



THE LEGAL PERSPECTIVE

Real estate investment in the UK

Some peculiarities of the country

- The law in England and Wales differs from the law in Scotland (and Wales is introducing an increasing amount of law and regulation which is different to that which applies in England – this is particularly the case in planning/zoning law, where regulations differ between England and Wales). In this guide, the position in England and Wales is covered first and this is followed by a description of how the separate legal system in Scotland operates. Where no description of the position in Scotland is given it can be assumed to be very similar or the same as in England and Wales.
- Business tenants in England and Wales benefit from “security of tenure”, meaning that their lease will not automatically end following the expiry of its contractual term. The tenant will be entitled to a new tenancy unless the landlord has reasonable grounds for opposing it, in which case compensation may be payable to the tenant. However, parties are free to exclude security of tenure from leases if they wish. In Scotland, there is no statutory provision for continuation of the period of a business tenancy beyond that provided in the lease, except for a few limited statutory provisions, which provide limited security of tenure to tenants of retail premises. If notice of termination is not given at the appropriate time by either the landlord or the tenant, the lease continues by the Scottish common law doctrine of “tacit relocation” for a further period of up to one year on generally the same terms, and so on from year to year until proper notice is given by either party.
- Commercial leases are generally subject to upwards only rent reviews, whether on an open market or index-linked basis.
- If an overseas entity owns or acquires freehold land or a lease of over seven years (or 20 years in Scotland), the entity has a duty to register (and maintain registration of) the beneficial owners of the entity on an official register maintained by Companies House. Failure to do so will prevent the acquisition or disposal of land from being registered at the Land Registry (registration at the Land Registry being a necessary requirement in order to obtain full legal title to property in the UK) and exposes the entity and its officers to criminal sanctions. The Land Register of Scotland is the Scottish equivalent of the Land Registry in England and Wales.
- In certain circumstances UK environmental regulatory authorities can take action (including requiring clean-up which can be expensive) in respect of any historic environmental contamination at a property against a new owner or occupier, even if they did not actually cause the environmental contamination. Buyers and investors therefore increasingly focus upon the potential environmental liabilities of a property when making a decision to proceed.
- Landlords and property owners are required to hold a valid Energy Performance Certificate before selling or letting a property (subject to some exceptions). It is also unlawful (in England and Wales) for a landlord to let, or continue to let, a property unless the certificate meets a certain energy rating (again, subject to some exclusions).
- If building safety defects are identified in a building in England which is over 11 metres in height (or 5 storeys) and contains at least two dwellings, anyone who developed the building, owns it now, or owned it as at 14 February 2022 (or anyone associated with any of them, even if they were not responsible for the defect), may be required to contribute to the costs of any remediation works. The legislation is very complex but, broadly speaking, a building safety defect means a defect which arises out of works carried out between June 1992 and June 2022 which pose a safety risk due to the spread of fire or collapse. In addition, landlords may be prohibited from recovering the costs of such remediation works from tenants under the service charge in a lease, or may be limited in the amount they are able to recover. There are also strict ongoing safety regulations that apply to such buildings that a building owner must comply with. Finally, a court may grant a ‘building liability order’ (where it is just and equitable to do so) against any corporate entity (or anyone associated with it) in relation to any liability arising from a building safety risk (here, meaning a risk to the safety of people in or about the building arising from the spread of fire or structural failure). This can be in relation to *any* building (whether commercial or residential). These orders are intended to prevent developers from escaping liability for defects where, for example, a development was carried out by a special purpose vehicle which has now been wound up because the liability can attach to the developer and anyone who is or was associated with it. Scotland has its own building safety regime. A complete prohibition on the use of combustible materials on the exterior of new residential buildings above 11 metres in height has been in place under Regulations which took effect on 1 June 2022. The prohibition also extends to other categories of high-risk buildings, including hospitals. The Regulations also ban cladding made from metal composite materials on any new building of any height. Legislation has recently been introduced which will enable the Scottish government to carry out assessments of residential or mixed-use buildings with cladding and carry out remediation works necessary to eliminate or mitigate fire risk, with or without the consent of the owners.

There are currently no statutory rent controls over residential leases in England. However, new legislation is proposed pursuant to which, if brought into force, it will not be possible to rely on a rent increase clause in a residential lease, except in relation to some low-cost tenancies. Instead, rent will only be capable of being increased once per year by the landlord

servicing a notice or a determination of the open market rent by a tribunal. Tenants will also be given rights to challenge the rent or any increase in rent. In addition, any advert for a rental property will be required to list the proposed rent and landlords will no longer be permitted to accept offers of rent that are higher than that figure. In Scotland, landlords of residential tenancies in the private sector are potentially subject to rent controls (in areas designated by local authorities as 'rent pressure zones') which could prevent them from increasing rents for sitting tenants above a specified level (Consumer Prices Index + 1%) for a

period of up to five years. As at February 2025, no such "rent pressure zones" have been designated, but a re-designed system of rent controls is expected to come into effect in 2027. It is likely that the new system will also set a limit on rent increases at 1% above the Consumer Prices Index within designated "rent control areas", but this will be subject to a cap of 6%. The Scottish Government is considering whether certain types of property (such as build-to-rent developments) will be exempt from the new system of rent control. A consultation paper on this question is expected to be published in Spring 2025.

Main documents to be drawn up in the context of a transaction

- Heads of terms, prepared by the seller or landlord

Asset deal

- Sale contract – typically prepared by the seller's lawyers. This contains the terms on which land is to be sold, and any pre-conditions to the sale. Risk typically transfers on exchange of this contract which means that a buyer needs to take out insurance at this point in case there is any damage to the property between exchange and completion of the sale.
- Transfer – typically prepared by the seller's lawyers (or the buyer's lawyers in Scotland). This transfers legal title to land.

Share deal

- The SPA is typically prepared by the buyer, except on an auction sale. It documents the agreement between the parties to sell and purchase the entire issued share capital of the target company at a specified price, and sets out the other terms governing the acquisition.
- A stock transfer form is required to transfer the legal title to shares to a buyer.



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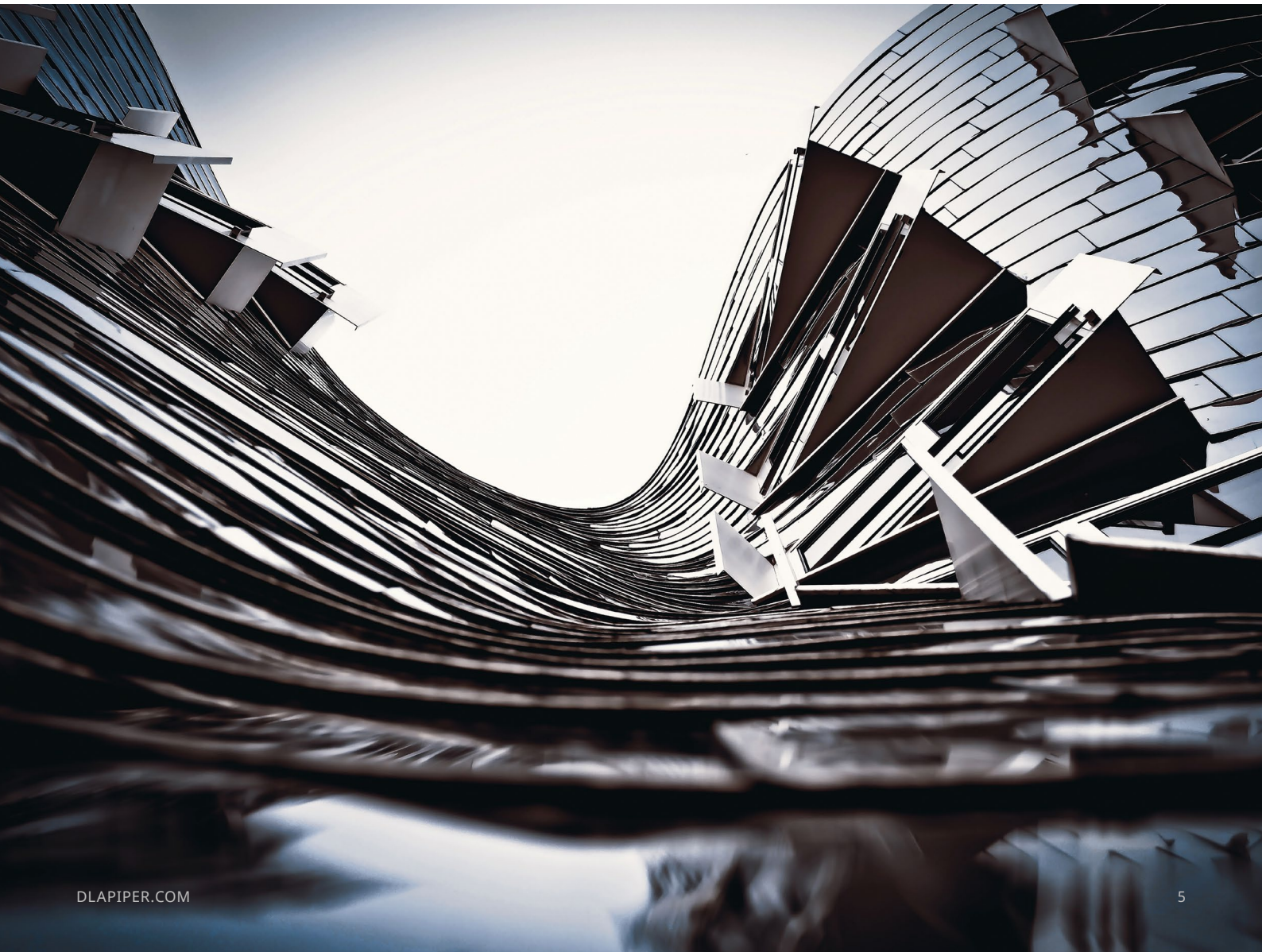
1. Ownership of real estate

1.1 Freehold ownership

Freehold ownership (which is sometimes referred to as having a freehold interest) is outright ownership which lasts in perpetuity (i.e. forever). A freehold interest cannot be challenged by third parties (including the state) save in exceptional circumstances, the most common of which is pursuant to compulsory purchase powers (the right of a local authority, subject to paying compensation, to acquire land required to implement local planning policies). While this is virtually always the preferred option, it is not often available in central London as generally the freehold interests are owned by the Crown Estate, the City Corporation (the governing body for the financial district in central London) and the landed estates (for example, Grosvenor, Cadogan etc.). It is often just as acceptable to buy a long leasehold interest in England and Wales as it is a freehold interest, provided the terms of the lease are appropriate.

In Scotland, heritable ownership is the most complete and comprehensive right over real property and is the equivalent of a freehold right in England and Wales. A heritable proprietor will benefit from the right to use or dispose of the land as its own, albeit in practice such use may be limited by public law rules such as planning or building control law or public access rights. Ownership of land in Scotland follows the principle of *coelo usque ad centrum* – “from the heavens to the centre of the earth.” However, in practice the ownership of minerals situated underneath land will often be held as a separate tenement or interest from that of the surface of the land, particularly in former coal mining areas, and such interests will need to be taken into account when acquiring title to the surface particularly with a view to redevelopment.

Unlike in England and Wales, it is not possible in Scotland to split the legal and beneficial ownership of land although heritable title may be vested in a number of persons as co-owners (including companies, individuals or other legal entities) via a trust arrangement.



1.2 Leasehold ownership

Leasehold ownership (or holding a leasehold interest) lasts only for a fixed period, although this can range from a few months to hundreds of years. Leasehold ownership is generally considered to be split between long leasehold interests and shorter term occupational interests. Leasehold interests have a reversionary owner which is the person to whom the property will be returned once the lease expires. While the leasehold interest subsists, the relationship between the leasehold owner and the reversionary owner will be governed by the terms of the lease agreement. The obligations on the leasehold owner under the lease agreement may range from very basic to quite significant and may include an obligation to pay the reversionary owner a rent.

Long leasehold investment properties are generally held for between 125 and 999 years (although they may be granted for up to 2,000 years). Commonly little, if any, rent is payable by the long leasehold owner, although some properties will be subject to more significant geared rent provisions (where the rent is a factor of the underlying lettable value). Shorter term occupational interests are generally held for between five and twenty years and are subject to payment of a full market rent to the reversionary owner, often reviewed on an upwards only basis every five years to the then market rent. Where a leasehold interest subject to a material rent payment obligation is being acquired, the reversionary owner may be able to require security for satisfaction of the rent payment (which is often satisfied by way of a cash deposit, bank guarantee or, where structure allows, a parent company guarantee).

In Scotland, property can also be held by a legal entity as a tenant under the terms of a lease. On the face of it, this would only serve to grant the tenant a personal right, based on the continuing contract between landlord and tenant. However, it has long been the case that tenants can acquire a real right under a lease. A real right means that the tenant's leasehold interest will be more than merely contractual and so will be binding on third parties, including protection if the landlord sells or otherwise transfers its interest in the property. This means that the legal relationship is between the individual and the property. It is a right which can be enforced against the world at large, that is against anyone who challenges the tenant's proprietary interest. Where a tenant is granted a lease for a term of more than 20 years, this will be registrable at Registers of Scotland in its own right and that registration is necessary to create the real right.

In order for the tenant to acquire a real right via the grant of a lease in Scotland, certain other requirements must also be fulfilled:

- The lease must be in writing.
- The subjects of the lease must be heritage. The heritage involved must be identifiable.
- There must be a specific continuing rent. The amount of the rent must not be elusory though the rent can be in kind.

- The lease must have a definite termination date/period of let. Where the other requirements for a valid lease are fulfilled but no period of let has been stated in the agreement between the parties, the court will construe the lease as being a lease for one year, or for any longer period indicated by the lease terms.
- The landlord must have recorded or registered their title to the land which is the subject of the lease.
- The tenant must have entered into possession of the subjects. Occupying under the equivalent of a license will not count as possession for these purposes.

Leases entered into after 9 June 2000 in Scotland must be for less than 175 years. The rationale is to prevent the use of very long leases effectively to re-create the relationship of superior and vassals which was the former system of land ownership in Scotland and has now been abolished.

1.3 Other interests in land

Commonhold ownership (introduced by statute in England and Wales and not applicable in Scotland) is a hybrid between freehold and leasehold. It is very rare and not relevant to the investment market.

An owner can also give non-exclusive rights, known as easements, to third parties to use the land, such as granting a right of way. If correctly registered, easements are binding on any future owners of the property.

Servitudes are the Scottish equivalent of easements. Generally, from 28 November 2004, a servitude constituted in a deed must be registered to be binding on future owners. Servitudes can also be constituted informally, by use for 20 years.

1.4 Restrictions on ownership by foreigners

Both freehold and leasehold interests may be owned by individuals or by companies (whether local or international) and the use of single asset offshore and onshore SPV property holding companies is common. There are some legal restrictions that may apply to the acquisition of real estate by foreign investors.

First, the National Security and Investment Act 2021 gives the UK government the ability to intervene in transactions, including land transactions, which may give rise to national security concerns. It introduced a mandatory notification regime (which applies largely to the acquisition of shares/ votes in an entity) and a voluntary regime (which applies to the acquisition of assets, including land). If there is a reasonable suspicion that a transaction may raise a national security risk, the Secretary of State may call-in the transaction for further scrutiny and could decide to allow the transaction to proceed, allow it to proceed subject to conditions or block/unwind an acquisition. The parties may make a voluntary notification about an acquisition if they want to be certain that it will not be called-in.

Secondly, the Economic Crime (Transparency and Enforcement) Act 2022 created a public register (the Register of Overseas Entities) to record the beneficial ownership of overseas entities which own certain interests in UK land. Any overseas entity which owns or purchases certain interests in UK property is required to enter details of its beneficial ownership on the register. The overseas entity is issued with an official registration number once the registration is completed by Companies House and it must update the register annually in order to maintain its registered status. As well as criminal penalties for non-compliance, overseas entities which are not validly registered at Companies House are not able to acquire a freehold or leasehold interest of more than seven years (or 20 years in Scotland), and are not able to sell, grant a lease of more than seven years (or 20 years in Scotland) or grant a legal charge over UK land. Whilst such transactions made by an overseas entity in breach of the rules are not void, they are not capable of registration at the Land Registry which is undesirable for both parties (as registration is a necessary requirement in order to obtain full legal title to property in the UK).

In Scotland, from 1 April 2022 there has also been a requirement to register details of persons with influence or control over specified categories of landowners or tenants (under registered leases of over 20 years) in a separate register known as the Register of Persons Holding a Controlled Interest in Land ("RCI"). The RCI is publicly available and operated by Registers of Scotland. Subject to specified criteria being met (and subject to various exceptions set out in the underlying regulations), the duty to register in RCI applies to overseas entities (regardless of whether they have registered in the Register of Overseas Entities) as well as other types of entity including trusts and some partnerships. Individuals are also within scope. Certain types of entity including UK companies, limited liability partnerships, and charitable incorporated associations are exempt from the requirement to register in RCI. After a transitional period (ending on 1 April 2024), non-compliance with the duty to register in RCI became an offence punishable by a fine of up to GBP5000, although it does not prevent registration of title in the Land Register.

2. Acquisition of ownership

2.1 Formal requirements

The sale and purchase of land in England and Wales is usually a two-stage process with the parties first exchanging contracts for the transaction and then, a set time later, entering into a deed transferring legal title. It is possible for a contract to be dispensed with and for the parties to proceed straight to transfer; however, this is unusual.

In order to be valid, a contract for the sale of property must satisfy the statutory requirements contained in the Law of Property (Miscellaneous Provisions) Act 1989 which states that a contract “for the sale or other disposition of an interest in land” must:

- be in writing;
- incorporate all the terms that the parties have expressly agreed in one document or, where contracts are to be exchanged, in each document; and
- be signed by or on behalf of each party.

There are a number of standard form contracts that are regularly used for real estate transactions; however, the more complex the deal the more bespoke the contract.

The transfer deed will be in a land registry prescribed form and must be executed as a deed.

In Scotland, a contract to give effect to this will normally take the form of missives or formal letters between the lawyers acting for the buyer and the seller. These formal letters constitute a formal offer to buy or sell the property (as appropriate) on the client’s behalf. The recipient of the offer will then issue either a formal acceptance of its terms or a qualified acceptance and once the parties have reached agreement the formal letters issued between the parties will constitute the missives and become legally binding on the parties (the equivalent of exchange of contracts in England and Wales).

Following conclusion of the missives, the parties will enter into a formal deed which will be effective to transfer title to the property and the most common forms of deed are set out below. The document will need to be in writing and should take the form of a self-proving deed, which will require the signature of the grantor to be witnessed subject to the exception for companies referred to below.

Each party must have formal legal capacity to enter into a conveyance and the grantor of the conveyance must have title to the land being transferred.

The two main forms a conveyance could take in Scotland are:

- Disposition. This is the equivalent of a transfer (TR1 or other appropriate Land Registry document in England and Wales) sometimes referred to as a special disposition as it conveys a particular piece of the seller’s property, as opposed to a will, for example, which operates as a general disposition of all of a person’s property.
- Contract of *excambion*. This will be used where two parties wish to exchange respective interests in real property where title is vested in each of them. The contract of excambion takes the form of a document signed by both parties which has the effect of a reciprocal transfer in the respective interests in land so that only one document is needed rather than two separate dispositions.

The contract must contain all the relevant terms of sale which the parties have agreed. Beyond this, there are no formal requirements regarding the structure of the contract.

Legislation in recent years has simplified the law in relation to signing and witnessing of documents in Scotland. To this extent, documents relating to property to be signed by a company and registered in the Land Register or recorded in the Register of Sasines, may be signed in two ways:

- by two directors or a director and a secretary or two authorised signatories, no witness being necessary; or
- by a director or the secretary or an authorised signatory and, in each case, by one witness.

Annexations, plans and the final page of each schedule must be signed, but not witnessed and any amendments to a document made before signing need to be documented in a testing clause or attestation.

A further requirement for registration in the Land Register in Scotland, besides being adequately subscribed, is that a document needs to be self-proving (or probative) so that the grantor’s subscription and the content of the deed requires no further corroborative evidence to establish its terms and the formality of execution, i.e. it is probative. A probative document will therefore bear the following elements:

- it is subscribed by the grantor and a witness (where appropriate);
- it states the name and address of the witness in the document or in the testing clause;
- there is no evidence or indication to the contrary in relation to either of the above matters.

2.2 Registration

A land registration system has been in existence in England and Wales for many years, and in 1990 it became compulsory for the transfer of land to be registered with the Land Registry. This now means that until a transfer of land is registered it does not operate at law and the buyer's title is merely equitable. The buyer is responsible for registration, although in practice this is done by the buyer's solicitor.

Once land is registered the title to that land is held electronically by the Land Registry and paper documents are no longer required.

The aim is for as much of the land in England and Wales to be registered as is possible and legislation was introduced in 2002 to accelerate this process. That being said, registration of title is only compulsorily triggered by a dealing such as a sale or the creation of a charge and therefore vast quantities of land in England and Wales remain unregistered.

In the case of unregistered land, a seller will need to provide documentary evidence of title.

Until 1979 all land transfers in Scotland were registered in a public deeds register called the General Register of Sasines. In the years following, a system of compulsory first registration at the Land Register of Scotland came into force throughout all areas of Scotland so that now it is an essential requirement that all dispositions are registered in the Land Register of Scotland to ensure the buyer perfects its title and establishes a real right. In an effort to have property moved from the older General Register of Sasines to the newer Land Register, the General Register of Sasines was closed to registering Standard Securities (see below) from 1 April 2016. This means properties over which security is granted following this date must also undergo registration in the Land Register. Recently introduced land registration legislation extends and clarifies the circumstances where first registration of title to property which formerly appeared only in the General Register of Sasines will be required and introduces a self-certification system as to investigation of title when applying to register title thus making it ever more important to involve legal advisors as early as possible. Following registration of title, and where it is satisfied that good evidence of title has been certified, the Keeper of the Registers of Scotland grants warranty to the buyer that at the date of registration the title sheet to which the application relates is accurate in so far as it shows an acquisition in favour of the buyer. Where it is not fully satisfied, the Keeper may exclude or limit warranty in relation to any such matters.

Members of the public can access all information relating to real estate recorded in the Land Register of Scotland, including the identity of the current owner, the price paid for the property and any obligations affecting the property.

In Scotland, other contracts granting an interest in property or any contractual right in connection with it will often be submitted to the Books of Council and Session, that is the court books of the Court of Session (Scotland's highest court). The original document will usually contain a consent by the parties for registration for preservation and execution. Registration for preservation means that the contract will be held in perpetuity with the principal document being held and an official extract or extracts being returned for the use of the parties. Further extracts can be obtained should the need arise. Execution is optional and is to allow for summary diligence by the creditor in respect of any financial obligation contained within the deed without the need for any preliminary court hearing.

2.3 Asset deals

On an asset purchase the buyer is able to pick and choose which land assets it acquires and the legal formalities detailed above must be observed for each one of those assets. The conveyancing process for such transactions will involve:

DUE DILIGENCE

It is highly advisable for the buyer to carry out due diligence on all aspects of the property prior to exchanging contracts as from that stage the parties are obligated to complete. Such due diligence will cover:

- all legal aspects including title to the property and rights and easements affecting it. As part of this the buyer will undertake various searches with local and statutory bodies to gather information about the property. This work will be undertaken by the buyer's solicitor;
- the title investigation will also include a review of the planning status of the property to ensure that all necessary permissions are in place;
- depending on the nature of the property, a physical inspection may be undertaken to ascertain the state and condition of any buildings and to investigate the environmental condition and whether the land is contaminated with hazardous substances which need to be remediated; and
- it has been a requirement in the UK for some time for a seller to provide an Energy Performance Certificate showing the energy performance of the property before marketing or entering in to discussions to sell or let a property. It is unlawful in England and Wales to grant a new lease of a commercial property, or to continue letting out a commercial property, where the property has an Energy Performance Rating which is worse than E, unless certain statutory exemptions or exclusions apply. The government has announced that the E rating may be replaced by a B rating, meaning that it will be unlawful to rent out commercial premises where they have a rating which is worse than a B but if and when this change will take effect is not yet known.

THE SALE CONTRACT

As set out above it is usual for the parties to enter into a sale contract and that contract must satisfy a number of standard requirements. The sale contract may however contain a number of bespoke provisions that are relevant to the property and transaction and it is important to make sure that such matters are properly dealt with. This may include:

- if the property is leasehold, provisions covering landlord's consent to assignment and what happens where consent is not obtained;
- if the property is let and is being purchased as an investment, the apportionment of rent and other outgoings as well as provisions detailing how the property is to be managed between exchange and completion;
- the assignment of third-party contracts;
- the tax treatment, e.g. if the sale is a transfer of a going concern and therefore VAT is not chargeable; and
- if the transaction is subject to conditions precedent, the sale contract will contain full details of those conditions.

EXCHANGE OF CONTRACTS

Contracts will be exchanged between the lawyers for the buyer and the seller and, unless the contract specifies otherwise, risk passes to the buyer on exchange. This means that the buyer is obligated to complete the purchase even if the property is damaged by an insured risk and, as such, they should take out insurance for the property with effect from exchange.

POST-EXCHANGE AND COMPLETION

After exchange and prior to completion a buyer will:

- in the case of registered land, carry out a search at the Land Registry to ensure that no changes have been made to the title and to secure a priority period during which no further changes can be made. If any matter is shown up on a priority search it must be investigated and if it is adverse to the buyer, appropriate steps taken to have it removed; and
- in the case of unregistered land, the buyer will carry out what is known as a Land Charges Act Search. In the case of unregistered land, rights are protected by reference to the owner and so a search will be made against each owner referred to in the title documents for the period of their ownership.

At completion a transfer deed will be entered into and legal title in the property will pass (subject to registration). Any stamp duty land tax that is due must then be paid and the transaction registered at the Land Registry.

In Scotland, depending on whether the property has been registered in the Land Register or remains recorded in the General Register of Sasines, searches will be carried out in the relevant register to check that nothing adverse has been registered against the seller's title. Further searches include searches in the Register of Inhibitions and Adjudications carried out to ensure that no adverse encumbrance affecting the seller's ability to deal with the property has been registered. Where the seller is a company there will be searches in the Register of Companies. In Scotland, searches are normally instructed by the seller's solicitors, although the buyer's solicitor will have approved the search instructions. Some buyers also carry out their own searches.

In Scotland, enquiries will usually be made with the relevant local authorities and other statutory bodies to check whether the property is affected by any adverse notices or proposals. The local authorities do not warrant the information they provide. Private firms of searchers operate, principally in central Scotland.

In Scotland, in addition to the requirement to pay Land and Buildings Transaction Tax (as to which please see below) a fee is payable to the Land Register of Scotland for registering the disposition in favour of the buyer. The fee payable is calculated on a sliding scale depending on the price paid. The Scottish system does not use notaries and all legal work is carried out by solicitors. Rates for this vary depending on the complexity of the transaction. Most real estate is sold through property agents, who will also charge commission for their services, normally conditional upon completion of the sale.

2.4 Share deals

Another way to acquire real estate is to purchase the legal entity which owns the property. This is often the case as part of a business acquisition but is also common when buying significant investment properties that are held in a special purpose vehicle or "corporate wrapper."

The buyer acquires the shares in the target company that owns the property and as such will also acquire all of its other assets, obligations and liabilities. In a share deal, all of the properties owned by the target remain with the target, but the ownership of the target changes. There is therefore no conveyancing aspect.

Under the laws of England and Wales, there is no legal requirement for an agreement relating to the acquisition of shares to be made in writing. However, where the target is a private company, it is common practice in all but the most basic transactions for the buyer and seller to document their agreement in writing – a share purchase agreement.

DUE DILIGENCE

Because of the greater risk assumed by a buyer of shares, the scope of due diligence required on a share purchase will generally be greater than an asset purchase. The due diligence will include the matters set out above for an asset purchase but, as well as looking at the property, the buyer will also need to undertake diligence in relation to the target company.

SHARE PURCHASE AGREEMENT

The share purchase agreement is the principal contractual document. It documents the agreement between the parties to sell and purchase the entire issued share capital of the target company at a specified price, and sets out the other terms governing the acquisition. The share purchase agreement is traditionally drafted by the buyer, except on an auction sale.

The share purchase agreement will also usually contain a suite of warranties. These are contractual promises made by the seller which the buyer can rely on and (subject to a maximum and minimum threshold) sue against if they turn out not to be accurate. The level of warranty cover achieved will be dependent on the nature of the transaction and the level of due diligence information available, and the quality of the cover secured will in turn have a direct impact on the amount of diligence work that is done.

In addition to the share purchase agreement, there are a number of ancillary documents that typically accompany the share purchase agreement, namely the disclosure letter and the tax covenant (also known as the tax deed).

Other agreements which often precede or accompany a share purchase agreement include:

- Exclusivity agreement (or lock-out agreement). This agreement prevents the seller from actively seeking or negotiating with other prospective buyers for a specified period, thereby giving the buyer a period of exclusivity in which to negotiate the share purchase agreement.
- Confidentiality agreement. This imposes a duty of confidentiality on the buyer in respect of confidential information concerning the target company and its subsidiaries pending the formal conclusion of a share purchase agreement.
- Contribution agreement. This is a seller document used in a transaction involving multiple sellers. Its main purpose is to apportion liability between the sellers as regards their contractual liability under the share purchase agreement.
- Formal transfer documents. A stock transfer form is required to transfer the legal title to shares to a buyer.
- Other transfer agreements. There may be other transfer agreements (for example, a lease assignment or patent assignment) under which specific assets are transferred from the target company to the seller, or specific liabilities within the target company are assumed by the seller.

TIMING AND APPROVALS

A proposed share purchase may require various consents or approvals and this could affect the transaction timetable. The main types of approval that may be necessary include:

- board approval;
- shareholder approval; and
- approval of regulatory authorities or other third parties.

The nature and extent of approvals required will obviously have an important bearing on the timing of the transaction, as will the level of due diligence required.

COMPLETION AND POST-COMPLETION

Following completion of a share purchase, the buyer will become the new owner of the target company and there will usually be various post-completion matters to attend to, including:

- a possible announcement of the transaction;
- making certain filings with Companies House (for example, to notify any changes in the directors of the target company and its subsidiaries);
- paying any stamp duty due on the transfer of the acquired shares; and
- certain administrative matters, such as insurance, payroll, PAYE, VAT and pensions.

As the buyer is acquiring the shares in the target, there should be no SDLT liability or registration requirements in respect of the properties.

On completion, the seller will send the title deeds and documents to the buyer and also signed certificates of title if these are being provided by the seller.

2.5 Public auctions

Properties are sold at auction for a number of reasons:

- for a quick sale;
- the property may have been repossessed;
- the property may need significant redevelopment or refurbishment; or
- the property may have proved difficult to sell on the open market.

Unlike a standard transaction, the auction contract is binding as soon as the price is agreed and the hammer falls. The buyer must pay 10% of the agreed sale price immediately, with the balance due on completion. If the property being sold is leasehold, it is usual that completion will be delayed until consent to the assignment has been obtained.

The seller's legal advisors must prepare a legal pack for the lot and deal with any statutory notices (e.g. termination of tenancies). The legal pack must be prepared prior to the auction so that buyers and their legal advisors can download the information and make an informed decision on whether to bid for the property.

Unlike a standard contract for sale of an interest in land, the contract is binding even if it is made orally. In practice, the successful buyer will be asked to sign a memorandum of sale setting out the terms of the sale.

Once a property has been sold at the auction, completion is usually 20-25 days later.

In addition to the purchase price, it is usual for the seller to request that the buyer reimburses the seller for the cost of searches added to the legal pack, notice fees and other expenses. These sums and any apportionments must be paid on completion.

In Scotland, heritable property can be sold by public roup or auction. In such a case, articles of roup are prepared by the seller and they set out the procedure which will be adopted at the auction and also the terms and conditions under which the seller is prepared to sell. The articles are in effect an offer to sell. Each property (or lot) will be provided with a reserve price and where this is not obtained during the bidding process, the lot may be withdrawn from the auction process.

At the auction, the subjects are sold to the highest bidder and the articles are then endorsed by the successful buyer and the seller's agent. This written endorsement constitutes a minute of sale or enactment and is in effect the acceptance of the offer contained in the articles of roup. It is normal practice for articles of roup to state that the buyer will accept the title as it stands and details of title to the property should have been made available prior to the auction for examination.

Auctions have become common in Scotland, especially where large companies or former utilities with surplus land wish to sell diverse pieces of land in lots. Certain property agents also collect disparate pieces of land and buildings from various sellers and put them together in a catalogue for one auction. A public auction is also used by banks or other heritable creditors to effect the sale of their interest following a calling up or insolvency event where they have been unable to agree a sale privately.



3. Other rights to property

3.1 Mortgages and charges

The most common forms of security over real estate are:

- legal mortgage; and
- floating charge.

A legal mortgage is a fixed charge against specified property. It entitles the mortgagee to take possession of the property and dispose of it where the mortgagor is in breach of the terms of the mortgage.

Lenders and other parties may take a legal mortgage to use property as security for future obligations e.g. to make further payments.

A corporate borrower only can also create a floating charge. This is a charge over all of the trading assets, including property and rental income, of a borrower. Floating charges cover a general class of assets and are not property specific. They would not typically be used where the borrower has other properties or it borrows from other lenders with their own existing security.

Floating charges may be found in transactions where a portfolio is owned by a single entity or where the borrower is a special purpose vehicle, in which case lenders would take a floating charge and a legal mortgage.

A standard security is the only manner in which a fixed security may be granted over real estate in Scotland. This can be used for commercial or residential property where an owner is required to grant security to a lender over its interest in property as security for a loan (commonly referred to as a mortgage in the residential sphere). A standard security must be in writing and registered in either the Land Register or Sasine Register in order to become a real right.

Since 1 April 2016 it has not been possible to register a new standard security in the Sasine Register, meaning that any property over which a standard security is to be created must first be registered in the Land Register. The usual object of a standard security will be the interest of the proprietor whether that is its heritable interest or a leasehold interest for a period of more than 20 years. Furthermore, where a standard security is granted by a company or a limited liability partnership it will require to be registered at Companies House within 21 days. Otherwise it will be void against a liquidator, receiver or administrator of that entity.

A valid standard security allows the creditor to call up or sell the property in the event of a default by the grantor and there is a detailed statutory procedure for giving effect to this. The creditor will obtain priority as a fixed chargeholder in preference to other unsecured creditors where the standard security has been validly granted and compliance

has been obtained with all registration requirements. It is also competent to grant a standard security in connection with the performance of certain contractual obligations and this is known as a standard security *ad factum praestandum*.

3.2 Easements

An easement is a right benefiting a piece of land (dominant land) that is enjoyed over another piece of land owned by someone else (servient land). Easements may be permanent or granted for a specified period of time.

Usually, an easement allows the owner of the dominant land to do something or exercise specified rights over the servient land, such as rights of access or a right to use service media.

An easement must contain four fundamental characteristics:

- there must be dominant land and servient land;
- the right must accommodate the dominant land – the easement must benefit the land, rather than any individual;
- the dominant and servient land must be owned by different persons – an easement cannot be created by the same party owning both pieces of land; and
- the right must be capable of forming the subject matter of a grant – the easement must be properly described in terms of its extent and duration.

Real burdens are conditions or obligations imposed upon land in Scotland which are effective to create real rights binding successors in title to the property due to their registration in either the Register of Sasines or the Land Register. There are no fixed forms of real burdens. They can impose a negative obligation (e.g. not use the burdened property for a given purpose). In addition, a real burden can impose positive obligations (e.g. to maintain and upkeep land to a certain standard) and also obligations ancillary to either the negative or positive imposition. All real burdens created must comply with the relevant statutory requirements governing their creation in order to be valid and binding on the land in perpetuity. The land burdened by the obligation is known as the burdened property, and the land which enjoys the benefit of the obligation is known as the benefited property. One of the requirements is registration at the Land Register of Scotland or General Register of Sasines against title to both the burdened and benefited property. It is common for real burdens to be imposed in order to govern the management of communal developments (both residential and commercial) and this is usually achieved by the imposition of a deed of conditions which contains the necessary real burdens and so binds each tenement within that development as a burdened and benefited property.

A servitude (the Scottish equivalent of an easement) imposes an obligation or burden on the owner of one piece of land (the servient tenement) for the benefit of the owner of another piece of land (the dominant tenement). Servitudes run with the land, and in general only require inactivity on the part of the proprietor of the servient tenement, unlike real burdens which can impose positive obligations on the person who is bound by them. Common examples of servitudes include rights to vehicular parking and rights of way for access.

3.3 Pre-emption rights

A right of pre-emption is a temporary right. It gives a potential buyer a right to buy land before the landowner can sell the land to anyone else during a specified pre-emption period.

It is a right of first refusal for the buyer which arises when the landowner decides to sell the land, and not before. The buyer cannot force the landowner to sell the land. If the landowner decides not to sell, the pre-emption right never becomes exercisable.

A right of pre-emption does not require the parties to enter into a transaction but it ties up the land for a period of years. It is important that the price or pricing mechanism and the length of the pre-emption period are carefully considered in negotiations.

Pre-emption rights are not generally imposed by statute but an exception applies in relation to certain residential apartment buildings. Failure to offer the freehold to the apartment owners is a criminal offence. The procedures are complex and specific advice should be obtained.

In Scotland, the owner of an interest in real estate is free to grant pre-emption rights to any third party. These are not imposed by statute. When a heritable proprietor comes to dispose of its interest in the property, it would be required to offer the party with the benefit of the pre-emption the right of first refusal in relation to the property ahead of any disposal to a third party.

The right of pre-emption will usually be constituted as a real burden on the sale of land as opposed to a merely contractual right and the formalities for that would require to be observed.

3.4 Options

Options are temporary rights. The most common form of option is a call option which allows a potential buyer to call for the landowner to sell the land. A call option is like a pre-emption right but the fundamental difference is that a call option places control in the hands of the buyer as the landowner must sell the land if the option is exercised.

A typical call option agreement operates as follows:

- The buyer pays an option fee to the landowner in exchange for the landowner agreeing to allow the buyer to buy the land at any time during an agreed option period. The option may be conditional on certain trigger events happening e.g. the grant of planning permission.
- The price payable may be fixed in the option agreement but would more normally be calculated at the time of exercise by way of a detailed pricing mechanism.
- If the buyer decides to buy the land, it exercises its call option by serving notice on the landowner during the option period. A deposit is paid and service of the notice creates a contract for sale and purchase of the land.
- If an option notice is not served within the option period, the option lapses and is void. Some options contain an ability for the buyer to extend the option period in exchange for an additional option fee.

By contrast, a put option enables a landowner to give notice requiring a buyer to buy land, and put and call options allow either party to require the other to transact. These are rarely encountered.

It is common in Scotland for parties to enter into an option agreement, giving the prospective buyer an exclusive option to buy the property in question at some future date. For example, a party might want to obtain detailed planning permission for a proposed development of the property before it decides to proceed to a binding purchase contract and can then enforce its option to purchase (known commonly as a call option). By the same token, the parties can enter into an arrangement whereby the seller has an option to require the buyer to acquire the property at some future date (a put option). The option agreement will contain details of the terms and conditions on which the purchase will proceed where the option is exercised by the relevant party but will not constitute a binding contract for the purchase of that real estate interest.

The option will ordinarily only be enforceable for a certain period of time, after which one or other of the parties will be entitled to bring the contract to an end. Obviously the owner of the land does not want to be tied into a contract for an unlimited period of time where there is no possibility of the sale ever taking place. The period of time for which the option is in place will depend upon the circumstances of the transaction, it could be months, or even years. In many instances the potential buyer will pay a fee for the option, which will be retained by the seller even if the option is never exercised.

It is also competent in Scotland for a landlord to grant an option to a potential tenant for the grant of a lease and in these circumstances the option holder's rights may also be protected the landowner granting a standard security over its interest in favour of the option holder. As a result, the option can be made binding on any successor in title to the original grantor of the option which result from a disposal during the option period as the option agreement will contain a requirement for the buyer to be bound by the terms of the option agreement and failure to comply can then result in the option holder enforcing its rights under the standard security.

3.5 Overage

Overage relates to outgoing sellers becoming entitled to further payments from buyers on the occurrence of certain future events during a specified overage period. Overage periods are temporary in nature.

The inclusion of overage is likely a result of there being an expectation that there will be a change in the characteristics of the land e.g. it will be redeveloped or a planning permission will be granted.

Such a change actually occurring will be a trigger event.

The seller sells at a lower price on completion but retains some of the future potential uplift in value. This can have cashflow benefits to the buyer and is a tool used by developers when acquiring sites.

An overage obligation requires the buyer to make a further payment to the seller after the occurrence of the agreed trigger event(s) within the overage period.

The amount payable will typically be a percentage of the uplift in value of the land but discounted by the buyer's costs incurred to achieve the trigger. The overage agreement will usually contain a detailed pricing mechanism.

Most sellers will take security to protect their overage payments by way of both a legal mortgage over the land and a restriction in the registered title to the land.



4. Land use control

In the UK, land use planning is a major consideration in the process of development and commercial occupation. Planning control is a devolved matter such that different planning laws and policies apply in each jurisdiction but they are very broadly similar. Planning is often highly political and is therefore subject to frequent policy and legislative changes as different governments seek to use the system to deliver their particular goals. Planning control is often a barrier to entry but provides opportunities to create real value where unlocked.

The emphasis is on decision-making at a local government level so long as local authorities are performing properly in accordance with national planning policy. Each local planning authority area is required to adopt and keep up to date a statutory local development plan that sets the planning policy for the locality (broadly in line with the overarching national framework) and directs the location and extent of land use and building and engineering operations that will be permitted. In England, neighbourhood forums and parish councils can also direct the use of land and development in their neighbourhood by adopting a neighbourhood plan, which then forms part of the statutory development plan.

There is a statutory requirement for planning applications to be determined in accordance with the development plan unless material considerations indicate otherwise. A right of appeal exists for an applicant who is aggrieved by a decision of the local planning authority. The body which determines the appeal depends on the jurisdiction. Planning permission may be subject to detailed conditions and also requirements for the provision of, or funding for, infrastructure. In 2010, a Community Infrastructure Levy was introduced in England and Wales, which allows local authorities to recover a development charge as a condition of the carrying out of consented development. The amount of the charge is set locally and is used for the provision of local infrastructure.

Other functions of local planning authorities include the promotion of social, economic and environmental well-being in an area which may include compulsory land assembly for regeneration, and the protection of amenity, historical and ecological features by means of enforcement.

Consent and land interests required for transport and infrastructure projects by the private commercial sector may be secured by an order which is promoted direct to the relevant minister of central government as a Transport and Works Act Order. There is a Transport and Works Order process in Scotland but use of this mechanism is infrequent.

Alternatively, since 2008, all consents and required land interests for all large-scale energy, transport, water, waste water and waste projects in England (and some in Wales) falling above identified thresholds (considered to be nationally significant) are promoted direct to the relevant minister as a Development Consent Order. National Policy Statements set out the need case and other policy considerations for particular types of infrastructure. In Wales since 2016 infrastructure developments which meet certain criteria and thresholds to be designated as Developments of National Significance will be subject to a specific consenting regime requiring determination by Welsh Ministers.

In Scotland, developments which are designated as of national significance are considered in accordance with the national planning framework for Scotland. However, unlike in England and Wales, the application process is not distinct from the consenting regime for all other types of development. National policy has a higher status in Scotland as the National Planning Framework forms part of the statutory development plan, along with the relevant local development plan, against which applications for planning permission are determined. Whilst Scotland has a right of appeal for applicants who are aggrieved by a planning decision, the appeal mechanisms are different from the rest of the UK. Appeals in relation to applications for local development which are delegated for determination by officers of the planning authority are made to a local review body of that planning authority. Appeals for other types of development (which are typically larger developments) are submitted to Scottish Ministers. Scotland does not have an equivalent to the Community Infrastructure Levy. Contributions to infrastructure funding are, however, commonly required as part of the planning process and secured through legal agreements with the planning authority.

Across all jurisdictions, a separate regime of building control requires separate consent to be secured from the local authority. The requirements for obtaining building control consent is set out in building regulations that apply nationally and whose function is to control the safe carrying out of development. Scotland has a separate building control regime but it functions in a similar way.

5. Environmental liability

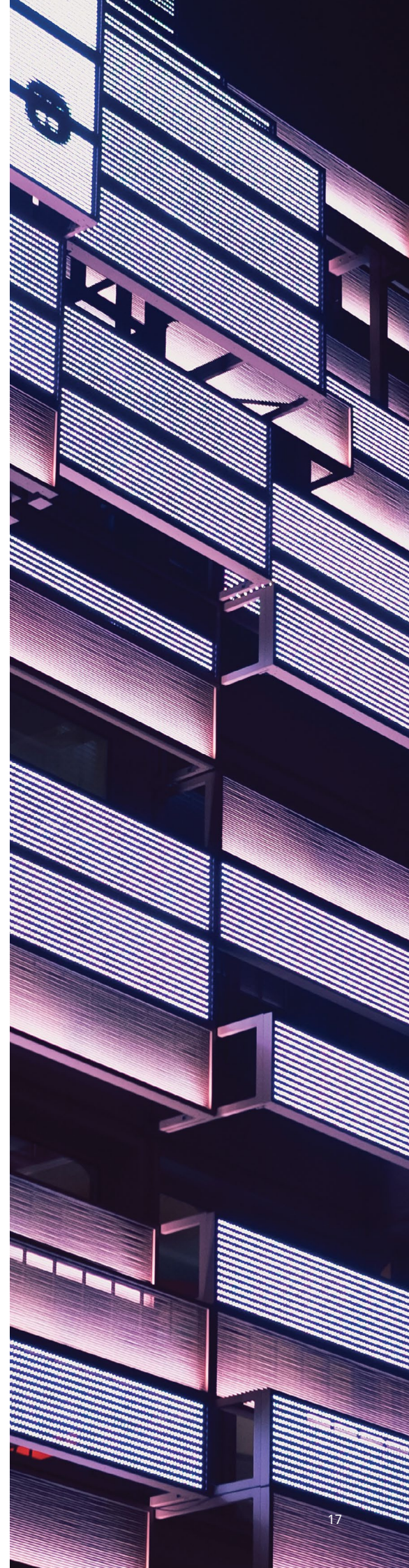
Under the UK contaminated land regime set out in Part IIA of the Environmental Protection Act 1990, regulators can take retrospective action against current and former owners and occupiers of land in respect of historic contamination. Not all land that is polluted will be contaminated for the purposes of the statutory regime and there is a test which must be satisfied in order for regulatory action to be taken. This test is based upon the harm, or the potential for harm to be caused, to the environment or human health by any contamination. If the regulators do determine that land reaches the relevant threshold such that land is contaminated then they are required to serve a remediation notice on all current and former owners or occupiers who caused the contamination which is the subject of that notice or have knowingly allowed it to remain at the property. In the absence of any such persons being found, the regulators can serve the notice on the current owner or occupier.

This potential for the UK authorities to take action in respect of historic contamination against a new owner or occupier, even if they did not actually cause the contamination, means that buyers and investors increasingly focus upon the potential environmental liabilities of a site when making a decision to proceed. Consequently, it is now common for buyers to undertake some form of pre-acquisition environmental assessment, ranging from a desk-top study of publicly available information through to intrusive investigations on the site to test the soil and identify the presence of any pollutants.

The UK authorities apply the contaminated land regime with reference to a detailed piece of statutory guidance. This effectively allows buyers and sellers of land to allocate liabilities between themselves such that if a regulator sought to serve a remediation notice on both parties the party who had not been allocated the liability (this is usually the seller) would, if the guidance was applied correctly, be eliminated from the regulator's group of potentially responsible parties. This can be achieved in a number of ways but the most common methods are for the seller to provide the buyer with detailed information, or the opportunity to obtain its own detailed information, about the condition of the site prior to the sale, the seller making a payment to the buyer which is sufficient at the time of the sale to cover the costs of specific identified remediation work or by the buyer and seller agreeing contractually that as between themselves the buyer will be responsible for any regulatory action brought against either of them in respect of contamination at a site post-completion. Allocation of risk in relation to civil claims is also sometimes sought.

We can advise you on the best ways of addressing any potential environmental liabilities on a site and in preparing any contractual provisions or agreements which are necessary to achieve this.

You should note that when investing in real estate in England and Wales the guidance referred to above is provided by the Department for Environment Food and Rural Affairs (DEFRA). In Scotland, this is provided by the Scottish government via the Scottish Environmental Protection Agency (SEPA). Besides this minor exception the legislative regime is identical.



6. Leases

As in most jurisdictions, there is a distinction between commercial and residential leases in the UK. Residential leases are more tightly regulated for obvious reasons but given the nature of the work we do in the UK, this summary focuses primarily on commercial leases.

6.1 Duration

In England and Wales there is no minimum or maximum term for a commercial lease. Very long leases (e.g. 999 years) are relatively common and normally granted for a one-off payment rather than at a market rent. For market rent leases, terms are usually much shorter, with five to ten years being the most common. The current market trend is towards shorter leases.

If the tenant is afforded security of tenure under the Landlord and Tenant Act 1954, this means that the lease will not automatically end following the expiry of its contractual term. The tenant will be entitled to a new tenancy unless the landlord has reasonable grounds for opposing it, in which case compensation may be payable to the tenant.

In Scotland, there is a differentiation between leases and ground leases, which are more akin to ownership of a property. Normally leases are used for commercial premises and generally more often than ground leases. There is no standard length, although it should be noted that in Scotland leasehold ownership is much rarer than in England and Wales. Current market trends are for leases of between five and fifteen years, although it is also common to find leases with shorter terms and/or with tenants' break options.

It has already been noted that where a lease is for a duration exceeding 20 years, it is eligible to be registered in the Land Register of Scotland, which confers a real right on the holder of the lease. Where the lease is for a shorter duration it requires only to be registered in the Books of Council and Session for the reasons already described.

In Scotland, with effect from June 2000, no lease can be granted for a period of more than 175 years (20 years for a residential lease).

In Scotland, from 28 November 2015, certain categories of long lease (in which the annual rent is less than GBP100) were converted automatically into tenants' ownership by virtue of the Long Leases (Scotland) Act 2012. Leases which qualify for conversion into tenants' ownership are leases that:

- were originally granted for over 175 years;
- in the case of residential leases, have over 100 years left to run from 28 November 2015; and
- in the case of non-residential leases, have over 175 years left to run from 28 November 2015.

In calculating the period for which a lease was granted, break options are disregarded, and landlords' obligations to renew are included. Mineral leases are specifically excluded from the provisions of the legislation. There is also scope for landlords to claim (limited) compensation for loss of ownership, and also for tenants to opt out of conversion to ownership.

Unlike in England and Wales, there is no statutory provision for continuation of the period of a commercial lease beyond that provided in the lease, except for a few limited statutory provisions, which provide limited security of tenure to tenants of retail premises. Under common law, if notice of termination is not given at the appropriate time by either the landlord or the tenant, the lease continues by the doctrine of tacit relocation for a further period of up to one year on generally the same terms, and so on from year to year until proper notice is given by either party.

For residential leases in Scotland, there was an important change in the law that took effect on 1 December 2017 with the entry into force of the Private Housing (Tenancies) (Scotland) Act 2016. This Act made many reforms in the area of residential leasing, but perhaps the most important was to put an end to fixed-term residential tenancies and to introduce new private residential tenancies. As a result, new leases granted are open-ended and the landlord can no longer require the tenant to quit the property on the basis that a fixed term has expired. Instead, it must cite certain prescribed circumstances to regain vacant possession. The tenant on the other hand can give the landlord 28 days' notice to quit the property at any point.

6.2 Rent

Rent is usually calculated on the basis of a figure per square foot and payable quarterly in advance. The traditional quarter days being 25 March, 24 June, 29 September and 25 December.

Value added tax (VAT) is often payable on commercial leases in addition to the rent but a landlord (or freehold owner) must generally exercise an option to tax in order to charge VAT. Most commercial properties are VAT opted and the majority of tenants are able to recover the VAT expended. However, if a building is let to a bank or insurance company (which cannot recover VAT), the landlord may decide not to exercise its option to tax. An option to tax has no effect on residential property, so VAT cannot be charged to residential tenants.

In Scotland the rent is usually payable on a monthly basis in the case of residential leases and quarterly in the case of commercial leases without deduction or set off. The traditional quarter days in Scotland were 2 February, 15 May, 1 August and 11 November. These were changed to the 28th day of each of those months by the Term and Quarter Days (Scotland) Act 1990. The rent is usually calculated on the basis of a figure per m² of the leased subjects. The tenant may be charged VAT on the rent, depending on whether the landlord has opted to tax. Again, an option to tax has no effect on residential property.

6.3 Rent review

Rent is most commonly reviewed on every fifth anniversary of the lease based on the open market rent, which is calculated based on a hypothetical lease on primarily the same terms. The rent is then almost always the higher of the open market rent and the rent before the review (i.e. upwards only). This is market practice and ensures that the landlord's investment and income is protected.

When considering the hypothetical lease, there are often a number of assumptions and disregards.

Common assumptions include:

- if the property has been damaged, it has been reinstated;
- the obligations in the lease have been complied with (although some concessions may be made in negotiating this assumption); and
- the property is fit and available for immediate occupation by a willing tenant for the purpose of carrying out its fitting out works.

Common disregards include:

- any goodwill attributable to the tenant's or another lawful occupier's business;
- the occupation of the property by a lawful occupier; and
- any improvement to the property by a lawful occupier with the landlord's consent and at no cost to the landlord.

Other types of rent review such as

- index linked rent review (often linked to the Retail Prices Index) or
- turnover rent review (where a proportion of the rent is reviewed based on the turnover of the tenant)

are also found in some leases but are considerably less common.

6.4 Operating expenses

In a commercial lease the tenant is usually expected to pay all expenses including utilities, rates and outgoings relating to the property.

Where part of a building (or estate) is let, a tenant is also expected to pay its share (often a fair proportion based upon a square footage calculation) of the service charge incurred by the landlord in maintaining the common parts and providing any services to the tenant(s). This is usually payable quarterly in advance based upon an estimated service charge, which will be reconciled following the end of the service charge year. Service charge caps (often index linked) are commonly seen, particularly in the retail sector, but landlords will wish to avoid any such caps where possible.

It is the norm for landlords to insure commercial property in order to ensure both that insurance is in place and to take advantage of economies of scale. A fair proportion of the cost of the insurance will be recoverable from the tenant under a standard commercial lease. Unlike rent and service charge, insurance rent is usually payable annually in advance.

6.5 Maintenance, repair and renovation at end of lease

Where a tenant is demised the whole of a property they are usually responsible for maintaining the property and keeping it in good and substantial repair and condition. Considerable negotiation is often undertaken on the lease over repairing responsibilities as this can understandably cost the tenant a considerable amount of money during the term. Where a tenant is demised part of a property the landlord normally (via a covenant to do so) maintains responsibility for structural parts with recovery of the costs expended being made via the service charge payable by the tenant.

The repairing obligations in the lease can be limited by reference to a schedule of condition (i.e. a set of photographs/narrative) detailing the condition of the property at the date of the lease. A tenant would usually only need to give the property back in no better condition than as detailed in the schedule of condition.

The majority of leases will require a tenant to decorate (internally every three to five years and externally every five years and also, in both cases, in the last year of the term) and to fully reinstate the property (i.e. remove any alterations or fixtures and fittings) at the end of the term.

It is common for there to be a dispute surrounding the condition the property should be given back in at the end of a lease, especially if a tenant has occupied the property for quite a while. A schedule of dilapidations is often prepared and negotiated heavily between each party's surveyors before a settlement sum or list of defects to remedy is agreed.

According to Scottish common law the landlord is obliged to keep the premises wind and watertight, although this can be excluded by contract under the terms of the lease. The lease will normally include a specific statement that the tenant has accepted that the premises (and the common areas) are in a good condition and state of repair and fit for their purposes in order to exclude this obligation.

In Scotland, the landlord is primarily liable for making repairs to the property, unless this obligation is specifically passed to the tenant. This is normally the case in commercial leases, in which case the tenant will then become responsible for the repair, maintenance and decoration of the premises, as well as any necessary rebuilding and restoration except where this is covered by insurance. In these circumstances, the landlord is normally responsible for using the proceeds of an insurance claim to make good any damage. Specific wording is required in a Scottish commercial lease to ensure that these obligations are passed onto the tenant in full and investors require to take care when undertaking due diligence from the landlord perspective.

Scots Law also draws a distinction between what are termed ordinary and extraordinary repairs. Recent case law has held that even where the tenant was required by the lease to carry out general or ordinary repairs, this did not extend to extraordinary repairs unless specifically provided for under the terms of the lease. When determining whether an item of repair is one that would fall within the usual category of those to be undertaken by a tenant and therefore be classed as ordinary the origin, extent and nature of the damage are the factors to be taken into account.

6.6 Assignments/transfers

Most commercial leases have detailed provisions regarding assignment. The landlord will want control over its direct tenant to ensure that the tenant is a strong covenant i.e. able and willing to pay the rent and other sums due both on time and in full and that they are able to comply with the other tenant covenants in the lease.

Despite this, commercial leases often permit assignments of the whole (rarely part) subject to landlord's consent (not to be unreasonably withheld or delayed) and subject to a number of conditions such as:

- an authorised guarantee agreement being provided by the outgoing tenant (effectively to guarantee the incoming tenant's covenants);
- the proposed assignee not being a group company of the tenant (to ensure the covenant strength is not weakened by a group reorganisation);

- the proposed assignee providing sufficient financial information and, possibly, being able to pass a financial test; and
- the proposed assignee providing sufficient security (for example, a guarantor or rent deposit).

A landlord may also wish to impose other conditions on assignment. However, conditions relating to assignments are governed by statute and there has been considerable case law regarding such issues.

In Scotland, if the lease does not specify otherwise, then the tenant can transfer its interest to a third party without the landlord's consent. However, in practice, almost all leases include restrictions on transfer.

In Scotland, assignments (or transfers) of part of a leased premises are usually prohibited and complete transfers are usually subject to the landlord's consent, although leases usually state that consent must not be unreasonably withheld. A commercial lease will usually permit the landlord to satisfy itself that the proposed tenant is of good standing and has the means to comply with the tenant's obligations in the lease. It is common for a landlord to call for the provision of a rent deposit or guarantee (corporate or individual) as further security for the performance of the proposed assignee's obligations.

Unlike in England and Wales, it has never been the case that a tenant will remain liable for performance of lease obligations to which it was subject following an assignment. This is unless the lease specifically imposes joint and several liability. In all other cases, the tenant will be released from all obligations under the lease.

6.7 Subleases

Leases often restrict the tenant's ability to underlet the property. The imposition of such restrictions enables the landlord to keep control over the identity of the undertenant. This is important because a head landlord may come into a direct relationship with an undertenant:

- if the headlease is surrendered;
- if the headlease is forfeited and the undertenant successfully applies for relief against forfeiture;
- in certain circumstances on a renewal of the undertenant's lease under the Landlord and Tenant Act 1954; or
- if the headlease is disclaimed in the event of the immediate tenant's insolvency.

Leases normally permit the tenant to underlet the whole of the property with the landlord's prior consent, which is not to be unreasonably withheld. It is less common (but not unusual) for leases to allow underlettings of part.

Under Scottish law, if the lease does not specify otherwise, then the tenant can sublet its interest to a third party without the landlord's consent. However, in practice, almost all leases include restrictions on subletting.

In Scotland, commercial leases may permit subletting of the whole of leased premises or part and it will be common to specify the permitted part and seek to restrict the number of parts which it is permitted to sublet at any one time. All subletting is usually stated to be subject to the landlord's consent, which must not be unreasonably withheld where the landlord can be satisfied as the status of the proposed subtenant as described above.

6.8 Termination

Provided the lease is not afforded security of tenure under the Landlord and Tenant Act 1954, the lease will end on the contractual expiry date stated in the lease.

It is not uncommon to see leases with break clauses allowing one or both of the parties to terminate the lease, before its expiry, on or after a specific date.

It is common for break clauses to provide that six months' written notice must be provided, all basic rent must be paid up to the termination date and that the property must be given back free of third-party occupation.

In Scotland, the landlord has no automatic right to terminate the lease except where the lease provides for a landlord's break right or the landlord exercises its right to irritate the lease (i.e. bring the lease to an end).

It is also common in Scotland for the tenant to negotiate an early break right in the lease. Additionally, the principle of *rei interitus*, namely that the lease will automatically terminate if the leased premises are destroyed, will be excluded from any well drafted lease. Failure to do so would ensure that the lease could not be used for security purposes.

It is also usual in Scotland for commercial leases to contain a detailed clause which sets out the basis on which the landlord can terminate the lease on the grounds of the tenant's non-compliance with its obligations, for example non-payment of rent, breach of non-monetary obligations, or as a result of the tenant's insolvency.

In Scotland, in the case of a breach of the terms of the lease, the landlord must serve a formal notice on the tenant requiring compliance with the obligations in question within a reasonable period (which in the case of non-payment of rent is normally 14 days). If the tenant fails to comply with this notice then the landlord will need to raise a court action to recover possession, which can take several months.

In Scotland, the operation of the doctrine of tacit relocation referred to above requires the landlord to serve a formal notice on the tenant to quit the premises on the expiry of the term. The requisite period and form of notice depends on the area of ground and period of lease. However, for leases of premises up to and including two acres, of more than one year, a notice to quit of at least 40 days must be given. It is also competent for the tenant to serve notice to quit within the same time period.

A local authority in Scotland has the right to require the compulsory termination of a lease as a result of compulsory purchase of the premises.

Compulsory purchase powers in Scotland are subject to rigorous controls and are usually exercised only where the local authority is constructing a new road or other public services.

In Scotland, the landlord and tenant would both be entitled to compensation for losses suffered as a result of compulsory purchase. Levels of compensation are calculated in accordance with the relevant statute.

6.9 Sale of leased property

A sale of property that is leased does not affect the lease in any way. The benefits and liabilities of the lease are inherited by the new owner as the legal successor to the title to the property.



7. Tax

7.1 Stamp duty land tax

Stamp duty land tax (SDLT) is payable by the buyer of commercial real estate, at rates of up to 5% of the purchase price (there is a sliding scale by which lower rates of SDLT are payable on the portion of the purchase price below GBP250,000). SDLT is also payable on any VAT element of the purchase price.

SDLT is also payable at rates of up to 15% on the purchase of residential real estate (although a higher rate of 17% applies to all the consideration on purchases of high value residential property by companies, subject to certain exceptions e.g. for property letting). An additional surcharge of 2% can apply where the buyer is non-UK tax resident. Again, the buyer is responsible for paying the SDLT.

SDLT is also payable on the grant of a lease of commercial or residential real estate (as well as certain other transactions involving leases). SDLT is payable at the rates set out above on any premium that is paid, and SDLT is also payable on the net present value of any rent payable under the lease (in the case of commercial real estate, at a rate of 1% up to GBP5 million and 2% above this).

SDLT is payable within 14 days of purchase/completion of the lease (although it can be payable earlier in certain circumstances).

The sale of shares in a UK or a non-UK company that owns UK real estate is not subject to SDLT although a separate stamp duty charge of 0.5% applies to the transfer of shares in UK companies.

SDLT is now only payable in respect of real estate in England and Northern Ireland – Land and Buildings Transaction Tax (LBTT) replaced SDLT in Scotland on 1 April 2015 and Land Transaction Tax (LTT) replaced SDLT in Wales on 1 April 2018.

LBTT and LTT operate in a similar way to SDLT, although there are some differences. For example:

- the top rate on the purchase of commercial real estate is 5% for LBTT (on the part of the purchase price above GBP250,000) and 6% for LTT (on the part of the purchase price above GBP1 million);
- LBTT is payable on the net present value of any rent payable under a lease of commercial real estate at a rate of 1% on the net present value of any rent payable under the lease from GBP150,001 up to GBP2 million and 2% above this; and
- residential leases are generally exempt from LBTT and no LTT is payable on any rent paid under a lease of residential real estate.

7.2 Value added tax

Value added tax (VAT) will usually be chargeable on the acquisition of UK commercial real estate (because the seller has often chosen to opt to tax the property for VAT purposes). The current rate of VAT is 20%. If the property is let, then a sale may be treated as a transfer of a going concern, provided certain conditions are met. In that situation no VAT will be payable, reducing funding costs and the amount of SDLT payable (as SDLT is paid on the VAT-inclusive price).

Similarly, VAT is usually charged on the rents paid by tenants of commercial real estate. Owners of UK commercial real estate do not automatically have to charge VAT on the rents or sale price; it depends on whether they have opted to charge VAT. However, if a landlord does not opt to tax in this way, it will not generally be able to recover any of the VAT it pays when acquiring, maintaining or refurbishing the property, and the VAT on those costs will become an absolute cost.

Different VAT rules apply to property for residential or charitable use. Specific advice should be obtained on the facts where appropriate.

7.3 Other real estate taxes

Business rates are payable by the occupier of commercial property (depending on the rateable value of the property). Rates are payable by landlords of vacant property (i.e. until a tenant can be found).

Property owners making substantial improvements to property in the UK may have to operate a payment deduction system when paying construction contractors (under the UK's Construction Industry Scheme). Owners that spend GBP3 million or more per annum on construction works, and property developers that carry out any value of construction works are generally required to (i) register under the scheme, (ii) verify the identity of its contractors, and (iii) if directed by the UK tax authority (HMRC), withhold up to 30% of payments and account to HMRC for the sums withheld.

7.4 Taxation of rental income from real estate

Companies holding UK property as an investment only are subject to UK corporation tax (the main rate of which is currently 25%) on their net rental income.

For non-UK residents, the UK also operates a system for withholding the relevant tax from the rent before it is paid to non-residents. However, it is possible to obtain a prior clearance from the UK tax authority for rent to be paid without a deduction of tax.

UK resident individuals holding UK property as an investment are taxed at their marginal rate of income tax (currently ranging from 20% to 45%) on net rental income. Non-UK resident individuals are also subject to UK tax on net rental income.

For corporates, the UK has rules that allow the amount of rent that is taxed to be reduced by the interest paid on third-party finance taken out to acquire UK real estate. Interest on shareholder debt may also be deductible, subject to the UK's transfer pricing rules (which requires transactions between connected parties to be treated as on arm's length terms for tax purposes, and can result in adjustments to the extent they are not), and the UK's wide interest deductibility rules.

"Corporate interest restriction" rules limit interest deductions to, very broadly, 30% of EBITDA, although there is an exemption from these rules for third-party finance taken out for public infrastructure projects (which can include property rental businesses provided that the relevant conditions are met). Individuals are also subject to restrictions on interest deductions.

Both UK and non-UK residents can claim capital allowances, which will reduce the amount of rent that is subject to UK tax. Capital allowances are a form of depreciation allowance on plant and machinery, and can be very valuable. Broadly, if available, they can offer 50% to 100% relief to companies on qualifying expenditure on plant and machinery investments in the year the expenditure is incurred, and for individuals, or for companies incurring expenditure before 1 April 2023 (or where only 50% relief can be claimed in the year of investment), can be claimed on a reducing basis at either 18% on plant and machinery or at 6% on integral features (which are items integral to the fabric of a building, e.g. elevators, electrical cabling and hot and cold water systems). No capital allowances can be claimed on the land itself, but in certain circumstances a form of capital allowances (known as Structures and Buildings Allowances (SBA)) can be claimed on buildings. SBAs are available at a rate of 3% per annum for qualifying expenditure on the construction, renovation or conversion of a building (or purchases of a building) where the qualifying expenditure was incurred under a construction contract entered into on or after 29 October 2018.

Capital allowances are available to a buyer of real estate where part of the purchase price is attributable to plant and machinery and/or integral features. A joint election (known as a section 198 election) can be entered into between seller and buyer in order to fix the amount of allowances passing to the buyer. SBAs also pass to a purchaser of real estate.

The partners of partnerships that hold investment property are treated in the same way as above, based on their share of the partnership's net rental profits. Both interest deductions and capital allowances are claimed by the partnership in the partnership's tax return (i.e. in calculating each partner's share of net rental income on which they are each taxed).

7.5 Taxation of dividends from a company owning real estate

Generally dividends received by a UK resident company from its subsidiary are exempt from UK tax. As a result, dividends paid by a company owning UK real estate to its UK parent company should generally not be subject to tax.

The UK does not generally impose withholding tax on dividends paid by UK companies. A non-UK resident individual or non-UK company (without a permanent establishment in the UK) that receives a dividend from a UK company should therefore only be subject to tax on receipt of the dividend in the jurisdiction in which they are resident (if applicable). There are exceptions to this, particularly in the case of real estate investment trusts and other property funds.

UK resident individuals holding shares in a property-owning company are taxed at their marginal rate of income tax on dividends (at rates of 8.75% to 39.35%) received from the company, subject to a tax-free allowance on dividends of GBP5000.

7.6 Taxation of capital gains on real estate

Historically, non-UK residents were generally not subject to UK tax on capital gains made on the sale of UK real estate unless they were either carrying on a trade through a UK permanent establishment or carrying on a trade of dealing in or developing UK real estate. In certain circumstances, non-UK residents could also be liable to pay UK tax on capital gains made on the disposal of UK residential property. However, this position fundamentally changed with effect from April 2019.

From this date, both UK and non-UK residents are subject to UK tax on capital gains made on the disposal of:

- commercial and residential real estate; and
- an interest in a property-rich entity (broadly, a company that derives at least 75% of its gross asset value from UK real estate), though there is an exemption for disposals of trading companies. In general, UK tax will only be payable where the seller owns (or has, in the previous two years, owned) 25% or more of the interests in the entity.

Whilst a detailed examination of these rules is beyond the scope this guide, key features of this regime include the following:

- a company will be subject to corporation tax on capital gains (the main rate of which is currently 25%). The company can deduct the costs of acquisition, enhancement and disposal in calculating the gain;
- individuals are subject to capital gains tax (at rates of up to 24%). Individuals are similarly entitled to deduct the costs of acquisition, enhancement and disposal in calculating the gain;

- where the new regime brought an asset into charge for the first time (whether a property or, for example, shares) that asset was 're-based' to its April 2019 market value, so any capital gains that accrued before that date would not be subject to UK tax;
- non-residents are generally entitled to the same reliefs or exemptions available to UK residents; and
- a bespoke and complex regime applies to real estate funds and other collective investment vehicles.

7.7 Real estate investment trusts

Companies and groups that meet certain conditions can choose to enter the UK real estate investment trust (REIT) regime. If a company or group elects to enter the REIT regime then:

- the REIT is exempt from tax on the income profits and capital gains of its qualifying property rental business;
- distributions of profits/capital gains are treated as UK property income in the hands of shareholders of the REIT; and
- 20% withholding tax is imposed on these distributions (subject to exceptions, e.g. a shareholder that is a UK company or a tax exempt pension fund or charity).

Among other conditions, to become a REIT a company/group must

- be tax resident in the UK,
- be admitted to trading on a recognised stock exchange or have 70% of its shares owned by "institutional investors", and
- not be a close company (i.e. be widely held). A REIT must also distribute at least 90% of its tax exempt property rental business profits to its shareholders each year.

7.8 Real estate funds

Funds investing in UK real estate can take a number of legal forms: companies (UK and non-UK), partnerships (including limited partnerships and limited liability partnerships), unit trusts (UK and non-UK), REITs, property authorised unit trusts and contractual funds.

The tax position of a particular fund will depend on its form and whether it satisfies any conditions for an available exemption.

Many investors in UK real estate have historically structured their holdings via an offshore property unit trust (although, due to the recent tax changes on real estate investment, this is not as common as before). The main difference between an offshore unit trust and a non-UK company is that the unit trust is generally treated as transparent for UK income tax purposes. The investors in the unit trust will, therefore, be taxed as if they received their share of the rents directly. These vehicles are particularly attractive to UK tax exempt investors (e.g. pension funds) because they can receive their share of the rent tax-free.

Note that, following the April 2019 changes referred to in section 7.6 above, a bespoke and complex regime now applies to the taxation of capital gains for real estate funds that may allow collective investment vehicles to create a tax exempt holding structure, and these rules should always be considered when structuring real estate funds.

It should be noted that funds investing in real estate which are collective investment schemes are subject to regulation under the UK's financial services legislation.



8. Real estate finance

Real estate finance involves the financing or refinancing of income-generating property by a borrower. The amount borrowed from the lender will be secured against the property as security for repayment of the debt.

The comments below relate to the financing or refinancing of an investment property which produces income. For development finance, the key principles below remain but there will be additional considerations for a lender e.g. reviewing development documents, considering the appropriate triggers for stage payments to be made to the borrower and obtaining step-in rights to enable the lender to complete the development if the borrower defaults.

The availability and terms of finance could be a key factor in the investment decision. A lender will be particularly interested in:

- rental income that will be used to pay interest and other sums due on the loan – known as the interest cover covenant; and
- the value of the property compared to the loan amount, as selling the property is likely to be how the principal will be repaid – known as the loan to value covenant.

8.1 Interest rate risks

Interest rates are frequently agreed by reference to a margin above a floating rate, such as SONIA for Sterling, SOFR for US Dollars or EURIBOR (or EURSTR) for Euro. There is a risk of increase to the interest rates. It is possible to counteract the risk by agreeing fixed rate interest with the lender but fixed rate transactions are often time limited and more expensive.

It is common for borrowers to enter into hedging arrangements to protect against interest rate fluctuations – in some cases, the lender will require that a certain amount of the principal loan is hedged. In the UK, hedging will typically be dealt with by an interest rate swap (or cap) agreement.

There are variations but, under a simple interest rate swap, the borrower pays a hedging fee to enable it to:

- pay a fixed rate of interest to a hedging counterparty (which may be the lender or a third party); and
- receive a floating rate of interest which is equal to the interest rate due under its loan.

The borrower will use the money received from the hedge to pay interest to its lender. By entering into hedging documents, the borrower reduces the risk of it being unable to pay interest on the loan because of an increase in the rate.

8.2 Assets held as security

A lender will require a legal mortgage over the property as its main piece of security to protect the money advanced under its loan.

This allows the lender to take control of the property where the borrower is in default and to use the rental income generated to pay the interest on the loan and/or sell the property to repay the principal loan amount owed.

As the land is (or will become) registered at the Land Registry, there are usually no physical assets held as security but the lender relies on registration in the public records, with what is called a “restriction” being placed on the title to the property at the Land Registry which makes it clear no transfer of the property, or further security being created over it, can occur without the lender’s consent.

8.3 Further collateral agreements

In addition to the legal mortgage, the lender will often require additional collateral documents to be entered into by way of security. Depending on the circumstances, the following collateral agreements may be used:

- **Floating Charge:** As stated in section 3.1 above, this relates to corporate borrowers only and is more typical where either the borrower is a special purpose vehicle (SPV) or there is a refinance of a portfolio of properties held by a single entity. This provides the lender with security across the whole of the borrower’s business and undertaking.
- **Share pledge:** If the borrower is a limited company and is an SPV or is the top company in a group of companies, the lender may take security over the shares in the borrower, and its subsidiaries, to allow for a potential share exit at any level within the borrower group rather than having to deal with the underlying property. An equivalent charge over the interests of the members of a limited liability partnership borrower may also be taken.
- **Guarantee:** If the borrower is an SPV or is of weak financial covenant strength, the lender may ask for a parent company or third party guarantee. This could be capped or limited in time, but is more likely to be unlimited.
- **Intercreditor Deed:** This applies where there are two lenders that are each creditors of the same borrower. One creditor can agree to subordinate its security interest to that of another by an intercreditor deed. The agreement will regulate the subordination of the debt as well as the security and will cover matters such as rights of enforcement. Where another lender to the borrower has no security for its loan a subordination agreement will be used to subordinate the debt of that lender to the debt due to the senior lender.

- **Assignment of Rental Income:** The borrower will be required to assign the benefit of the rental income to the lender. There will be controls over which account rental income is paid into and how much can be withdrawn by the borrower.
- **Assignment of Insurances:** While the lender will normally require that it is a co-insured in its own name on the insurance policies, it will also want an assignment of the borrower's interest in the insurances, plus confirmations around non-cancellation from the insurers.
- **Management Agreement/Duty of Care Deed:** As the property is income producing, the lender may require the formal appointment of a managing agent together with a duty of care deed to the lender. This ensures rental income is paid into the correct account and also gives the lender additional comfort that the property will remain income producing and well maintained.
- **Charge over accounts:** The lender will take security over any rental income accounts or other accounts e.g. escrow sums or other assets of the borrower.
- **Hedging:** As above, hedging is likely to be required in relation to some or all of the interest due and this would typically be an interest swap agreement. The lender will take security over the borrower's rights under the interest swap arrangement.

8.4 Taxation on the creation of security

There are no stamp taxes payable on creating a security interest. There are also no notaries' fees.

English corporate borrowers (ie limited companies or limited liability partnerships) must register any charge at the registry of companies, known as Companies House. The fee for registration at Companies House is GBP24 from 1 May 2024 (GBP15 for online registrations).

There is no requirement for security created by non-UK corporate parties or by individuals to be registered at Companies House.

A legal charge over land in England and Wales should be perfected by registration at the Land Registry in order to ensure the priority of that charge even if it is granted by non-English or Welsh parties, by partnerships/limited liability partnerships or by individuals. There is a fee payable but it does not exceed GBP305 for registration of the charge alone (if there is a registration involving a transfer e.g. to a buyer who grants a charge the fee will not exceed GBP1105 for registration of both). Both of these fees are reduced if the application is submitted online.

Glossary

SCOTTISH LAW TERM	ENGLISH LAW EQUIVALENT
Articles of roup	Conditions of Sale by Auction
Heritable	Freehold
Irritancy	Forfeiture
Real Burden	Restriction/Covenant
Registers of Scotland	HM Land Registry for England and Wales
Servitude	Easement/Reservation
Disposition	Transfer
Standard Security	Legal Charge

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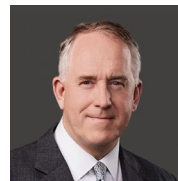
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This guide was written predominantly by Mark Keeling, Jane Summerfield, Mark Davenport, Michael Greig and Sophie Stewart of our Real Estate practice group, Richard Harbot and Gemma Grunewald of our tax group, Carolyn Agnew of our Finance, Projects and Restructuring group and Taryn Jones and Jaya Bagri of our Safety, Health and Environment team.

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