K&L GATES

Overriding Interest

Highlighting developments and issues in the real estate industry

Winter 2012

In this issue:

Not Waving but Drowning

Risk of damage due to flooding has been a long-term concern of the Government and the insurance industry. The issue has become even more important in recent years due to rising sea levels and increasingly severe weather patterns. Approximately 5.4 million properties in the UK are now at risk of flooding and over 185,000 of these properties are commercial properties. Until now, the owners of properties in areas deemed to be at a high risk from flooding have had their premiums subsidised. However, this may change when the Government's Statement of Principles with the insurance industry on flood insurance ends on 30th June 2013. With the Association of British Insurers estimating that the floods of 2007 cost the UK £3.2 billion and an average cost of between £75,000 to £112,000 per flooded business, this change could significantly affect those who own high risk properties. Owners of these properties need to ensure that they are fully aware of their flood risk as well as the terms of their insurance policies and mortgage covenants.

In 2008 the Government and the insurance industry concluded an agreement which outlined a number of actions that the Government and the insurance industry would take to ensure that high risk properties could continue to obtain insurance. In return, the Government committed to improve flood defences significantly in the hope that when the agreement expired in 2013 there would be very few high risk properties remaining and a competitive insurance market would take its place. In September 2010 the Government met with representatives of the insurance industry at the Flood Summit to discuss the alternative options available to replace the agreement. Despite this, no alternative option has yet been agreed.

The ABI has proposed that the risk and premiums for high risk properties should be "pooled" with the Government underwriting the "pool" if claims exceed the amount available. This has been rejected by Government who wants to leave insurers free to decide whether or not to take on high risk properties and what levels of premium and excess to put in place. Talks have just resumed but there is doubt over whether an agreement will be reached.

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Impact on the Real Estate Industry

Purchasers need to consider whether to instruct their professional advisers to carry out enhanced due diligence. Advice on the availability and terms of flood insurance, now and in the future, could be crucial in many transactions. It may also be useful to find out whether there are any future plans for flood defences in the area as this may lead to reduced insurance premiums.

With high risk properties, it may be prudent to consider installing flood risk preventative measures. Insurance companies are increasingly taking these into account because they help reduce the impact of flooding and any subsequent insurance claims. Practical suggestions such as increasing the height of sockets, water resistant plaster, door and window guards, as well as waterproof doors, windows and airbricks could reduce insurance premiums.

Local planning authorities are also now required to consult the Environment Agency when a proposed development is at risk from flooding or would increase the risk of flooding elsewhere. The ABI has stressed that it is important that local authorities implement this new planning policy effectively and take into account all sources of flooding not just that from rivers and seas.

Impact on Lenders

Borrowers who own high risk properties may cease to be able to afford flood insurance or the cover may cease to be available, resulting in a risk of breach of mortgage covenants and default. A lender may have problems realising its security.

Consequently, lenders should ensure that they obtain sufficient data during their due diligence process fully to appraise the risk of flooding. Lenders will also need to be vigilant in policing the upkeep of flood insurance policies in place and may wish to stipulate that certain prevention measures are undertaken as a condition of the loan.

Conclusion

The risk of flooding affects property owners, borrowers, lenders and the insurance industry alike. The ABI has warned that without a replacement agreement 200,000 properties are likely to become uninsurable. Despite the millions spent by the Government on flood defences in recent years, the Environment Agency has reported that 43% of flood defences are still in a fair, poor or very poor condition. It is therefore feared that not enough money has been invested in flood defences to allow a competitive market to replace an agreement next year and as a consequence insurance premiums and excesses may rise steeply and many may find themselves unable to obtain flood insurance.

To prepare for these changes property owners should become more aware of the risk of flooding to their properties and should also consider reviewing the terms of any insurance policies and/or mortgage covenants currently in place. ■

Client/Sector Focus—Our Residential Investment Practice

Background to the UK Residential Investment Market

In the UK, despite the country's poor economic condition, house prices are becoming more and more unachievable, thereby generating increased demand in the rented sector. It is that demand which has been identified by a number of funds as being ripe for investment, although most of those are targeted at build-to-let rather than at existing rental. Residential investment is becoming increasingly diverse and sophisticated with new forms and structures of investment being introduced to the market. The UK has always had a very strong drive to home ownership. Successive Governments have encouraged home ownership often by the introduction of tax incentives and discounts. The current Government has offered mortgage guarantees.

The drive to own sometimes means that there is a focus on security, an ability for a tenant to remain in place, or for a tenant to be able to control its own building. That does mean that ownership of apartment blocks in the UK is more constrained by statute and by regulation than in many other countries. The Government also recognises the need to support the private rented sector, especially at a time when "would-be home-owners" are unable to borrow money on mortgage. It is therefore rather perverse that only recently the Government announced an inquiry into the sector, with one of the topics for investigation being rent control: the prospect of re-introduction of rent controls is unlikely to encourage the growth of the sector at a time when it is so needed.

Focus on one of our clients in the Residential Investment Sector—Akelius

Akelius is one of Sweden's largest property fund groups with over 35,000 residential properties in Sweden and Germany, worth around €3.1 billion. We recently acted for Akelius on their first major move outside Sweden and Germany and into the UK residential investment market, which they had identified for growth. Akelius' main objective is to acquire residential units in London and the South East, forming part of a wider objective to create one of the UK's largest rental portfolios. Their initial aim was met in March this year, with the acquisition of 574 apartments, across 26 properties/locations (from Terrace Hill) for £75.35 million. This transaction was a very significant deal for both Akelius and the residential investment market, and was widely reported in the UK property and financial press. Piers Coleman and his team have subsequently acted on further residential investment transactions for Akelius. ■

Case Summaries

Consent to Assign Lease

The landlord was the leasehold owner of a retail shop, rented by the tenant. The tenant sought to assign the lease and requested consent for this assignment by email. Eleven days passed without response from the landlord. At this point the tenant completed the assignment without having obtained the landlord's consent. The following year, the assignee went into administration, defaulting on rental payments. The landlord proceeded to serve notice on the former tenant under section 17 of the Landlord and Tenant (Covenants) Act 1995, seeking to recover rental arrears from them on the grounds that consent had not been obtained and therefore the former tenant remained liable.

The tenant countered by arguing that the landlord had unreasonably delayed consent to assignment and it was therefore lawfully entitled to assign. The court rejected this submission on the grounds that email was insufficient under s.196 to constitute delivery - either physical delivery or registered post was required. Because the application had been served incorrectly, the court held that the landlord's duty under the Landlord and Tenant Act 1988 was not engaged. Accordingly, the landlord was under no obligation to give its consent within a reasonable time and that even if such a duty had arisen, the time period (eleven days) was too short a period to expect the landlord to come to a decision.

Comment: This decision is a useful reminder of the pitfalls of failing to obtain consent on the assignment of a tenancy. It also demonstrates the importance of making an application in the correct way.

E.ON UK plc -v - Gilesports Ltd, HC (ChD)

Nuisance - Fire

The freehold owner of a commercial premises (a tyre fitting business) stored a large quantity of tyres on the premises. A fire broke out and escaped onto the land adjacent to the premises, belonging to the claimant.

The claimant subsequently brought a claim in negligence under the 19th century rule in *Rylands v Fletcher*, which imposes a tort of strict liability on a landowner who brings a non-natural thing likely to do mischief onto his land and damage is caused by the escape of that thing.

On the facts of this case, what had been brought onto the land was tyres. The court ruled that the rule in *Rylands v Fletcher* could not apply because it was the fire that had escaped from the land and not the tyres which had been brought onto the land. Furthermore, it found that the tyres which had been brought onto the land were not in themselves exceptionally dangerous or mischievous.

In addition, the commercial activity carried on by the defendant as a motor tyre supplier was a perfectly reasonable activity to be carried on the type of premises (an industrial estate) and therefore this was not a non-natural use of the land for the purposes of *Rylands v Fletcher*.

Comment: A reminder that this rule will only be helpful in unusual cases.

Stannard (t/a Wyvern Tyres) - v - Gore, CA

Lease Interpretation

The landlord owned a building containing four flats and sought to claim service charges based on a calculation of the overall costs incurred in relation to the building and two additional buildings. The lease relating to the flats stipulated that a service charge was payable in relation to "the Development". The term "the Development" was not, however, defined in the lease and so whether the landlord could recover the monies under the lease hinged on the interpretation of this term.

The Upper Tribunal (Lands Chamber) held that there was no burden of proof on the landlord to demonstrate the meaning of the term "the Development" in the lease, since this was purely a matter of law rather than fact. Furthermore, the Upper Tribunal made it clear that a burden of proof was very much a last resort.

Comment: This case provides a reminder that there is no burden of proof where the court is required to construe a document.

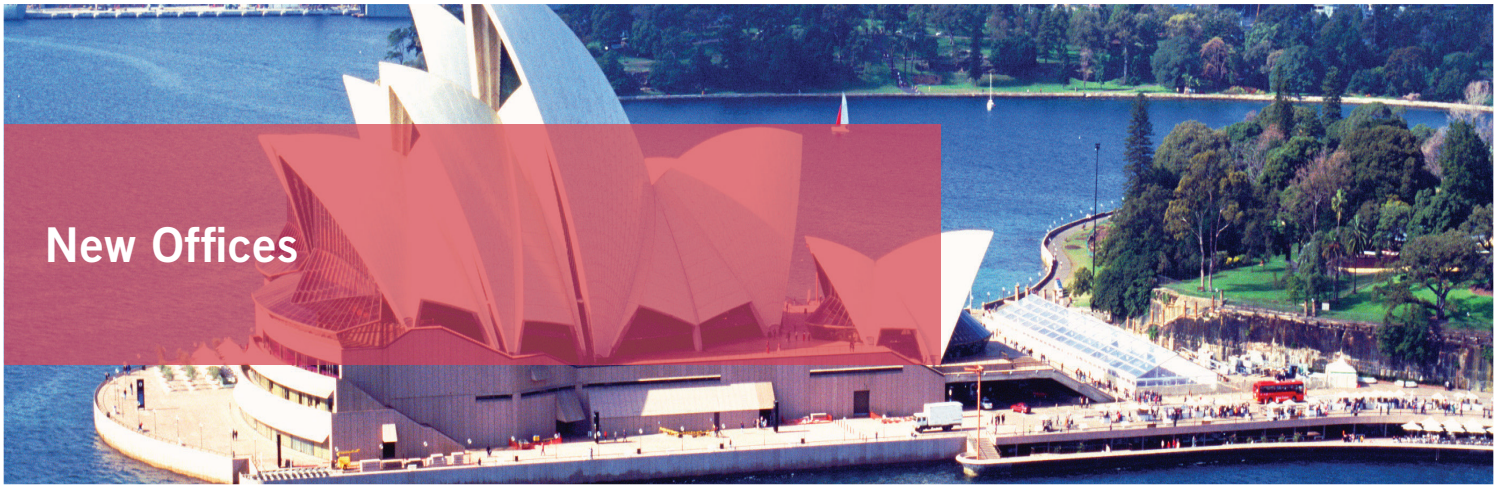
Redrow Regeneration (Barking) Ltd and another - v - Edwards and others, UT

Lease Renewals

A number of traders at Smithfield meat market were seeking renewal leases from their landlord, the City of London Corporation. The existing leases provided for a rent inclusive of service charge whereas the City Corporation proposed that the new leases provided for an exclusive rent plus service charge. The Court held that since earlier leases had in fact contained a separate service charge the usual presumption, that the person seeking a change to the provision of a lease was obliged to justify it, did not apply.

Comment: There were some special features to this case but this decision provides an interesting qualification to the general principles set out in *O'May v City of London Real Property Co. Ltd*.

Edwards & Walkden (Norfolk) Ltd -v- City of London Corporation, (Ch)



New Offices

Seoul

The Korean Ministry of Justice granted final approval of the application of global law firm K&L Gates LLP for a foreign legal service office in Seoul, the capital of the Republic of Korea. Pending registration with the Korean Bar Association in the coming weeks, K&L Gates' Seoul office — the firm's 42nd office worldwide and seventh in Asia — will be formally launched in January 2013. K&L Gates is one of the first U.S.-based law firms to avail themselves of the benefits of the Korea-U.S. Free Trade Agreement, which, upon becoming effective in March 2012, opened the Korean legal market to U.S. law firms for the first time.

K&L Gates and Australian Firm Middletons to Combine

The partners of global law firm K&L Gates LLP and Australian national firm Middletons have voted unanimously to combine firms effective January 1, 2013. The addition of Middletons' 300 lawyers and four offices — in Melbourne, Sydney, Perth, and Brisbane — extends K&L Gates' global reach to more than 2,000 lawyers in 46 offices across five continents. The combined firm will employ the K&L Gates name.

Through the combination, K&L Gates greatly enhances its Asia-Pacific regional coverage to 400 lawyers and 11 offices, including the recently announced office in Seoul, and becomes the first firm to combine with an Australian firm to form a single integrated global law firm. In addition to the common brand, from the outset the firm will enjoy full financial, operational, and technological integration, as well as unitary global governance and a single approach to partner compensation.

K&L Gates Chairman and Global Managing Partner Peter J. Kalis and Middletons National Managing Partner Nick Nichola stated: "By their resoundingly affirmative votes, our partners have boldly seized the future by aligning our business with the businesses of clients in an era of intense consolidation and globalization. With the largest integrated network of law offices and law partners of any global law firm, our clients will be able seamlessly and efficiently to access top-notch legal resources around the corner and around the world. ■

Events and Announcements

It has continued to be a busy season in the K&L Gates events calendar. Just some of our recent events are highlighted below. If you would like further details of these or copies of the slides, please contact one of the editors.

Sustainability Events

On 22nd November K&L Gates hosted the IPD in relation to a seminar on the IPD's EcoPAS Measurement Service. This seminar was chaired by Richard Jones, Managing Director of Aviva Investors, and included an update on IPD's EcoPAS measurement service, together with an analysis and panel discussion by key investment and valuation professionals. The panellists/speakers included Jess Stevens, Sustainability Risk Analyst, IPD, Will Edwards, Fund Manager, Legal & General, Claudine Blamey, Sustainability Manager, The Crown Estate, and Lee Bruce, Associate Director, CBRE. We also recently hosted a dinner for a number of speakers at the 40% Symposium event held at RIBA. Steven Cox, one of the speakers and a lawyer in the K&L Gates real estate and sustainability practice, gave a presentation on green leases.

Financial Opportunities in Spain

A recent seminar looked at financial opportunities in Spain and included a short talk by the deputy Ambassador for Spain to the UK, Snr José Manuel Gutiérrez Delgado. It looked at some practicalities of participating in asset deleveraging, infrastructure funding and investment within the context of the Spanish economic crisis. Speakers included Manuel Martínez-Fidalgo, a Managing Director in Houlihan Lokey's Financial Restructuring Group in the London office and Head of the Spanish Restructuring practice; Fernando Bernad, a Partner in the Madrid office of Cuatrecasas, Gonçalves Pereira, a leading Spanish law firm with over 900 lawyers which advised on the creation of the 'bad bank'; and Diego Shin, a Senior Associate in the Finance group of the London office of K&L Gates.

Construction and Engineering Seminar—2012 Legal Update

Our annual Construction and Engineering seminar took place on 7th November 2012. This seminar discussed a number of topics including: the new Construction Act, one year on; alliancing and the rise of project bank accounts; key construction cases of 2012; using and amending NEC3 contracts; EU public procurement and contract ineffectiveness; and insolvency in construction. ■

New Joiners

A warm welcome is extended to our recent joiners.

Theresa Kradjian

Theresa Kradjian is a partner in the firm's Finance practice and joined us in September 2012. Her practice is focused on a broad range of mortgage-backed and asset-backed securitisation and structured finance transactions, with particular concentration in recent years on covered bond transactions for US and UK issuers. Ms. Kradjian has worked on both public and private offerings of securities in cross-border transactions. Her experience also includes the representation of financial institutions in connection with repurchase transactions and other financing transactions.

Sean Donovan-Smith

Sean Donovan-Smith is a partner in the firm's Financial Services practice and joined us in August 2012. He is a financial services lawyer with over 14 years' experience in the financial services industry, having acted for a range of clients including funds, managers, advisers, and institutional investors. Mr. Donovan-Smith focuses his practice in financial services and markets regulatory advice, regulatory enforcement and investigations, advising on regulated and unregulated funds and the international marketing of funds, and other financial products.

Diana Ford

Diana Ford joined the firm in November 2012 as special counsel in the firm's Finance practice. Her practice is focused on a broad range of securitisation and structured finance transactions, including covered bond transactions for US and UK issuers, residential mortgage-backed securities and repurchase financing transactions. Her experience in recent years also includes work-outs and restructurings involving various types of securitisations, structured finance transactions and leveraged finance transactions. Ms. Ford is a US qualified lawyer, and has practised in New York, Australia and London.

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