



N A B A R R O

CLARITY MATTERS

Real Estate update

Revised model remediation planning conditions – implications for developments [page 2](#)

UNIPLEX: An end to the need to act “promptly” when challenging planning permissions by judicial review? [page 5](#)

Feed-in Tariffs – FiT for purpose? [page 7](#)

SDLT and partnerships: All change or no change? [page 10](#)

What is a collective investment scheme and what are the practical regulatory issues? [page 13](#)

Distressed real estate debt: what borrowers can do [page 15](#)

Ask a question

If you have any questions please contact Marie Scott, Partner
T +44 (0)20 7524 6783
m.scott@nabarro.com

QuarterDay - Lady Day Edition

For our latest Real Estate Dispute Resolution update [click here](#)

The Real Estate team

To find out more about the team, and our capabilities [click here](#)

Update on Good Harvest case - We issued a briefing in February on the Good Harvest case in which the High Court held that a guarantee given by an original tenant's guarantor in respect of an assignee's obligations was unenforceable ([click here](#)). Leave has been granted for an appeal of this decision, scheduled for June – watch this space for an update once the appeal decision is known.

Revised model remediation planning conditions – implications for developments

Summary and implications

The Planning Inspectorate is currently revising the set of model planning conditions used by Local Planning Authorities (LPAs) when granting planning permission. The proposed conditions relating to land remediation could have significant time and cost implications for development projects. This will particularly apply if the conditions are used indiscriminately, without proper site specific consideration.

- There will be two sets of conditions: one of which is more complicated and expansive, for large and/or complex developments; and a shorter form for small and/or simple developments. There is no guidance as to how the different types of development will be classified. In some circumstances this may be an inappropriate distinction to draw.
- Key themes in both sets of conditions include requirements:
 - to identify and prepare remediation statements and undertake remediation ahead of the main development;
 - to suspend development in any area where previously unidentified contamination is found and undertake further assessment and remediation; and
 - to obtain validation certificates for the remediation work from the LPA.
- For complex developments there is a requirement to undertake long term monitoring of the remediation works, something which in practice may be difficult to manage following completion of the development and onward sale or letting.
- It may also be difficult to apply the revised model planning conditions to phased developments.

The revised model planning conditions

To coincide with the Department of Communities and Local Government's (DCLG) recent publication of new draft policy and measures aimed at making the discharge of planning conditions more efficient, the Planning Inspectorate has consulted on a set of revised and consolidated model planning conditions. These include model conditions for identification and remediation of land contamination, which are largely based on those published in May 2008. However there are some key distinctions which could have potentially onerous implications.

There will be two sets of model conditions: one to be used for planning permissions for large and/or complex developments, the other, less expansive form, for small and/or simple developments. The conditions

Ask a question

If you have any questions please contact:

Alex Ibrahim, Associate
T +44 (0)20 7524 6569
a.ibrahim@nabarro.com or

Clare Deanesly, Partner
T +44 (0)20 7524 6208
c.deanesly@nabarro.com

The Environment team

To find out more about the team, and our capabilities [click here](#)

Model planning conditions

The model planning conditions were originally published by the DCLG in May 2008 for use by LPAs in connection with planning permission granted for the development of land affected by contamination. The aim was to encourage consistency and help LPAs achieve the objectives set out in Planning Policy Statement 23 (Planning Pollution and Control) for the remediation of brownfield land.

for large/complex developments are more detailed and prescriptive. Key obligations applicable to both are outlined above and detailed below.

This approach creates potential issues. Firstly, it is not clear how LPAs are supposed to draw the distinction between small/large, simple/complex developments ahead of empirical evidence as to a site's underlying state and condition. Secondly, there is inconsistency in the timing of the remediation works. The simple form planning condition specifies that remediation has to occur before development starts; whereas the long form refers to remediation taking place in accordance with an agreed timetable.

Site characterisation

For both categories of site, development is prohibited until a full assessment of the extent, scale and nature of the contamination at the site (whether or not it originates on site) has been submitted to and approved by the LPA. This could cause delay to the proposed development timetable.

The risk assessment required as part of the site characterisation must include an assessment of the risks posed by any identified contamination to adjoining land, ecological systems, woodlands, groundwaters, surface waters and archaeological sites. This information could become accessible to neighbouring land owners for use in a potential claim. Or it could be used by other interested parties opposed to the development to assert environmental damage or the imminent threat of environmental damage, pursuant to the provisions of the Environmental Damage (Prevention and Remediation) Regulations 2009 (as amended).

Submission of a remediation scheme for approval

Development must not commence until a detailed remediation scheme has been submitted to and approved by the LPA. The remediation scheme must include all works to be undertaken, proposed remediation objectives and remediation criteria, an appraisal of remedial options, a proposal for the preferred option, and a timetable of works and site management procedures.

Preparing a remediation scheme, negotiating with the LPA (and other consultees such as the Environment Agency) and receiving their written approval for the scheme can often take time. This may adversely impact the development timetable. Despite the prescriptive nature of the conditions, there are no obligations on the LPA to provide responses to submissions within a set timeframe.

Implementation of the approved remediation scheme

The long form model conditions require that the remediation scheme must be implemented in accordance with the approved timetable of works. This approach does not seem to take into account the changes to development schemes which are inevitable once development has commenced. Compliance with this condition may therefore be difficult to achieve. However, the short form requires the site to be remediated "before development begins".

Key requirements of the model planning conditions:

- Site characterisation
- Submission of a remediation scheme
- Implementation of the approved scheme
- Reporting of unexpected contamination
- Long term monitoring and maintenance

The model conditions do not specifically provide for situations where large developments are undertaken in phases. It may not be possible to install certain remediation techniques (e.g. ground gas mitigation measures) or verify their effectiveness until a specific phase of construction has started.

Reporting of unexpected contamination

If any previously unidentified contamination is found during the development of the site, then this must be reported to the LPA within a specified number of days of discovery. Importantly, once the LPA has identified the part of the site affected by this contamination, development must stop in this area. Assessment of the unexpected contamination and approved remedial measures must then be carried out, both of which can cause potentially costly delay. Appropriate drafting within development agreements should take this into account.

Long term monitoring and maintenance (complex schemes)

Development must not commence until a monitoring and maintenance scheme to monitor the long-term effectiveness of the proposed remediation over a period of years has been submitted to and approved by the LPA. Reports demonstrating the effectiveness of the scheme must also be submitted to the LPA upon completion.

The practical implications of this approach have not been fully considered. It is unlikely that a developer will be prepared to assume responsibility for monitoring for a period long after practical completion. In many instances long term monitoring may not in practice even be necessary. In the past when such conditions have been imposed it has been for a site specific reason. Who will take on this requirement and who will meet the cost of compliance? Future purchasers and/or investors will be reluctant to do so. Equally there will be concerns as to the need and responsibility for further remedial works revealed by the monitoring if the results are unfavourable or inconclusive. Liability apportionment and access issues could be complex.

Conclusion

It is unclear how these revised model planning conditions will be used in practice. The lack of development in the past two years has meant that the 2008 model conditions have been largely untested. The Planning Inspectorate has said that the applicability of the model conditions will need to be considered in each case against the policy tests which will be set out in the final version of the DCLG's "Improving the Use and Discharge of Planning Conditions". However, care will need to be taken when negotiating conditions to ensure that this guidance is followed. It is all too easy to adopt the "let's be on the safe side" catch all approach and go for the standard model wording without sufficient site specific consideration.

The practical implications for developments have not been fully considered

The lack of development in the past two years has meant that the 2008 model conditions have been largely untested

UNIPLEX: An end to the need to act “promptly” when challenging planning permissions by judicial review?

Summary and implications

The requirement for claimants to act promptly within the three-month period in issuing judicial review claims has been considered in a recent decision of the European Court of Justice (ECJ) in the potentially ground-breaking case of *Uniplex (UK) Limited v NHS Business Services Authority*. Although the case, challenging an NHS procurement decision, was brought under the Public Contracts Regulations 2006, it potentially has ramifications outside the specific realm of public procurement and, in particular, may have significant implications for developers, planning authorities and their advisors.

- The case found that a requirement under the Regulations for actions to be brought “promptly” was contrary to European law because it prevents claimants from knowing the exact time limit that will apply.
- Under UK law an action for judicial review must be filed “(a) promptly and (b) in any event not later than three months after the grounds to make the claim first arose”.
- If the UK courts decide to apply the reasoning in *Uniplex* to domestic judicial review proceedings this would have a significant effect in the planning field where challenges brought within three months of the grant of a planning permission have, nevertheless, been refused permission to proceed for not being “prompt”.

Uniplex

Uniplex was a case that was brought by an unsuccessful tenderer for the supply of good to the NHS.

The English courts referred the case to the ECJ, who provided important guidance on the limitation period established in the UK’s Public Contract Regulations, which implement the European Remedies Directive (89/665). Article 1(1) of the Remedies Directive requires member states to adopt the necessary measures to ensure decisions taken by contracting authorities under the procurement rules may be reviewed effectively and as quickly as possible. It does not contain any provisions setting out specific time limits, leaving this to be dealt with at a national level.

The ECJ ruled that a provision of national law that allows a national court to, at its discretion, dismiss proceedings as being brought out of time on the basis that they were not brought “promptly” – even though brought within the stated three month time limit – breaches the principles of certainty and effectiveness and is not compatible with European Directives.

Ask a question

If you have any questions please contact:

Holly Trotman, Associate
T +44 (0)20 524 6487
h.trotman@nabarro.com

Anna Mullins, Trainee
T +44 (0)20 524 6334
a.mullins@nabarro.com

The Planning team

To find out more about the team, and our capabilities [click here](#)

The ECJ sought to clarify as to when the period in which a claim could be brought ends. Instead it introduced uncertainty as to when that period starts. It held that the time period for bringing proceedings seeking to have an infringement of the public procurement rules declared, or to obtain damages for that infringement, should start to run from the date on which the claimant knew or ought to have known of that infringement, not the date of the infringement itself.

Implications for planning

For public procurement it is clear that *Uniplex* means that decisions by contracting authorities may be validly challenged at any point within the three month period and that the three month period only begins to run when the complainant knew, or ought to have known, about the infringement, but what about other statutory regimes such as planning, or judicial review in general?

On the question of promptness it appears that *Uniplex* could have wider application, at least where European rights are engaged, for example under the Environmental Impact Assessment regime. The principles applied by the ECJ in relation to this issue would apply to any UK legislation transposing EU law. As a result, will the UK courts no longer refuse to grant permission for challenges to proceed where they are brought in time, regardless of whether “promptness” is in question?

What about planning or judicial review in general?

Uniplex's impact on when the period for challenge starts to run is less clear. In UK planning law, following the House of Lords decision in *Burkett**, the three month clock starts ticking from the date of grant of planning permission. Commentators have sought to restrict this aspect of *Uniplex* to the specific area of public procurement, drawing a distinction between the remedy sought under the public procurement rules, namely a declaration of an infringement or compensation, and the severe legal consequences of having a planning permission quashed.

Advice

These issues are clearly relevant to property and development agreements conditional on the grant of a planning permission and other development consents and orders, including CPOs and highways orders. Advisors and clients will need to consider even more carefully the trigger points after which a planning permission will be regarded as free of any possible third party challenge.

Nabarro's specialist planning team can advise on the issues arising from *Uniplex* and its potential impacts on planning and development schemes from both private and public sector perspectives. The team can also assist developers in insulating schemes from the risk of a third party challenge.

Public Contracts Regulations 2006

Regulation 47(7)(b) provides that “proceedings must be brought promptly and in any event within three months from the date when grounds for the bringing of the proceedings first arose, unless the Court considers that there is good reason for extending the period within which proceedings may be brought”.

Civil Procedure Rule 54.5 (Judicial Review)

“The Claim Form must be filed:

- (a) promptly; and*
- (b) In any event not later than 3 months after the grounds to make the claim first arose”.*

*Burkett

R v London Borough of Hammersmith and Fulham and others, ex p Burkett and Another
[2002] UKHL 23

Feed-in Tariffs – FiT for purpose?

Summary and implications

The Government's long awaited Feed-in Tariff (FiTs) scheme for individuals, organisations and small businesses who install small to medium scale renewable projects was launched from 1 April of this year.

It is hoped that the new scheme will transform the UK's renewables market by making projects economically viable for developers and attractive for investors and Nabarro is working with its clients to find new legal structures that incorporate FiTs in such a way.

This article looks at the following:

- how land and property owners can benefit from the scheme to create new additional income streams; and
- some of the fundamental weaknesses of the scheme.

What does this mean for your business?

a) *Payments to generators*

Renewable energy generators who own installations with a generating capacity of less than 5MW of electricity will be eligible to receive from their electricity supplier both:

- a fixed price for every kWh generated (the **generation tariff**) which will vary per technology and scale (as set out in the table below); and
- a guaranteed minimum payment of £0.03/kWh over the life of the scheme (25 years), in addition to the generation tariff, for every kWh exported to the electricity grid (the **export tariff**).

Generators will be able to choose whether they want to sell the exported electricity at the export tariff or whether they want to go into the open market and negotiate a price for that exported electricity.

It is estimated by the electricity regulator, Ofgem, that the retail price of electricity will rise by 8% over the next 10 years. The generation tariffs under the scheme will be linked to the Retail Price Index and could therefore increase by as much as 2.5% every year for the life of the scheme. On this basis, the financial benefits of the scheme become clear.

b) *Reduce your energy bills*

Generators can benefit from reduced energy bills by using the power generated on-site to reduce the amount they require from the electricity grid. Alternatively, the generator may export surplus power to the grid and still qualify for payment under the scheme.

Ask a question

If you have any questions please contact Jonathan Cohen, Associate
T +44 (0)20 7524 6645
j.cohen@nabarro.com

The Climate Change and Energy team

To find out more about the team, and our capabilities [click here](#)

c) *Lease of land or roof space*

Land or building owners can benefit from the FiTs scheme in the following ways:

- lease roof space or land to third party generators to develop renewable projects that qualify for the scheme in return for rental incomes and/or cheap electricity;
- generators will be able to assign their rights to FiTs to a third party, for example a land or building owner, via a bilateral agreement in return for a sharing, for example, of some of the upfront capital costs of installing the equipment;
- by entering into commercial deals with generators and receiving green electricity to fulfil planning commitments or corporate environmental responsibility in return for using their roof space; and
- setting up joint ventures or energy services companies (ESCOs) to become part of a development consortium for qualifying projects.

Land or building owners can benefit...by receiving green electricity to fulfil planning commitments

Energy Supplier "Statement of FiT Terms"

On 1 April of this year, the Secretary of State introduced modifications to the Standard Conditions of the Electricity Supply Licence. These modifications oblige electricity suppliers and generators to enter into a statement of FiT terms when negotiating FiT arrangements.

Generators will be dependent upon their electricity supplier providing them with sensible terms and conditions to participate in the scheme. However, there is a danger that these terms could be unattractive from the generator's perspective. Ofgem intervention to ensure fair play may be essential.

Planning

There are currently no permitted development rights for the installation of, for example, non-domestic solar photovoltaic (PV) panels. As a result a planning application will be required in order to develop such a project. The Government's development consultation document entitled "Permitted development rights for small scale renewable and low carbon energy technologies" closed on 9 February 2010. The consultation recommended that rights to put PV on roof tops would be incorporated into a permitted development rights order but there remains a risk that FiT projects may be held up by the planning process.

One of the drawbacks to the scheme is that the capital costs of installing renewable energy installations are high

Up-front capital installation costs

One of the drawbacks to the scheme is that the capital costs of installing renewable energy installations are high:

- to install 2 PV panels (about 3m²) on the roof of a residential house would typically cost around £2,500; and
- to install PV panels on a 1,000m² flat roof on top of a commercial building would cost around £500,000.

There have been no signals from the Department of Energy and Climate Change that central government funding will be available to finance the large upfront capital costs of making installations that will qualify for the scheme. Instead, it is hoped that third party finance will become available or “Pay As You Save” solutions will develop as the scheme progresses.

Comment

Whilst the FiTs scheme has been one of the most effective models for implementing the adoption of renewable energy technologies in countries such as China, Germany and the US, it remains to be seen how some of the weaknesses illustrated above will affect the scheme’s introduction. However, early signs are that many property developers see the scheme as a welcome boost to the UK’s renewable energy financial incentives.

Early signs are that many generators, property developers and individuals see the scheme as a welcome introduction to the UK’s plethora of financial renewable incentives

Table of generation tariffs up to 2013		Tariff level for new installations in period (pence/kWh) (NB: tariffs will be inflated annually)			Tariff lifetime (years)
Technology	Scale	Year 1: 1/4/10 – 31/3/11	Year 2: 1/4/11 – 31/3/12	Year 3: 1/4/12 – 31/3/13	
Anaerobic digestion	≤500kW	11.5	11.5	11.5	20
Anaerobic digestion	>500kW	9.0	9.0	9.0	20
Hydro	≤15kW	19.9	19.9	19.9	20
Hydro	>15–100kW	17.8	17.8	17.8	20
Hydro	>100kW–2MW	11.0	11.0	11.0	20
Hydro	>2MW–5MW	4.5	4.5	4.5	20
MicroCHP pilot	<2kW	10	10	10	10
PV	≤4kW (new build)	36.1	36.1	33.0	25
PV	≤4kW (retrofit)	41.3	41.3	37.8	25
PV	>4–10kW	36.1	36.1	33.0	25
PV	>10–100kW	31.4	31.4	28.7	25
PV	>100kW–5MW	29.3	29.3	26.8	25
PV	Stand alone system	29.3	29.3	26.8	25
Wind	≤1.5kW	34.5	34.5	32.6	20
Wind	>1.5–15kW	26.7	26.7	25.5	20
Wind	>15–100kW	24.1	24.1	23.0	20
Wind	>100–500kW	18.8	18.8	18.8	20
Wind	>500kW–1.5MW	9.4	9.4	9.4	20
Wind	>1.5MW–5MW	4.5	4.5	4.5	20
Existing microgenerators transferred from the RO		9.0	9.0	9.0	to 2027

SDLT and partnerships: All change or no change?

Summary and implications

A small change to the Stamp Duty Land Tax (SDLT) rules in this year's pre-election Finance Act could have big implications for the property industry. A change aimed at outlawing certain SDLT saving schemes has created huge uncertainty as to how transactions which are not designed to save SDLT will now be taxed.

The amendment has caused particular confusion in relation to the application of the SDLT legislation to transactions involving partnerships. Industry bodies have approached HM Revenue and Customs (HMRC) for clarification. HMRC have responded as follows:

- HMRC were fully aware of the implications of the legislative change;
- they do not intend to seek to tax "innocuous transactions"; and
- Industry bodies are invited to provide a list of potential "innocuous transactions" which will, by HMRC concession, not be taxed.

SDLT anti-avoidance legislation: section 75A Finance Act 2003

Since late 2006, HMRC have had at their disposal anti-avoidance legislation referred to as "section 75A". It applies where:

- a seller disposes of a chargeable interest and a purchaser acquires either that interest or a chargeable interest deriving from it;
- a number of transactions (including the disposal and acquisition) are involved (known as the "scheme transactions"); and
- the sum of the amounts of SDLT payable in respect of the scheme transactions is less than the amount that would be payable on a notional land transaction effecting the acquisition by the buyer of the seller's chargeable interest.

Essentially, HMRC are entitled to look at the start and end of any transaction and disregard anything done en route. The "notional transaction" measures the SDLT on a straight sale from the seller to the buyer. If the SDLT on the notional transaction would be higher than that which is actually payable under the scheme transactions, HMRC can impose a higher SDLT charge.

Development of the anti-avoidance rules

Although the introduction of this legislation was not exactly welcomed, it did in most circumstances make sense. Where schemes had been devised to reduce or eliminate a charge by adding extra steps, the effects of such steps could be negated. The issue then, and again now since the recent change, is what happens when a statutory reduction or relief is involved. Should the legislation give a reduction only to take it away again by

Ask a question

If you have any questions please contact Simon Rose, Tax Partner
T +44 (0)20 7524 6823
s.rose@nabarro.com

Recent Tax Briefings

Does the Hastings-Bass principle allow two bites at the cherry? [Read more](#)

Virtual assignments and their tax treatment. [Read more](#)

The Tax team

To find out more about the team, and our capabilities [click here](#)

comparing the reduced charge with a notional transaction which does not utilise the relief?

Partnership transactions

Partnerships are subject to their own specific SDLT regime. Where an entity contributes a property to a partnership, SDLT is broadly only due to the extent that that entity does not continue to effectively own the property via the partnership. If Company A has an 80% partnership interest and a third party owns the other 20%, when Company A contributes a property to the partnership, SDLT of only 20% of the market value of the property will be payable.

Given that the partnership legislation reduces the SDLT charge from what it would otherwise have been, a straight application of the principles in section 75A would always result in a higher charge than that under the partnership SDLT rules.

After much lobbying, the partnership rules were effectively imported into section 75A. As a result, section 75A would not automatically overrule the partnership rules and impose a higher SDLT charge.

Taking advantage...?

Almost inevitably this was seen by some as an opportunity for SDLT planning. One such SDLT scheme involved A contracting to sell a property to B and then B sub-selling into a limited partnership where B was the only limited partner. With a favourable interpretation it was claimed that the only transaction to look at would be a transfer to the partnership by B. Neither the partnership rules alone nor section 75A (which at the time incorporated the partnership rules) would impose any material SDLT charge.

HMRC have recently fought back against this particular structure and it is thought that they are currently enquiring into 300 plus cases where this structure has been used. They have also changed the law to remove the partnership rules from section 75A. So, whilst HMRC have achieved their objective in preventing the 'sub-sale to a partnership' scheme, we are faced with an old problem: how should the anti-avoidance law and the normal rules fit together if an entity owns a property and contributes it to a limited partnership where that entity is the main partner? The partnership rules would impose little or no charge and the anti-avoidance law would impose a full market value charge.

HMRC are fighting back. Whilst the changes successfully close down a number of known schemes, legitimate taxpayers are faced with the unsatisfactory prospect of being subject to an unintended tax charge on a strict reading of the law

Current position

It did not take long for industry bodies to approach HMRC on this. HMRC have said that they were fully aware of the implications of the legislative change and would not seek to tax "innocuous transactions". HMRC have invited the industry to provide a list of potential "innocuous transactions" which by HMRC concession would not be taxed. This leaves huge uncertainty and advisors are left in the unenviable position of suggesting that the law says one thing and HMRC practice says another.

Going forward

There may yet be further refinements to the law in this area whilst HMRC discussions with relevant bodies continue. HMRC are likely to claim that although the wording of the legislation seems harsh, the previous softening of their stance led to SDLT saving structures being widely used. For now the property industry will have to watch this space whilst trying to ensure that all of their dealings are “innocuous transactions”.

What is a collective investment scheme and what are the practical regulatory issues?

Summary and implications

A collective investment scheme (CIS) is an arrangement that enables a number of investors (called “participants” in the legislation) to pool their assets with a view to the investors sharing in the profits or income from the purchase, holding, management or disposal of the assets or sums paid out of such profits or income. To be a CIS, participants in the arrangement must not have day to day control over the management of the assets.

The consequences of a fund being a CIS include:

- the need to appoint an operator, authorised by the Financial Services Authority (FSA) to perform certain regulated functions in respect of the fund;
- being subject to certain restrictions on the promotion of the fund to the public;
- depending on the nature of the assets, and whether or not a group exemption applies, the need to appoint an FSA authorised manager.

Which exemptions may help, and how?

The two most relevant exemptions that prevent arrangements from being a CIS are the “group” exemption and the “existing business”/ article 9 exemption.

a) *The “group” exemption*

This can apply where the operator is in the same corporate group as the investors. If it applies, the scheme is not a CIS and does not need the operator to be authorised.

b) *The “existing business” (article 9) exemption*

This exemption typically applies to joint venture structures, as funds with multiple participants who are not all “permitted participants” cannot benefit from it.

Existing and new vehicles can elect not to be a CIS. This can be done if all of the participants in the joint venture (or their immediate holding entities) are carrying on an existing business which is not a regulated activity under the Financial Services and Markets Act 2000 (FSMA). You can look through any special purpose vehicle which participates in the joint venture in the structure to its owner to determine if a permitted business is being carried on by its parent – but you cannot look through multiple SPVs. If the exception applies, the scheme is not a CIS and does not need to appoint an operator or comply with the various UK regulatory requirements.

Ask a question

If you have any questions in relation to this briefing, please contact Rob Moulton, Partner
T +44 (0)20 7524 6391
r.moulton@nabarro.com

Recent briefings

Alternative Investment Fund Managers Directive: impact on real estate funds. update and practical application.

[Click here](#) for our latest briefing on the European Commission proposals on regulating Alternative Investment Fund Managers and examples of how these may apply to three common real estate fund structures.

CRC Energy Efficiency Scheme: compliance issues for fund managers in phase one.

CRC is mandatory and cannot be ignored. To do so would impair your fund’s financial performance and give rise to civil and criminal penalties. [Click here](#) for a full briefing.

Seminars and workshops

We offer tailored, individual seminars for your organization. [Click here](#) for a list of the latest presentations available.

The Indirect Investment team

To find out more about the team, and our capabilities. [click here](#)

Operation – what it means

Establishing, operating and winding-up a CIS is a regulated activity and has to be carried out by an FSA-authorized operator. In our view, operating a CIS means looking after relations with investors, rather than managing the assets of the CIS (for which, see below). Examples of operation include:

- appointing auditors and valuers;
- dealing with subscriptions and any equity raising or re-organisation; and
- operating accounts.

Any decisions on these matters that are discretionary should be carried out by the operator.

Management – what it means

The FSA also regulates anyone seeking to act as the advisor to, or third party discretionary manager of the assets of, a CIS where those assets include regulated instruments (such as shares or units in other CISs). Direct property investments are not regulated for these purposes.

Why, in some cases, being a CIS is important

For some structures, it is important for marketing and tax reasons that the fund constitutes a CIS (e.g. a Jersey unit trust (JUT)). The tax legislation takes the definition of unit trust from the FSMA definition. Therefore, if a JUT is constituted as a CIS, the tax position in relation to income, capital gains and SDLT is clear cut.

Examples of regulated management	Examples of property management
Advising on the buying or selling of assets (shares, units etc.)	Appointing a property manager and any consultants
Arranging deals	Lease management work
Taking discretionary investment decisions	Building maintenance
Dealing as agent	Repairs

Distressed real estate debt: what borrowers can do

Summary and implications

Borrowers are restructuring existing lending and entering into third party arrangements to avoid lenders enforcing security on distressed real estate assets.

The arrangements may involve a lender swapping all, or part, of their outstanding distressed debt with the equity of its borrower as part of the deal.

A debt for equity swap may be suitable if the underlying real estate asset has enough potential value to incentivise the borrower and the lender. The potential asset value may be the future development of the asset and/or a change of asset management.

Real estate debt

In a real estate transaction, debt is used either to fund a property acquisition from a third party or to refinance existing indebtedness. The terms upon which finance is provided by a lender is governed by a facility agreement. The facility agreement will contain covenants, including financial covenants, with which the borrower must comply. In addition to various property related covenants a typical facility agreement will contain financial covenants such as loan to value covenants (LTV) and interest cover ratios (ICR). A breach of the financial covenants by a borrower will trigger an event of default which entitles a lender to, amongst other things, enforce any security it holds.

Distressed real estate debt

Distressed real estate debt means debt secured on real estate which is in breach of the covenants in the facility agreement. The most common breach has been of the LTV covenant as values have reduced. In some cases there will be a more fundamental breach meaning that the debt is unlikely to be repaid in full and on its due date.

Borrower breach of covenants

The three most common covenant breaches are late repayment, loan to value (LTV) and interest cover (ICR) (see table below).

Before the credit crunch LTV ratios were as high as 85% but, in the current market, new lending is typically being provided at LTV ratios of 65%. This difference between existing and new LTV ratios is causing borrowers difficulties when they look to refinance. Borrowers may be able to fund the LTV gap by injecting equity themselves or may look to an arrangement with a third party such as a mezzanine finance provider, which is an expensive option for the borrower.

Borrower options to address distressed real estate debt

A borrower has two options for dealing with distressed real estate debt. Both options may involve a debt for equity swap with a lender.

Ask a question

If you have any questions please contact James Dakin, Partner
T +44 (0)20 7524 6216
j.dakin@nabarro.com

The banking and restructuring team

To find out more about the team, and our capabilities [click here](#)

1. Restructure with existing lender.

Borrowers struggling to find a new lender to refinance existing debt may seek to restructure the existing debt and in particular to extend repayment dates. Consequently, the lender may use the opportunity to increase fees and/or the margin, tighten up the ICR, or renegotiate other terms as a condition for not accelerating the loan upon an LTV or ICR covenant breach. A premium may be charged for this arrangement.

Restructuring with an existing lender may involve a straightforward restatement of debt. Alternatively, a debt for equity swap may form part of the consideration to the lender for restructuring/reducing the existing debt.

2. Borrower enters into an arrangement with third parties to inject equity and/or management skills

a) Equity arrangement

A borrower may enter into an arrangement with a third party who would inject new equity into an existing finance structure to prevent the debt becoming distressed. This is particularly common for developments where significant sums are needed to achieve practical completion.

b) Management skill arrangement

A borrower may approach third party asset managers or property managers to enter into management agreements in respect of the distressed real estate. This solution may be particularly apt when financial investors purchase performing real estate which has since become distressed. Specific management skills can be accessed to increase the value of the property.

Key covenants
Repayment
<ul style="list-style-type: none"> Requires the borrower to repay the loan on the due date.
LTV
<ul style="list-style-type: none"> Requires the borrower to ensure that the value of the outstanding loan does not exceed a certain percentage of the value of the property under which the loan is secured.
ICR
<ul style="list-style-type: none"> This is a measure of interest to be paid on the loan compared to income generated by the property. The covenant requires a borrower to maintain a minimum amount of income cover out of the profits derived from the property to pay the interest on the debt. Tenant insolvencies or rent arrears may cause borrowers to default on interest cover covenants, as may defaults of providers of interest rate swaps.

Lenders may use a debt for equity swap as an opportunity to renegotiate terms

Borrower arrangements to work out distressed real estate may include elements of both options 1 and 2 depending on the commercial nature of the deal.

Incentives to participate in debt for equity swap

A debt for equity swap may enable a borrower to:

- include third parties in the existing lending arrangements to maximise the value of the asset. Equity in the borrower may be offered as consideration;
- exit the existing lending arrangements;
- salvage its reputation in the market; or
- preserve its relationship with its lender.

Participating in a debt for equity swap may enable a lender to:

- avoid the crystallisation of losses on its loan book;
- participate in any future uplift in the value of the asset;

- benefit from favourable tax treatments;
- provide further funding to the borrower in the future; and
- obtain a platform for dealing with similar distressed real estate.

For a third party, participating in a debt for equity swap can give access to distressed real estate which is not being released onto the market by lenders.

London

Lacon House,
84 Theobald's Road,
London WC1X 8RW
T +44 (0)20 7524 6000
F +44 (0)20 7524 6524

Sheffield

1 South Quay,
Victoria Quays,
Sheffield S2 5SY
T +44 (0)114 279 4000
F +44 (0)114 278 6123

Brussels

209A Avenue Louise,
1050 Brussels, Belgium
T +32 2 626 0740
F +32 2 626 0749

Alliance firms

France

August & Debouzy
Gilles August
T +33 (0)1 45 61 51 80
www.august-debouzy.com

Germany

GSK Stockmann + Kollegen
Rainer Stockmann
T +49 (30) 20 39 07 - 0
www.gsk.de

Italy

Nunziante Magrone
Gianmatteo Nunziante
T +39 06 695181
www.nunziantemagrone.it

Nabarro LLP

Registered office: Lacon House, 84 Theobald's Road, London, WC1X 8RW.

Nabarro LLP is a limited liability partnership registered in England and Wales (registered number OC334031) and is regulated by the Solicitors Regulation Authority. A list of members of Nabarro LLP is open to inspection at the registered office. The term partner is used to refer to a member of Nabarro LLP.

Disclaimer

Detailed specialist advice should be obtained before taking or refraining from any action as a result of the comments made in this publication, which are only intended as a brief introduction to the particular subject. This information is correct on the date of publication. Nabarro LLP is not responsible for the operation or content of any external website or hyperlink referred to in this publication.

© Nabarro LLP 2010