

FOREARMED: A REAL ESTATE DISPUTES GUIDE TO LIKELY TRENDS IN 2021 AND BEYOND

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Guides

Thankfully, most real estate investments do not suffer from complex disputes.

But, as a real estate disputes team with experience going back to the early 1990s, and through several cycles of the economy, we have seen the kinds of issue that can arise at times when there is uncertainty in the global outlook, and the timeframe in which they are most likely to occur.

In this note, we have set out our prediction as to where disputes are likely to arise, if they arise at all. Naturally, not every real estate developer or investor will experience them, but we think they will happen in the market as a whole and with an increase in frequency.

Most important, we think, is that an eye is kept out for the tell-tale signs that there could be an issue on the horizon, and consideration given to what can be done to avert risk.

Here is our summary - with a link in each case to our detailed view and our roadmap to preparing for the coming months.

	<p>1. Covid-19 enforcement moratoria will end, but we expect them to go beyond June 2021 The current restrictions on landlord/enforcement have now been in place for nearly a year, and will remain in place until 30 June 2021. The Government had stated that the previous extension (to 31 March 2021) would be the final one, but yet another extension has now been announced. We expect a further extension until the end of Q3/2021 because there will be pressure, led by retail tenants, for the lifting of restrictions to coincide with the typical Q4 upturn in the retail economy. Government has requested "evidence" before fixing its policy. An attempt may be made to phase in the return to permitted enforcement, but this may create its own difficulties. Landlords may want to consider enforcement measures that still exist now, and are not affected.</p>
	<p>2. Tenant CVAs will continue to push the boundaries of landlord acceptability As more tenants suffer the financial impact of the pandemic, further insolvencies are inevitable. The recent trend for CVAs as a mechanism to strip out unprofitable stores is bound to continue, and each major new CVA has taken a step further to the detriment of landlords. We do not expect this to stop. We recommend close scrutiny of any new CVA, and caution, as there can be hidden notice periods.</p>
	<p>3. Tenants' guarantors will try to manoeuvre themselves out of liability Prior to the pandemic, it was common for prospective tenants to offer a worthless SPV tenant entity, backed by a valuable parent guarantor, perhaps with limits on the length or financial value of the guarantee. These guarantees are only worthwhile for as long as the guarantor entity is financially solvent. The pandemic saw certain guarantors declaring insolvency or at least cutting available assets. This compromised their ability to make good on their guarantees. It is likely that further manoeuvring by guarantors will be seen in 2021.</p>
	<p>4. Valuation issues may arise for 2020/2021 rent reviews Assuming a 3-yearly rent review cycle, it is possible that some 2020/2021 rents may well have increased above 2015/2016 passing rents, notwithstanding the impact of the pandemic. This is likely to be most applicable to offices, not only because of difficulties in the retail sector impacting on passing rents, but also because retail tenancies are now typically shorter and therefore may not contain rent review provisions. Equally, in the context of a typical rent review, a "hypothetical tenant" in Q2 2020 may have had certain expectations as to how the market would play out in the following months, for example that the consequences of the pandemic could be short-lived (which very sadly have not become a reality). We could see an increase in rent review disputes where the hypothetical scenario differs greatly from the real world.</p>
	<p>5. Tenants could try to use the 1954 Act to engineer lower renewal rents Many landlords and tenants may not wish to trigger a 1954 Act lease renewal right now, but certain retail tenants may try to benefit from current depressed market rents by serving short (6 month) renewal requests, to fix the date for assessing the new rent and maybe even reduce it from the current passing rent. Equally, tenants may seek unusually short renewal leases with maximum flexibility, leading to disputes as to the appropriate term on renewal.</p>
	<p>6. Dilapidations claims could become trickier for landlords Terminal dilapidations claims are always limited by the requirement for a >18(1) valuation which caps the landlord's recovery to diminution in the value of the subject property, between its value in and out of repair. This in turn means estimating those capital values and the difference between them. For leases which ended in the middle of lockdown or at the height of the pandemic, tenants may try to argue that the prospect of a quick, high-value-letting was diminished, and thus has no real impact on capital value.</p>
	<p>7. Termination by landlords for tenant's repudiatory breach, and loss of bargain damages, may be recognised by the courts In the law of contract, an innocent party who is faced with a significant breach by the counter-party, is entitled to treat the breach as repudiating the contract, entitling the innocent party to bring the contract to an end and claim damages, calculated on what it would have received had the contract been performed. Traditionally the courts have been resistant to extend this doctrine to leases, limiting the landlord to the choice of forfeiture (ending the future rent stream) or keeping the lease on foot but not being able to re-let the premises. This aspect of the law is arguably overdue for judicial attention, and the fallout from the pandemic could be the perfect opportunity.</p>
	<p>8. Sale and purchase disputes, particularly those concerning conditionality, will be on the rise The last economic downturn saw an increase in prospective purchasers seeking to pull out of contracts, or prospective tenants escape from agreements for lease, when they became financially burdensome. We expect to see a resurgence of these cases, particularly contracts or agreements with complex conditionality arrangements. Conversely, there may be situations where a seller wishes to terminate because the prospective purchaser or tenant is no longer a good covenant strength. This puts the insolvency termination provisions of the contract or agreement under the spotlight.</p>
	<p>9. The law of relief from forfeiture could extend to new territory The Manchester Ship Canal case saw the law of forfeiture extended (sometimes) to licences, rather than just leases. For landlords, this came with the unattractive consequence that a licensee can, in some circumstances apply for relief from forfeiture. Applying the same logic that the court did, it is not hard to conceive of other situations where forfeiture, and relief from forfeiture, might apply. Most importantly, will there be a right to relief from forfeiture where an agreement for lease or development agreement is terminated?</p>
	<p>10. Professional negligence claims will increase, especially on valuation matters In our experience, valuation of assets can be more difficult during turbulent periods for the economy. We have found that claims against valuers tend to emerge at the end of a cycle when it is clear to the claimant that they have actually suffered a permanent loss rather than being disadvantaged by a temporary market dip. This means these claims will start to emerge as limitation periods begin to impose themselves.</p>
	<p>11. Misrepresentation claims tend to be a focus Similar to the above, we have found that purchasers of under-performing assets often look to other sources to recover their loss, perhaps against the seller. Again, these are claims that have tended to occur at the end of a cycle where it is clear that an asset has not reflected what the seller claimed. Claims can also be triggered by a subsequent disposal of the asset where a loss is then crystallised, and this may be years later.</p>
	<p>12. Residential disputes are likely to increase With all the additional time that people are spending at home, it seems likely to us that residential disputes will increase. These may be between leaseholders (concerning the scope and acceptability of home improvements), freeholders (boundary disputes that became prominent during lockdown) or between freeholders and tenants (concerning increased service charge costs or utility provision).</p>
	<p>13. Protection against squatters may be needed for empty, closed or infrequently used commercial premises The Government's decision to close certain businesses and venues in response to the Covid-19 pandemic throughout 2020 and into 2021 has meant that there are many commercial premises which have been left seemingly empty or at least more infrequently used by occupiers (be it landowners, landlords or tenants). High streets, retail and leisure parks may seem deserted and, against this backdrop, trespassers may see such premises as prime targets, particularly if there is a lack of security and ease of entry. Empty buildings and brownfield development sites will also be equally attractive to trespassers. Preventative measures to secure them may be needed to stop these premises from attracting unwanted, and often costly, attention by trespassers.</p>
	<p>14. Developers will increasingly seek to vary planning permissions and section 106 agreements Many developers are already looking to change their projects to reflect an evolving real estate sector, either as a direct result of the pandemic, or because existing underlying trends have accelerated. For example, developers might seek variations to planning permissions due to uncertainty over the future market for office space and retail uses or to reflect strong demand for build to rent and logistics. It will be key for developments to be able to adapt to reflect this changing environment. However, developers may face a number of challenges under the rules of the current planning system. Engaging with local planning authorities, many of whom are still applying the same pre-pandemic planning policies, is not straightforward and, where agreement to change cannot be reached, this may result in appeals or the need for new planning applications to be submitted instead.</p>
	<p>15. Joint venture development disputes could become more likely There are a number of reasons for this. JV allow parties with on-the-ground knowledge and expertise to work alongside investors who may or may not have experience in the sector or a particular geography. They are also a way of sharing cost and risk as well as the rewards, which can be particularly appealing in these unpredictable times. However, these contractual relationships, particularly in the case of development JVs, often have complex conditionality and commitments built into them, to take into account the shifting viability and returns which can be expected from a particular development, which is often planned years in advance. With any period of economic turbulence, parties to a JV can often seek to extricate themselves from these relationships (or seek to renegotiate them) when they consider that a proposed development is no longer viable. This can lead to complex contractual disputes about the ongoing relationship, particularly when one party to the JV may already have invested substantial time and upfront cost into developing a particular scheme.</p>
	<p>16. Insurance policies will be scrutinised and tested, with particular attention on and business interruption insurance and warranty and indemnity insurance The Government's decision to close certain businesses and venues in response to the Covid-19 pandemic throughout 2020 and into 2021 has meant that there are many commercial premises which have been left seemingly empty or at least more infrequently used by occupiers (be it landowners, landlords or tenants). High streets, retail and leisure parks may seem deserted and, against this backdrop, trespassers may see such premises as prime targets, particularly if there is a lack of security and ease of entry. Empty buildings and brownfield development sites will also be equally attractive to trespassers. Preventative measures to secure them may be needed to stop these premises from attracting unwanted, and often costly, attention by trespassers.</p>
	<p>17. Issues around return to work will be prevalent In England, the law, as it currently stands, is that people are only permitted to leave their homes for a very limited number of prescribed reasons. As an extension to that rule, the Government has made clear that employers must take all practicable steps to allow, and to enable, employees to work from home where they possibly can. In the coming weeks and months, it is expected that these restrictions will be relaxed, and ultimately lifted. The precise approach adopted by the Government will depend largely on the data it receives regarding the efficacy of the various vaccines being deployed, the impact on the spread of the virus (and seriousness of the illness it entails) and the impact of virus variants. It is reasonable to assume that, given the Government's approach to date, there will not be a single "big bang" date on which all precautions will be lifted and the message will become "everyone back to the office". All employers in the real estate sector will need to consider their approaches to a return to work, including their positions on vaccines, employees who are uncomfortable about a return to the workplace, issues around a more flexible working from home/being present in the workplace model and the health and safety implications around the return to the workplace.</p>

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KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.



MATTHEW BONYE
PARTNER, LONDON

+44 20 7466 2162
Matthew.Bonye@hsf.com



RHIAN ARRENBURG
PROFESSIONAL
SUPPORT LAWYER,
LONDON

+44 20 7466 2594
Rhian.Arrenberg@hsf.com



JULIA TOBBELL
SENIOR ASSOCIATE,
LONDON

+44 20 7466 7613
Julia.Tobbell@hsf.com



MATTHEW WEAL
SENIOR ASSOCIATE,
LONDON

+44 20 7466 7535
Matthew.Weal@hsf.com



JEREMY WALDEN
MANAGING PARTNER,
REAL ESTATE,
LONDON

+44 20 7466 2198
Jeremy.Walden@hsf.com

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