on foot when the tide was out. It was relevant that the modern boat-based dredging techniques had only become available in recent years, meaning that historically it would have been impossible to gather the cockles and mussels from some of the choicest areas, only exposed at the lowest of tides, unless the right extended to include those areas.

The sand bars

Mr Loose and his co-respondents did not win an unqualified victory. The Court decided that the sandbanks were not covered by the right to take cockles and mussels. Part of the basis for this involved a somewhat counter-intuitive finding of fact, namely that the sandbanks had not become attached to the land gradually, but became so attached at a particular moment in time. Though the channels between the sandbanks and the foreshore had become silted up gradually over a period of time, and the gap between them thereby closed, there had nevertheless been a defined point in time at which the gap actually closed.

This fact was important, because it served to undermine both bases of Mr Loose's argument. First, the common law prescriptive right that had been acquired in respect of the foreshore could not extend to the sandbanks, because up until the defined moment in time when the sandbanks became attached, the public fishing rights over the Wash as an inshore waterway had applied to them, meaning that no exclusive prescriptive rights could have existed in favour of the Lord of the Manors. Secondly, the sandbanks could not have become attached to the area covered by those rights by means of the doctrine of accretion, as a gradual and imperceptible attachment of the sandbanks to the foreshore area would have been required for accretion to apply, and the court decided the attachment happened suddenly, albeit as a result of a gradual process.

Wider significance

The case is obviously of considerable significance to those who may become concerned with the extent of manorial fishing rights over the foreshore. In some areas in the UK the extent of foreshore uncovered at low tide is very large, and it is now clear that prescriptive fishing rights over the foreshore can extend as far out as the tide will recede.

More generally, the Supreme Court has provided some helpful clarification in that common law prescriptive rights can be variable, provided that the extent of the area covered by the rights is capable of being ascertained from time to time, and are in any event dependent on actual use, not some fiction of an ancient, presumed grant.

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INSURANCE OF EXISTING BUILDINGS IN WHICH CONSTRUCTION WORKS ARE TO TAKE PLACE

Where works are to be carried out under a JCT building contract 2011 to an existing structure, insurance option C in schedule 3 of that contract ("**Option C**") is generally meant to apply. Under Option C, the employer is required to take out and maintain insurance both for the works and the existing structure. In respect of the policy of insurance for the existing structure, this is meant to cover the full cost of reinstatement, repair or replacement of loss or damage to the existing structure due to a "Specified Peril". Specified Perils comprise fire, lightning, explosion, storm, flood, escape of water from any water tank, apparatus or pipe, earthquake, aircraft and other aerial devices or articles dropped therefrom, riot and civil commotion. The policies are to be in the joint names of the contractor and the employer and the insurers are to waive any rights of recourse they may have against the employer and the contractor as well as sub-contractors who are to be recognised as insureds thereunder.

This is relatively straightforward if the employer is the owner of the building and has taken out its own buildings insurance. However, it is not straightforward if the employer is the tenant in the building and the buildings insurance is maintained by the landlord. Landlords are, generally, reluctant to include tenants' contractors, let alone their sub-contractors, as insureds under their buildings insurance policy predominantly because it may affect their premiums. Consequently, the employer is not in a position to satisfy the requirements of Option C.

Alternative bespoke insurance arrangements, usually boil down to requiring the contractor to maintain third party/ public liability insurance, with an appropriate level of cover, to respond to damage caused to the building in which the works are to be carried out. This generally entails either:

- An amendment of Option C, so that the employer is not obliged to maintain insurance of the existing buildings and its contents (but which would still require him to insure the works), and consequential amendments to other clauses, such as clause 6.2, which cross-refer to Option C; or
- use of either JCT Insurance Options A or B (depending on whether it is the contractor or the employer who is to insure the works) so that any damage to the existing structure would be dealt with in the same way as damage caused to third party property. Some amendments to the JCT contract will be required including removing references to "New Build" from Option A or B as appropriate.

Whilst this 'solution' is not an unusual one, it is not a perfect substitution for the usual Option C insurance arrangements.

Material differences include the following:

1. The contractor will carry the responsibility for and, therefore, control over maintenance of its public liability insurance rather than the employer. If the

contractor fails to properly maintain that insurance, then the employer will have to look to the contractor itself to cover any shortfall in insurance recovery.

2. Public liability insurance cover to be maintained by the contractor may not be sufficient to cover reinstatement costs in the event of substantial damage to or the entire destruction of the building.
3. Under the JCT building contract, the contractor's public liability insurance is only required to react to damage to property caused by the negligence, breach of statutory duty, omission or default of the contractor or those for whom it is responsible. Therefore, this insurance will not react to damage to the building caused by Specified Perils, which are the risks normally expected to be covered by Option C, unless it can be established that their occurrence has been caused by the negligence, breach of statutory duty, omission or default of the contractor or those for whom it is responsible.

Consequently consideration should be given to the insurance arrangements for existing buildings at an early stage in the procurement process and advice sought from appropriately qualified insurance advisers to put in place suitable insurance arrangements.

However, bear in mind that in the next edition of the JCT suite of contracts, the JCT Contracts 2016, one key change concerns this insurance issue. JCT say they have included an extension of Option C to allow alternative solutions to the problems encountered by tenants and domestic homeowners in obtaining existing structures cover for contractors. We will have to wait and see just what those alternative solutions to this long outstanding problem are.

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THE RETURN OF VACANT BUILDING CREDIT AND THE SMALL SITE EXEMPTION FROM AFFORDABLE HOUSING

On 19 May 2016, the Department for Communities and Local Government reinstated its guidance on affordable housing contribution exemptions for small sites following the judgment of the Court of Appeal in *R (West Berkshire District Council and Reading Borough Council) v. Secretary of State for Communities and Local Government* [2016] EWCA. The initial challenge to its policy and subsequent appeal has been described by ministers as *"a total waste of taxpayers' money"*.

Parts of the Planning Practice Guidance ("**PPG**") limiting the affordable housing requirements for small developments were removed on 31 July 2015, following the High Court's decision to uphold West Berkshire's challenge of the policy. PPG stated that "small sites" – those with 10 units or less and a combined gross floor space of under 1,000 square meters or 5 units or less in certain rural areas – should not be required to contribute towards affordable housing. Also removed, and subsequently reinstated on 19 May, was the vacant building credit (which reduces an affordable housing contribution, where disused buildings are redeveloped or brought back into use).

The High Court initially found that the exemptions were "incompatible" with the National Planning Policy Framework. In a written ministerial statement dated 28 November 2014, the Minister for Housing and Planning referred to the "*disproportionate burden of developer contributions on small scale developers*" as justification for the introduction of the two policies which were designed to make smaller developments financially viable in order to assist the Government's pledge to increase house building. Overturning the High Court judgment, the Court of Appeal found that the Government's policy position was consistent with the statutory planning regime, and that the Secretary of State had taken into account the necessary material considerations following adequate consultations and having properly assessed the impact of the proposals in line with the Equality Act 2010.

Whilst allowing the appeal on all four grounds, the Court of Appeal made clear that although the Secretary of State can lawfully express his policy (and his preference) in unequivocal terms, that does not mean that the policy must be applied as rigidly. The principle that a decision taker has an unfettered discretion to exercise

their planning judgment remains intact – a local planning authority can depart from the Secretary of State's policy where material considerations, such as local circumstances and the evidence base, support a different approach.

The written ministerial statement did not need to spell out that it was not to be applied without flexibility or that it was to be properly treated as a material consideration in the normal way: these matters are a given.

We are now, once again, in a position whereby developments of under 10 units (and totalling under 1,000 square meters of combined gross floor space) will not trigger the requirement to enter into a section 106 obligation to provide an affordable housing contribution. Authorities may still seek other obligations where they meet the statutory tests and are necessary to make a development acceptable in planning terms.

As before, vacant building credit will be applied as a financial credit to offset against any obligation to pay affordable housing contributions. The floor space of any relevant disused buildings on the site will be credited against the total floor space of the new development when calculating the value of any contributions to be made. Contributions may still be required for any net increase in floor space.

It should be remembered in relation to developments of any size that in the event that affordable housing contributions would render the development financially unviable, developers can negotiate with local planning authorities for exemption from the contribution.

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