The Real Estate Law Review

Tenth Edition

Editor
John Nevin

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THE REAL ESTATE LAW REVIEW

TENTH EDITION

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PREFACE

Just as the ninth edition of *The Real Estate Law Review* was being published, the world was thrown into total confusion by the rapid spread of a deadly new disease. Covid-19 has affected the global economy like nothing this generation has experienced, with every major jurisdiction forced into a series of lockdowns. However, it must not be forgotten that the pandemic is primarily a human tragedy with more than 93 million cases globally and 2 million deaths. As we begin to see light at the end of the tunnel, the global health crisis will undoubtedly complete its transition into an economic one, with significant global debt and widespread unemployment. Covid-19 will leave its mark on all aspects of how we live and work, including each and every sector of the global real estate market.

A great deal has happened since the first edition of *The Real Estate Law Review* appeared in 2012, but nothing more significant than the covid-19 pandemic, a truly global crisis. This tenth edition of *The Real Estate Law Review* will continue to prove its worth by providing readers with an invaluable overview of how key markets across the globe operate and how they react to major world events. Covid-19 has served as a stark reminder that it is no longer possible to look at domestic markets in isolation. Investors and their advisers need to understand real estate assets in the context of global events, and *The Real Estate Law Review* continues to help its readers to do just that.

This edition extends to 27 key jurisdictions around the world, and I am very grateful to all the distinguished practitioners for their insightful contributions. Each chapter has been updated to highlight key developments and their effect on the relevant domestic market. Together, the chapters offer a helpful and accessible overview of the global real estate market. Overseas investors are key influencers in most markets, and it is vital that practitioners are able to advise on a particular deal in the light of an understanding of their client's own jurisdiction.

In the year that the UK finally left the EU and Joe Biden became president of the United States, the significance of Brexit and American politics have been put into perspective by the covid-19 pandemic. Covid-19 is a truly global issue affecting every jurisdiction and, of course, its real estate market. In the background, and almost forgotten, Brexit and the associated economic and political fallout has continued to be a concern for the UK economy and its real estate markets. Although investment volumes fell off a cliff in the first half of the year, we have started to see interest from both overseas and domestic investors, underlining the continued importance of UK real estate as an investment asset. The world's cache of investment capital is likely to prompt a surge in investment activity once some degree of confidence returns. The UK, and London in particular, seem certain to remain attractive to overseas investors looking for a safe haven for their funds. The next few years will undoubtedly

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be challenging as we begin the road to recovery, but opportunities will arise, and real estate will remain a key part of investment strategies.

Once again, I wish to express my deep and sincere thanks to all my fellow contributors to this tenth edition of *The Real Estate Law Review*. I would also like to thank the members of the Law Review team for their sterling efforts in coordinating the contributions and compiling this edition. Finally, I wish everyone the very best of health for 2021 and beyond.

John Nevin
Slaughter and May
London
February 2021

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Chapter 1

COVID-19 AND REAL ESTATE: A UK PERSPECTIVE

John Nevin[1]

I INTRODUCTION

The uncertainty caused by the British electorate's decision to leave the EU has been put firmly into context by a truly catastrophic global event. At the start of 2020, it became apparent that the whole world was about to come under unprecedented attack by the rapid spread of a deadly new disease. What started off in a market in Wuhan, China did not take long to cast its shadow over every part of the globe. Covid-19 has affected the global economy like nothing this generation has previously faced. Not since World War II has the entire world been so adversely affected by one event. The pandemic has hit 218 countries and territories; every major jurisdiction has been forced into implementing a series of lockdowns and other measures to ensure the health and safety of its population while at the same time seeking to limit lasting financial damage. What started as a global health crisis has transitioned into an economic crisis that will leave its mark on the global economy long after the pandemic has run its devastating course. Lest we forget, covid-19 is first and foremost a human tragedy of epic proportions. At the time of writing, there have been more than 93 million cases and 2 million deaths. Although there have been some more positive recent signs with the development and approval of a number of vaccines, the task of manufacturing, distributing and administering an effective vaccine is enormous. This means that we are unlikely to be back to any sense of normality until the summer at the earliest. The process of dealing with the economic, social and political fallout will then be able to gain steam. By this point, the pandemic will have changed aspects of how we design, build and use buildings forever.

II REAL ESTATE

Real estate has arguably been hardest hit by covid-19 with a sharp decline in values across all sectors. Confidence in the property market had already been knocked by the uncertainty surrounding Brexit. The UK has finally completed the exit process and will have to forge its own recovery outside of EU membership. This may amount to a double whammy depending on how confident the rest of the world remains in dealing with an independent UK.

The retail, hospitality and leisure sectors were already in difficulty, as key players sought to adapt to changing consumer behaviour. These sectors have suffered the most, and many household names have joined the seemingly endless list of companies collapsing into administration. It has been a year to forget for traditional retailers, and the UK's high street will emerge from the crisis looking very different. The dearth of overseas visitors has hurt

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central London's normally resilient luxury retail and hospitality offering, and the resumption of international travel is eagerly awaited. Not surprisingly, the major supermarkets and the established online retailers and delivery companies have fared much better. From a broader economic perspective, it is worth noting that any increase in online shopping volumes has fallen well short of making up for the collapse in overall sales. A new lockdown introduced just before Christmas 2020 and affecting much of the country, including London and the South East, will not have helped those businesses hoping for a last minute seasonal boost.

The industrial sector has remained relatively resilient as competition remains strong for well-connected, high-specification distribution centres in the right locations. The logistics sector has continued to attract investment from both overseas and domestic investors, and this trend seems destined to continue. We are also likely to see the repurposing of redundant retail space for storage and distribution purposes.

Although the office market held up relatively well through the uncertainty of Brexit, covid-19 has had a much more significant impact on occupier demand as all businesses have revisited their UK and global requirements. At present, there is an overwhelming urge to reduce space as remote working has become an established part of how we all live and work. Although we are likely to see increasing vacancy rates in the second-hand office market, large corporates and major international professional services firms have remained active in their quest for new London headquarters buildings. In addition to incorporating facilities to meet the expectations of their workforce, as well as attracting customers and clients, the building must meet ESG targets and provide a safe and healthy place in which to work and do business. Occupiers are under increasing pressure to implement their green policies as part of their corporate identity, and, for many, the obvious place to start is their office premises. The gap between modern, safe and sustainable buildings and tired, second-hand space is set to widen. Connectivity, of course, remains essential. Although investment volumes have been affected badly, a resurgence in activity towards the end of the year indicates that London and the UK will remain attractive to overseas investors looking for a safe haven for their capital in difficult times.

III LEGAL IMPLICATIONS

The government has introduced a number of measures to protect businesses adversely affected by covid-19. Although the focus has been on the hospitality, retail and leisure sectors, protection has been given to all business tenants. The measures include affording protection from forfeiture for non-payment of rent, limiting the exercise of commercial rent arrears recovery (CRAR) by landlords and banning the use of winding-up orders. Originally implemented in April 2020, the measures have been extended three times and now seem likely to come to an end on 31 March 2021, a few days after the first rent payment date of 2021. The measures were introduced to protect tenants from aggressive landlords taking enforcement action to recover rents. However, in many respects it is the property sector that has found itself squeezed in the middle. Although the financial implications of covid-19 are no one's fault, without rent landlords are unable to meet their own commitments, including those to funders. A number of major property companies have been badly affected, particularly those with exposure to the hospitality, retail and leisure sectors. The government also introduced a new Code of Practice for commercial property relationships during the covid-19 pandemic. Although not compulsory, the Code encourages landlords and tenants to work together collaboratively to agree a shared recovery plan to help businesses to survive the crisis. The

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Code is not an excuse for tenants not to pay their rent, and landlords are not obliged to grant concessions. In practice, many rent payment plans have been agreed, waiving, reducing or deferring a tenant's rental liability for a set period. In many cases, the rent or part of it has simply been deferred and there will inevitably be further re-gearing negotiations when the deferred amounts start to become payable. The need for flexibility, including shorter contractual terms, break rights, options to renew and rights of pre-emption, has become an established part of a business's requirement for space. Rental structures are also evolving as landlords and tenants look for a viable model that meets both their requirements. This has led to a resurgence in the use of turnover rent models that allow an element of the rent to match the success of the tenant's business. The increasing importance of data, not only in relation to the calculation of turnover rents, but also in relation to the respective ESG priorities of the parties, has led to the emergence of a new breed of property professionals focusing on the obtaining and use of data as part of the landlord and tenant relationship.

Other measures introduced by the government include a business rates holiday for all retail, hospitality and leisure business that applies for the 2020 to 2021 tax year. A number of the major supermarkets that remained open throughout the crisis have agreed to repay the relief to the government. A stamp duty holiday introduced by the government at the start of the first lockdown to help support the housing market comes to an end on 31 March 2021.

Finally, and perhaps of most long term significance, is the government's proposal to review commercial landlord and tenant legislation to ensure that it remains fit for purpose as the UK contemplates its recovery from the pandemic. The main piece of legislation is Part II of the Landlord and Tenant Act 1954, which confers security of tenure on business tenants. Many commentators have called for a reform of the security of tenure regime on the grounds that the landlord and tenant relationship has changed significantly since the legislation was introduced nearly 65 years ago. The government will also look at different models of commercial rent payment and consider the effect of covid-19 on the property market generally. The pandemic has also forced the property industry to adapt to new working practices, and the use of electronic signatures and virtual completions has become an essential part of day-to-day transactions.

IV CONCLUSION

In 2021, the world has become a very different place. We have not witnessed a global crisis of this magnitude in modern times. To think, this time last year we were still fretting about Brexit. Although the covid-19 pandemic has well and truly put leaving the EU into perspective, Brexit does remain bubbling away in the background and potentially adds an additional layer of complication as we look to set off on the long road to recovery. Global markets have been encouraged recently by the positive news around the development of various covid-19 vaccines. The speed with which vaccines have been developed is astonishing, but those vaccines need to become widely available before confidence can return to the property market and wider economy. The task of manufacturing, distributing and administering sufficient doses of an effective vaccine will be nothing short of Herculean. As we look to begin the long journey to recovery, there will undoubtedly be opportunities for investors in the UK and global real estate markets. However, those investors will need to keep up to speed and remain agile if they are to take advantage.

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Chapter 10

ENGLAND AND WALES

John Nevin[1]

I INTRODUCTION TO THE LEGAL FRAMEWORK

i Ownership of real estate

The two main types of ownership of real estate in England and Wales are freehold and leasehold. Freehold is, in effect, absolute ownership for an indeterminate period, whereas leasehold is a right to possession and use of land for a limited period; the landlord retains its interest and grants the leasehold interest to the tenant for the term of the lease. Ownership of land also includes ownership of any buildings or other structures attached to the land and, as a general rule, includes the subsoil beneath and the airspace above the land.

Generally, freehold interests are more attractive to investors because they are not subject to termination and there are fewer restrictions on the owner, whereas a tenant is constrained by the terms of a lease. That said, long leasehold interests are often held for investment purposes. In central London in particular, properties may be owned by the Crown Estate, trusts, charities or other entities that may choose not to dispose of their freehold interests as a matter of policy, and will instead grant long leases. It is also common for leaseholds to be used when structuring joint ventures, and other arrangements and structures where owners wish to retain an element of control by imposing positive covenants.

A leasehold property held as an investment should be distinguished from an occupational lease, which is typically granted for between five and 20 years subject to a market rent, and, therefore, has a negligible capital value. An investment leasehold interest will most likely be granted for a term of between 99 and 250 years, at a premium. There are generally fewer onerous obligations on the tenant of a leasehold property held as an investment. The income generated from most investment properties is in the form of rent paid under occupational leases.

A relatively new form of land ownership called commonhold was introduced in England and Wales by the Commonhold and Leasehold Reform Act 2002. Commonhold comprises a freehold unit within a larger development and membership of the company that manages the common parts. As such, commonhold is suitable for residential flats as well as commercial developments such as shopping centres; however, its use has not been adopted by the property industry and it remains a rarity.

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ii System of registration

Most freehold and long leasehold titles are registered at the Land Registry; however, a number of unregistered titles remain, and these will generally only become registered once there has been a dealing with the land that triggers a requirement for 'first registration'. Trigger events include sales, mortgages and leases granted for more than seven years. Until a trigger event occurs, titles will usually remain unregistered. Registration fees are payable, calculated by reference to the type of transaction and the price paid.

Registration at the Land Registry provides a state guarantee of title. Compensation is payable if loss is suffered because of a mistake on the register. Therefore, there is no separate US-style title insurance regime. The registered title has a unique title number and identifies the extent of the land on a plan. The register also provides details of the property, including any rights that benefit it, and identifies the owner and any rights or matters adversely affecting the property, including financial charges. It also includes the purchase price at which the owner acquired the property and the purchase date, if done so through an asset as opposed to a share purchase. If the property is leasehold, brief details of the lease are included. Various short leases and rights of occupation are not, however, required to be registered in their own right. These and some other non-registrable interests will bind a purchaser, and should be uncovered by the purchaser's due diligence process. Accordingly, the information on the register cannot be treated as being comprehensive. Documents and other information held by the Land Registry are widely available to the public, although it may be possible to protect certain commercially confidential provisions for a limited period.

The government is proposing to introduce a register of the beneficial owners of overseas companies acquiring real estate in the UK. Draft legislation has been published and the new register is expected to become operational in 2021. There are also ongoing plans to introduce a system of electronic conveyancing to facilitate the online buying and selling of property. These plans seem likely to be accelerated by the Land Registry as a result of the increasing significance of e-commerce.

iii Choice of law

Dealings with real estate in England and Wales will be covered by the law of England and Wales. Although a contract may include an express choice of governing law, which in general the courts will uphold, English law will still apply in relation to the transactional formalities that involve English and Welsh real estate.

Real estate law in England and Wales is different from real estate law in Scotland, Northern Ireland, the Channel Islands and the Isle of Man, and thus specialist advice is required where these jurisdictions are involved. Because of tax planning, property ownership vehicles are often incorporated in the Channel Islands, although the benefits of holding UK real estate through offshore vehicles have declined markedly following changes to the tax rules that took effect from April 2019, from which point non-residents will be brought fully within the scope of capital gains tax on disposals of UK real estate.

II OVERVIEW OF REAL ESTATE ACTIVITY

The uncertainty caused by when, how and if the UK was to leave the EU has been firmly put into context. This year has, of course, been dominated by the devastating global impact of the covid-19 pandemic. The pandemic is without doubt the most significant and damaging

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event in a generation. This tragic event has taken its human toll with over 93 million cases and 2 million deaths. With the world's leading economies under intermittent lockdown, the covid-19 health crisis has become a global financial crisis.

Real estate has been hardest hit by covid-19, with a sharp decline in values across all sectors. Retail and leisure were already in serious decline and have suffered the most, as footfall has fallen off a cliff. Any increase in online activity has fallen well short of compensating for the collapse in overall sales. Squeezed property companies have been caught in the middle with their tenants unable or unwilling to pay rent and their funders continuing to look for interest and loan repayments. A number of major listed property companies, including Land Securities, Hammerson and British Land, have reduced their dividends. The government has sought to encourage collaboration between landlords, tenants and funders and has introduced limited measures to prevent 'rogue' landlords from taking enforcement action against struggling tenants. The message is that the situation is not the fault of any particular party and that all those involved are in this for the long term.

In addition to the above, the UK finally left the EU on 31 January 2020 and the 12-month transition period came to an end on 31 December 2020. The UK's relationship with the rest of the world is now dependant on individual trade deals. Although negotiations have been overshadowed by covid-19, UK Prime Minister Boris Johnson has not found it easy to impose his will on Europe, the United States and other key trading partners. Joe Biden's victory in the US election would appear to signify a more Euro-friendly direction in US foreign policy.

Pre-covid-19, the office market continued to hold up relatively well despite the ongoing political and economic uncertainty. Many landlords had become less concerned about Brexit as the much-anticipated collapse in demand failed to materialise and, in many respects, the industry had already allowed for Brexit and the associated fallout. The feared mass exodus of international businesses from London and the UK did not happen. Although companies had implemented post-Brexit strategies, relocations did not have a significant impact on occupier demand. However, covid-19 has had a much more profound effect on the office market as occupiers across the spectrum have been forced to re-evaluate their UK and global requirements. Most occupiers are looking to reduce their office space requirements and flexibility remains a priority. Unsurprisingly, the office letting market has been subdued and volumes are down significantly on 2019. Despite this, larger corporates and professional firms have continued to see the need for a landmark headquarters building to identify with their brand. Major deals included Linklaters' new London headquarters at 20 Ropemaker Street, The Office Group's offices at 210 Euston Road, NW1, BP's pre-let of offices at Cargo, North Colonnade, E14, Baker McKenzie's new London headquarters at 280 Bishopsgate and Diageo's new headquarters at 16 Marlborough Street, W1. Real estate investment volumes have also been badly affected. Although there has been some resurgence in investment activity in recent months, this follows record lows in the first half of the year. Major transactions included Link Reit's £380 million acquisition of 25 Cabot Square, E14, NTT Urban Development Corporation's acquisition of 130 Wood Street, EC2, Sun Ventures' purchase of 1 New Oxford Street, WC1 for £173 million, M&G's acquisition of Fleet House, EC3 for £111.7 million, Brookfield's £472 million sale of 1 London Wall Place, EC2Y and Derwent London's sale of 2&4 Soho Place, W1. Investment transactions have been dominated by overseas capital, with Singaporean investors being particularly active, while activity from UK buyers has tended to focus on smaller lots. Continued interest from overseas investors suggests that London remains a safe haven for investment capital in uncertain times.

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Although the construction pipeline is reasonably strong, much of the space has been pre-let, helping to maintain healthy competition for new space. Outside of London, the regions will continue to benefit from continued decentralisation and cities such as Manchester, Edinburgh and Birmingham have proved particularly attractive for occupiers and investors, offering a strong talent pool combined with attractive amenities. While London will undoubtedly retain its attraction as a key global city in which to live, work and do business, rapidly evolving technology and flexible working practices established in lockdown mean that not everyone needs to be in the office all of the time. While major businesses are likely to still look for a flagship central London headquarters building, that building may well be smaller than before and repurposed away from simply providing desk space. Sustainability is becoming increasingly important as businesses come under pressure to achieve environmental, social and governance (ESG) targets. This will focus demand on new developments allowing an occupier to impose its green credentials as part of its corporate identity. A two-tier market is emerging, with increasing vacancy rates in second-hand space and modern, safe and environmentally friendly buildings letting at a premium.

Professional service firms, including major international law firms, have been the dominant force in the letting market, closely followed by the TMT sector. Although the co-working sector has taken an immediate hit, the demand for flexible space will continue. However, in addition to connectivity and facilities, providers will need to ensure that they can offer a safe place in which to work. The co-working sector has become an established part of the market, including the development of sub-markets as operators have sought to establish niche appeal. The sector will continue to be driven by demand for good quality office space, available on flexible terms and in well-located, safe and sustainable office buildings.

The covid-19 pandemic has caused the UK population to rethink its relationship between home and work. For many, working from home has become the new normal. Rapid advances in technology mean that long commutes to and from the office have ceased to be an essential, and time consuming, part of the working day. This has led to an increase in demand for larger properties with outside space, while the market for flats in urban areas has been badly affected. Interest has been strong outside of urban areas, with increased demand in traditional second-home locations such as Cornwall, the Cotswolds and Norfolk. Other factors affecting the residential market include the government's stamp duty holiday, concerns about cladding and the safety of taller blocks of flats, and the release of pent-up demand following the first lockdown. The country's housing crisis continues as successive governments have failed to meet new build targets and the UK's rising population will ensure that residential property will continue to provide opportunities for investors. Covid-19 has slowed construction, with delays in the supply of building materials and difficulties in ensuring the availability of a skilled and unskilled workforce. In difficult times, high net worth individuals have started to return to the capital's super-prime market, prompting optimism for the previously deflated central London investment market. The wider residential market may be tougher in 2021 as the economy struggles with the ongoing legacy of covid-19. In particular, a slump is predicted when the government's stamp duty holiday comes to an end at the end of March 2021.

With the exception of the major supermarkets and established online retailers, it has been a particularly disastrous year for the UK's retail sector. A succession of household names, including Edinburgh Woollen Mill, Arcadia, Debenhams and Laura Ashley joined the seemingly endless list of casualties in a sector struggling even before lockdown. Property companies and investors exposed to the high street have been badly hit as rent recovery rates have plummeted. London's normally resilient high end retail offering has been hit badly by

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the absence of overseas visitors. Traditional retailers have been forced to adapt to the changing habits of their customers, while online retailers and delivery companies have benefitted from a significant increase in custom. Technology has adapted rapidly to the situation and there has been a particular growth in e-commerce sales from mobile devices. Investors will continue to rethink how they see retail assets and there will be a renewed focus on repurposing available space for residential, logistics and other uses. The industrial sector continued to attract investment and well-located, high-specification distribution centres in the right locations continued to benefit from the boom in e-commerce. Logistics has been a rare success story in 2020, with online retailers such as Ocado and Amazon looking to expand their distribution networks. The sector has proved to be an attractive target for investment capital with logistics assets high up on the shopping lists of a range of overseas and domestic investors.

Alternative assets have become an established part of the investment market, alongside the traditional office, retail and industrial sectors. The build-to-rent boom continued as institutional investors looked to increase their market share and there has been an increase in the number of new projects in the construction pipeline, both in London and the regions. Despite immediate covid-19 related operational difficulties, confidence remains high for operators in the specialist retirement living and student housing sectors, where major institutional investors are looking to increase their portfolios. For example, Legal & General entered into a £4 billion partnership with Oxford University to provide student and staff accommodation, as well as innovation space. The hotel and leisure sector is desperate for a return to healthy occupancy rates. Confidence in the travel industry is essential, with foreign tourists required to fill an increasing number of available beds. More than 200 new hotels are currently planned for London, including the redevelopment of the former American Embassy on Grosvenor Square into a 137-bedroom luxury hotel. Alternative real estate assets seem likely to offer opportunities as investors are forced to be more flexible in their quest for growth in this rapidly evolving and increasingly important sector.

It has been a difficult year for the UK lending market, with an increase in defaults, restructurings and refinancings. The retail and leisure sectors have been particularly badly hit. Landlords and developers have found themselves squeezed in the middle as rental recovery rates have stalled badly, making it difficult for borrowers to meet their loan obligations. Development loans have been adversely affected by delays and defaults on construction contracts. This has led to an increase in lending costs. Despite caution in the banking sector, it is hoped that an already diverse lending market will help maintain liquidity. A significant development has been the emergence of green financing. Derwent London became the first UK REIT to sign a green revolving credit facility to finance projects meeting its green criteria and Tritax Big Box REIT issued the first sterling green bond by a UK REIT to finance or refinance new or existing green projects.

In 2020, the world became a very different place. We have not witnessed a global event of this magnitude in modern times. Covid-19 brought real estate activity to a grinding halt and has had a profound effect on how we all live, work and relax. Global markets have been buoyed recently by positive news regarding the development of various covid-19 vaccines. On 2 December, the UK became the first nation to approve a vaccine and around the world others are approaching a similar stage. Despite this remarkable scientific achievement in such a short period of time, it is clear that confidence will not return fully until those vaccines become widely available. The world faces an enormous logistical challenge as millions of

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doses need to be manufactured, distributed and administered across the entire globe. By the time we reach a point broadly approaching normality, aspects of how we design, build and use buildings will have changed forever.

III FOREIGN INVESTMENT

Overseas investors are able to own, sell and lease real estate in England and Wales without any legal restrictions. A legal opinion may be required to confirm that an overseas investor has legal power to enter into a transaction involving property in England and Wales, to deal with the property and to execute the relevant documents.

IV STRUCTURING THE INVESTMENT

A number of alternative structures are available for direct or indirect investment in real estate in England and Wales. The decision how best to structure an investment is likely to be dictated by tax considerations, and it is important to ensure that appropriate tax advice is sought, taking into account both UK tax legislation and that of the investor's own jurisdiction. There are, however, a number of advantages and disadvantages to each structure, which may also prove critical depending on the investor's particular objectives.

i Corporate entity

A company can hold assets in its own name and create floating charges. There is potential for flexibility in terms of share structure, and there can be the advantage of limited liability. More generally, corporate entities are widely recognised, and can promote a strong and legitimate identity. Nonetheless, there is a lack of confidentiality in comparison with other investment structures and the added administrative burden of complying with the relevant regulatory framework. There is also a lack of tax transparency, and it may be expedient to base the company offshore.

ii General partnership

Whereas property co-ownership is not in itself sufficient, the active, joint management of property may constitute a partnership; it is a matter of substance rather than form. The main advantage is tax transparency, while the main disadvantage is the unlimited liability of the partners.

iii Limited partnership

In a limited partnership, investors will be limited partners who are only liable to the extent of their investment. This limited liability is particularly advantageous when coupled with the tax transparency that, to an extent, is offered by a limited partnership. However, a limited partnership must comply with the Limited Partnerships Act 1907, and a limited partner should not become involved in the management of the partnership. This may prove to be unduly restrictive for investors looking to actively manage their real estate investments. The limited partnership regime has been modernised by the introduction of a new private fund limited partnership to help meet the needs of fund managers.

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iv Limited liability partnership

Limited liability partnerships (LLPs) are governed by the Limited Liability Partnerships Act 2000 and combine limited liability for members with the tax transparency of a partnership. LLPs are not subject to the same restrictions as limited partnerships, and partners are able to actively manage the business of the LLP. Furthermore, an LLP is a body corporate (having a legal entity separate from that of its members), so there are no issues as to the legitimacy of floating charges. If the LLP is a collective investment scheme, it must be operated by an authorised person in accordance with the Financial Services and Markets Act 2000 (FSMA).

v Property unit trust

A property unit trust is an open-ended fund that allows pooled investment and is tax-efficient. A unit trust is governed by a trust deed, and as such may be an unfamiliar structure to certain overseas investors. One drawback may be the need for authorisation under FSMA. Offshore unit trusts are popular, and can provide further tax advantages because of their offshore status (albeit that such advantages have been largely curtailed from April 2019); Jersey property unit trusts in particular have been used extensively in recent years. However, there may still be local regulatory supervision, and the fact that the trust must be managed outside the UK may be undesirable for certain investors and difficult to achieve.

vi Property authorised investment fund (PAIF)

PAIFs are open-ended investment schemes that invest in property and are authorised under FSMA. The PAIF regime allows gross dividends to be paid, and was introduced to make property attractive to tax-exempt investors. A number of conditions apply for entry into the PAIF regime, including the need to carry on a property investment business and the genuine diversity of ownership condition. PAIFs benefit from SDLT seeding relief.

vii Offshore vehicle

Offshore vehicles can take advantage of lighter regulatory and tax regimes. As well as Jersey, popular offshore locations include Luxembourg, Guernsey, the Isle of Man, the British Virgin Islands and the Cayman Islands. UK corporation tax will be extended to the UK property income of non-resident companies without a UK permanent establishment with effect from April 2020.

viii Listed property company

Investing in a listed property company offers a popular means of investing in UK real estate. Listed property companies can benefit from a high profile and augmented credibility as well as greater liquidity. The drawbacks include stringent regulatory and filing obligations, and a general lack of confidentiality. In addition, listing may be costly and places extra pressure on the company management to perform. The investor also has limited control over the underlying real estate assets.

ix Real estate investment trust (REIT)

Based on an investment structure first developed in the United States, REITs were introduced in the UK in 2007. REITs are tax-efficient, as they are exempt from tax on income and capital gains arising from property rental business; distributions of profits are treated as property income in the hands of the shareholders and are generally subject to withholding tax at

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20 per cent. To gain REIT status, a company must comply with a number of conditions, including a requirement to be listed and either widely held or owned by specified types of 'institutional investor' (such as pension funds), and have property rental business as its predominant activity.

x Property joint venture

Joint ventures allow parties to share risk, and, therefore, provide a particularly attractive investment structure while the availability of debt remains constricted and investors are keen to mitigate risk exposure. A property joint venture can be structured in whatever form the parties choose, and in many cases may involve more than two parties. Of course, as well as sharing risk, parties share gains and management, so joint venture provisions need to be considered carefully.

V REAL ESTATE OWNERSHIP

i Planning

The planning administration in England and Wales primarily consists of local planning authorities (LPAs) and the Secretary of State for Communities and Local Government. The Mayor of London is also able to exercise specific planning powers at a London-wide level, including the power to decide strategically important planning applications. Planning administration is governed by various statutes, the most important of which is the Town and Country Planning Act 1990. In general, planning permission is required for development, including material changes of use, although certain restricted types of development are automatically granted planning permission under the Town and Country Planning (General Permitted Development) Order 2015. Particular planning requirements exist for conservation areas and listed buildings, as determined by the Planning (Listed Buildings and Conservation Areas) Act 1990. Third parties have a right to make representations about any planning application, which in turn must be considered by the relevant LPA. Applicants are able to appeal LPA planning decisions to the Secretary of State, in which case the Secretary of State will decide the application afresh and on its merits. Third parties have no such right of appeal but they (and applicants) may appeal decisions of the Secretary of State on the grounds of legal error. LPAs have enforcement powers to deal with development that is carried out without or in breach of planning permission. The Planning Act 2008 provides a streamlined decision-making process for nationally significant infrastructure projects, which are projects within the five general fields of energy, transport, water, wastewater and waste, as well as certain commercial and residential projects. A development consent order granted under the Planning Act 2008 provides a single consent for such projects, thereby removing the need for developers to seek planning permission and other related consents separately.

ii Environment

The environmental issue of particular significance to investors is the contaminated land regime, which is set out in Part IIA of the Environmental Protection Act 1990, as amended by the Environment Act 1995. Contaminated land is land that is causing, or may cause, significant harm to the environment or human health, and the regime also applies to water pollution. Local authorities are obliged to inspect their land to identify areas of contamination. Where land is deemed to be contaminated and is not being remediated voluntarily, the local authority or the Environment Agency (in England) or Natural Resources Wales (in Wales) is obliged to

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serve a remediation notice on the relevant persons requiring the clean-up, investigation and monitoring of the contamination. It is a criminal offence to fail to comply with a remediation notice. In general, those who cause or knowingly permit land to become contaminated are responsible in the first instance; however, if no such person can be identified, the current owners and occupiers of the site may be liable for remediation costs. While regulators in the UK do not take enforcement action as readily as in other jurisdictions, remediation costs can be substantial, and it is often necessary to obtain specialist advice when dealing with land that is or may be contaminated.

iii Tax

VAT

The starting point is that a supply of land (i.e., any sale, letting or licensing, or the grant or surrender of property rights such as rights of light) will be exempt from VAT. However, the seller or landlord can exercise the option to tax, which will generally make any sale or letting of the property by that seller or landlord a supply subject to VAT. The standard rate of VAT is currently 20 per cent. The landlord or seller can then recover the VAT charged on supplies of goods and services made to him or her in connection with the property concerned. In addition, supplies of land are generally subject to VAT if the sale involves a new commercial building completed within the past three years, or an incomplete industrial or commercial building.

SDLT

SDLT is a transactional tax payable by the buyer on the acquisition of a chargeable interest, and applies to any chargeable consideration payable by the buyer on a relevant transaction. The rate depends on the value of the transaction, and the highest rate for non-residential transactions is currently 5 per cent in respect of that part of consideration that exceeds £250,000. Residential properties are subject to rates ranging from 2 per cent up to 12 per cent for higher-value properties where the consideration exceeds £1.5 million, and there is an additional 3 per cent charge on second homes and most buy-to-let properties. Where the buyer of a residential property costing more than £500,000 is a corporate vehicle, the rate of SDLT is 15 per cent and an additional annual charge may also apply. The government has announced that there will be an additional 2 per cent charge for non-residents buying residential property in England. A new land transaction tax replaced SDLT on property transactions in Wales with effect from April 2018, which, following the introduction of a similar tax in Scotland in 2015, leaves England and Northern Ireland as the two areas of the UK where SDLT remains in place. SDLT is also payable by the tenant on the rental element of a lease on grant, and is charged at banded rates of 1 and 2 per cent of the net present value of the rent payable for the term of the lease. Limited types of transactions are normally exempt from SDLT, including mortgages and personal licences to use or occupy land. A number of reliefs that may apply, including group relief, sale and leaseback relief, acquisition relief, reconstruction relief and charity relief. It is important to consider how best to structure a transaction for SDLT purposes, although the introduction of various anti-avoidance provisions has made it increasingly difficult to implement tax-saving schemes. A stamp duty holiday introduced by the government at the start of lockdown to help support the housing market comes to an end on 31 March 2021.

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Rates

The occupier of a business property is responsible for the payment of business rates, which fund local government expenditure and are calculated by reference to the rateable value of the property. Rateable values are usually assessed every five years, and a revaluation took place in 2017 based on 2015 rateable values. This has resulted in a significant uplift, particularly for those businesses in property hot spots such as central London. Following a significant reduction in the relief available, business rates are generally payable on empty properties, and this has become a significant issue for owners in sectors with high vacancy rates. A business rates holiday for all retail, hospitality and leisure businesses applies for the 2020-to-2021 tax year. A number of major supermarkets that remained open throughout the crisis have agreed to repay the relief to the government.

iv Finance and security

Lenders will generally require security over real estate, the best form of which is a charge by way of legal mortgage. It is necessary to register a mortgage over land at the Land Registry. If the company giving the security is registered at Companies House, the security must also be registered at Companies House within 21 days of creation. The mortgage will typically impose restrictions on the ability of the borrower to deal with the property and obligations on the borrower to preserve the value of the security. Security is also commonly taken over the rental income derived from occupational leases.

VI LEASES OF BUSINESS PREMISES

In general, the landlord and tenant are free to agree the terms of a commercial lease. The law does not prescribe a particular form or contents of a lease and, subject to the tenant's security of tenure referred to below, there are relatively few statutory provisions affecting the landlord and tenant relationship under a commercial lease. The Code for Leasing of Business Premises seeks to encourage fairer and more flexible terms for tenants but, despite industry endorsement, remains voluntary. Traditionally, the industry has not enjoyed a reputation for being customer-driven, and leases have tended to be lengthy, complex and onerous for tenants. This is, however, changing as owners seek to meet the needs of their occupiers. The position for commercial leases should be contrasted with that for residential leases, where statute plays a significant role.

i Term

Leases can be granted for a wide range of terms. Leasehold interests held for investment purposes are normally held on long leases for a term of between 99 and 250 years. Historically, occupational leases were granted for a term of 20 or 25 years; however, shorter terms of 15 years, 10 years or less have become more common recently. A tenant of an occupational lease may also require a right to determine the lease before the end of the term. For example, the tenant of a 10-year lease may have a contractual right to determine or break the lease at the end of the fifth year of the term.

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ii Rent increases

The property industry has traditionally required five-yearly upward-only rent reviews to the open market rental value of the property. This guarantees a minimum return of no less than the original rent for the remainder of the term of the lease, even if market rents have fallen. Although there has been some pressure on the property industry to offer leases on more flexible terms, it is still very rare to see rent review provisions that allow for the rent to go up or down in line with the market. An alternative form of rent review is indexation, for example in line with the retail price index or the consumer price index, but this, too, is often on an upward-only basis. Fixed uplifts in the rent are another possibility, and changes to the rent can also be restricted by agreed caps and collars. An element of the rent, particularly in the retail sector, may also be calculated by reference to turnover. The covid-19 pandemic has accelerated the focus on turnover rent structures and many existing leases of retail premises have been re-geared to include an element of turnover-based-rent. This trend will continue as the retail and leisure sectors look for a viable business model in the aftermath of covid-19. This, in turn, will increase the significance of data and technology in the landlord and tenant relationship. VAT may be charged on the rent if the landlord has exercised the option to tax.

iii Tenant's right to sell and change of control

There are likely to be restrictions on the tenant's ability to sell, charge, underlet or share occupation of the property without the landlord's consent. In a typical occupational lease, consent must not be unreasonably withheld. In considering applications for consent, the landlord will be keen to ensure that a tenant of good covenant strength is responsible for paying the rent. Provisions restricting a change of control of the tenant itself are, however, rare.

iv Tenant liability and security for payment of rent and performance of covenants

The Landlord and Tenant (Covenants) Act 1995 (LT(C)A) introduced a regime whereby tenants of new leases (granted on or after 1 January 1996) are released from liability on an assignment of the lease. The tenant's guarantor is also released at this point. This is in contrast to the previous regime, whereby the tenant and its guarantor remained liable for the duration of the term of the lease under the doctrine of privity of contract, even after an assignment of the lease. The doctrine continues to apply to old leases (granted before 1 January 1996). The LT(C)A also introduced authorised guarantee agreements (AGAs), which provide the landlord with a guarantee from the outgoing tenant for the incoming assignee's obligations under a new lease. The AGA is for the duration of the assignee's term only, so that when the lease is assigned again, the original tenant is released from all liability. The decision in *K/S Victoria Street v. House of Fraser (Stores Management) Ltd and others*[2] confirmed that, although an existing tenant's guarantor cannot guarantee the liability of an incoming assignee, it can guarantee the outgoing tenant's obligations under an AGA given by that tenant in respect of the assignee. This has been considered by the High Court in *Co-operative Group Foods Ltd v. A&A Shah Properties Ltd*[3] where it was held that the guarantor's obligations amounted to a guarantee of the tenant's obligations under the AGA and were enforceable. In *EMI Group*

2 [2011] EWCA Civ 904.

3 [2019] EWHC 941 (Ch).

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Limited v. O&H Q1 Limited,[4] the court confirmed that a purported assignment of a lease to the tenant's guarantor was void and of no effect. A landlord will also consider other security, including a rent deposit or bank guarantee.

v Repair and insurance

A tenant of business premises will usually be expected to be responsible for all liabilities in respect of the property, including maintenance and repair costs. Where a property is multi-let, those costs are recovered through a service charge. The landlord generally insures the property, but recovers the cost of the premiums from the tenant. As a result, leases of business premises are often known as full repairing and insuring (FRI) leases. An FRI lease is important for the UK real estate investment market, as it allows the landlord to receive a clear income stream without incurring any expense itself in relation to the property. Liability for any wants of repair typically crystallises at the end of the term when the landlord prepares a schedule of dilapidations. The tenant may also be required to reinstate any alterations made to the premises during the term.

vi Collateral warranties

For investors in a property that has been recently constructed, collateral warranties provide investors, funders, tenants and other third parties with a contractual link that can be used to enforce the performance of the duties of the professional and construction teams. Third parties can also be given equivalent rights under the Contracts (Rights of Third Parties) Act 1999.

vii Termination

If the tenant fails to pay the rent or is in breach of any of its other obligations, generally the landlord is entitled to bring the lease to an end by forfeiture; however, the tenant is given the opportunity to remedy the breach and can apply to the court for relief. The landlord's right to forfeit also normally applies if the tenant of an occupational lease becomes insolvent. In *Vauxhall Motors Ltd v. The Manchester Ship Canal Company Ltd*,[5] the Supreme Court confirmed that relief from forfeiture was also available in respect of possessory rights as well as proprietary rights, in this case a right to discharge surface water into the canal. The government introduced a number of measures to protect tenants adversely affected by covid-19, including a moratorium on forfeiture and other enforcement action. The protection has been extended until 31 March 2021.

viii Security of tenure

The Landlord and Tenant Act 1954 (LTA) provides security of tenure to tenants of commercial properties in England and Wales. If the property is occupied for business purposes, the tenant has the right to remain in occupation at the end of the term of the lease and is entitled to apply for the grant of a new lease on substantially the same terms; however, the landlord may be able to resist the grant of a new lease based on one of the grounds prescribed by the LTA. The most common ground relied on in practice is that the landlord plans to redevelop the property. This ground is not always easy to establish and, if the landlord is successful,

4 [2016] EWHC 529 (Ch).

5 [2019] UKSC 46.

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the tenant may be entitled to compensation. Security of tenure can be a valuable statutory right for tenants, and can have a significant effect on a landlord's plans for dealing with its property, including future development. It is possible for the landlord and tenant to agree to contract out of the security of tenure provisions of the LTA. To contract out, a notice must be served on the tenant explaining that security of tenure is to be excluded, and the tenant must make a declaration acknowledging this before the lease can be completed. Contracting out tends to be more common in relation to short-term leases. A recent reform ensures that tenants operating a business from home do not acquire security of tenure. The government has announced a review of commercial landlord and tenant legislation to ensure that the LTA remains fit for purpose in the context of modern business leases.

ix Energy efficiency

The minimum energy efficiency standards (MEES) came into force in April 2018. Landlords are not able to grant new leases unless the property meets the required energy efficiency rating. The rating for a property is set out in its energy performance certificate. From April 2023 (and April 2020 in respect of domestic property), MEES will apply to all existing lettings. A property must have an energy efficiency rating of band E or better to meet the minimum standard. If a property is substandard, the landlord must carry out energy efficiency improvement works unless one of the exemptions applies. Any relevant exemption must be registered and will normally last for five years. If the property is sold, the new landlord must register the exemption if it continues to apply. The main exemptions are:

a the seven-year payback exemption for commercial property, which applies where the cost of the relevant energy efficiency improvement cannot be recovered by way of energy savings over a seven-year period;

b the all-improvements-made exemption, where all the relevant energy efficiency improvements have been made and the property is still substandard;

c the third-party consent exemption, where a third-party consent is required for the improvement works, such as planning permission or the consent of a superior landlord, mortgagee or tenant, if the landlord has sought to obtain the consent and it was refused or granted subject to a condition that the landlord could not reasonably comply with; and

d the devaluation exemption, which is available where an independent surveyor has provided a report indicating that the energy efficiency improvement measures would result in a reduction in the value of the property or building it forms part of by more than 5 per cent.

A temporary six-month exemption may apply in certain circumstances where the relevant person has suddenly become the landlord of a property, including where the grant of the lease is down to a contractual obligation, the lease has come into effect by operation of law and the new lease has been granted under the Landlord and Tenant Act 1954. With effect from April 2023, the landlord will have a temporary six-month exemption when it becomes the landlord of an existing lease as the result of a purchase of the property.

x Mixed-use developments

Mixed-use developments are generally permitted in England and Wales, and have become a facet of urban renewal. There are specific issues relating to mixed-use developments, including increased levels of statutory protection for residential tenants. Residential tenants'

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rights include collective enfranchisement and individual lease extension rights, as well as the right of first refusal and protection in relation to service charges and the management of the property.

VII DEVELOPMENTS IN PRACTICE

i New Code of Practice for commercial property relationships during the covid-19 pandemic

A new Code of Practice was published by the government on 19 June 2020, and seeks to provide support in the commercial property sector in relation to rent, service charge and insurance rent liabilities. Although the focus is on the hospitality, leisure and retail sectors, the Code applies to all commercial leases affected by the pandemic. The intention is that landlords and tenants should work together collaboratively to agree a shared recovery plan, providing support to businesses in need through the recovery period. There is nothing new in the Code. It reflects what most landlords and tenants were already doing and many rent payment plans have already been agreed. The Code is voluntary and it does not change the underlying landlord and tenant relationship. A number of leading bodies in the industry, including the British Property Federation, the British Retail Consortium and the Royal Institution for Chartered Surveyors, have pledged their support until 24 June 2021. The Code sets out a number of principles to help landlords and tenants to work together and agree a reasonable way forward. It is clear that the pandemic is not an excuse for businesses not to pay rent; tenants should pay what they can. Similarly, landlords are not obliged to accept concessions and should take into account their own financial obligations, for example payments due to funders. Landlords can also require something in return for a waiver, reduction or deferral, such as an extension in the term of the lease or the loss of a tenant break right. Further supplemental guidance is expected early in 2021.

The government has also extended measures protecting tenants from forfeiture, CRAR and winding up until 31 March 2021, a few days after the first quarter day of 2021. The March quarter day will be key in assessing whether businesses are starting to recover from the series of lockdowns and also as to whether further government intervention is required. Although the government's approach initially received the united support of the property industry, a divide has opened up between the interests of landlords and tenants. The British Property Federation had campaigned against extending the measures further whereas the British Retail Consortium broadly welcomed the move while acknowledging that the issue will re-emerge in 2021 when the protection comes to an end. In addition, there are likely to be economic crunch points when the rent deferred under existing rent payment plans starts to become payable and further re-gearing negotiations between landlords and tenants are expected in 2021.

ii Brexit and frustration

In contrast with its impact on the property market, the legal implications of Brexit for property are limited. The High Court decision in *Canary Wharf (BP4) Ltd v. European Medicines Agency*[6] confirmed that Brexit would not frustrate the European Medicines Agency's (EMA) lease of 30 Churchill Place at Canary Wharf. Following the outcome of the 2016 referendum,

6 [2019] EWHC 921 (Ch).

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the EMA made it clear that it would need to leave London and relocate to new European headquarters in Amsterdam. The EMA had argued that Brexit would frustrate the lease and entitle it to walk away without any further liability to pay the rent or comply with the other tenant covenants.

The High Court did not accept that the EMA had to remain at Canary Wharf until 2039 when the lease expires. The possibility of the EMA needing to relocate had been addressed by the terms of the lease, and in particular the comprehensive alienation provisions that permitted assignment and underlettng with Canary Wharf's consent. The EMA had consciously entered into a 25-year lease without a break clause and had contractually assumed the risk of subsequent events including Brexit. Although the EMA had been granted leave to appeal to the Court of Appeal, the parties settled after the EMA agreed to sublet 30 Churchill Place to WeWork. Accordingly, the High Court decision remains good law. This is good news for landlords, offering some certainty in uncertain times.

iii Land Registry accepts electronic signatures

Although the Land Registration Act 2002 provided the framework for the introduction of e-conveyancing, an electronic system for creating and transferring interests in land remains a distant reality. Despite rapid advances in the development of e-commerce, the Land Registry has, until recently, continued to insist on 'wet ink' signature originals for deeds effecting registrable dispositions. The first UK lockdown led to a significant softening of this position. First, the Land Registry agreed to accept deeds completed virtually, and then, under pressure from the industry, it began to accept deeds executed using electronic signatures. New guidance has been published allowing for the use of an online signature platform with a two-factor authentication process for both signatories and witnesses. The process must be controlled by a solicitor who must certify that the Land Registry's requirements have been complied with.

Although there are a few issues with the new guidance, the Land Registry has indicated that it will continue to work with both the legal profession and platform providers to help facilitate property transactions while preserving the integrity of the register. The change marks a significant step for the Land Registry, and is likely to accelerate the introduction of qualified electronic signatures followed, in due course, by an e-conveyancing system.

iv Guarantor was liable under a guarantee of an AGA following assignment

The courts have considered the enforceability of a guarantee of an AGA (GAGA) given by an original guarantor. In *EMI Group Limited v. The Prudential Assurance Company Limited*,[7] EMI was the guarantor of a lease of Oxford Street premises granted to HMV. HMV assigned the lease to Forever 21 with Forever 21's parent company acting as guarantor. HMV guaranteed Forever 21's obligations under an AGA and EMI guaranteed HMV's obligations under that AGA by way of a GAGA. Both HMV and Forever 21 entered into administration and HMV was dissolved. The Prudential sought to recover from EMI, which claimed that the GAGA was void under the anti-avoidance provisions of the LT(C)A or that the GAGA had come to an end when HMV was dissolved. The Prudential sought a declaration that the GAGA was enforceable and sought to recover nearly £5 million from EMI.

The court rejected EMI's arguments and held that it was liable for the sums claimed under the GAGA. The wording of the original guarantee and the GAGA should not be

7 [2020] 2061 (Ch).

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construed as an embedded repeat guarantee that fell foul of the LT(C)A and the GAGA was valid. In addition, the dissolution of HMV did not affect the liabilities of EMI as guarantor under the lease. The decision follows the Court of Appeal ruling in *K/S Victoria St* and confirms that a guarantor can remain liable following a lawful assignment by guaranteeing the obligations of the outgoing tenant under an AGA. It also indicates that a court is likely to prefer a more realistic construction when considering the effect of the words used.

v Injunction granted for interference with right of light

In *Beaumont Business Centres v. Florala Properties Ltd*,[8] the High Court has awarded an injunction requiring the demolition of part of an extension of hotel premises built by the defendant. The claimant operated high class serviced offices and business services from its adjacent premises. Part of its office premises suffered a reduction in light as a result of the extension. Although the adversely affected part was already poorly lit and dependent on artificial lighting, the court granted an injunction. The claimant had shown that its premises had become substantially less comfortable and the reduction in light would result in a reduction in rental income. The claimant was entitled to an injunction or damages of £350,000. The defendant argued unsuccessfully that the claimant was not seeking to protect its proprietary rights and was merely seeking to extract a ransom payment. The court took into account the behaviour of the parties, and although the defendant had considered offering to make a payment of £155,000 to the claimant, that offer had been withdrawn and the development works were carried out notwithstanding the claimant's objections.

This case marks the first time an injunction has been awarded since *Coventry v. Lawrence*[9] and the first in the City of London for 30 years. Because the hotel was let, the tenant would need to be joined into the proceedings seeking an injunction. It serves as a warning to developers proposing to carry out works without first resolving rights of light issues.

vi RICS launches new lease Code

The RICS Code for Leasing Business Premises came into force on 1 September 2020. A lot has happened since the original Code of Practice for Commercial Leases was launched in 1995. Although the original Lease Code, and subsequent versions, have had a significant effect on commercial lettings, in many respects it has been market conditions, notably as a result of the financial crisis and the result of the EU referendum, which have pushed landlords towards fairer and more flexible lease negotiations. Similarly, the 2020 Code's launch has coincided with considerable market uncertainty brought about by the global covid-19 pandemic and Brexit. Nonetheless, the Code's status as a Royal Institute of Chartered Surveyors (RICS) professional statement will help ensure that it becomes an important part of the lease negotiation process. In contrast with previous versions, RICS members must comply with the mandatory requirements and should comply with the remaining provisions detailing best practice.

The new Code applies to business lettings in England and Wales. There are a limited number of exceptions, including agricultural lettings, tenancies of six months or less, premises only housing plant and equipment and those that are intended to be sublet. The provision

8 [2020] EWHC 550 (Ch).

9 [2014] UKSC 13].

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of heads of terms on a letting with vacant possession is mandatory. The new Code includes a template heads of terms and sets the minimum requirements that must be dealt with. Although it contains nothing new, the latest incarnation of the Code does set out a useful starting point and should help the parties, with the assistance of their professional advisers, to reach a fair and balanced outcome. However, its impact on commercial lettings will, at least initially, be overshadowed by market conditions as tenants across a range of sectors reassess their property requirements.

vii Landlord was in breach by granting consent

In *Duval v. 11-13 Randloph Crescent Ltd*,[10] the landlord of a block of flats had given consent to one of the tenants to carry out structural works, notwithstanding that the leases of the flats contained an absolute prohibition against such works. Each lease also contained an obligation on the landlord to enforce the tenant covenants in the other leases, including the absolute covenant preventing structural alterations. Another tenant in the building objected to the works and sought a declaration that the landlord was in breach of covenant by consenting to the works. The Supreme Court found in favour of the tenant. The landlord did not have the right to consent to the works without the consent of the other tenants. To do so would prevent it from complying with its covenants with the other tenants to enforce the covenant against structural alterations. The case serves as a reminder that landlords must check carefully the provisions of other leases in a block or on an estate when dealing with management issues.

viii Law of nuisance does not protect privacy

In *Fearn and others v. The Board of Trustees of the Tate Gallery*,[11] the Court of Appeal has dismissed appeals by tenants of The Neo Bankside development on London's South Bank whose flats are overlooked by the public viewing gallery at Tate Modern. The panoramic views from the platform included the interiors of a number of flats in the block. The tenants argued that the use of the viewing platform unreasonably interfered with the amenity of their flats and constituted an actionable nuisance. Although the judge at first instance dismissed the claims on the grounds that urban living required an element of give and take, he left the door open for the law of nuisance to protect privacy. The Court of Appeal disagreed, the law of private nuisance did not extend to an invasion of privacy by overlooking.

ix ATMs located at supermarkets are not separate rateable hereditaments

In *Cardtronics UK Ltd and others v. Sykes and others (Valuation Officers)*,[12] the Supreme Court has confirmed that ATMs located at supermarket premises should not be assessed separately for business rates. The ruling applies to both machines located outside and forming part of building and also to those inside the stores. An ATM located at a supermarket premises was for the benefit of the retailer as well as the machine operator. Accordingly, the supermarkets had retained occupation of the ATM sites and there was no separate rateable hereditament. This decision is expected to lead to the repayment of around £430 million in overpaid

10 [2020] UKSC 18.
11 [2020] EWCA Civ 104.
12 [2020] UKSC 21.

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business rates and has been welcomed by the operators of both supermarkets and convenience stores. As the number of bank branches continues to fall, the decision should also help ensure members of the public can continue to access their cash.

x Electronic Communications Code

The Electronic Communications Code provides telecommunications operators with Code rights to install, inspect, maintain, upgrade, operate and share telecommunications equipment on another person's land to facilitate the provision of network services. Although the Code seeks to strike a balance between operators and landowners, both sides remain dissatisfied with the rights and obligations conferred by the Code. For operators, the Code does not go far enough in allowing them to install their apparatus in the best position to provide nationwide connectivity. Landowners are concerned about the extent of Code rights, lengthy procedures required to terminate Code agreements and remove operators' apparatus and the payment of lower levels of compensation calculated on a 'no scheme' basis. The introduction of the new Code in 2017 has seen an increase in the number of cases heard by the Upper Tribunal (Lands Chamber) following applications by operators seeking to assert their rights under the Code.

In *Cornerstone Telecommunications Infrastructure Ltd v. University of the Arts*,[13] as part of a wider development scheme, the University had agreed to move into a new building and to sell its existing campus to the developer. The University was to be granted a leaseback of its existing building to give it time to move into the new premises. The leaseback was for three years with an initial 18-months' rent free and then a substantial rent of £3 million per annum. The University also had a right to break the lease at any time conditional upon yielding up with vacant possession. The telecoms operator applied for a Code agreement in respect of a site on the roof of the existing premises. The University objected on the ground that if the operator failed to vacate it would not be able to satisfy the vacant possession condition to its break right and would remain liable to pay the rent on a property it no longer needed.

The Tribunal decided that the potential prejudice to the University if a Code agreement was granted would be substantial. The University could not be adequately compensated by money and the potential prejudice outweighed the public benefit that would be conferred by a new electronic communications site at that location. The Tribunal also commented with disapproval on the acrimonious manner in which the case had been handled by the parties.

xi Restrictive covenant and restraint of trade

In a Northern Irish case, *Peninsula Securities Ltd v. Dunnes Stores (Bangor) Ltd*,[14] the Supreme Court has held that a restrictive covenant given by a developer in favour of the anchor tenant of a shopping centre did not engage the common law doctrine of restraint of trade. The original developer of the shopping centre site had granted a long lease to Dunnes for a premium. In the lease, the landlord covenanted not to build a competing store over a certain size. Peninsula acquired the centre and sought a declaration that the landlord's restrictive covenant was in restraint of trade and unenforceable at common law.

13 [2020] UKUT 248 (LC].

14 [2020] UKSC 36].

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The Supreme Court departed from the 'pre-existing freedom test' established by the majority of the House of Lords in *Esso Petroleum v. Harper's Garage (Stourport)*[15] and followed the 'trading society' test favoured by Lord Wilberforce in that judgment. The lease was not in essence an agreement between traders but a transaction in land that did not engage the doctrine of restraint of trade. However it remained open to Peninsula to apply for the modification or discharge of the restrictive covenant under the Northern Irish equivalent of Section 84 of the Law of Property Act 1925.

VIII OUTLOOK AND CONCLUSIONS

More than ever, it is impossible to predict the future. Covid-19 has thrown much of what we know and trust into confusion. The pandemic has had a profound effect on how people around the world live and work. Although a crystal ball is required to determine the outlook for the real estate sector, some trends are starting to emerge. Despite positive news regarding the availability of a vaccine, it is very clear that covid-19 will remain with us for some time yet, and real estate and the wider economy will feel its legacy for longer still. Most of the UK has already been in lockdown at least twice and it is difficult to rule out similar measures in the first quarter of 2021.

In 2019, despite WeWork's much publicised woes, we were looking at the inexorable rise of the serviced-office sector. Although flexible working practices will clearly become a more accepted part of how we work, the lockdown has also confirmed that face-to-face contact is a key part of our working lives. Although fewer workers may need to be in the office, those workers will be more conscious of social distancing and businesses will need to comply with new rules and regulations as to how space can be used. The industrial sector has fared best in the current crisis. Demand for logistics space remains strong to meet the requirements of internet shopping and UK-wide distribution. In particular, there has been a post-Brexit spike in demand for storage space and a move to refocus existing buildings for distribution and storage use. The industrial sector has become the top performer and the new safe haven for investors. With the exception of the major supermarkets, the retail and leisure sectors face an uncertain future and we will see further insolvencies and restructurings. Even when the threat of lockdown is fully lifted, it will take some time for confidence to bounce back and for footfall to return to viable levels. Out of town retail parks that lend themselves to social distancing requirements may recover ahead of traditional high street outlets. Rental structures are likely to evolve further to enable landlords and tenants to share the pain and gain by reference to turnover and commercial success. The obtaining and sharing of data will become an increasingly important part of the landlord and tenant relationship, not only in relation to turnover rents but also to help meet respective ESG targets. It will be fundamental that people feel safe where they live, work and relax. The normally robust hotel sector may also take time to recover as confidence returns and travel restrictions are lifted. The serviced apartment sector may benefit as people prioritise their own personal space and facilities. Demand for housing is likely to remain strong in the residential sector, although the lockdown may involve a rethink in the design and location of new developments. Those finding themselves working from home on a much more regular basis may start to prioritise space over location and convenience. A combination of covid-19 and Brexit has already led to problems in the supply chain, and issues associated with ensuring both a skilled and

15 [1967] UKHL 1.

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unskilled workforce may lead to delays on construction projects. Covid-19 will also cause a major rethink on major infrastructure projects as we revaluate our transport requirements and funding becomes stretched. Crossrail 2, for example, has been put on ice as part of the funding agreement reached between the government and a cash-strapped Transport for London.

The covid-19 pandemic has put concerns about leaving the EU into perspective. In order to recover, the market needs certainty and that certainty will only arrive once the covid-19 threat is contained. As and when an effective vaccine is widely available, renewed optimism is likely to prompt a surge in activity. Until we reach that point, although there will be some distressed asset and debt opportunities, volumes will remain flat. There is no shortage of global investment capital and it is reasonable to believe that UK real estate will remain high up on investor shopping lists. London in particular will retain its position as a leading global city. However, competition will be strong and the UK must work hard to ensure that it remains attractive as place in which to invest and do business. Much will depend on the steps taken to stimulate the economy by a government saddled with increased debt. To that extent at least, the world has become a more level playing field. Lest we forget, there remains the small issue of Brexit and the UK will need to come to terms with its new relationships with Europe and the rest of the world. Although minor in comparison with covid-19, Brexit will no doubt provide an extra layer of complication as we seek to return to some sense of normality. After a gloomy 2020 dominated by the covid-19 pandemic, it is sincerely hoped that next year's edition brings with it much more positive news.

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Chapter 13

HONG KONG

Dennis Li[1]

I INTRODUCTION TO THE LEGAL FRAMEWORK

i Ownership of real estate

In Hong Kong, land grants are made on a leasehold basis. The 'ownership' of the leasehold land is granted by way of a government lease or a government grant. The government grant will contain conditions, which, when satisfied, will lead to a government lease being deemed to be issued (the practice is that the government will not issue an actual government lease). The government lease or grant will usually specify the government rent, term duration, building covenants and user restrictions, the breach of any of which entitles the government to re-enter the land and determine the government lease or grant.

For multi-storey buildings, government leases are granted for the piece of land on which the building is erected. There are no separate government leases for the ownership of units in that building and all unit owners are 'co-owners'. A deed of mutual covenant governs ownership of each individual unit in a building by notionally dividing the combined land and building into a number of undivided shares and allocating a certain number of these undivided shares to each unit in the building. These undivided shares have attached to them the right to exclusive use and possession, and the purchase of a unit in a building is effected by way of an assignment of all the rights attached to those undivided shares for the remainder of the term of the government lease.

Following the change of sovereignty on 1 July 1997, all land in Hong Kong has become property of the People's Republic of China, and the responsibility for the management, use and development rests with the government of the Hong Kong Special Administrative Region of the People's Republic of China (Hong Kong). The Basic Law of Hong Kong provides that government leases granted prior to 1 July 1997 will continue to be recognised and protected under the laws of Hong Kong. All government lease terms are either granted or entitled to an extension for another 50 years or until 2047.

ii System of registration

Hong Kong operates on a system of document registration (as opposed to title registration) where instruments affecting real properties are lodged for registration with the Land Registry. The registered particulars and relevant documents are open to public inspection. Registration in the Land Registry confers priority on registered documents and serves as notice of registered instruments to anyone dealing with the particular property.

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However, the document registration system in Hong Kong only determines the priority of registrable interests in real property. Under Section 2(1) of the Land Registration Ordinance, 'deeds, conveyances, and other instruments in writing, and judgments' affecting land are capable of being registered with the Land Registry. Consequently, a registered interest holder may be in competition with an unregistered interest holder of an unregistrable interest in real property. In these circumstances, priority is determined in accordance with common law principles.

All registrable instruments registered within one month after the date of execution will take priority from their execution date. All registrable instruments registered more than one month after the date of execution will take priority from the registration date.

Although the register maintained by the Land Registry does not establish title to the property, it does act as a record of transactions that can be relied upon in establishing the details of the title to a particular property.

The Land Titles Ordinance was passed by the Legislative Council on 7 July 2004, which provides for the gradual conversion from the existing deeds registration system to a title registration system. However, the Land Titles Ordinance is not yet in force, and it is unclear when preparatory work will be completed to enable the commencement of the Land Titles Ordinance for a title registration system in Hong Kong.

iii Choice of law

A contract may have a clause expressly providing the governing law applicable, which will generally be upheld by the courts, but formalities, including conveyance and securitisation of the property and registration of instruments in the Land Registry, will usually be governed by Hong Kong law.

II OVERVIEW OF REAL ESTATE ACTIVITY

i Activity levels in real estate market

Hong Kong's real estate market remained subdued in 2020. The total volume of real estate investment transactions in the first three quarters of 2020 decreased significantly year-on-year, and investment volume for commercial properties worth over HK$20 million dropped over 20 per cent year-on-year, reaching the lowest level since the global financial crisis. The retail leasing market is stressed by the covid-19 pandemic. High street rents fell by double digits year-on-year in the first three quarters of 2020, and the overall vacancy rate in tier 1 streets in core districts climbed noticeably in the third quarter of 2020, the highest in four years. Office leasing demand remained weak with a low net absorption in the first three quarters of 2020. Grade A office rent in Central fell from its peak, and the vacancy rate in the overall office market is notably rising to the highest level since 2004. Only the residential property market remained resilient with the total number of transactions and the total consideration recorded in 2020 staying largely unchanged as compared to government data in 2019.

In the 2020 Policy Address, the Chief Executive of Hong Kong announced the abolition of the double *ad valorem* stamp duty (Double AVD) on non-residential property transactions in a bid to revitalise the real estate market in the commercial property sector. The abolition of the Double AVD will reduce commercial property transaction costs and is aimed at facilitating sales of commercial properties by businesses that are in financial predicaments or liquidity needs due to the economic downturn, caused by a number of factors in the previous two years and several waves of the covid-19 pandemic.

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In addition, the Chief Executive proposed various initiatives relating to the real estate industry, including the introduction of a pilot scheme for charging land premiums for industrial buildings, accelerating the redevelopment of industrial buildings in Wong Chuk Hang as part of the 'invigorating Island South' initiatives, streamlining approval processes for land development and private residential site lease modification applications, pushing ahead with the Lantau Tomorrow Vision housing project, continuing the feasibility study on the potential development of Tuen Mun coastal area, redeveloping Siu Ho Wan Depot Site into a residential cluster, releasing more land at Lok Ma Chau Control Point, increasing land supply for the construction of public housing units and supporting urban development and renewal in various sites across Hong Kong.

ii Availability of finance

Regarding residential mortgage lending in Hong Kong, banks must comply with a 30 to 60 per cent loan-to-value (LTV) ratio guideline. Banks can only approve mortgage loans for over 60 per cent of the value of the property without incurring additional credit risk by joining a mortgage insurance plan provided by HKMC Insurance Limited (HKMCI). Under the mortgage insurance plan, banks can grant mortgage loans of up to 80 per cent LTV ratio for property valued below HK$6 million and up to 90 per cent LTV ratio for property valued below HK$4 million to eligible applicants. On 16 October 2019, HKMCI announced that, subject to an additional 15 per cent premium, the maximum property value eligible for mortgage loans of up to 80 per cent LTV ratio is increased to HK$10 million and eligible first-time homebuyers can take mortgage loans of up to 90 per cent LTV ratio for property valued below HK$8 million. The maximum debt servicing ratio of mortgage loans of a mortgage applicant who has more than one property ranges from 30 to 50 per cent, depending on the location from which the applicant's income is mainly derived. First-time homebuyers will still be eligible for mortgage loans of up to 80 or 90 per cent LTV ratio even if they cannot meet the stressed debt servicing ratio, subject to an additional adjustment to the premium based on relevant risk factors.

The Hong Kong Monetary Authority released a number of requirements on mortgage lending for properties transacted after 19 May 2017. First, the risk-weight floor (the lowest level of capital reserve that a bank has to maintain) has been raised from 15 to 25 per cent for new residential mortgage loans approved. Second, the applicable LTV cap will be lowered by 10 per cent for property mortgage loans involving borrowers or guarantors with one or more pre-existing mortgage loans, in addition to the existing requirement of lowering the applicable debt servicing ratio limit by 10 percentage points for these loans (i.e., a 20 per cent reduction in the LTV cap for borrowers or guarantors with one or more pre-existing mortgage loans). Third, the applicable debt servicing ratio will be limited by 10 percentage points for property mortgage loans extended to borrowers whose income is mainly derived from outside Hong Kong.

In August 2020, the Hong Kong Monetary Authority relaxed its LTV rules on mortgage lending for non-residential properties (i.e., commercial and industrial properties or car parks), raising the LTV caps by 10 per cent across all property security transactions. As a result, the current LTV caps range from 30 to 50 per cent, depending on the conditions of the underlying transaction, including, for example, whether the applicant's income is mainly derived in or outside Hong Kong.

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III FOREIGN INVESTMENT

While there are generally no legal restrictions on foreign investors owning, selling, leasing and developing real estate in Hong Kong, it may be more difficult for foreign investors to obtain a mortgage in Hong Kong. In addition to the aforementioned new requirement by the Hong Kong Monetary Authority, mortgage insurance plans are generally unavailable to applicants whose income is mainly derived from outside Hong Kong, unless these applicants can demonstrate a close connection with Hong Kong. Further, legal opinions may be required to confirm that the foreign corporate investor has legal power to enter into the transaction, to deal with and to execute the relevant documents involving the Hong Kong property; this may impact transaction costs.

IV STRUCTURING THE INVESTMENT

The structuring of an investment in real estate in Hong Kong will likely be based on tax and accounting considerations of the investor. It is therefore prudent to obtain advice on tax and accounting implications for the investor in both the investor's own jurisdiction and in Hong Kong when investing in Hong Kong property. The availability of financing (and the LTV ratio) may also be a factor when determining the structure of the investment.

i Corporate entity

In Hong Kong, a company is a separate legal entity that can hold real estate assets and mortgage and charge the property it holds. It is not unusual for corporate special purpose vehicles (SPVs) to be set up to hold one or a portfolio of properties. Subject to the administrative requirements under Hong Kong company law, the investor may enjoy advantages of limited liability and tax advantages when realising the value and disposing of the real estate asset through a transfer in ownership of the SPV instead of through assignment of the property.

An investor may also make use of a corporate offshore SPV, depending on regulatory and tax considerations. Popular jurisdictions for setting up offshore SPVs include the British Virgin Islands, the Cayman Islands and Bermuda.

ii Partnership structures

When there is co-ownership and joint management of the real estate asset, a general partnership may be formed if the relation between parties is to carry on a business in common with a view of profit. When deciding whether the parties are partners, the law will look at the substance of the relationship. Partners in a general partnership are liable for each other's debts and liabilities.

The Limited Partnerships Ordinance provides for limited partners who would only be liable up to the amount of their investment. However, limited partners are subject to the restrictions specified in the Ordinance, including the limitation that limited partners are not allowed to participate in the active management of the partnership and the real estate assets held, which must be left to the general partners to manage.

iii Real estate investment trusts (REITs)

REITs are collective investment schemes constituted as unit trusts that invest primarily (at least 75 per cent of its gross asset value) in income-producing real estate assets and are listed on the Hong Kong Stock Exchange. The goal of REITs is to provide returns to investors

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derived from recurrent rental income. The Hong Kong Securities and Futures Commission has issued a 'Code on Real Estate Investment Trusts' (REIT Code) together with other guidance on the authorisation and operation of REITs. The REIT Code prohibits REITs from investing in vacant land other than in specific circumstances or engaging in property development activities unless certain conditions are satisfied and REITs are subject to a maximum borrowing limit of 50 per cent of their gross asset value. REITs have to distribute annually an amount not less than 90 per cent of their audited net income after tax to their investors as dividend.

iv Listed property company

In addition to investing in a REIT, investors may also indirectly invest in Hong Kong real estate by acquiring shares in a Hong Kong listed property company. Many of the major developers and owners of residential, office, retail, industrial and hotel properties in Hong Kong are listed on the Hong Kong Stock Exchange. This method offers a ready and liquid form of investment as well as the regulated governance of a publicly listed company. Conversely, however, a listed company will be subject to regulatory and disclosure requirements that may hinder the company's strategies in property investment.

V REAL ESTATE OWNERSHIP

i Planning

The Town Planning Board is a statutory body established under the Town Planning Ordinance tasked with guiding and controlling the development and use of land and types of buildings suitable for erection, preparing new draft zoning plans, exhibiting draft plans for public comment, considering applications for planning permission, and submitting draft plans for approval by the Chief Executive in Council. Its executive functions are carried out by the Planning Department, which is responsible for creating plans on behalf of the Town Planning Board, providing technical services and enforcing zoning restrictions. The Town Planning Appeal Board hears appeals against the Board's decisions to reject planning applications.

ii Environment

The environment is an issue of significance for town planning and land development in Hong Kong. Governmental supervision is generally by way of proper land use planning, along with appropriate controls at the source through licensing and enforcement of environmental protection ordinances. Environmental planning is an early consideration when the government scrutinises and considers approving land use plans. The government review focuses on the impact of the development on air, noise, water and waste pollution levels.

Development projects that have the potential to cause significant damage to the environment may be classified as Designated Projects under the Environmental Impact Assessment Ordinance and are required to follow the statutory environmental impact assessment process to obtain the requisite environmental permits before construction and operation commence.

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iii Tax

Stamp duty on disposition of immovable property

There are three types of stamp duty that may be applicable to the sale of property in Hong Kong. The *ad valorem* stamp duty (AVD) is applicable to all dispositions of immovable property. The government has also introduced a special stamp duty (SSD) and a buyers' stamp duty (BSD) with effect from 20 November 2010 and 27 October 2012 respectively for the sale of residential properties. The SSD and the BSD were introduced with the aim of cooling the overheating residential property market.

The parties legally liable to pay AVD, BSD or SSD are defined under the laws of Hong Kong. However, it is customary for a contract for sale to stipulate that the purchaser will pay the AVD and BSD and the vendor will pay the SSD.

Effective from 27 October 2012, BSD is payable on a contract for sale or a conveyance on sale of any residential property. BSD is charged at 15 per cent on the consideration or the market value of the property (whichever is higher). The BSD is subject to specific exemptions, including the sale of the property to a Hong Kong permanent resident. Any residential property acquired and resold within certain holding periods, up to 36 months, will be subject to the SSD ranging between 10 to 20 per cent of the value and consideration of the property, depending on the timing of resale.

AVD for residential properties has been increased to a flat rate of 15 per cent on the consideration or the market value of the property (whichever is higher). Persons who qualify for a lower rate of AVD must satisfy certain exemption criteria stipulated by the Hong Kong government. Examples of this exemption are when the buyer is a Hong Kong permanent resident and is not a beneficial owner of any other residential property in Hong Kong at the time of acquisition of the residential property or the buyer has divested himself or herself of ownership of all other residential property in Hong Kong within six months.

On 11 April 2017, the Hong Kong government tightened up measures on the existing exemptions to the effect that, unless specifically exempted or otherwise provided in the law, acquisition of more than one residential property under a single instrument executed on or after 12 April 2017 will be subject to the proposed new AVD flat rate at 15 per cent. As mentioned in Part II section i above, the Hong Kong government abolished the Double AVD on non-residential property transactions effective from 26 November 2020, which means that non-residential property transactions will attract the same stamp duty rates as those residential property transactions who qualify for lower rates of AVD thereafter. The rates of AVD range from 1.5 per cent to 4.25 per cent, depending on the value of the non-residential property.

Stamp duty on transfer of Hong Kong stock

The acquisition or transfer of shares in a property holding company is not subject to the AVD, SSD or BSD. However, parties will still have to pay stamp duty at the following rates if the transfer directly involves Hong Kong stock:

Document	Rate
Contract note for sale or purchase of Hong Kong stock	0.1 per cent of the amount of the consideration or of its value on every sold note and every bought note
Transfer operating as a voluntary disposition inter vivos	HK$5 + 0.2 per cent of the value of the stock
Transfer of any other kind	HK$5

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The parties legally liable to pay stamp duty on the transfer of Hong Kong stock are defined under the laws of Hong Kong. Customarily, the stamp duty is borne by the buyer and the seller in equal shares.

Rates and government rent

Owners of Hong Kong properties will also have to pay rates and government rent on their real estate assets.

Rates are a tax on the occupation/use/holding of property. They are charged at a percentage of the rateable value being the estimated annual rental value of a property at a designated valuation reference date, assuming that the property was vacant and to be let out. The rates percentage charge is determined by Hong Kong's legislature, the Legislative Council. For the 2019–2020 financial year, the rates percentage charge is 5 per cent.

The basis of the government rent is derived from the government lease or grant that provides that rent is payable to the government. The government rent is calculated at 3 per cent of the rateable value of the property situated on the land leased and is adjusted with any subsequent changes in rateable value.

Property tax (levied on rental income)

Property tax is levied on property owners on the rental income derived from Hong Kong property. The tax is assessed on the net assessable value of the rental income. The current property tax rate is 15 per cent.

iv Finance and security

The financing of a real estate asset acquisition will usually involve the lender taking security over the property by way of a mortgage or a charge. The distinction between a mortgage and a charge is historical whereby the mortgagee has legal and equitable interest in the land subject to the mortgagor's right of redemption as compared to charge having certain rights, such as the right to sell, but legal and equitable interest still belongs to the chargor. Since 1984, a legal mortgage can only be created by way of a legal charge and the Conveyancing and Property Ordinance grants the holder of a mortgage by legal charge the same rights as a historical mortgagee.[2] Other securities that are common include an assignment of sale proceeds, assignment of rental income and assignment of insurance proceeds. The security documents that effect property will constitute a registrable encumbrance on the property and should be registered with the Land Registry to establish the chargee's priority interest.

VI LEASES OF BUSINESS PREMISES

The parties to a commercial lease are generally free to agree to the terms and there is no specified form. With relatively few restrictions on lease agreements with all rules on security of tenure abolished, the law in Hong Kong is generally viewed as being more favourable to the landlord.

2 Conveyancing and Property Ordinance (Cap. 219) Section 44.

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i Term

Subject to the remaining term of the government lease or grant, there is no limit on the term of the lease. In practice, the actual length of the term depends on the negotiations between landlord and tenant, taking into account a variety of factors including location, price, use, their respective bargaining power and market conditions. Generally, the lease term for a residential property may be negotiated in ranges between one and three years, whereas lease terms for a commercial property range between two and six years and may be extended with option terms open to negotiation between the commercial lessee or lessor.

ii Registration

A lease or tenancy agreement for a term exceeding three years must be executed as a deed to create a legal estate in land. Furthermore, all leases, save for bona fide leases at market rent for any term not exceeding three years that are exempted,[3] are required to be registered with the Land Registry to establish notice (against a bona fide purchaser) and the lessee's priority interest in the property. An option to renew should be registered at the Land Registry even if the original term of the agreement does not exceed three years.[4]

iii Rent review

Rent is usually fixed during the fixed term of the lease. Any provision or mechanism for rent adjustment is negotiable between the lessee and the lessor, and would usually be agreed before entering into the binding agreement. A typical provision for rent review in the lease is for the rent to be determined in accordance with prevailing market rent. Generally, an option to renew or extend the term of the lease usually triggers rent review in accordance with prevailing market rent.

iv Lessee's right to sell and change of control

The general practice is for leases to contain an anti-alienation provision prohibiting the lessee from transferring, assigning or subletting the lease or possession of the premises to others whether directly or indirectly. Although this may be subject to negotiation between the parties, it is quite unlikely that the lessor would concede this prohibition or control.

v Lessee liability and security for payment of rent and performance of covenants

A lease or tenancy agreement is a contract and constitutes an interest in land.

Under privity of contract principles, the original contracting parties to the agreement remain liable for the performance of the covenants, terms and conditions that are binding on them. Therefore, the lessor or lessee remains liable to each other, even if the lease is assigned by one party. If the intention is to safeguard the assignor from future liabilities arising from the contract, all parties to the original contract and the assignee should enter into a novation of the lease. If a novation is not signed, then the assignor may consider procuring an indemnity

3 It is also possible, but not required for priority, to register bona fide leases at market rent for any term not exceeding three years. In practice, it is not uncommon to see leases for less than three years being registered at the Land Registry.

4 *Markfaith Investment Ltd v. Chiap Hua Flashlights Ltd* [1991] 2 AC 43.

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from the assignee. However, that does not affect the assignor's contractual obligations (as the lessor) towards the lessee under the lease, which includes the lessor's obligation to repay the lease security deposit at the end of the lease term.

Under privity of estate principles, covenants that touch and concern the land will bind third parties. Therefore, assignees are only bound by covenants in the lease if they touch and concern the land. Such covenants include repairing covenants, user covenants and covenants for quiet enjoyment. This is beneficial from a lessor's perspective, because the lessor's assignee (in becoming the new owner of the property) would be obliged to perform or observe the covenants that touch and concern the land under the privity of estate principles, thus, releasing the lessor from his or her obligations.

vi Repair and insurance

Unless the parties agree otherwise, the lessee is obliged to maintain the premises in a good and tenantable condition and the lessor is usually responsible for structural repairs such as concealed wires and pipes drainages. While there is no statutory or regulatory requirement to procure property insurance, it is prudent and advisable for both the lessor and lessee to ensure that there is adequate insurance coverage for the property. Some commercial leases stipulate that insurance coverage must be procured by the lessee for a minimum threshold on any single claim.

vii Termination

There are a number of ways in which a lease may be terminated, including expiry of term, by notice or through an express condition, power or option provided in the lease. A breach of a condition or a covenant with a proviso for re-entry will allow the lessor to terminate the agreement by forfeiture; however, the lessee may be able to apply for relief from the court. A lessee can also repudiate the lease and if the repudiation is accepted by the lessor, the lease will immediately terminate and the lessor will be entitled to sue for damages.

viii Security of tenure

In 2004, several sections of the Landlord and Tenant (Consolidation) Ordinance were amended with the effect of abolishing security of tenure of residential tenancies and leases created after 9 July 2004.

VII DEVELOPMENTS IN PRACTICE

i The Residential Properties (First-hand Sales) Ordinance

The Residential Properties (First-hand Sales) Ordinance came into effect in April 2013 and sets out detailed requirements in relation to the conduct and materials used for selling first-hand residential properties concerning, inter alia, sales brochures, price lists, show flats, disclosure of transaction information, advertisements, sales arrangements and mandatory provisions for preliminary sale and purchase agreements and formal sale and purchase agreements.

So far, 11 land developers have been fined for violating the Residential Properties (First-hand Sales) Ordinance for lack of information in and transparency of the sales brochures, failure to include certain mandatory provisions in preliminary sale and purchase agreements and general malpractice. The total fine exceeds HK$2.5 million.

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ii Lantau Tomorrow Vision

In the 2018 Policy Address, the Chief Executive of Hong Kong proposed building artificial islands for the development of Lantau. In addition to building 260,000 to 400,000 residential units, it was proposed that new major transport infrastructures will link up the coastal areas of Tuen Mun, North Lantau, the artificial islands and the traditional business centre in Hong Kong Island North. The project has stirred concerns about the development of the artificial islands; thus the government will establish a platform for professionals and young people to take part in the process, and to explore how to link up the housing development plans on the artificial islands with the housing needs of Hong Kong. In December 2020, the Hong Kong Legislative Council approved initial funding of HK$550 million to kick-start a feasibility study for the development, which would take 42 months to finish.

iii The Lands Resumption Ordinance

In the 2019 Policy Address, the Chief Executive of Hong Kong proposed to invoke the Lands Resumption Ordinance to resume three types of private land for developing public housing and starter homes. These include: privately owned brownfield sites in the New Territories that may have development potential, private land that has been zoned for high-density housing development in statutory outline zoning plans but without any development plans yet and the urban private land located in three areas in Kowloon East. The government's approach of resuming land will require support from various sectors of the community, particularly developers. In this regard, the property development industry previously expressed that developers will not oppose such an approach.

VIII OUTLOOK AND CONCLUSIONS

2020 has been a challenging year for Hong Kong's real estate market. The covid-19 pandemic with several recurring spikes in Hong Kong, continuing Sino-US trade disputes, the political saga around the city's national security law and the economic recession following the social unrest in 2019 dominated the landscape of Hong Kong's property market in 2020.

In the commercial and industrial property markets, trading activities stayed at low levels by historical standards in the first three quarters of 2020. There were some signs of rebound towards the end of the third quarter after the Hong Kong Monetary Authority relaxed its LTV rules for mortgage loans on non-residential properties in August. However, no major improvement could be expected in the fourth quarter with the fourth wave and by far the most severe wave of local epidemic hitting the already troubled economy. The abolition of the Double AVD on non-residential property transactions in late November may provide some momentum to investment activities, and we are seeing some large cap transactions at the start of 2021 in this sector. While local investors and foreign funds are expected to stay cautious towards property acquisitions of most types over the next six to 12 months, Mainland Chinese buyers are likely to remain relatively active in the market with the Chinese economy on the track of recovering. Looking ahead to 2021, transaction volume is expected to pick up compared to the low base of 2020, provided that the pandemic stabilises.

In the residential property market, home prices in Hong Kong remained stable in the first 11 months of 2020 and were expected to drop about 1 per cent on an annual basis for the first time in 12 years. Increasing emigration and the shrinking headcounts at multinational corporations in the city could lead to a buyers' market. Emigrants who were rushing to sell their properties were willing to negotiate discounts with buyers. According to government

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data, the total number of sale and purchase agreements (SPAs) for residential building units recorded in the second half of 2020 increased by 20 per cent compared to the data in the first half of 2020, which also represents a 29 per cent increase compared to the figure in the first half of 2019. December 2020 data recorded a 90.5 per cent surge and an 87.9 per cent increase in the number of SPAs for residential building units and the total consideration respectively, as compared to the 2019 December data. In 2021, the residential property market is expected to stay resilient with home prices falling slightly by up to 5 per cent, due to the pent-up demand in the city and low interest rates. However, sustainability of demand in the residential property market will certainly depend on the impact of the covid-19 pandemic on the job market.

In terms of the retail leasing market, border control has virtually put the city's inbound tourism to a complete standstill with visitor arrivals falling by 92 per cent year-on-year in the first 10 months in 2020. In the fourth quarter of 2020, the retail leasing market remained frozen with more tourist-targeted retailers exiting and only a handful of food and beverage operators and mass-market retailers targeting the local market and taking up the spaces. The retail market is expected to rely on local consumption in the short run. However, the prevalence of online shopping caused by the pandemic and the narrowing price gap between Hong Kong and Mainland China on luxury goods may accelerate a structural change of the retail spending profile. The retail market is expected to bottom out in 2021 with a possible rebound of a single digit percentile on the assumption of a modest economic recovery and some travel bubbles put in place.

The office leasing market experienced an overall yearly rental fall of around 15 per cent in 2020, the largest drop in over 10 years. Some property valuers observed that the rate of decline in overall rents increased in the fourth quarter of 2020. Meanwhile, vacancy rates across all major areas continued to increase towards the end of 2020. However, cooling of the rental market can render Hong Kong more attractive for PRC companies and financial institutions to set up offices in 2021, as the homecoming listings of US-listed PRC companies are expected to remain hot and the implementation of the Greater Bay Area Wealth Management Connect scheme (a policy initiative by the central government to allow residents in Guangdong province to invest in wealth management products distributed by banks in Hong Kong and Macao) may have potential for significant growth opportunities for financial institutions in 2021.

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Appendix 1

ABOUT THE AUTHORS

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Slaughter and May

John Nevin is a partner in the real estate group at Slaughter and May. He has considerable experience in a wide range of real estate work. He has acted extensively on acquisitions and disposals of all types of property interests, on significant development projects and on major lettings. His clients include investors, occupiers, developers, livery companies, hotel owners, housebuilders and banks. He is listed as a leading individual in the real estate section of *Chambers UK* 2021 and the Commercial Properties: Corporate Occupiers Section of *The Legal 500* 2021, as a notable practitioner in *IFLR1000* 2020 and is also listed in *Who's Who Legal Real Estate* 2020.

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