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China walks the tightrope

Slower growth in China will mean less investment for other countries, explains Sean Ellison

China has developed into one of the most important players in the global economy. Developments in the Middle Kingdom now not only have consequences for other Asian nations but significantly affect the rest of the world.

Last year proved to be a tightrope walk for Chinese authorities as they aimed to balance growth without overinflating property markets. Amid concerns over a hard landing for its economy, the Chinese government encouraged a policy of credit expansion, much of which was granted to developers to be directed into residential real-estate development.

Although the policy achieved some success – output stabilised and manufacturers began to see the prices of their goods rise for the first time in more than four years – it resulted in developers being vastly overleveraged and dependent on continued rapid expansion in house prices for projects to remain solvent.

The tightrope walk continues thus far in 2017. Wary of the excess credit being directed into the system, Chinese authorities have placed residential real-estate squarely in the policy crosshairs.

The annual Central Economic Work Conference held at the end of 2016, which the Chinese government uses to set out its policy objectives for the next year, marked the start of this as the government announced it would move to rein in excessive credit to the property sector.

This was followed by President Xi Jinping calling for wide-ranging reforms to tame the excessive rise in house prices, and by the People’s Bank of China indicating that it had begun the tightening of credit conditions.

Global impact

However, China’s concerns extend beyond the property sector. The mixture of slowing economic growth and increased leverage have put downward pressure on its currency, the yuan, and while the rhetoric surrounding the US election has suggested otherwise, Chinese authorities have been desperately trying to strengthen the yuan to avoid destabilising capital outflows.

Reports have suggested that the leadership may even consider the growth target – long regarded the sacred pillar of stability – as a secondary objective to structural reforms such as corporate debt reduction and environmental regulation.

If Chinese growth were to slow to 6% in 2017 from the 6.7% recorded in 2016 it would equate to a more than US$50bn reduction in global growth. With economic crises in Europe and US growth reduced to a snail’s pace, Chinese growth has been a stable source of demand in recent years.

Even 6% growth looks optimistic if the Chinese authorities are serious about deleveraging. Right now, for every yuan deposited in banks more than five yuan of loans are made, a record high.

Given the deceleration in growth of deposits, it would require a substantial slowdown in lending to revert to its longer-term average of one to four or 4.5. If this were to happen, Chinese companies would find it very difficult to obtain domestic financing, further reducing economic activity.

But that is only one side of the coin. As international transaction volumes globally have remained subdued in recent years, Chinese money has been a key source of investment for a number of countries, particularly in terms of real-estate investment.

In 2015 alone, the Chinese accounted for $10.45bn of inbound investment to the USA, $4.58bn to Australia and $2.13bn to the UK.

This dynamic is set to change in 2017. Tighter domestic financing conditions and capital controls mean Chinese firms will have less cash available for deals.

Offshore financing will also become harder to obtain as Chinese authorities pressure domestic firms to keep credit exposures internal.

Bloomberg has reported that mainland financial regulators are already urging Chinese state-owned enterprises to sell foreign currency, and may go as far as asking them to convert foreign currency holdings into yuan under a contingency plan to defend the currency.

Despite the consequences, reducing leverage is long overdue. Chinese corporations are being crushed under the weight of their debt as lending continues unabated. Though it removes a key pillar of global growth and investment, a shift to slower Chinese growth would be much better than a Japanese-style collapse – to which it is inching closer.

Sean Ellison is Senior Economist, RICS Asia
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 update

RICs’ work on conflicts of interest is continuing, with a consultation having taken place for the UK commercial investment agency professional statement. The professional statement and its global equivalent will be formally launched at MIPIM 2017.

www.rics.org/standards

Conflicts of interest update

A government-backed pilot scheme has been launched to remove infrastructure hold-ups to the building of new homes. It has been set up by the Housing and Finance Institute, which last year published a report highlighting how failing water companies are limiting private developers’ ability to build more homes.

The pilot scheme is being carried out in the South East with the help of the South East Local Enterprise Partnership, the Home Builders Federation, Laing O’Rourke, Anglian Water, Kent and Essex County Councils, KeepMoat, the Chair of the All-Party Parliamentary Group for Infrastructure and the Department for Communities and Local Government.

It will seek to identify, assess and then overcome infrastructure problems to speed up housebuilding. It will pay particular attention to housing developments that have been delayed due to a lack of water, sewage, electricity, gas or road connectivity. If successful, the plan is to roll the scheme out across the UK in 2017.

Natalie Elphicke, co-author of the Treasury-sponsored Elphicke-House Report on housing, says the lack of local infrastructure on new housing sites is drastically slowing down the rate of such homes coming on to the market.

www.thehfi.com

Infrastrucure pilot for housing

“it was our intention for property professionals to see themselves as part of the solution to ending rising homelessness: for example, to seek out sites that might be suitable for homes; to help housing associations secure planning on new homes; and to ensure that sites with planning consent come forward for construction.

“The UK currently has a horrendous housing crisis and in simple terms, we want our profession to see beyond maximising profit when providing housing. There are already innovative and insightful ideas out there that we can tap into; we simply need to collaborate better.

“Given our position in the industry and our public interest remit, we are uniquely placed to work with organisations across the property, land and construction sectors to champion existing initiatives that work and to help formulate new approaches where these are needed.

“Our influence in the property sector and with government will stand us in good stead to raise awareness of our recommendations and call for a united effort to end rising homelessness.”

If you would like to contribute to our ‘A Home for Cathy’ manifesto, please email Kim Bailey, RICS PR & Communications Officer (North): kbailey@rics.org

‘A Home for Cathy’

Events were held across RICS’ UK offices at the end of 2016 to launch our anti-homelessness campaign ‘A Home for Cathy’, and commemorate the 50th anniversary of acclaimed BBC drama Cathy Come Home.

The national launch event saw senior representatives from the private, public and third sectors gather to view a screening of Ken Loach’s seminal film at our London headquarters.

The screening was followed by a debate in which the panel – including LandAid CEO Paul Morrish, Shadow Housing Minister Andrew Slaughter and the Tenancy Deposit Scheme’s Ben Beadle – discussed how our profession can better collaborate to end rising homelessness and create more affordable homes.

Former RICS President Michael Newey FRICS, Chief Executive at Broadland Housing, chaired the panel. He commented: “Cathy Come Home marked a turning point in public and political perception of people who are homeless, and it certainly sparked a lively discussion around modern-day homelessness and the housing crisis of today, 50 years on.

“It was our intention for property professionals to see themselves as part of the solution to ending rising homelessness: for example, to seek out sites that might be suitable for homes; to help housing associations secure planning on new homes; and to ensure that sites with planning consent come forward for construction.

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Auction fees and charges

The Committee of Advertising Practice (CAP) has announced new guidance on how auction houses should present mandatory fees and charges when referring to guide prices. The guidance will be published on the CAP website (www.cap.org.uk); further context can be downloaded from www.rics.org/auctionguidance.

The Advertising Standards Authority (ASA) investigates complaints to ensure that non-broadcast marketing communications comply with the UK Code of Non-broadcast Advertising and Direct & Promotional Marketing (the CAP Code). The government and the courts both recognise the ASA as the “established means” of regulating non-broadcast advertising.

The ASA hopes that the new guidance will help auction houses ensure that their marketing material – including online and hard-copy catalogues – complies with the CAP Code, thereby avoiding the potential for complaints and subsequent investigation by the ASA.

According to a statement, the ASA recognises that advertisers may need some time to implement any necessary changes to their marketing and, if further support is required, to seek advice from the CAP Copy Advice team.

“As such, for a period of time we do not intend to investigate complaints made about this issue. The ASA envisages that complaints would be looked into further from the beginning of March onwards, and therefore strongly recommends that advertisers take prompt action to incorporate the position outlined in the guidance.”

In brief...

Events

**RICS UK Valuation Conference 2017**
London, 29 March
This event provides a comprehensive programme for enabling commercial valuers to get to grips with key issues. Plenary talks will focus on economic updates, professional indemnity insurance and valuer liability, global market conditions and predictions, and International Valuation Standards, together with talks on the International Property Measurement Standards.

**Propteq Europe 2017**
London, 11 May
Tickets are now on sale for this interactive, attendee-led event, bringing together senior real-estate professionals and property technology innovators to network and share ideas.

**RICS Real Estate Investors’ Conference**
London, 16 May
This exclusive event aimed at key players in the real-estate sector provides a forum to debate and discuss the most important dynamics and emerging thought leadership that are shaping the future of the built environment in the UK.

The programme will combine keynote presentations and discussion to make for an engaging agenda. Speakers will include those at the forefront of their profession, such as Guy Grainger, the CEO of JLL, and Dominic Wilson, the Co-founder and Managing Partner of venture capital platform Pi Labs.

**cap.org.uk**
First among equals

Alexander Aronsohn explains why international standards are so important throughout the property development process

Many people are confused by the term “international standards”, often seeing it as relating to anywhere other than the place where they are. It is almost as if some mysterious “international” land exists where all these standards go to live harmoniously together and do their best not to bother the inhabitants of other countries.

The outlook has worsened of late, given that voters in many countries are supporting what would previously have been seen as separatist, isolationist or at the very least nationalist policies. So what do international standards mean in the current political climate and how are they good for your business?

Perhaps it is a misnomer to refer to international standards when what we are really talking about is professionalism; after all, standards are the unique selling point of RICS when compared with other service providers.

Professionalism and RICS

The importance of professionalism to RICS is seen in the following two key questions that the organisation is currently exploring.

- What are the expectations of a professional today, and how do these differ from those of the past?
- What constitutes a high standard of service, and how do we manage and meet clients’ expectations in a world where so much information is freely available?

These and many other questions need to be answered to ensure that RICS and its members remain relevant in an ever-changing society. Over the past 20 or 30 years, the world has become a smaller place – people travel more and operate with a more global outlook, and even when they are working nationally or regionally they can be affected by international factors.

Avoidable scandals

The International Ethics Standards, which RICS has helped to develop (see Property Journal November 2016, pp.12-13), can both create business and often save your organisation significant amounts of money.

Consider the VW emissions scandal. According to the Financial Times, VW has had to set aside €6.5bn to fix this problem (http://on.ft.com/2gXNu50), and this figure does not even cover share or brand damage.

But if VW had been a member of the International Ethical Standards (IES) Coalition, the scandal may not have happened; all its suppliers and contractors would also have to have been members and abide by its 10 ethical principles, which include accountability, financial responsibility, integrity, standard of service and transparency.

However, having ethical standards in place is not the whole answer. Enron had a code of ethics but this was not implemented or enforced, which is what led to the company’s eventual collapse. Suppose that business ethics had played a more central role in the organisation: would that have meant Enron would still be operating today?

As a member of the IES Coalition, RICS incorporates the international standards into its own five ethical principles and regulates its members under these. The RICS code of conduct will also be incorporated into the review.

Good business sense

Chartered surveyors are highly qualified service providers, but service providers nonetheless. There are a number of other service providers operating in our markets, such as brokers – who may have significant experience but limited qualifications – as well as architects and engineers providing property valuations, but often incorrectly equating price with value.

International standards are what distinguish RICS from the competition in this regard.

RICS is involved in the following international standards:

- International Ethics Standards (IES; https://ies-coalition.org)
- International Land Measurement Standards (ILMS)
- International Construction Measurement Standards (ICMS; www.icms-coalition.org)
- International Property Measurement Standards (IPMS; www.ipmsc.org)
- International Valuation Standards (IVS; www.ivsc.org)

What do international standards mean in the current political climate, and how are they good for your business?
Enabling regeneration

The International Land Measurement Standards Coalition deals with the issue of registered and unregistered land. Hernando de Soto claimed in his book *The Mystery of Capital* that some $9tr of “dead capital” was locked up in land, homes and businesses belonging to poor people who did not technically own them. He argued that without deeds or titles, poor people all over the world are not able to leverage their property for profit.

In recent times this view has been seen as slight oversimplification, since even unregistered property in the favelas of South America can change hands on an informal basis. But it is true that a lot of land cannot be developed due to issues with ownership titles.

The creation of agreed International Land Measurement Standards will unlock this development potential and enable regeneration in these emerging markets. This will create multiple business opportunities and public interest, provide confidence in the system to the favela owners and allow them a foothold on the property ladder.

Even when the land has been registered and transferred to new owners who wish to develop it, developers must first carry out a cost analysis and development appraisal. Currently, construction costs can vary enormously between countries and firms, each of whom may use their own basis for calculation and in some cases include planning and professional fees.

Potential cost overruns can be extreme: the highest on record is 36,917% for the Canadian Arms Registry, which escalated from an initial estimate of CAN$2m to a final cost of CAN$946m (http://bit.ly/2gpyVGj).

All this risk and lack of transparency can discourage business, whereas the ICMS provide an internationally agreed system allowing comparison of national and international construction and development costs. This additional level of clarity will mean that firms and non-governmental organisations have greater confidence in the overall cost of the developments they are undertaking.

When the development is complete, the premises must be measured for the purposes of transactions such as lettings or sales. This process is easier said than done, as many transactions are made according to national measurement standards and many occupiers and investors operate on a local basis so external developers may not be aware of the prevailing national standard when providing their space requirements.

Furthermore, research shows that, depending on the standard used, office measurements can vary by up to 24%, residential apartments by up to 15% and houses by up to 58% across world regions. In local markets, there can be a 27% variance in the measurement of residential apartments and 10% for houses (www.rics.org/loggias/loodings).

Fortunately, the IPMS Coalition comprises more than 80 member organisations and 300 partners, all of whom are committed to the adoption and implementation of the standards. The global adoption of IPMS will make transactions much easier for international investors and tenants and encourage further business from them.

International valuation

Finally, once the premises have been built and measured, you will need to value them, normally for reporting or accounting purposes, and to do so you will need a common basis of valuation.

RICS is a member of the International Valuation Standards Council (IVSC), which includes academic, corporate and institutional members. These standards provide agreed terms, and in some instances a methodology, for the valuation of businesses, intangible assets such as intellectual property, tangible assets such as personal property, plant and machinery, and real estate.

Meanwhile, international financial reporting standards, which are adopted by more than 120 countries as the basis for accounting, work with the IVSC to encourage business and stimulate trade. This gives investors and secured lenders the confidence that reported valuation figures are accurate.

"Selecting a surveyor who is not an RICS member is like buying an electrical item without a guarantee"

Alexander Aronsohn FRICS is RICS Director of Technical International Standards and Executive Secretary of the IPMS Standards Setting Committee

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Visit the international standards section of the RICS website

www.rics.org/intstandards

Related competencies include

Conduct rules, ethics and professional practice, Measurement of land and property
India’s built environment is in transition. New cities and urban areas are being created and existing ones being renewed or made smarter. Together with this transition from rural to urban, the country’s identity is also being transformed, and India often needs to balance its heritage with the need to create a foundation for its future generations.

Jobs in India are no longer what they used to be, and it is no longer possible to engage young adults in the trades that had kept the family name alive for generations. Families themselves are no longer large or connected by shared concerns about safety or common business because it has become easier to travel, and those who leave their home towns find it increasingly difficult to return.

What, then, is the meaning of sustainability for these populations in transition from one centre to the other?

Building design
Traditional construction techniques and vernacular architecture were fast replaced in India in the late 20th century by glass and steel. Architects and buildings owners alike were seduced by the high rises they had seen in western countries, though it was not steel but reinforced cement concrete that actually changed the way buildings were constructed in India. Architects such as Le Corbusier – who designed the entire city of Chandigarh, completed in 1960 (see photo, above right) – expressed fluidity of form in brutalist, exposed-concrete structures.

Such new materials responded to the demanding nature of congested urban sites, and when India’s economy opened up to foreign direct investment in 1991, it was no surprise that new capital brought with it new ideas. Glass became toughened, insulating, shading and aesthetically pleasing at the same time.

With bricks no longer bearing the structural load of buildings, the sizeable voids left behind by reinforced cement concrete frames were elegantly filled by large glass panels. Modern, air-conditioned offices for multinational corporations flaunted large, open floor plans, attracting workers who were younger and more affluent.

Yet the built environment was slowly creating new problems. Those beautiful views of the outside had to be obscured by blinds to keep out excessive light, while it was expensive to keep the air conditioning running during long power cuts. With increased urbanisation, tree cover fell drastically and cars took over the streets. Cities were slowly changing – socially, economically and environmentally.

Issues in modern cities
The built environment in India includes first-tier cities such as Delhi, Mumbai, Bengaluru, Chennai, Hyderabad and Kolkata as well as second-tier ones such as Patna, Chandigarh, Ahmedabad, Dehradun and Bhubaneswar. Each faces their own problems, such as the urban heat island effect, water table depletion, air pollution and vehicular congestion. Those moving from a rural to an urban area have not necessarily found the improved quality of life that they expected, leaving them with
mixed feelings about the detrimental effects of the city on child care, entertainment, sense of community and job satisfaction.

It is evident from this that the built environment plays an important role in shaping the lives of those who use it, and the Indian government has been working to address these issues. Many international accords such as those struck at the Earth Summit in 1992 and more recently the Paris Agreement on climate change are aimed at improving living conditions for all, and it has been widely understood that such sustainable objectives cannot be fulfilled in isolation, so the UN's 17 Sustainable Development Goals (SDGs), ratified by the Indian government, address issues across the spectrum.

The National Institute for Transforming India, or Niti Aayog, is largely seen as a replacement for the erstwhile Planning Commission of India and is responsible for progress on achieving the SDGs, and its strong influence on both central and state government ministries can be seen through the array of schemes and targets that have already been assigned to a particular ministry or department.

India has been quite active historically in adopting agreements on climate change, including the Earth Summit's Agenda 21, which to date has not seen participation from major developed nations such as the Australia, the UK and USA, neither from China and Malaysia. Government progress on the SDGs remains to be seen.

Green buildings

Green building has been gaining importance in the eyes of Indian policymakers recently. An increasing number of developmental authorities have revised their byelaws to encourage the use of third-party green building certifications by providing additional floor area ratio for free. Lack of uniformity in such incentives has led to competition between the certification bodies, with some claiming more acceptance than others. The policies themselves are mostly unclear on the penalties for misuse of certification.

This creates ambiguity, and as a result very few projects have actually been encouraged by the byelaws, though a large number of developers are making the business case for green buildings on that basis alone. Intended as a catalyst, these are fast becoming a distraction from sustainability in the built environment, as they end up being seen as just another compliance issue or revenue stream for all stakeholders. Neither are certification bodies themselves above criticism for favouring certain segments of the market or even weakening their standards to remain in business.

The impact of these high-level policies and requirements on the lives of building users is yet to be properly understood. One of the key issues is the lack of public awareness about the benefits of green buildings. The concept of sustainability itself is not consistently defined by those managing buildings and those occupying them. Green building rating systems are failing to address the social and economic aspects of sustainability, and some would argue that they do not comprehensively address the environmental aspects either.

Corporations have been preparing annual sustainability reports for their stakeholders for some time now, and an umbrella organisation that could help integrate all aspects of sustainability and advise governmental and non-governmental bodies alike would be welcome, as it would help policymakers decide their priorities while assessing the sustainability of a project. The current choices are to endorse third-party certifications, as is done by the New Okhla Industrial Development Authority, Ghaziabad Development Authority and others, or to lay down their own performance requirements, as under the model building byelaws of the Delhi Development Authority. The problem with the latter is that the requirements are not clear and it is easy to show compliance without evidence of performance.

Need for skills

Some significant work has already been done on sustainability in India. This includes establishing a number of programmes encouraging people to use green technologies such as solar power, mandating environmental impact assessments for larger projects, creating standards such as the Energy Conservation Building Code of India, inclusion of a separate chapter on sustainability in the National Building Code of India, and a range of other initiatives under the government's Smart City Mission.

The country still needs a number of skilled professionals to handle responsible construction practices as well as bridging the widening gap between policymakers and building users, and this is one area where the RICS School of the Built Environment is contributing. The true objectives of a sustainable built environment need to be understood through increased user participation and dissemination of knowledge by the responsible parties. None of the current efforts are perfect or sufficient, and though the journey has begun we still have a long way to go.

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Nature counts

Property professionals should all be invested in natural capital and ecosystem service valuation. Morgan Taylor and Lisa Lange explain why

From an environmentalist’s perspective, last year’s Autumn Statement was notable for the allocation of £15m in funding for natural flood prevention measures. While this was a rather small gesture, it could, with optimism, be seen as a turning point in the political rhetoric. This money is a metaphorical deposit in the ‘Bank of Natural Capital’, and will go towards ecosystem service provision, something that has not been explicitly allowed for in previous statements. Ecosystem services are the beneficial outcomes of functioning ecosystems – biological communities and their chemical and physical environments, such as rivers, wetlands, woodlands or coastlines – and can be divided into four key categories.

- Cultural: benefits for people’s health, wellbeing and cognitive development as well as the aesthetic value of experiencing nature.
- Provision: products obtained from ecosystems, such as food, fuel, pharmaceuticals or fresh water.
- Support: services such as nutrient cycling, photosynthesis and soil creation.
- Regulation: processes such as carbon cycling, air quality control, water regulation, pollination, natural hazard reduction, pest regulation and, most important now, climate change regulation.

These are the manifestation of what is termed natural capital, the stock of renewable and non-renewable resources from which we derive value. Inherently, all financial capital relies on its natural cousin, with the flow of associated services providing us with the water we drink, the food we eat and the air we breathe. But few have heard of the concept, and it has been rare for valuation of natural capital to feature in large-scale economic decision-making, particularly in the planning process.

Our indentured ecosystems are essential to our ability to combat climate change and sustain our comfortable 21st-century existence.

Valuation assessments

It is becoming increasingly important for us to consider more than immediate financial returns when making development decisions. One major issue, however, is determining who should foot the bill for ecosystem service provision, because the services are in effect public goods that may benefit many even though no-one in particular is obliged to pay.

As an example, this issue is evident when considering major catchment management for rivers that cross national borders: impacts to the riverine ecosystem upstream in one administration could have unforeseen consequences for provisioning downstream in another. Valuing the services at least provides some financial context for management in the wider sense of the service, or in effect, the service provider – the ecosystem itself.

Ecosystem service valuation is a relatively new concept, and one steeped in controversy. The idea of placing a value on nature, while useful, poses many risks, and paves the way for all natural capital decisions to be made from a purely financial perspective. Ecosystem service valuation should not only dwell on financial output, but also on often unquantifiable elements such as aesthetic or even spiritual value. Implicitly, the valuation process runs the risk of making a trade-off between a development and ecosystem conservation, particularly where assessment may prioritise a measure such as habitat destruction. It is therefore best handled with care.

Ecosystem service valuation is theoretically allows for non-monetised elements to be effectively traded through the provision of compensatory service provision, whereby damage done on site is redressed by measures elsewhere. The government’s biodiversity offsetting pilots of 2012–14 (http://bit.ly/2h3Ufg) and the “no net loss” calculator being used by High Speed 2 (http://bit.ly/1PeQwB3) are variations on this approach.

There are a variety of tools available for ecosystem valuation, alongside a bewildering amount of literature. What they have in common is that most make a distinction between direct services such as fish, timber, water and so on and indirect ones including water quality regulation and carbon cycling.

Tools for ecosystem valuation can be broadly categorised according to whether they are calculators for payment of ecosystem services or ecosystem service mapping. The former are market-based tools that aim to foster behavioural change; there is great potential, for instance, in creating markets for provisioning services such as nutrient cycles and pollination. However, these direct, incentive-based mechanisms only account for a single service at a time, rather than for the complexity of the entire system.

Ecosystem service mapping on the other hand aims to identify and visualise different ecosystem services through spatial analysis using GIS technology. Such mapping exercises can then be used as a basis for decision-making and help identify opportunities for ecosystem service interventions, such as woodland restoration, flood plain management or urban green infrastructure creation.

Most ecosystem service mapping tools concentrate on landscape-scale service provision, and can be used to help inform policy, legislation and nationwide approaches to ecosystem management. However, ecosystem service valuation also has potential value for much smaller-scale placemaking. If one can compare the baseline service provision of a site with that of a proposed scheme, it is possible to devise mitigatory or compensatory actions, and – of greater importance to a developer – identify where financial gain can be made from environmental benefits.

What is important when applying any valuation model, sometimes referred to as taking the ecosystems approach, is recognising how all businesses depend
on nature and its services to some extent. Such schemes as the Natural Capital Protocol (http://bit.ly/29MRq4Q) build on this to inform business decision-making in an holistic manner, considering natural capital alongside traditional finances.

**Practical considerations**

Developers should be encouraged to provide green infrastructure such as living roofs, sustainable drainage, green walls or biodiverse landscaping on all schemes where assessments show that ecosystem service provision could directly benefit the community or the wider environment. Valuations can tell developers how much money their scheme will bring into the local area as a consequence of green infrastructure, or health and wellbeing benefits for the local NHS trust, for example. These can be valuable bargaining chips in the planning process.

Some service valuations are as follows.

- People are 24% more likely to meet NHS-recommended levels of physical activity and so reduce the sedentary population, if they live within 500m of accessible green space. With potential savings for the NHS of £1.44bn from a 1% reduction in morbidity and mortality rates, there are fairly major implications for providing people with access to green space (http://bit.ly/1LuPXLW).
- Agricultural environmental stewardship was estimated to save 3.46mt of carbon dioxide equivalent a year from 2007 to 2013, roughly equal to saving £1.26bn (http://bit.ly/2lKroCC).
- Street trees in Greater London are estimated to provide a value of more than £130m a year in storm water alleviation, carbon sequestration, energy savings and pollution removal (http://bit.ly/1JOtNLNe).
- Natural coastal floodplain restoration has been shown to have a cost–benefit ratio of 1.32 (http://bit.ly/1s01xGG).

- Studies have shown the potential benefit that well-managed natural space can have on inward investment and house prices; a community woodland created in St Helens in Merseyside was estimated to enhance property values in the area by £15m (http://bit.ly/2lEKeN9).

The evidence is exhaustive. Forest Research’s Benefits of Green Infrastructure (http://bit.ly/1LuPXLW) and Natural England’s Microeconomic evidence for the benefits of investment in the environment (http://bit.ly/1s01xGG) are two useful reviews that collect a lot of contemporary data on ecosystem service valuation, offering useful further reading.

The Department for the Environment, Food and Rural Affairs is currently working on a comprehensive 25-year plan with the Natural Capital Committee (http://bit.ly/T2WeGj) that will include ecosystem service valuation. Several councils have also cooperated with universities in ecosystem service mapping and valuation exercises, incorporating this into planning approaches.

One current example is the University of Northampton’s Nene valley project (http://bit.ly/2h9z9r5), which identified, mapped and valued natural capital and ecosystem services along the river, and has been embedded in the recently adopted North Northamptonshire Joint Core Strategy. North Northamptonshire Joint Planning Unit and the university are currently formulating a guide to ecosystem services for planners and developers, and service valuation should have a key policy role in the near future.

**Final thoughts**

Climate change forces us to make decisions that relate not only to the ethics of conserving nature but also to our desire to fund and enable the survival of future generations. In January, the government accepted the conclusions of its official advisors, the Committee on Climate Change, which stated that the UK was poorly prepared for climate change (http://bit.ly/29xAjzH). One of the key six areas of risk was the threat to natural capital and ecosystems. Combatting this threat was identified as an urgent priority; such robust conclusions should not be ignored by those with influence.

Valuing ecosystem services is a major challenge. While it is relatively simple to put a figure on provisioning elements such as fish stocks or fuel as direct market value can be assigned, valuing the ability to take a walk in a woodland is very subjective. Valuation alone does not therefore provide sufficient basis for fully informed decisions. Nevertheless, it has potential to help planning decisions and should be used more frequently by those across the property sector.

**Related competencies include**

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Hitting the target, missing the point

Julie Hirigoyen explains why those responsible for our built environment must aim higher

Targets are always tricky to set. Some people set them around what can easily be achieved, others are more ambitious and seek to challenge themselves; but few set their targets based on hard scientific facts. Yet this is precisely what is required when setting emissions reduction targets to ensure we avoid catastrophic climate disruption.

The UK has a very ambitious target enshrined in the Climate Change Act 2008 to reduce its greenhouse gas emissions by 80% from 1990 levels by 2050. The construction sector itself has a target to reduce UK built environment emissions by 50% by 2025, showing that at a national level we are quite good at setting stretching targets.

Lead by example

But targets do not mean anything unless considerable efforts are directed at achieving them, and at present, the government has very little policy to help meet the 2050 target. It scrapped the zero-carbon targets for new buildings and the Green Deal, and shied away from setting a trajectory for the Minimum Energy Efficiency Standards, so it is unclear how the built environment – which contributes 40% of our national carbon emissions – will help meet the target at all. Developers will thus have to lead by example and set their own targets at the project level to achieve radical energy efficiency improvements.

The only problem with that is that it presupposes that the industry is both setting the right targets and able to meet them. Yet at present, our buildings consume up to five times more energy in operation than they were designed to do. So there must be a better way to set targets. And let us be clear: targeting regulatory compliance is not in itself stretching or ambitious. Building Regulations only take into account fixed building services, such as heating, cooling, hot water, auxiliary energy use and internal lighting, and exclude IT, security, small power loads and operational factors, so items that can significantly raise a building’s energy consumption are largely overlooked.

Accurate targets

The industry must urgently address this by setting performance targets for design based on accurate predictions of energy use and occupational patterns, with simple indicators understood by all parties, such as kWh/sq. m.

In any other industry, failing to provide products that perform as expected would be a scandal. Yet the UK’s property sector is getting away with it. Responsibility for building performance is fragmented among the project team and areas of accountability are ill-defined, leaving us with no real recourse when buildings fail to perform as expected.

We need better control over the procurement process; an integrated approach across projects; and client commitment to validating operational performance. High energy efficiency standards ought to be built into the contractual obligations of the whole project team, with guarantees as to the performance of the end product.

Joined-up thinking should be adopted throughout the lifecycle of our buildings, especially at handover, as reciprocal links and monitoring can allow us to understand how a new building is performing during use, and realise any potential for optimisation. Links must be made between operational facilities management (FM) and the design team, and between FM and building occupiers, with a commitment to monitor and feed back on energy performance. Post-occupancy evaluation enables benchmarks to be set for future buildings and to learn what does not work.

Benefits

Better knowledge and awareness are essential in tackling this issue. The benefits of enabling higher building performance make for a compelling business case. But, under schemes such as the outgoing Carbon Reduction Commitment and the Climate Change Levy, it has often been seen as easier simply to pay the tax since energy use is so small a proportion of total running costs in non-industrial building sectors.

UK Green Building Council research suggests that there is a much more powerful case to be made based on the productivity, health and wellbeing benefits of buildings that perform well. Owners, occupiers and letting agents need to understand that it makes economic sense. Through its work with the World Green Building Council, the UK Green Building Council seeks to educate these groups regarding the financial benefits of high-performing buildings through the Better Places for People campaign (http://betterplacesforpeople.org).

In just a few short decades, we need to be providing zero-carbon, zero-energy buildings. But today we are not even providing low-energy or low-carbon buildings. We must wake up to both the business case and the moral imperative of delivering high-performing buildings. Only by working together to challenge conventional attitudes and improve knowledge through the value chain can we hope to begin to make the change that is needed.

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UK Green Building Council, Delivering Building Performance
http://bit.ly/1TzPuIx

Related competencies include
Construction technology and environmental services, Sustainability
Is there another answer?

Tom Hyde discusses important research that could help solve the UK’s housing deficit.

It is a fact that not enough homes are being built in the UK and homeownership is at its lowest rate in 30 years (http://bit.ly/2fIHEQH).

Alternative approaches are increasingly in demand, and the private rented sector (PRS) has an integral role in reducing the UK’s housing deficit. The sector involves stakeholders from small-scale landlords to large-scale developers constructing purpose-built rented accommodation. In recent years, the number of large stakeholders has significantly expanded, building on the work of major established players such as Grainger, with its portfolio of around 3,600 homes (http://bit.ly/2fI8AMH).

Other ventures have included Fizzy Living, run by Thames Valley Housing, and Be:here, run by Wimott Dixon, whose apartments have on-site teams offering amenities and additional services such as organising repairs and events for tenants.

Speaking at the RESI 2016 conference, Housing and Planning Minister Gavin Barwell said: “We need to build more homes of every type and not focus on a single tenure ... a thriving PRS is an integral part of that.” This is certainly encouraging, and with an appropriate policy direction the PRS could certainly fulfil the pledges set by the government.

With the number of people renting set to increase and homeownership at such a low rate, there is a clear market for the PRS, but it seems that planning policy guidance on this sector has yet to realise its potential. As long as this remains the case, the PRS will lie largely dormant, to the detriment of thousands of people seeking an appropriate home.

Policy direction

Lack of government intervention means that it has been largely left to local authorities to address the specific planning policy needs of the PRS, and London’s boroughs have taken a definite lead. The Minor Alterations to the London Plan (http://bit.ly/2hryBO) published in March 2016 include an updated policy on the PRS in the capital. Policy 3.8 – housing choice – states: “The planning system provides positive and practical support to sustain the contribution of the PRS in addressing housing needs and increasing housing delivery.”

London Mayor Sadiq Khan has placed a strong emphasis on affordable housing, and boroughs will have to consider his priority of getting London to build the homes and communities it needs; he has set a target for half of all the new homes built across London to be genuinely affordable for renting or buying, as well as seeking more stability in the PRS.

The updated London Plan has prompted the capital’s planning authorities to produce their own guidance and policy positions, with the initial response showing a considerable range of approaches. Nexus Planning has reviewed the planning policies of all London boroughs and the City of London to see how each is responding to the challenges and potential of the PRS. The response has been relatively mixed (see Figure 1).

- Of the 32 boroughs and the City of London, eight (24%) have recognised the role of the PRS in helping meet housing need in their area. One example is the London Borough of Wandsworth, whose policy guidance addresses this directly: “The council supports the development of PRS housing and schemes offering a mixture of private and intermediate rented housing aimed at working households” (policy 15.5 of its core strategy, 2016).
- Five London boroughs (15%) have highlighted the importance of the PRS to their housing stock, but have not outlined their support for the sector through specific policy guidance.
- Westminster City Council and the London Borough of Richmond upon Thames have indicated that further updates will be needed, with the latter stating in its local plan that “the PRS can assist in meeting a range of needs and be particularly suitable for certain locations. It could offer longer-term tenancies and more certainty over long-term availability, and ensure effective management through single ownership”.
- Surprisingly, 20 boroughs (61%) have not recognised the PRS in their development plan documents or local plans. Some have even sent a clear message on the importance of affordable housing contributions in all new developments at the expense of the PRS.

The London Borough of Haringey’s emerging development plan document of January 2016, for example, stipulates that “while the PRS may provide a cheaper alternative to owner occupation, for the purpose of planning, these units are treated as conventional market housing (use class C3) and are subject to affordable housing contributions”.

Council companies

In the past few years, some London boroughs have formed their own development companies, which are independent of, but owned by, the council. If managed correctly, these have...
the potential to use public land to build large-scale PRS schemes, with the rent ensuring a steady long-term revenue stream for the council. This could then be reinvested in more affordable housing projects and other essential services.

Examining all London boroughs and the City of London, Nexus’ research found that 11 authorities (33%) have established or are establishing a development company capable of building its own PRS schemes. A further 10 authorities (30%) have either started or are planning to start building their own council housing again, many for the first time in 30 years; the remaining 12 authorities (36%) are relying primarily on the private sector and housing associations to meet their residential needs.

With consistently low interest rates, now is a good time to borrow and invest. Furthermore, by creating an independent company, councils are able to borrow beyond the government-imposed caps on their debt. Such housing would also be exempt from right-to-buy policies, ensuring that boroughs retain rental stock in the long term.

Some London boroughs are investigating ways of building their own homes, which represents an encouraging development in the policy approach to housing provision. The scale of this is still small, however, with relatively few boroughs considering large-scale PRS schemes as a vital part of their long-term revenue stream. While this remains the case, the potential of the PRS will remain largely unfulfilled.

Developing debate
There has been much debate around how the planning system can better accommodate the PRS. The key message from those looking to develop and invest in the sector is that greater flexibility is needed in terms of section 106 contributions, along with more innovative design to speed up construction. Consequently, many have called for the government to provide stronger policy direction beyond its build-to-rent initiatives, with some asking for a specific use class for the PRS. This class could allow developments to take a more flexible approach to space standards. Developers could then offer more space-efficient flats, provided the London Housing Design Guide’s minimum sizes no longer applied in their current form; in the way that student accommodation is, for example, normally exempt from these standards. Larger room sizes mean higher costs, and with communal facilities representing an important part of much of the PRS, the use class can negate the need for certain features and therefore enhance the capacity of developments.

There are a number of drawbacks to a new PRS use class, to a new PRS use class, however, meaning that its introduction would not be appropriate. A use class ties a development into a specific function and makes change of use even more challenging. This would be a disadvantage for those looking at shorter-term investments, as they would not have the flexibility to navigate changing markets with confidence. It would also become increasingly difficult to encapsulate the different approaches and forms that PRS developments can take. Despite the high prices, there would appear to be little appetite for a dilution of space standards.

The policy answer
The benefits of a dedicated PRS use class are difficult to quantify, and the industry remains undecided on whether its perceived merit outweighs its potential long-term limitations. Overall, a specific PRS use class is not necessary at present, as it would represent further unwanted complexity, creating barriers to development and limiting options in challenging market conditions.

The required impetus can be achieved more effectively with a strong policy approach, led by both central government and local authorities – policy that engages with developers on the issues of design, local contributions and long-term viability, along with appropriate covenants and leases. Furthermore, flexibility in initial section 106 contributions for PRS schemes would help reduce the burden on developers at the outset and potentially return greater long-term rewards for local authorities.

A more comprehensive and consistent policy approach to developing PRS provision would be valuable to all. Managed correctly, the PRS is vital in providing much-needed housing. Robust policies must be adopted to maximise its potential to benefit local authorities and their surrounding communities.

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Revaluation & statutory compensation

Q I own a central London building let to a retail tenant on a lease protected under the Landlord and Tenant Act 1954 that expires soon. Although the tenant wants to renew the lease, I intend to redevelop the whole of the building, including the part let to the tenant. Could the forthcoming rates revaluation affect the amount of statutory compensation I may have to pay the tenant?

> Markus Klempa and Louise Kellaway

A If the tenant enjoys protection under the 1954 act, including the right to apply for a new lease, it may be entitled to statutory compensation from you on leaving. The right arises only if the ground(s) on which you successfully oppose a new lease request do(es) not depend on tenant fault. There are three “no fault” grounds, including “ground (f)”: redevelopment.

However, if you can successfully oppose a new tenancy on one of the grounds involving tenant fault, you will not have to pay statutory compensation. These grounds include persistent delay by the tenant in paying rent on time, disrepair, other substantial breach of tenant covenants, or situations where you have offered suitable alternative accommodation.

If it looks as though you will only be able to oppose a renewal on a “no fault” ground, you should check whether the tenant has agreed, for example in the lease, that the landlord does not have to pay such compensation. Such agreements, however, tend only to be valid if the tenant has been in continuous occupation for the purpose of its business for less than five years at the date it quits. Occupation by the tenant’s predecessors can be taken into account if the same business has been carried on, that is, if one business has been acquired by another.

Broadly speaking, a tenant is entitled to the property’s rateable value in compensation, unless it and any predecessor has been in occupation for 14 years or more, in which case compensation is twice the rateable value. The 14-year period is calculated backwards from the termination date specified in the landlord’s section 25 notice, or the tenant’s section 26 request. You can check the draft rateable values taking effect on 1 April 2017 online at the Valuation Office Agency’s website (http://bit.ly/2iyXPEC) to see whether the value for the property in question is due to change.

The first step if you want to terminate the tenancy and oppose the grant of a new lease is to serve a valid notice pursuant to section 25 of the 1954 act. The notice must state your ground(s) of opposition and specify a lease termination date that can be the contractual expiry date or later, but must be no more than 12 months, and not less than six months after the date of service of the notice.

If the tenant has already served on you a section 26 request for a new tenancy, then you cannot serve a section 25 notice, but must instead serve a valid counter-notice on the tenant no more than two months after service of its section 26 request. The counter-notice must also specify the ground(s) on which you oppose its request.

Compensation is based on the rateable value in effect on the date of service of either your notice under section 25 of the 1954 act or counter-notice to the tenant’s section 26 request for a new tenancy. Therefore, if the date of service of one of these notices is on or after 1 April and the rateable value of the property is higher in the new valuation list, you may have to pay more compensation to the tenant when it leaves the property if its lease is not renewed.

If, as seems likely, the rateable value of your property will increase on 1 April, you should consider serving your section 25 notice on or before 31 March. Alternatively, if you receive a section 26 request before 1 April, you should serve your counter-notice within the two-month deadline and on or before 31 March for compensation to be based on the pre-April valuation list.

If instead the rateable value of the property will fall on 1 April, you may have to pay less compensation if you serve your section 25 notice or counter-notice to a tenant’s section 26 request on or after 1 April.

Ultimately, compensation is one of many commercial factors that needs to be considered when planning a redevelopment. Opposing a tenant’s right to a new lease is a complex process, and it is therefore recommended that you seek legal advice at an early stage.
Despite their perennial value, capital allowances are particularly relevant at the moment says Robert Walker

Capital allowances have always been an extremely valuable tax relief for companies incurring expenditure on buildings and plant. However, we are seeing an even greater focus on them in the light of the potential loss of other reliefs – for example, the restrictions due in April on interest relief and the carrying forward of trading losses.

Normal accounting practice is to capitalise expenditure on buildings and plant and gradually record it as an expense in the profit-and-loss account over the useful life of the asset through depreciation. For tax purposes, no deduction is allowed for depreciation; instead, the business identifies and claims tax relief as capital allowances.

These allowances can arise on a range of expenditure on capital employed in the business, but most commonly occur on plant and machinery since the abolition of Industrial Buildings Allowances.

Types of allowance
There are special and general rate pools of plant and machinery allowance and these are claimed annually on a reducing balance basis.

The following items go into a special rate pool, which attracts an 8% allowance:
- features integral to buildings, such as electrical or lighting systems, hot and cold water, lifts and escalators
- long-life assets, i.e. where the predicted useful life is at least 25 years
- cars with higher carbon dioxide emissions
- thermal insulation added to existing buildings
- solar panels (photovoltaics only).

Most other plant and machinery defaults into the general pool and is eligible for an 18% allowance. Cars with lower carbon dioxide emissions may also qualify for an 18% rate.

100% allowances
These allowances are extremely attractive given that all the expenditure can be deducted from the profit in the year of being spent. However, in our experience they are often overlooked.

Annual Investment Allowance is available for all businesses, and provides 100% relief on expenditure up to £200,000 per annum on plant and machinery.

Enhanced Capital Allowances (ECAs) also provide a 100% relief for energy-saving or environmentally beneficial plant and machinery, cars with low carbon dioxide emissions – that is, less than 75g/km – zero-emission goods vehicles, and plant and machinery for natural gas, biogas and hydrogen refuelling stations. It is reasonably simple to check whether plant qualifies by checking the published lists (see www.eaca.gov.uk).

Loss-making businesses, which might not otherwise be attracted by capital allowances, may be able to convert the loss generated by the ECA claim into a repayable cash tax credit, making it especially appealing.

Cash tax credits may also be available to businesses making a loss that have incurred expenditure on the remediation of contaminated land. This relief is available at 150% for the costs of remediating land contaminated by third parties.

Other 100% allowances include Business Premises Renovation Allowance, which is available for costs incurred before April of bringing derelict or unused properties in disadvantaged areas back into use, and Research and Development Allowance, available for the costs incurred on buildings used for such purposes.

Dispelling myths
It is not uncommon to find that businesses have either not claimed or have underclaimed allowances. This is often due to a misunderstanding of the rules or the process for making a claim.

We have therefore tried in what follows to address some of the more popular myths that persist.

You should not delay consideration of capital allowances until after you have bought a property. Rules on “fixtures” require both parties to consider the capital allowances at the time of the transaction. Often an election is required to transfer the allowances between the parties, otherwise both parties may lose the benefit of them.

It is worth noting as well that neither claiming allowances nor entering into an election should have any adverse impact on capital gains base cost.

You should also not discount capital allowances due to a lack of information. Where your business has expenditure that you cannot analyse because you lack information, it may be possible for advisors to help make claims by filling in the missing details, using our knowledge of building components.

And finally, you should not discount capital allowances if your business is making a loss. Even if your business cannot use the relief, identifying qualifying expenditure on a property can increase its value to a future purchaser. Alternatively, if ECA or contaminated land tax relief are available, a claim can mean welcome cash back.

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Can green bonds flourish?

Standardisation is needed if green bonds are to align the interests of tenants, commercial real-estate companies and global investors successfully, argues Michael Wilkins.

In a speech to the UN General Assembly in April last year, Bank of England Governor Mark Carney made the point that green bonds – debt instruments whose proceeds are used to fund environmentally sustainable projects – have the potential to align the interests of issuers and investors. This is particularly true for real estate. Green bonds can allow commercial real-estate firms to acquire funds for developing assets such as office blocks and residential buildings, and improve the sustainability of their portfolios, while they also make for reliable investments that contribute towards a green economy.

Yet despite the benefits, green bond issuance in real estate has so far been limited. This is a result of lack of formal standardisation and the absence of a coherent set of defining procedures for bond governance and use of proceeds, which has been hampering confidence. Increased standardisation, going beyond the positive contributions already made by frameworks such as the International Capital Market Association’s Green Bond Principles (http://bit.ly/2d659op), should therefore be established for such bonds to fulfil their potential.

**Tenant demand**

An increasing number of commercial real-estate tenants – mostly large international corporations – are looking to rent sustainable property. There are several reasons for their interest:

- According to the UN Environment Programme, buildings consume about 40% of energy, 25% of water and 40% of resources globally, as well as emitting around a third of the world’s greenhouse gas emissions. So it is not surprising that a growing number of commercial tenants are looking for economically sustainable properties that will reduce their energy bills and other operational expenses.
- Occupying environmentally sustainable property not only enables corporate tenants to reduce their costs, but also shows their dedication to tackling climate change goals and building a sustainable economy. In fact, most large companies now incorporate their green credentials into regular reporting and consider environmental factors as part of their global strategy.
- The CBRE European Occupier Survey 2015/16 (http://bit.ly/Rpqzep) also found that, among 120 European global corporations, sustainability and environmental concerns rank equally with geopolitical issues in terms of future operational concerns, higher than currency fluctuations and emerging market competition.

**Sustainable portfolios**

To meet rising expectations from tenants, commercial real-estate companies are increasingly looking to implement stronger sustainability measures for the buildings in their portfolios.

As of December 2015, most of the commercial real-estate companies that S&P Global Ratings assesses report that a majority of their office portfolio is certified as green by various energy efficiency and environmental awareness labels, with the aim of certifying more assets over the next two to three years.

**Percentage of office portfolio certified in terms of floor area**

<table>
<thead>
<tr>
<th>Selected commercial real-estate companies</th>
<th>Portfolio in 2012</th>
<th>Portfolio in 2015</th>
<th>Target over the next two to three years</th>
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<td>Société Foncière Lyonnaise S.A. (credit rating = BBB)</td>
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Source: Standard & Poor’s Financial Services LLC
Note: Green certifications or labelling are any relating to energy efficiency or environmental awareness, sourced from the companies’ corporate social responsibility reports
Most large companies now incorporate their green credentials into regular reporting.

Figure 1 illustrates how leading European commercial real-estate companies have increased – and are further aiming to increase – the green certification of their portfolios.

In addition, S&P Global Ratings has found that sustainable properties attract more reliable tenants, which in turn helps commercial real-estate companies collect steady, adequate rents while reducing vacancies. Moreover, high occupancy and creditworthy tenants are beneficial for such companies’ competitive advantage and credit rating, as they enable predictable cash flows.

Stronger market position

The “greenness” of real-estate assets can also be a distinguishing factor in oversupplied markets where tenants are more aware of environmental factors. Paris is a good example; French commercial real-estate company Société Foncière Lyonnaise, for instance, has a relatively small number of assets, but can boast high energy efficiency across these because it views green certification as necessary to demonstrate the superior quality of its holdings.

For markets that are undersupplied in higher-quality green assets, including Madrid and Barcelona, certification is also a way for commercial real-estate companies such as Merlin Properties to affirm market leadership.

In the London real-estate market, however, there has been less of a focus on green certification than in continental Europe. Put simply, attracting tenants has historically proven less difficult in London than in other European cities. For this reason, UK commercial real-estate issuers such as Derwent London have focused on improving the sustainability of future assets rather than existing one. Yet, should the London rental estate environment turn sluggish in the light of Brexit, buildings’ green qualities may come to play a larger part of UK real-estate investment trusts’ strategies.

Access to the bond market

S&P Global Ratings has found that, for the pool of green bond investors to grow, clarification of and standards for the market are necessary. Currently, issuers are responsible for documenting and reporting the “greenness” of the bonds they issue. This can come at a high cost, including fees for external reporting and third-party certifications, which could pose a barrier to green bond expansion in the long run.

Moreover, bond documentation typically includes commitments to use proceeds for environmentally sustainable projects, which can restrict the flexibility of the issuer in terms of property management. As a result, green bond issuance has thus far been limited to a group of large issuers of high-quality credit that can afford these extra costs and absorb the proceeds without disrupting their operational strategy. This issue seems to stem from the lack of a sector-specific framework for the green bond market, which would unify green bond criteria and preserve the issuers’ flexibility in terms of property management.

Currently, the sector benefits from various established methods of certifying the “greenness” of buildings: the Building Research Establishment Environmental Assessment Method (BREEAM), High Environmental Quality (HSEQ) and Leadership in Energy and Environmental Design (LEED) certifications. Each assesses buildings by indicators such as carbon emissions, water efficiency, waste management and construction materials. However, the future success of green bonds in real estate will most likely rely on introducing standardisation.

To help increase momentum, S&P Global Ratings plans to release a green evaluation product before July, to assess the governance, transparency and environmental impact of a green bond in real estate as well as in other sectors. The ability of investors to benchmark the “greenness” and credit quality of their bond portfolio should lead to greater transparency and ultimately bolster market growth in this nascent sector.

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Related competencies include
Investment management, Sustainability
A going concern

Valuing trade-related property is a task for qualified specialists alone, cautions Becky Thomson

Certain types of industrial and commercial property often sell as going concerns, and are referred to in the UK property market as “trade-related property”. These have certain defining characteristics, as follows.

- The property is designed or has been adapted for a specific trading use – a cinema, for instance, can really only be used as a cinema, and another type of business could not occupy it and operate successfully without making significant alterations to the building design.
- Any property that requires a licence to operate, such as a public house, has a commercial advantage over other types of property in that area without a licence.
- Ownership of the property passes with the sale of the business – the two are interlinked.
- Value is based directly on the building’s trading potential for the specific use. Instead of using other comparable properties or rental income as a basis, valuers will analyse the business accounts and the potential for profit when valuing trade-related property.

RICS members should be careful to undertake valuations of such properties only when they have the correct training. This article will cover the many factors involved in these complex valuations.

Kinds and characters

Trade-related properties are typically found in the following sectors.

- Healthcare:
  - residential care homes
  - private hospitals
  - mental health units
  - learning disability units
  - nurseries and day care centres.
- Hospitality:
  - public houses or bars
  - hotels
  - restaurants.

- Leisure:
  - gyms and sport clubs
  - arenas
  - golf courses
  - ice rinks or bowling alleys
  - cinemas.

The difference between an operational trading property and other types of commercial property is that the asset can often include more than land and buildings. A trading property typically comprises the following elements.

- Legal interest in land: this can include either freehold or leasehold titles.
- Trade fixtures and fittings: in addition to the actual bricks and mortar, a trading property will also have a number of permanent fixtures and fittings that will be fundamental to trading; these carry an additional value that has to be taken into account by a profits method valuation, which is described below.
- Transferable goodwill: when valuing a trading property, it can be difficult for valuers to distinguish between its trading potential and the goodwill that is associated with a current owner. For example, a pub or restaurant with an excellent reputation will have some goodwill value, but when the current owner sells the property and moves on the goodwill could go with them. Transferable goodwill is inherent in the property itself and brings economic trading benefit, for example due to location or a monopoly position. The valuer’s expertise is sought to distinguish between influence on property value and what is classed as an intangible asset, which needs identifying separately.

- The benefit of any transferable licences: the valuer should assume that the proposed purchaser can obtain or renew any existing licences, consents, certificates or permits.

The complex nature of trade-related property means the investigations associated with valuation are more extensive than for standard commercial properties. The valuer will review any relevant income statements going back at least three years; examine details of the existing levels of trade; analyse the pricing structure being used; note local competition; advise on the impact of location; and investigate any statutory restrictions and legal aspects of planning consents, licensing and supply agreements and so on.

Distinguishing intangible assets and real estate

The distinction between intangible assets and real estate gets particularly nebulous in the case of trade-related property. Valuations undertaken for financial statements involving both real estate and intangible assets require a high level of experience and competence in the relevant market, as well as a detailed understanding of other codes such as the International Financial Reporting Standards. Distinguishing between real estate and intangible assets may seem relatively straightforward, but a valuer must be aware of certain anomalies.
**Intangible assets**

An intangible asset by its very nature lacks physical substance, so a valuer will use the rights and privileges to which it entitles the owner as a basis of value. Examples of intangible assets include trademarks or trade names, internet domain names, customer lists and relationships, order books, copyrights, service contracts, patented technology, computer software and goodwill.

Intangible assets may also have attributes that influence their value; however, these are not in themselves intangible assets. They may include high market share, competitive edge, uniqueness, being the first to market or offering particular innovations, efficiencies and cost savings, and technological superiority. It is important to distinguish between intangible assets and attributes.

**Real estate**

While real estate is a tangible asset, it may, too, have intangible attributes that influence the value; for example, the location and situation of a property may increase the value of the property as a result of the surrounding neighbourhood, adjacent occupiers, proximity to local amenities and transport links, and development potential.

However, it is still important to note that these do not count as intangible assets either, and cannot be valued as such in financial statements.

**Methods of valuation**

The majority of operators will decide whether or not to take on a specialist trading property based on the profits that they can earn – if they cannot make an adequate return, they will not take the premises. Therefore, the profits method is the most appropriate for valuing the majority of specialist trading property, and can be used to find both market rent and market value.

To find market value using this method, the valuer has to determine the potential profitability of a competent operator of the business. This value is known as the fair maintainable operating profit (FMOP), and is expressed as earnings before interest, taxation, depreciation and amortisation (EBITDA). This figure is then capitalised using a multiplier derived from market yields called a “years purchase multiplier”, which will be established by comparison with similar businesses using the valuer’s expertise.

The basic methodology is demonstrated in Figure 1. Note that application of the profits method does vary between different asset classes, so discussion of the methodology is based on its broader principles.

Once market value has been established using the profits method, it may be checked by comparable sales evidence using direct capital comparison.

**Applying the profits method**

**Inspection and research**

Before undertaking a profits valuation, the valuer needs to have a thorough understanding of the economic factors affecting the turnover of a trading property. The following information would assist them.

- **Local area knowledge**: proximity to sensitive neighbour groups (e.g. elderly people, children etc.), local competition, proposed development, surrounding land uses, local economic conditions, demand and price sensitivity etc.
- **Nature of the trading property**: customer profile, prices, levels of sales, promotions, awards, occupancy rates (if relevant) etc.
- **Nature of the property itself**: construction, design and layout, provision of service for the trading business, surplus site or buildings, development opportunities, standard of accommodation etc.
- **Potential** for the operation of a more profitable style of business.
- **Legal data**: permits, licences, certificates, safety consents, planning permissions, title deeds etc.
- **National and local market trends**: occupier requirements, availability of finance, business benchmarks etc.
- **External influences**: legislation such as the Licensing Act 2003, which amended licensing hours, and the Health...
Act 2006, which banned smoking in public places, both potentially affect the pub, bar, restaurant and hotel trades.

Analyzing the financial data
To carry out a profits valuation, the valuer will need to draw up a hypothetical profit and loss account or income statement for the subject trading property, assuming a reasonably competent business operator.

This means they will require a full set of accounts for at least three years of trading so they can determine reasonable levels of turnover, purchase costs and fixed costs for the business and derive the FMOP and EBITDA.

Where no accounts are available, the valuer needs to forecast their own, based on any business plans for the subject operational entity and their market knowledge of similar businesses. The valuer must have confidence in the reliability of the information provided by the client and seek verification or audit the accounts if in doubt.

Adjusting the financial data
The accounts provided by the current operator reflect only the existing business under current management at the current time. If the income and expenditure figures are above or below the norm for that type of business, the valuer will need to make adjustments to the actual figures. This is a critical stage in a profits valuation and requires a great deal of expertise on the valuer’s part.

Adjustments are crucial for the following reasons:
- the accounts must reflect the trading of a reasonably competent operator, not the actual operator
- current and past trading is no guarantee of future trading levels
- accounts can be drawn up for any purpose and may include personal expenditure or central costs, if the property is part of a larger portfolio
- accounts might not have been independently audited
- receipts and expenditures in any one year may be particularly high or low
- the potential profit arising from an individual operational entity reflects the EBITDA; these costs are based on arrangements that are distinctive to each operator, so they are not relevant for a market valuation, and the actual accounts need to be scrutinised by the valuer – and adjusted if necessary – to ensure costs are not deducted from the net profit.

Once the relevant adjustments have been made to the actual accounts, the valuer should be confident that they then have the FMOP.

Capitalizing the FMOP or EBITDA
Although a years purchase multiplier is used to capitalise the profit, it is not determined as an all risks yield percentage but as a multiplier that is analysed against comparable sale transactions. However, the multiplier still reflects the valuer’s opinion of the associated risks, so the more profitable the business, the higher the years purchase multiplier. There are ranges of multiplier for each trading property sector, and the determination of which to use relies entirely on the valuer’s judgement and experience.

Calculating market rent
Rental valuations must be undertaken in the context of the lease clauses and reflect market rent. The rent for trading property is often calculated by taking a proportion of the FMOP, thus creating a rent for the landlord and enabling a return for the tenant.

Special assumptions
Due to the specialist nature of trading property, it is common for valuers to be asked to provide a range of values based on different special assumptions.

The valuer must have confidence in the reliability of the information provided by the client

- Where a property is trading, the market value should assume a fully equipped operational entity, having regard to trading potential.
- Where a property is vacant following closure, no trading records are available and the trade inventory has been removed, the market value should assume an empty property, having regard to trading potential.
- Where a property is a fully equipped operational entity that has yet to trade, the market value could assume possible trading potential subject to projections.

In many circumstances, the valuation requires an allocation of separate values to the individual components of the going concern, and each different asset class requires specialised valuation knowledge and experience. Therefore, valuation professionals should have the qualifications, background and training necessary to perform valuations in each asset category.

Conclusion
Valuation of trade-related property is especially complex because understanding the methodologies, core concepts, industries, and intended use – for the purposes of tax, financial reporting and so on – requires experience and expertise to produce a good-quality analysis that is reasonable and auditable. When valuers meet technical competency requirements, adhere to ethical codes of conduct and act with due care, companies and financial stakeholders are protected and regulators can have confidence in the profession.

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Time for an audit?

Stewart Little offers five key reasons to consider an audit of your property assets

Asset portfolio managers are responsible for millions of pounds’ worth of bricks and mortar. Their reputation dictates that they need to be fully aware of the value of the assets they are managing, so they can advise their clients on the best course of action for their investment.

To maintain an up-to-date understanding of your asset portfolio, look out for the following five signs that it is time to commission an audit.

1. You do not trust the data you have.
2. Your company is merging with another firm.
3. Your client wishes to dispose of its assets.
4. There is market uncertainty thanks to Brexit.
5. Legislation presents a risk.

This article will review each of these in turn, before considering how technology can help you conduct audits more smoothly.

Data

You must be in possession of the facts to make good decisions. Too often, businesses are forced, coerced or misled by dodgy tradespeople into carrying out works that are not required.

If you are being asked to embark on a major capital programme but are not given the resources and tools to achieve results without risk, think again. Do not rush headlong down a path without examining the data and ensuring that it is accurate and impartial, having come from a trustworthy source.

Mergers

Merging businesses means merging portfolios, so you need to be certain whether or not the other company’s data is accurate.

Do your due diligence better than the other party and you stand a good chance of leaving the room confident in your decision. Royal Bank of Scotland’s due diligence on the purchase of Dutch Bank was actually so lacking in diligence that it almost bankrupted the firm.

Disposal

At some point your client will want to sell on a property or two, or maybe even its whole portfolio. What do you advise? Which ones do you sell?

Nothing short of an in-depth understanding of that portfolio is good enough. You need to be confident that you know it inside out and that the information that you have at your fingertips is up to date if you are going to provide accurate advice.

Brexit

Last year brought a fresh challenge for the property world in the form of the UK’s vote to leave the EU. Investors find bricks and mortar appealing as they represent the long-term stability of the built environment, but Brexit threatens this situation. The market will definitely recover, but the long-term uncertainty and risk of dramatic change is toxic for us all.

Yet the world is still turning: people want to invest and make decent returns. If you are currently trying to dispose of a portfolio, you may want to consider putting it on the back burner while the weak pound creates low-price sales and instead use the time to ensure it is the very best it can be – by using technology to increase the value of assets, for example, in improving energy efficiency.

Legislation

Legislative uncertainty as a result of Brexit is a credible risk to the market. So will Minimum Energy Efficiency and Performance Standards be scrapped by a government looking to break away from the EU’s Energy Performance of Buildings Directive 2010 that underpins these?

Both pieces of legislation prohibit the sale, renting or lease of a building with an energy rating of F or G – which consultancy WSP estimates could represent 31% of the built environment, based on its assessment of Aberdeen Asset Management’s portfolio. There has thus been opposition from property professionals, whom a post-Brexit government may wish to appease through a bonfire of EU-led legislation.

Technology can help

Today, rapid portfolio evaluation and impartial advice are readily available. Technology has progressed to the point where infrared images can be quantified, data can be augmented and calculations carried out by sophisticated algorithms.

Advances in drone technology and software mean that surveying is easier, reporting can be carried out online and the software, analysis and road mapping are all dynamic and interactive.

Experts are being replaced by dashboards that allow asset managers to test the combination of one or several changes to energy efficiency measures and watch potential energy savings achieved.

So although there are plenty of good reasons to audit your portfolio, it has never been easier to do so.

Stewart Little is CEO of irt surveys www.irtsurveys.co.uk

Related competencies include
Commercial real estate management
The Minimum Energy Efficiency Standards (MEES), formerly known as Minimum Energy Performance Standards, will make it unlawful to let domestic or commercial buildings in England and Wales that do not achieve a minimum energy performance certificate (EPC) rating of E or higher from April 2018.

As poor energy performance is not limited to old or obsolete buildings, the MEES will have significant impacts for a number of landlords, tenants and property advisors. Landlords need to take action now to avoid higher compliance costs and to protect the revenues that they receive from their properties.

As the EPC is an asset rating, it is based on the asset itself – that is, the building's fabric and installed building services – rather than on how much the present occupiers use those services. A building with a poor energy rating may currently have reasonably low fuel bills simply because the present occupiers do not heat the premises. Conversely, a high energy rating may not be matched by low fuel bills where the current occupiers heat and illuminate the premises overnight even though they are unoccupied.

Have data to hand

To collect the relevant data, the assessor will undertake a full visual inspection and measured survey. In some instances, a comprehensive data set may be impossible to collect by visual inspection alone, and the assessor will refer to any additional information provided by the building owner or occupier. If no such information is made available, the assessment will proceed on the basis of the default values in the official energy rating methodology.

As these defaults assume a higher level of energy consumption, if you are able to provide any written information of this type it is more likely that the assessment will lead to an improved energy rating.

Cost-effectiveness

Incorporating energy-saving features into new buildings is now common and relatively cost-effective; retrofitting is generally more difficult and costly. It is possible to achieve very good ratings on old buildings, but the higher the rating achieved, the greater will be the relative cost for achieving it.

After April 2018, an E rating will be the minimum required for any property that is let. After April 2018, an E rating will be the minimum required for any property that is let, so landlords must ensure that their building stock is at least up to this standard. While an E rating is still pretty poor, many landlords will have to take action to achieve even this level, and will be looking to do so for the least expenditure possible.

An EPC is based on consideration of a range of elements, including the building fabric, its airtightness and the building services installed – heating, cooling and hot water, for example – as well as the lighting and lighting controls, and any use of renewable energy or low- or zero-carbon technologies.

The first step for landlords of buildings with a rating of F or G would be to review the recommendations made by the assessor following the inspection and then to survey each aspect of the building envelope and services to see where improvements can be made.

Some will have more influence on the energy banding, some will be more expensive to implement and some will be more physically difficult. Another consideration is whether the building is currently occupied, and the potential impact that any work may have on these existing tenants.

Costs could be as simple as installing energy-saving light bulbs and draughtproofing. However, they could also involve comprehensive improvements, such as replacing an ageing boiler, putting in secondary glazing or upgrading heating controls, and installing systems that are likely to improve overall energy efficiency.

Where to seek improvements

Building envelope

While wholesale alteration of the building fabric is likely to be an unrealistic option, ensuring that repairs are carried out, gaps filled and insulation is as good as it can be are all essential.

It may also be possible to replace sections of the envelope that have poor thermal insulation qualities with better material for a relatively low cost, such as replacing corrugated plastic or PVC with fibre cement-profiled sheeting or corrugated roofing.

First rate

Jes Rutter considers some of the simpler ways for you to improve a building’s EPC energy rating

After April 2018, an E rating will be the minimum required for any property that is let

**“**

**After April 2018, an E rating will be the minimum required for any property that is let.**
Roofs
You should ascertain whether the roof is insulated, and if any insulation that is installed could be improved.

Construction joints and connections
There are often heating or cooling losses at joints and connections; for example, at floor slabs that extend outdoors, heat can be conducted away through the slab.

Penetrations of the building envelope
Where, for example pipes, conduits or chimneys penetrate walls and roofs, there are often gaps that should be insulated.

Floor insulation
Suspended timber floors should be insulated with mineral wool supported by netting between the joists, and the gaps between floors and skirting boards should be sealed to reduce draughts. Solid concrete floors with no insulation can have rigid insulation laid on top. Any floors that are above unheated spaces, such as garages or warehouses, should also be insulated because you may be losing a lot of heat through these.

Doors, window frames and skirting
Look for leaks resulting from poorly fitting doors and windows; but spot repairs to sources of major loss such as roof leaks usually offer faster payback than fixing door and window seals. Consider double glazing if it is not already in place. Install rapid roller doors to goods entrances.

Heating, ventilation and air conditioning
The heating, ventilation and air conditioning (HVAC) system is usually one of the biggest consumers of energy in a building. Even the highest-rated HVAC system wastes energy without a well-sealed duct system and good control and maintenance.

Some points to consider for improving efficiency are as follows:
- improve the controls for temperature and timing
- install de-stratification fans to high bay workshops
- optimise ventilation with the addition of active controls
- reset incoming transformer voltage tapping to give optimum voltage supply
- replace heating boilers with modern condensing type boilers
- ventilate compressor room with cold air from outside to ensure minimum inlet air temperatures.

Building energy management system
A building energy management system (BEMS) controls and monitors mechanical and electrical equipment – such as ventilation, lighting, power systems, fire systems and security systems – via computer.

As a longer-term strategy for helping owners or managers improve their energy efficiency ratings, a correctly configured BEMS can offer many additional benefits:
- higher rental value
- flexibility on change of building use
- time-saving billing of individual tenants for services and facilities
- remote monitoring of plant such as fire and plumbing pumps, air-handling units, electrical supplies, sewage treatment, water and grey water treatment
- intelligent reporting.

Space and water heating
Some areas to consider when seeking energy efficiency improvements include:
- replacing the boiler or heating system
- new heating controls; for example, timers, programmers and thermostatic radiator valves
- point-of-use water heaters
- insulation of hot water pipework and hot water cylinder.

Lighting
Switching to energy-efficient lighting is one of the fastest and most cost-effective ways to cut your energy bills and improve your EPC rating. Consider these changes:
- LED lighting is the most efficient source available
- slimline T5 tubes can be used instead of T8 fluorescent lights
- low-energy compact fluorescent lamps can be installed instead of standard bulbs
- timers and motion sensors could also be installed.

Electrical appliances
The efficiency of electrical appliances varies widely, and some easy ways to improve an EPC assessment are to:
- replace old appliances with more energy-efficient ones i.e. A-rated or higher
- install programmable on-off timers
- ensure all electrical appliances have energy saving settings and use them.

Renewable energy
It is best to reduce energy use and increase efficiency as much as possible before considering renewables. However, energy generated from on-site renewable sources will reduce the building’s reliance on importing power and could provide a steady income to help meet running costs or pay for other activities.

Government initiatives have been established to provide a financial incentive for the generation of renewable energy, through the Feed-in Tariff for electricity generation such as solar photovoltaics (PV), and the Renewable Heat Incentive for heat generation such as biomass boilers.

Some technologies you could consider for heat and electricity generation are:
- electricity: PV, micro wind, biomass combined heat and power
- heat: solar hot water (solar thermal), biomass boiler, ground-source, air-source or water-source heat pumps.

Even with the incentives, however, these are not likely to be a cheap or quick fix to improve your EPC.

Advice and assessment
It is always worth consulting a specialist for advice on the best approach for your specific property and circumstances.

In fact, a good starting point is to ask your assessor to carry out a pre-assessment survey. This will allow them to conduct a preliminary property inspection and discuss potential improvements, as well as the likely rating resulting from those measures, before you begin the EPC assessment proper.

All EPCs are valid for 10 years, so it is worth ensuring that you do everything you can to achieve the highest possible rating and maximise the potential yield of your building. 

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Related competencies include
Property management, Sustainability

It is best to reduce energy use and increase efficiency as much as possible before considering renewable energy.

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More than science fiction

Artificial intelligence is moving ever closer to changing profoundly the way we design, build and work, claims Chris Hoar

Artificial intelligence (AI) is already an everyday feature of our lives, for example in the form of ‘personal assistants’ such as Siri on our phones and Cortana on our PCs. We might not even know it exists, but it is there.

This is still, however, a long way from the scenarios that some scientists have portrayed of ‘actroids’ (http://bit.ly/2i0zwNg), or humanoid robots, taking over routine tasks. There is a more apparent in the next few years. How in particular is the advancement of AI going to affect the built environment?

Retrofits & new build
First, we need to make a distinction between our existing built environment and changes or additions to it. There will be significant challenges in implementing AI in existing buildings, despite reasonable expectations as to its long-term benefits.

Retrofits are often difficult and might not realise the intended benefits, or those benefits may be outweighed by the costs. Even so, this balance between benefits and costs will tip in favour of the former over time.

The new built environment will be designed with AI developments very much in mind. For example, it will be easy to implement floor layouts that take into account the use of actroids or other autonomous machines for cleaning and catering by removing obstacles and being conscious of the way in which they move.

It will also be easy for environmental systems to generate large amounts of data that are collected and automatically processed and actioned. This process has already begun because energy costs and those of other scarce resources are forcing the pace.

Al areas
What types of AI are going to have an impact on the future built environment? Some of the key areas are as follows.

- **Cleaning:** autonomous guided vehicles (AGVs) could be used for internal cleaning; drones for external windows would have significant operating expenditure.
- **Waste disposal:** AGVs and automated collection points for them could reduce costs.
- **Security:** apps, drones, AGVs and high-definition or thermal imaging cameras may be relatively costly upfront, but will save operating expenditure and also reduce risk to personnel.
- **Mechanical and electrical services maintenance:** apps, AGVs, cameras and 3D-printed parts will streamline work, although they will require good management of planned preventative maintenance.
- **Catering:** AGVs and actroids could serve food and clear utensils and waste.
- **Reception and helpdesk:** actroids and apps could provide such services.
- **Condition surveys:** drones and thermal imaging cameras could survey facades, roofs and structural framework, reducing risks to inspection personnel.
- **Logistical support:** AGVs and actroids could manage deliveries and porterage.

Implementing measures such as these presents a significant challenge in terms of the built environment’s physical structure and organisational culture. But that can be overcome when refurbishment or other major changes are to be carried out. We already have to introduce higher levels of thermal performance and other environmental measures into buildings when seeking approval to refurbish, and the same may soon apply to smart infrastructure as well.

**Timeline**
Opinions differ on the timescales for the implementing AI in our sector. Development is accelerating almost exponentially, so predictions vary.

Our own investigations through the consultancy Artificial Intelligence in Facilities Management – suggest that the tipping point might come within five to seven years’ time when there is critical mass in terms of both the hardware and software to implement full-scale building projects with a high level of AI.

The implications are likely to be profound. One significant impact will be the need for a complete overhaul of working practices with consequent loss of jobs, as well as a change in the supplier landscape as more IT companies seize the opportunity to move into facilities management.

They have the know-how and capital – unlike service providers offering cleaning and waste disposal, which have to survive on cash flow alone. From an owner’s or operator’s perspective, where is the financial argument for pushing expenditure into the operation and use phase when more and more technology, including AI, can be capitalised?

With the new built environment and its innovative designs, implementing AI will be easier and the benefits more immediate and obvious. The challenge will be futureproofing the design of buildings to accept newer, replacement technology and ensuring a balance between AI and human operations.
Ear to the grounds

Christopher Sullivan examines the grounds on which surveyors will be called in to help contest lease renewals

Contested lease renewals all but disappeared during the last recession, as landlords were avoiding the kinds of redevelopment that would necessitate tenants leaving at lease expiry or renewal and thus prompt disputes. However, with today’s tenants eager to remain in situ at a below-market level of rent while landlords are seeking to extract greater value, contested renewals are now on the increase.

Dealing with contested lease renewals is a highly specialised area, but there are clear avenues of work for building surveyors with dilapidations expertise and project management skills.

Statutory framework
Under section 30(1) of the Landlord and Tenant Act 1954, there are a number of grounds on which a landlord may oppose a request for a new lease by a tenant: a. failure to repair b. persistent arrears c. other reasons or breaches d. suitable alternative accommodation e. current tenancy created by subletting f. demolition and reconstruction g. own occupation.

It is fairly unusual for building surveyors to become involved other than when grounds a or f are invoked, but there are of course exceptions.

Failure to repair
If this is the ground for a contest, building surveyors are required to appraise the physical condition of the holding, setting out remedies and their associated costs. This ground is broadly akin to a form of interim dilapidations claim, or forfeiture, though it is not governed in the same way because there is no guidance note to follow. In interim dilapidations claims, the surveyor would simply prepare a list of defects and wants of repair: essentially, they have to produce a fully populated and costed Scott Schedule.

There is little point in contesting a lease renewal on trivial defects, as attention should only be directed towards very significant breaches of covenant. Major faults with mechanical and engineering services, water penetration or structural damage, for instance, are very difficult to ignore or defend.

The key is to record the best available evidence and present it in a logical manner, so thorough site notes and quality photographs are essential. Specialist testing – for example, mechanical and engineering validation – may also be required.

Most claims are settled well in advance of court proceedings, but if the dispute remains then the surveyor must be prepared for that possibility. Disrepair issues and arguments will be at the forefront here – the domain of the dilapidations specialist. It is always possible that, before a hearing, the tenant finally complies and brings the property back into a state of repair, so while the landlord will not then get their building back, it will at least brought up to a decent standard.

Demolition & reconstruction
Under section 30(1)(f) of the 1954 act, a landlord may oppose an application for a new tenancy on the ground “that on the termination of the current tenancy the landlord intends to demolish or reconstruct the premises comprised in the holding or a substantial part of those premises or to carry out substantial work of construction on the holding or part thereof and [they] could not reasonably do so without having obtained possession of the holding”.

Where it is clear that the whole or a substantial part of the premises are to be demolished and/or rebuilt, there is usually little argument to be had: the difficulties lie where the landlord’s plans are perceived as being more marginal.

The building surveyor is responsible for preparing an expert report, advising on: a. the extent of the proposed works – commenting on how “substantial” they are and whether the works amount to construction or demolition b. whether possession is reasonably necessary to undertake the works.

In the absence of statutory definitions of “construction” or “reconstruction”, “demolition”, “substantial” and “intent”, the surveyor must turn to case law. The works need not be structural to qualify, however, although it often helps in demonstrating that they are significant.

There are typically sensitivities about the extent of the holding, what works are to be assessed as relevant, bearing in mind that obligatory repair works are not to be assessed; and the landlord’s motives and intentions, which will require the involvement of a legal advisor.

Caution
A major difficulty for surveyors will be the stage at which they are brought into the process. Often it is well under way, with planning permission in place and a précis of work and financial sign-off agreed. Conversely, detailed specifications are rarely drawn up at the time of appointment, which can lead to a lack of clarity.

Surveyors taking on contested lease renewal instructions must therefore ensure that they are well briefed and thoroughly understand the legal nuances. Otherwise, they will run the risk of being on the receiving end of an embarrassing grilling in the witness box.
Agents of change

A partnership between property managers is helping to ensure clients’ sustainability requirements are met, writes Sarah Ratcliffe

It is often said that 80% of the buildings that we will need in 2050 have already been built. If this is the case, then the management of these existing buildings will be absolutely critical in tackling many of the sustainability challenges we face.

To date, many property managers have been reactive when it comes to sustainability issues. More recently, however, a number of the major firms of managing agents have begun to see sustainability as a business opportunity. Why is this? What are the challenges? And does the sector have the capacity and skills to take up this opportunity?

**Regulation and expectation**

While the government has recently taken a step back from some of its built environment sustainability policies, a number of requirements already enshrined in UK law affect property managers and will continue to do so. These range from the Building Regulations and Heat Network Regulations to energy performance certificates, Minimum Energy Efficiency Standards and the Energy Savings Opportunity Scheme. Property managers play a role in ensuring that their clients’ portfolios comply with such regulations and are often involved in carrying out assessments, identifying risks and implementing mitigation programmes.

But sustainability is not just about regulation – for many of the large property owners, it is now becoming the norm rather than the exception. They acknowledge the importance of sustainability across their investment portfolios and are asking property managers to help them deal with the associated risks and opportunities and ensure market-leading performance. Sustainability is therefore becoming a critical aspect of attracting and retaining clients and the ongoing management of their portfolios.

This push from property investors is paralleled by occupier demand. While many argue that energy costs are not yet significant enough to influence occupiers, the emergence of the health and wellbeing agenda is certainly getting their attention. The role of sustainable buildings in employee retention is becoming increasingly important, and the managing agent is often in the front line when it comes to keeping occupiers happy.

If these factors were not compelling enough, many managing agents are, as listed entities, under increasing pressure to disclose their performance on a range of sustainability issues. Once they get their own houses in order, they are quickly transferring their attention to the portfolios they manage for clients. Being accountable for the impact of their services is becoming integral to their reputation and market performance.

**Management challenges**

It is for these reasons that many large managing agents are beginning to engage with sustainability across the vast portfolios of assets they manage. There are, however, significant challenges to overcome, such as the following.

- **Differing client expectations**: managing agents often have a range of clients, from large property owners with diverse portfolios to individual clients with single buildings. What one client expects in relation to sustainability may be very different from another. The standards they require are often unclear, whittled down to a single line in the management contract.

- **No common approach**: managing agents are responsible for a diverse range of assets, and the approach to sustainability for a single-let industrial building on a full repairing and insuring lease will look very different from a multi-let shopping centre. There are no consistent standards that can be applied across these differing asset types.

- **Data, data everywhere**: the property sector has often been described as a data dinosaur, and nowhere is this more apparent than in property management. Data gathering and analysis remains complex and inefficient, and is often inaccurate. This is a real challenge when the drive for transparency from clients requires more data to be gathered across significant asset portfolios.

- **The sustainability skills silo**: many of the larger firms of managing agents have a sustainability team to determine overall strategy. There is, however, a massive skills gap across the sector. Property management teams quite often lack the knowledge or the skills to implement their clients’ sustainability requirements. This requires investment in resources and training.

- **It is all in the price ... or is it?** Eager to get the client to sign a contract, property managers take part in little detailed discussion about the resources required to fulfil it and, indeed, the cost of doing so. While many sustainability services can be provided as part of good property management, some client requirements go beyond this and are simply not priced into the contract. This means that the managing agent cannot invest in the resources and skills to fulfil the contract, the clients’ expectations are not met and they then tender to another equally willing but poorly resourced agent.

- **Running to stand still**: keeping pace with evolving policy, technological innovation and best practice is challenging at the best of times. For property managers who are deeply involved in the day-to-day management of properties, finding reliable information and guidance and having the time to use it represent a big ask.

**Managing Agents Partnership**

It is these challenges that led to the creation of the Managing Agents Partnership (www.managingagentspartnership.co.uk),...
representing a collaboration between 11 of the UK’s largest firms that together oversee more than 29,000 assets and in excess of 100m square metres of space. Launched in May 2015, its 10 founding members (as seen in the image, below) represent a significant proportion of the market. The secretariat for the initiative is provided by the Better Buildings Partnership (www.betterbuildingspartnership.co.uk), a similar collaboration between the UK’s largest property owners.

The Managing Agents Partnership enables agents to make collective progress, enhancing their ability to compete for property management mandates and fulfil their clients’ sustainability aspirations. The partners meet on a regular basis to share knowledge and best practice, discuss common challenges in a confidential environment, and develop guidance, tools and skills that can help them implement sustainability measures across their clients’ portfolios.

Acknowledging the lack of consistent standards across the profession, one of the first steps taken by the partnership was to establish a set of core sustainability provisions. These provisions (see image, left) are designed to set out the sustainability services that managing agents should provide on all contracts, clarifying service provision for property owners and putting managing agents on a level playing field.

The core provisions outline the steps managing agents should be taking to ensure that sustainability becomes part of good property management. These include:

- managing compliance of sustainability requirements
- providing data on utilities consumption and waste, and procuring energy, water and waste reviews
- incorporating sustainability requirements into the selection of, agreements with, and ongoing monitoring of suppliers and contractors
- ensuring that employees are competent enough to meet the core provisions
- communicating sustainability performance and initiatives to building occupiers
- promoting the inclusion of sustainability considerations in maintenance, alterations or improvement works
- taking responsibility for providing and retrieving sustainability documentation and data when properties are handed over.

The full core provisions can be found at http://bit.ly/2h7X4Jy. They have been adopted by all 11 members of the partnership and will be implemented across their portfolios regardless of the nature of their clients, asset classes or locations. This gives an important signal of the first step towards ensuring that responsibility for sustainability is integrated throughout property management teams.

It is hoped that providing these services consistently across large client bases will enable managing agents to invest in processes, procedures and skills that are essential to meet clients’ sustainability requirements.

The partnership’s longer-term programme of work is to set out more challenging best practice standards that will encourage proactive engagement with sustainability issues. The partnership will be working in collaboration with the Better Buildings Partnership to review and expand the previously published Managing Agents Sustainability Toolkit (http://bit.ly/2hDniMN).

The Managing Agents Partnership will also be publishing insights that reflect on key challenges for the profession, highlighting examples of best practice and providing practical recommendations that can be adopted by property managers. The first two of these insights were published in February, covering the topics of monitoring and reporting energy and waste data. All the outputs from the partnership’s programme of work are publicly available in order to encourage uptake across the profession.

The partnership is a clear indication that managing agents not only acknowledge the role they have to play in improving the sustainability of existing buildings for their clients but also the business opportunities that it creates for their firms. There is no doubt that the scope and quality of managing agents’ sustainability services can provide a competitive advantage. However, for the moment the focus is on working together as a profession to set consistent standards and develop the skills that are desperately needed to ensure that buildings perform to their full potential.

Sarah Ratcliffe is Programme Director, Better Buildings Partnership s.ratcliffe@betterbuildingpartnership.co.uk

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Relative dimensions

Vanessa Griffiths discusses the Upper Tribunal decision on leasehold reform

In May 2016, the long-awaited Upper Tribunal decision in Sloane Stanley Estate v Mundy [2016] UKUT 223 rocked the leasehold reform sector. But did it change things for the better?

The tribunal aimed to achieve more clarity on ‘relativity’, which can essentially be defined as the difference between the notional freehold value of a leasehold flat or house and the existing lease value. In making its decision, the tribunal considered work by Parthenia Research as well as the findings of Kosta v The Trustees of the Phillimore Estate [2014] UKUT 0319 (LC) (http://bit.ly/2h6vJQC), both of which were discussed by Parthenia’s James Wyatt in a previous issue of Property Journal (May/June 2015, pp.40–41).

Long-term problem

Neither the Upper Tribunal decision nor Parthenia’s research was the first attempt to address the problem of determining relativity. In 2009, RICS had commissioned the research paper Leasehold reform: Graphs of relativity (www.rics.org/leaseholdreform). The researchers spoke to different companies specialising in leasehold reform – the process of extending the lease or purchasing the freehold of a leasehold property in both prime central London and Greater London locations. These companies suggested how the relative value should be established. This led to what we now know as the prime central London relativity graphs and the Greater London graphs.

Although these relativity graphs from specialist firms have previously been adopted by practitioners, it was Kosta that first raised questions as to whether this was the right approach, drawing on analysis of 8,000 sales by Parthenia Research – a company set up in part to ascertain the existing lease value of a property, assuming that particular property does not have the right to a lease extension.

Parthenia’s was the first research to adopt an hedonic regression approach rather than settlements of previous claims. The Leasehold Reform, Housing and Urban Development Act 1993 (http://bit.ly/2hjhcoy) requires valuers to assume that a tenant has no statutory rights to acquire the freehold in a world where other tenants do have such rights, also known as “act rights”.

As the sales evidence on which the Parthenia model was based pre-dated the act, it does not have the advantages initially claimed by Dr Phillipe Bracke of the London School of Economics, who supported Parthenia in Kosta, because no-one had such rights, so their effect cannot be assessed. While Bracke’s work was described by the Upper Tribunal as formidable, it concluded that valuation evidence was missing and so it did not accept Parthenia’s research.

Life after Parthenia

There is a comparative lack of consistency regarding the relevant discount for shorter unexpired terms; as Table 1 shows, this was evident in Mundy (http://bit.ly/1X3nKBF) among other cases.

The Parthenia model was again put forward in Mundy, but because the evidence resulted in the open-market value of the leasehold property being lower than the “no act rights” value, the tribunal could not regard it as a reliable tool, having determined that an existing lease without rights under the act should be a less valuable interest than one with those rights.

The tribunal then considered the other firms’ relativity graphs, with a number of valuers from the firms in question giving evidence to support those graphs. Additional analysis was made of the Gerald Eve graph, regarded as the one most commonly used at the valuation dates of February, March and April 2014 for the three properties in Mundy. Although the market may have been influenced by this graph, it did not perhaps rely on it to the extent that was claimed by valuers who gave evidence, as it does not reflect any market change.

Further evidence given by Colin Lizieri, Grosvenor Professor of Real Estate Finance at Cambridge University and Bryan MacGregor, MacRobert Professor

<table>
<thead>
<tr>
<th>Lease length (years)</th>
<th>Deduction for act rights</th>
<th>Name of property or tribunal case</th>
</tr>
</thead>
<tbody>
<tr>
<td>53.00</td>
<td>7.0%</td>
<td>58 Hamilton Terrace</td>
</tr>
<tr>
<td>53.00</td>
<td>11.5%</td>
<td>58 Hamilton Terrace (re-analysed)</td>
</tr>
<tr>
<td>44.00</td>
<td>7.5%</td>
<td>Nalirle Ltd v Earl Cadogan [2009] RVR 95</td>
</tr>
<tr>
<td>43.75</td>
<td>13.5%</td>
<td>18 Gerald Road</td>
</tr>
<tr>
<td>41.32</td>
<td>10.0%</td>
<td>Flat 5, 17 Cranley Gardens (Mundy)</td>
</tr>
<tr>
<td>37.71</td>
<td>10.0%</td>
<td>Flat 11, 26-28 Elm Park Road (Mundy)</td>
</tr>
<tr>
<td>37.70</td>
<td>10.0%</td>
<td>Trustees of the Eyre Estate v Saphir [1999] 2 EGLR 123</td>
</tr>
<tr>
<td>23.00</td>
<td>20.0%</td>
<td>Flat 3, 36 Elm Park Road (Mundy)</td>
</tr>
<tr>
<td>18.70</td>
<td>15.0%</td>
<td>Chelsea Properties v Earl Cadogan LRA/69/2006</td>
</tr>
<tr>
<td>17.80</td>
<td>25.0%</td>
<td>The Cadogan Square Ltd v Cadogan Estates LRA/128/2007</td>
</tr>
<tr>
<td>11.82</td>
<td>20.0%</td>
<td>82 Portland Place (Freehold) Ltd v Howard de Walden Estates Ltd [2014] UKUT 0133</td>
</tr>
</tbody>
</table>
of Land Economy at the University of Aberdeen, suggested that changes to the market and economy had led to a change in relativity, and this was supported by the new Savills Enfranchiseable graph (2015) – an “enfranchiseable” graph dealing with a situation where act rights exist. A comparison was made between this graph and the Savills Enfranchiseable graph (2002). The latter is based on the opinions of a panel of valuers, and the 2015 graph is based on a sample of 5,904 leasehold flat sales.

The tribunal considered the 2015 Savills graph to be a “significant improvement on its 2002 equivalent ... albeit subject to technical criticism”. Importantly, the tribunal held that as the 2015 Savills graph was not available at the valuation dates, it could not have affected the market’s approach to the assessment of relativity at that time.

The tribunal was clear that the evidence suggested that relativity has changed with time and declined between 2002 and 2014. The possible change in relativity has been previously discussed in other economics journals. Richard Grover published research in the Journal of Property Investment & Finance in 2014 (http://bit.ly/2howcOs), stating: “Graphs in 2014 of Property Investment & Finance Journal Grover published research in the other economics journals. Richard Grover published research in the Journal of Property Investment & Finance in 2014 (http://bit.ly/2howcOs), stating: “Graphs that incorporate data from different dates may include several relativities for the same lease length from different periods of time … There are many reasons for this: changes in legislation, case law, changes in property type or characteristics.”

The only clear decision arising from the case was that the Parthenia model is not to be used in the future

Tribunal valuation guidance

The Savills 2015 graph, like the Parthenia model, is based on hedonic regression and subject to technical criticism. However, the tribunal said that if this were reliable, it would provide further support in calculating the relative value of an existing lease with act rights.

The tribunal decided that a prospective purchaser would most likely have referred to the Gerald Eve graph first, even though it saw “no convincing reason why the relativity of leasehold to freehold value should be considered immutable”.

The various relativity graphs were considered to be subjective, inconsistent or dependent on Leasehold Valuation Tribunal decisions; the Upper Tribunal found they were all based on small sample sizes and the settlements of a single surveyor.

I believe the tribunal was hoping to provide clear guidance to practitioners on the methodology of valuing short leasehold interests. However, the only clear decision arising from the case was that the Parthenia model is not to be used in the future. The question of whether the tribunal’s decision provided more or less clarity was put to a room of practitioners at the 2016 Association of Leasehold Enfranchisement Practitioners (ALEP) conference, 65% of whom said they thought that it has actually made it harder to advise clients.

Unanswered questions

Following the decision, we are still left with unanswered questions about methodology. Three approaches seem to be available.

1. Market evidence is the best evidence: if the subject property has sold on the existing lease, then making a reasonable deduction for act rights from the sale price would provide the existing lease value for the valuation. However, what is the reasonable deduction? We are left with no clear direction.

2. When adopting an enfranchiseable graph and making a reasonable deduction to reflect act rights, what is the correct graph to use?

3. Is there a gap still for an unenfranchiseable graph to be created and used in practice?

4. Is the Gerald Eve relativity graph robust enough to be adopted after the decision?

Questions also remain about the reliability of the Savills 2015 enfranchiseable graph, if this is to be used to assist option 2, and the reasonable deduction for act rights.

Life after Mundy

Last May’s decision has caused much confusion. Denholm v Stobbs [2016] UKUT 288 (LC) (http://bit.ly/2hi56I8) involved a flat in west London, with an unexpired term of 43.37 years as at the valuation date of 13 August 2013. The tribunal arrived at relativity by making a 1% deduction from the Gerald Eve graph on the basis that, since Mundy, this graph now overstates relativities, despite the valuation date being before those in Kosta and Mundy. Nevertheless, when practitioners at the ALEP conference were asked whether they agreed with this decision, 74% believed that the tribunal should have instead followed the market.

Further research is therefore required to answer the outstanding questions and provide clarity for leaseholders. If the starting point is a market-based relativity, then this has to be established.
Jamie Willsdon stresses the importance of specifying the right lighting and planning for maintenance

Have you ever looked at the way the energy bills are split for the blocks you manage? If not, you could be in for a shock. More than 70% of the charges for a typical residential block could be accounted for by the lighting alone. Many blocks around the country have outdated lighting systems, and a good proportion of these leave communal lighting on all day and night, even where stairwells and corridors are flooded with natural illumination.

The cost of energy is only going one way – up. So it is no surprise that in leasehold apartment buildings, property managers frequently take the blame for generating sky-high fees. Even in blocks that have occupancy sensors installed, many units are poorly commissioned, leading to costly damage to lighting and additional maintenance charges that are ultimately passed on to residents.

Another common cause for complaint among leaseholders is the issue of failed lights, with outdated installations being particularly vulnerable. This means endlessly changing light bulbs, which sends the wrong message to prospective flat buyers and tenants, and does nothing to enhance the reputation of the company responsible for managing the block. A badly lit block says clearly: “This building is poorly maintained – avoid it.”

Poor lighting makes a block look rundown, reducing its kerb appeal and ultimately its value, while failed lights are also a serious health and safety issue. Both factors increase the risk of accidents for residents and visitors and raise the threat of legal action being taken against residential management company directors and their property managers.

Plan your maintenance
Planned maintenance has an important role. It takes more energy to run a failing unit, putting strain on the rest of the system while reducing overall performance and output. And once lighting equipment has deteriorated to the point of total failure, the only option is complete replacement. The average light fitting, without maintenance, will probably run for between four and six years. Then it will need to be replaced at an average cost, including labour, of around £150. Over the same period, the planned maintenance cost would amount to a matter of pennies each month.

Planned maintenance scheduling (PMS) has been around for decades, but too few property managers include it as standard in their business operation. The key is to programme the replacement of outdated lighting into the PMS for your block so that the new or upgraded system is installed at the same time as the next refurbishment of the common areas. This way, any cosmetic damage will be repaired at the same time, keeping cost to a minimum.

What else can property managers do to save residents money and protect their own professional reputation? Here are some straightforward options:
- install occupancy detectors; a simple recommission can save thousands of pounds in wasted maintenance costs
- commission occupancy detectors correctly to maximise saving from use of natural light and to prevent damage to fittings
- install an LED system
- ensure your maintenance contract includes a routine servicing visit
- lighting companies may offer free site surveys to evaluate your systems – take advantage of this service.

It is vital to consider whether or not lighting installation in a block with high energy charges is fit for purpose. High numbers of maintenance call-outs should ring alarm bells. One solution is to consider retrofitting LEDs as a simple and in most cases straightforward way to reduce maintenance and cut the cost of block lighting. The return on investment is estimated at around 20 months for a typical scheme.

A new LED system with integral occupancy detectors could save residents more than 70% in energy costs and, once installed, maintenance should be cost-neutral for around five years. LEDs are environmentally friendly and cheap to
run, saving your client from spending time and money on maintenance. Around 98% of LED fittings can be retrofitted into existing positions with no negative impact on the daily running of the building or its existing decor. Every block is different, and as LEDs improve illumination levels, a lighting design can be chosen in a colour that suits the specific environment.

Doing the maths
Here is an example of the savings to be made by replacing outdated lighting with LEDs. An underground car park has 50 fluorescent light fittings that are switched on 24/7. The cost to run is around:
- £22/day
- £7,970/year.

Costs for the equivalent LED fittings using integral occupancy detectors are around:
- £0.40/day
- £145/year.

Typical supply and installation costs for LEDs are £9,500. This represents a return on investment of just less than 15 months, which does not include the ongoing saving of £7,500 each year made simply by not wasting energy. And that is just in the car park.

In the case of blocks that do not have reserve funds or are strapped for cash, a lighting upgrade need not be an impossibility. Leasing is one option to consider, whereby a new lighting installation is fitted on a buy now, pay later basis. For more information on funding options, take a look at www.future-lighting.co.uk.

Developers take note
Wholesale lighting failure is not just a problem in older blocks; it can be just as bad in new-build schemes. Not enough thought is given to designing and planning a lighting scheme that will work with the mechanics of the building and how residents will use it.

Similarly, too little consideration may be given to specifying low-maintenance lighting that will keep costs to a reasonable level. Lighting may be specified that looks good for a few months but is not fit for purpose. As a result, effective, regular maintenance becomes a challenge, and once the developer has packed up and gone, it is the block manager and the tenants who inherit the problem.

So what can be done? The answer is in the hands of developers and their architects. By identifying lighting consultants that have experience in maintaining block lighting at feasibility stage, before design and installation, many problems faced by property managers and their clients could be avoided. Considerable money and energy could be saved, and the lighting that looks so enticing to new residents would be just as efficient many years later.

With the trend for developers such as EcoWorld Ballymore at London’s Wardian scheme (http://bit.ly/2dRDMN2) to retain the management of blocks in house, we could begin to see a different approach to specification. If this is the case, it would be a positive move towards saving tenants money, as well as ensuring that the enormous amount of energy expended on lighting new schemes is not being wasted.

How many does it take to change a light bulb?
In the average block of flats, it costs around £45 to change a simple lamp. The lamp itself may not be that expensive to replace, but consider what is involved in the process of getting an engineer on to the site:
- the tenant or site manager calls the property manager to report bulb failure
- the property manager logs a report
- the property manager instructs a company to repair
- the company logs the task and schedules an engineer
- the engineer repairs the fault
- the engineer reports to the company
- the company raises an invoice to the property manager
- the property manager logs the invoice
- the property manager records the cost against the account for the block.

When an existing lighting system has come to the end of its useful life, commissioning a new, low-energy alternative will ultimately save both you as the property manager and your leaseholders time and money and cut wasted energy.

Jamie Willsdon is Managing Director of Future Lighting
jamie@future-lighting.co.uk

Related competencies include
Housing maintenance, repair and improvements
Property management
Airbnb is facing an increasing number of legal and political challenges.

Planning legislation

The Greater London Council (General Powers) Act 1973 required that planning permission be obtained for short-term lets of a property in the capital – which were defined as lets of fewer than 90 consecutive nights – on the basis that this amounted to a material change of use from private dwelling.

Before 1973, it was for the individual London boroughs to decide whether a change of use from private dwelling to short-term lets needed such permission; the act therefore removed any uncertainty by defining terms more clearly.

The Deregulation Act 2015 changed the position in Greater London again, stating that planning permission will not now be required, provided that the property is not used as temporary sleeping accommodation for more than 90 nights in any one year and council tax is paid.

Property owners, whether freeholders or leaseholders, who let their home on Airbnb in accordance with the 2015 act are therefore not in breach; however, those who let on a short-term basis for more than 90 days a year are carrying out an unlawful use, in which case a council has the discretion to take enforcement action.

Where an owner or leaseholder lets part of their property and remains resident in it, it is arguable that no material change of use occurs because the main use remains as a private residential unit, with the letting of parts only being ancillary. Whether or not such an argument would be defensible if challenged by a council would depend on how many lets were made at any one time and for what proportion of the year.

Outside Greater London, the position remains unchanged, in that there is no objective test for the number of days that a property can be let without needing planning permission. Each case will be determined by the local authority according to the facts and local planning policy.

Enforcement

If an enforcement notice is served by the local authority, this will require the owner to cease using their property for short-term lets by a set date. It is a criminal offence not to comply with such a notice, and prosecution can lead to a fine of up to £20,000.

Enforcement action can also enable the council to use legislation under the Proceeds of Crime Act 2002 to recover the income obtained from the unlawful subletting.
to stop or limit the number of short-term lets, and can result in bookings from Airbnb customers being cancelled at the last minute.

However, other owners choose to ignore the threats and wait for the enforcement notice to be served, because no actual offence is committed until the notice’s compliance date is ignored. Many owners find that a series of short-term lets is significantly more lucrative than longer-term lettings.

Consideration also needs to be given to the house in multiple occupation (HMO) licensing regime and relevant regulations if a larger property is let to several different groups. A growing number of councils are introducing selective licensing for smaller HMOs, as well as mandatory licensing for those of at least three storeys, and a fee is payable for this.

The regime applies regardless of whether the HMO is used for short- or longer-term lets. Failure to obtain selective licensing could result in prosecution by the council in the magistrates’ court, with possible sentences including an unlimited fine or a criminal record.

Other considerations
Alongside planning issues, short-term lets can amount to breaches of lease covenants and mortgage terms if the landlord’s consent has not been obtained. With Airbnb increasing in popularity, it is likely the courts are going to see a greater number of private landlord and tenant cases; sometimes a council will encourage a landlord to take action in their private capacity to stop the short-term lets so that the authority itself does not have to resort to statutory enforcement action.

Airbnb’s next hurdle appears to be political. London Mayor Sadiq Khan has voiced concern over the short-term rental service reducing the availability of longer-term lets, in turn contributing to the housing crisis in the capital. The shortage of affordable homes is rising up the political agenda, though whether Airbnb contributes to this shortage has yet to be confirmed; the mayor has hinted, however, that further legislation may be introduced to regulate short-term lets.

Nothing relating to such legislation has been published, so it is unclear whether any changes will affect the current 90-day annual limit or require engagement with the council.

Nevertheless, as a result of this pressure, Airbnb has agreed that from 1 January, its systems automatically limit home listings in London to 90 days a year unless the owner confirms they have permission for longer lets.

Given the sometimes scarce resources of council enforcement teams, it is likely that many will now want to see whether this new system results in any significant change in terms of compliance with the legislation before taking action against those in breach of planning laws.

These new measures still rely on Airbnb checking that owners actually possess the permission for longer lets they claim to have, and owners are also free to list with other agencies, either in conjunction with Airbnb or on their own, which may not be as rigorous.

London councils are increasingly taking enforcement action against owners who do not abide by current legislation

Under current legislation, it is only possible to take enforcement action against the actual property owners because the letting agency does not itself own an interest in the rented properties.

To track down owners who are potentially breaking the 90-day limit on short-term stays, some councils are trying to use other powers to force agencies to reveal details of the properties they advertise. It is not clear that councils actually have such powers, which may necessitate amendments to legislation to compel agencies to police the 90-day limit rather than washing their hands of the problem.

If you are the freeholder of a property, we recommend that you explicitly state in any long lease whether you want to allow short-term lettings without your knowledge. If you prohibit these and then your tenant does not comply with planning legislation, this will assist your defence against any prosecution brought for failure to comply with a statutory enforcement notice served by the council.

On the other hand, if you are an owner – whether freeholder or long leaseholder – wanting to allow use of your property for short-term lets, it is suggested that you keep a record of these and their duration as evidence should you ever be challenged by the local authority.

Related competencies include Landlord and tenant, Legal/regulatory compliance, Property management

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Short-term lets can breach lease covenants and mortgage terms

Enforcement notices must be served by a council on both the landlord and all tenants, so the former may apply pressure to the latter when such a notice is threatened. A long lease will often prevent tenants from subletting the property on a short-term basis; should they do so, they can face private litigation from their landlord and statutory enforcement action from the council.

London councils are increasingly taking enforcement action against owners who do not abide by current legislation. This threat causes some owners
Letting without hindrance?

James Gordon warns property owners to take legal advice before letting out their homes

Airbnb operates a hugely successful business model that helps many property owners maximise value from their investment – but what other effects can it have on that value?

Whereas most online accommodation sites enable hotels and private holiday rental businesses to sell their accommodation, Airbnb quickly became the go-to site for those looking to rent out their spare room or their entire property to paying guests. It should be noted that Airbnb is just one of the online platforms providing this service, though, so it is important not to single it out – this article applies equally to such other services.

What is on offer?

For a host looking to supplement their income or simply enjoy the company of new people in their own homes, the Airbnb-style offering can be particularly attractive. It can be equally appealing to visitors who would prefer to stay in a home from home rather than a soulless and impersonal hotel room.

A recent search on Airbnb for weekend accommodation for two people in London returned in excess of 300 available properties. These ranged from a room in a flat for £13 per night – with reviewers commenting that the general cleanliness was appalling, the accommodation was damp and it was not fit for people to stay in – to a £2,000-per-night house in Knightsbridge sleeping up to eight people. The profile of the latter specified that the hosts only rented to responsible guests, and stated that they lived across the street and would call the police immediately if the guests tried to hold a party. They also required details of the guests’ ages, professions and backgrounds. However, most hosts may not be quite so discerning.

Unanswered questions

Many have queried the legality and the neighbourliness of people renting their properties through Airbnb. Questions as to the former are more than likely a result of allegations made about the rented premises by those in the neighbourhood and other tenants in the same building.

There have been several articles in the press concerning complaints from people living in close proximity to an Airbnb property. The recurring themes are parties, drugs, thefts, violence, property damage and general antisocial behaviour. Many complainants have said that they have felt unsafe and deprived of any quiet enjoyment in their own homes. In early 2016, riot police were
Many have queried the legality and neighbourliness of renting properties through Airbnb called to Brixton in south London after more than 150 partygoers descended on a flat that had been rented out through Airbnb. It was not the first time that local residents had complained to the police as similar parties had occurred on previous occasions (http://bit.ly/2hjaICH).

In response to the Brixton incident, Airbnb launched an online tool enabling neighbours to lodge a nuisance complaint through the site; this can be passed to the host and if problems persist, Airbnb can suspend or remove that host from its site. It is not known whether anyone has yet been banned, or whether suspended hosts can simply re-register under a different identity.

So what effect does this have on the value of properties? The answer is that we just do not know yet. What is clear, however, is that leasehold properties are at greater risk.

Effect on property sales
Most readers will be familiar with the property sales process, and the fact that anyone selling their property must disclose any disputes with neighbours. Any such disputes arising out of short-term Airbnb lets would have to be disclosed, and this could easily affect the saleability and value of a property.

In the same way that many residential property lawyers enquire as to whether any flats in a block are rented out on assured shorthold tenancies rather than owner-occupied, I can see many residential property practitioners adding the question “Is the seller aware of any properties in the building being let via Airbnb or similar platforms?” to their list of standard enquiries. It is difficult to see a positive response having a good effect on value; even if the answer is “no”, there is no guarantee that a flat in the building will not be listed on Airbnb at some point in the future.

Case study: letting legalities
The Upper Tribunal (Lands Chamber) case of Nemcova v Fairfield Rents Ltd [2016] UKUT 303 (LC) highlights the legal pitfalls of renting your property via Airbnb (http://bit.ly/2gdHIHS). This is particularly relevant in the context of leasehold flats where the lessee is bound by various restrictive covenants and may be breaching those by entering into short-term sublets or using the flat other than as a private residence.

In this particular case, the lease rather unusually contained no material restriction on subletting, but like many residential leases included a restrictive covenant that the flat was only to be used as a private residence. Fairfield sought to challenge the short-term letting by Ms Nemcova on the basis that they breached this restrictive covenant in her long lease; she advertised her flat on the internet and rented it out on a series of short-term lets, and her neighbours complained to the freeholder.

The Upper Tribunal concluded that neither Nemcova’s occasional occupation of the property nor the short-term occupation by each of the subtenants had sufficient permanency for it to amount to use as a private residence. In particular, each of the occupiers would have had their own private residence that, presumably, they left temporarily to occupy Nemcova’s property.

Although the Upper Tribunal found in Fairfield’s favour, it was clear that its ruling was confined to the particular facts of the case. Given the proclivity of similar restrictions on users and subletting, it is highly likely that other leasehold property owners will be in breach of their lease by subletting their properties in this way; they could face legal action and substantial costs, and ultimately may forfeit their lease.

As well as the possibility that such short-term lettings may be unlawful, there are other questions to ask.

- How can this type of arrangement comply with the terms of either an owner-occupier or buy-to-let mortgage?
- Are lets open to income tax abuse?
- Do the lettings invalidate buildings and contents insurance? This is of particular concern where the insurance covers a whole block of flats.

While guests continue to rent and hosts choose to ignore the rules, it is difficult to foresee any material impact on Airbnb’s business model. Once legal action is taken against more leaseholders by the freeholder, or against borrowers by lenders, then we may see a significant shift in how these platforms operate.

For now, other than adverse publicity, there is little or no comeback on Airbnb as the host accepts all responsibility under the terms and conditions of the site; Airbnb simply acts as a facilitator. Some countries and cities are introducing laws prohibiting short-term lets such as these; they are also imposing substantial fines due to the cost and effects they have on their infrastructure and resources, as well as the pressure being put on them by hotel and guesthouse owners.

It is advisable for anyone using their property in this way or considering doing so to seek advice as to whether they are, or could be, breaching the terms of their lease or mortgage. They should also give serious consideration to the impact that any legal action or disputes could have on the capital value or the marketability of their property.

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Related competencies include Housing aid or advice, Housing management and policy, Valuation
James Ginley considers the impact of new energy performance requirements on residential property

Save your energy

Energy performance certificates (EPCs) are a well-established feature of the residential property market, having been introduced in 2007 in England and Wales and 2008 in Scotland. An EPC provides information about a residential property’s energy use and typical costs, and records its energy efficiency rating on a scale from A to G, where A is the most efficient and G the least.

EPCs are valid for 10 years and are lodged on the Department for Communities and Local Government’s website (http://bit.ly/OM8XLq). They are needed whenever a property is built, sold or rented, and must be ordered before it is marketed, while in Scotland the EPC must be displayed in the property. The certificate:

- makes recommendations about how to reduce energy use and save money
- shows estimates of energy costs of the property over a three-year period, based on the current costs of lighting, heating and hot water, and possible savings over the same period if recommended improvements are made
- provides a current and potential energy efficiency rating, for example “E, and with improvements C”
- summarises features of the property related to its energy performance, such as walls, roof, windows, heating and controls, hot water and lighting
- provides the carbon dioxide emission rating and its potential level if improvements are made.

From 1 April 2018, any new lets and tenancy renewals in the private rented sector will normally be required to have a minimum rating of E; the same requirement will come into force for existing tenancies on 1 April 2020. Unless there is an applicable exemption, breaches of this requirement will incur a civil penalty of up to £4,000. Separate regulations also came into effect on 1 April 2016, under which a tenant can apply for consent to carry out energy efficiency improvements in a privately rented property.

But will a better EPC rating affect a residential property’s value? What impact will the new requirements have on lenders in the buy-to-let market and on mortgage valuations? Although a property’s value is determined by its location, size and condition, will it also be affected by the rating due to the potential energy cost savings?

A large-scale study undertaken for the former Department of Energy & Climate Change, published in 2013 (http://bit.ly/tkMRVZa), analysed 325,950 dwellings that were sold at least twice between 1995 and 2011. The results suggested a positive correlation between energy rating and dwelling price per square metre.

Compared to G-rated homes, those in higher bands consistently sold at a statistically significant price premium: those rated F or E sold for around 6% more, D-rated homes for 8% more, those rated C for 10% more, and A- or B-rated homes for 14% more. But further research is essential to allay fears that expenditure on energy measures in a property is not a waste of money, particularly in an unstable market.

The likely impact of the new requirements on buy-to-let lenders – who will have to ensure from April 2018 that rented property has a minimum rating of E – is unclear. Should lenders and brokers change their lending criteria to cover this potential shortfall and the funds to bring a property up to a suitable standard for letting?

UK appendix 10 of the RICS Valuation – Professional Standards (the Red Book), residential mortgage valuation specification, states at 3.7: “The energy efficiency rating provided within the EPC is to be considered, if it is available.”

Given that a property will not be considered a suitable security for lending until it meets the required rating, in future, will surveyors carrying out buy-to-let valuations have to determine whether it is compliant? Does this also mean that mortgage valuations for properties that will be owner-occupied and those that are to be let become totally different?

Should RICS, the Council for Mortgage Lenders and the Building Societies Association have a separate specification for buy-to-let residential mortgage valuation? Further guidance from the regulators is awaited.

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Related competencies include Housing maintenance, repair and improvements, Inspection, Sustainability, Valuation
We are not amused

Vivien King comments on a costly party wall award that could have been avoided

Building works and developments – whether commercial or residential – on or near a boundary between properties in differing ownerships lead to numerous arguments and disputes.

The Party Wall etc Act, 1996 (the act) contains a much-respected dispute resolution framework administered by impartial surveyors. It sets out statutory procedures, rules and regulations for giving notice of proposed works and a procedure for both the building owner and the adjoining owner to follow before, during and after works are conducted.

These should be followed with care: surveyors specialising in party wall work should be instructed, and lay clients given a clear explanation of the act, particularly where residential property is involved.

The Queen on the Application of Farris Lane Developers Limited v Bristol Magistrates Court (Defendant) and James McAllister (Interested Party) [CO/3431/2015] concerned a developer – the building owner – who was converting an abandoned industrial building into flats and who had instructed a surveyor, Mr McAllister, to serve party structure notices on 10 owners of adjoining sites under the act.

McAllister, in accordance with the act, made 10 awards: five as the “agreed surveyor” and five acting jointly with the surveyor appointed by the relevant adjoining owner. Each award stated that the developer should pay McAllister’s fees of £1,300 plus VAT for preparing and serving each notice, together with fees for extra work based on an agreed rate of £90 per hour plus VAT. Fees for the 10 cases totalled £24,363.72.

Despite agreeing McAllister’s hourly rate, the developer felt that the surveyor’s fees were excessive. But rather than appealing the awards to a county court as it was entitled to do, it simply failed to pay.

Under the act, McAllister issued 10 complaints in the Bristol Magistrates’ Court for non-payment of his awarded fees. The developer defended its decision, saying the magistrates had no jurisdiction to make the orders McAllister sought as he was neither the building owner nor the adjoining owner under the act, and his fees were not a matter of dispute between those parties.

The magistrates said they had been making orders for unpaid fees for 10 years and granted McAllister a judgment for his fees and costs, but refused to give reasons. Accordingly, the developer issued proceedings for a judicial review of their decision, and the case came before Mr Justice Holgate sitting in the High Court.

Three issues were to be decided in court. 1. Were the awards themselves pertaining to the surveyor’s costs ultra vires – beyond the powers – as they did not relate to a dispute between the building owner and adjoining owners? 2. Even if an award can include an order to pay surveyor’s costs, can it direct a party to pay them to the surveyor directly, instead of awarding direct payments between the building owners and adjoining owners? 3. Had the magistrates erred in awarding McAllister his costs based on his 38.5 hours on the case multiplied by his £90 hourly rate?

Mr Justice Holgate concluded the following. 1. While the act did relate to disputes between the building and adjoining owners, an award may determine “any other matter arising out of or incidental to the dispute”, according to section 10(12)(c) of the act. The judge found an award under the act is not restricted to matters about which the building owner and the adjoining owner disagree.

2. He rejected the contention that an award could not direct payment to be made directly to the surveyor.

3. Addressing the magistrates’ award for costs, the judge said it was in their discretion to award the surveyor reasonable and just costs. He did not interfere with their order. However, in relation to the costs of the case heard before him, the judge awarded McAllister costs at the rate for a litigant in person only, that is, £19 per hour.

It is not so much what he said as what he did not say that has caught this commentator’s eye.

According to the judge, the developer had an opportunity under the act to challenge the 10 awards in the county court. The route down which this case had subsequently been drawn – that is, through the magistrates’ court and High Court – incurred costs that exceeded the challenged fees, and although this did not form any part of the basis of his judgment, he said it should be noted. His disapproval was very clear.

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Related competencies include Conflict avoidance, management and dispute resolution procedures, Legal/regulatory compliance
Where does the fault lie?

In the concluding article in this series, Mike Parrett considers important legal cases and their impact on surveyors

Having considered the legal context for building pathology work on damp (see Property Journal December 2016/January 2017, pp.36–37), this issue refers specifically to cases involving building surveyors.

There are two seminal cases on disrepair. Proudfoot v Hart [1890] LR 25 QBD 42 stated the need to keep a premises in repair “having regard to its age, character and locality”. In a Georgian house, for example, we are not required to implement repairs to modern standards; when dampness is penetrating a wall, we need not render the whole wall if this would be out of keeping with neighbouring properties.

Quick v Taff Ely Borough Council CA [1986] QB 809 was the first case that defined disrepair as “not related to a lack of amenity or inefficiency” to the property. This means a landlord can let a tumbledown house that could be in a very poor state but falls outside the definition of disrepair because this state is a result of its design and construction rather than any breach under section 11 of the Landlord and Tenant Act 1985.

Disrepair cases can be defended or dismissed where inherent building defects exist, which typically fall under the Latent Damage Act 1986: if a gap appeared in a floor slab but it can be shown that the original design or construction omitted an expansion joint, then it is an inherent defect.

I have previously discussed design problems caused by heat loss and condensation in maisonettes cantilevering over a walkway (Property Journal May/June 2016, pp.36–39). McNerny v London Borough of Lambeth CA [1986] QB 809 related to a design defect that was causing condensation and held that the landlord was not contravening section 11 of the 1985 act as a result. Lee v Leeds City Council [2002] EWCA Civ 6 was another case citing Quick, where mould, mildew and condensation were caused by the building’s design.

Southwark London Borough Council v McIntosh [2001] 47 EG 145 found that a tenant’s use of a dwelling – drying clothes in a cupboard – contributed to mould and damp, and a leaking washing machine from an upstairs property was similarly unconnected with the defendant landlords.

**Damages**

There is a vast difference between the awards that claimants can receive in civil and criminal cases.

In terms of disrepair, the landmark case for assessing general damages is Wallace v Manchester City Council [1998] 30 HLR 1111 CA. This said actual damages can vary depending on the circumstances but should range from £1,000–£2,750 for each year that the landlord was put on notice of the disrepair. In the 19 years since Wallace, general damages have probably since increased to £3,000–£4,000 a year.

Disrepair claims that have prevailed for a long time can result in sizeable damages. In London Borough of Camden v Olaniyan and Oshibote, Central London County Court 2014, general damages of £40,000 were awarded. General damages usually relate to issues such as rental values; additional special awards concern items such as damaged furniture.

In contrast to disrepair claims, prejudicial to health and statutory nuisance claims have a £5,000 limit, but landlords can also be found guilty of a criminal offence. Repeated failure can lead to imprisonment, as with disrepair cases.

**Impact on surveyors**

A Pre-Action Protocol for Housing Disrepair Cases was created to avoid adversarial court cases (http://bit.ly/2dB8Frw). This recommends a single joint expert report directly to the court: a surveyor acting in this capacity must answer questions from both sides on the content, details and recommendations in their expert witness report. This is to a strict timetable – typically 20 days to conduct the survey and issue a report.

In the case of prejudicial to health and statutory nuisance claims, once an abatement notice has been served, a landlord has 21 days to remove the nuisance. It can be onerous for surveyors acting for the defendants to organise suitable remedial works.

If a single joint expert is not appointed, then the claimant and defendant will appoint separate experts. A surveyor is often

“A landlord can let a tumbledown house that falls outside the definition of disrepair”
“Landlords should follow the advice of William Morris and conduct regular maintenance more comfortable acting for the claimant because they merely have to establish dampness, offer a reasonably compelling cause – such as failure of the physical, horizontal damp-proof course – and confirm it breaches the repairing covenants under section 11 of the 1985 act.

The defendant’s surveyor on the other hand has to undertake pathology work to prove or disprove the claim. I think this is the wrong emphasis – the claimant’s surveyor should be required to unequivocally prove causation.

Key issues
To avoid problems, landlords should follow the advice of William Morris, founder of the Society for the Protection of Ancient Buildings, who advocated regular maintenance to stave off decay. A blocked gutter – a section 11 failure – leading to cascading water penetrating solid walls could easily be prevented if landlords cleared gutters annually.

While the law in this area is commendable and has evolved from Proudfoot v Hart, cases of disrepair and statutory nuisance hinge on experts’ opinions: a legal case for disrepair or statutory nuisance cannot be won or lost on the claimant’s evidence alone.

We know that, for example, the failure of a horizontal damp-proof course in a Victorian wall dating from after 1875 would be demised to the building owner and could be the subject of a claim for breach of repairing covenant under section 11 of the 1985 act. But who says dampness rises through a failed damp-proof course?

Two important cases discuss the need to repair damage to a structure. In Staves & Staves v Leeds City Council [1990] 23 HLR107, it was held there was damage to the plaster and the landlord was responsible. There was a clear failure with the structure that was echoed by the plaster, which was in this case found to be part of the structure. Equally, we could argue that the plaster is not part of the structure where the tenant has damaged it (as discussed in Property Journal December 2016/January 2017, p.37).

Southwark London Borough Council v Tanner [2001] 1 AC 1 HCL concerned whether under disrepair legislation a landlord had to improve a property’s sound insulation beyond what was provided at the time of letting. It was held that they did not: anything beyond what was provided at construction or the time of letting is considered an improvement, with which the law of disrepair is not concerned.

Expert witnesses
The requirements of an expert witness, particularly a single joint expert, can be found in the guidelines and Practice Directions of the Civil Procedure Rules Part 35 (http://bit.ly/2daQCF7). An expert witness has a duty to comment only on matters that are within their expertise and highlight those that are not.

It is imperative that surveys are holistic and that expert investigators can prove causation and the source of a defect or problem. Merely identifying symptoms that do not consider building defects, building design and use and occupation runs the risk of misdiagnosis, leading to inappropriate remediation or advice, and, in turn, wasted expenditure and the potential for miscarriages of justice.

Most importantly, surveyors acting as expert witnesses in criminal or civil actions must form a completely unbiased opinion, irrespective of who is paying their fee. Investigations involving dampness and mould are often complex, and causation can be multifarious, so it is important that the expert possesses all the facts. This will often involve an holistic and sometimes invasive survey and testing of various building elements, possibly requiring revisits and ongoing monitoring before a final opinion can be offered.

A landmark case affirms that surveyors acting as expert witnesses can be sued for breach of duty. The Supreme Court’s decision in Jones v Kaney [2011] UKSC 13 overturned the Court of Appeal’s ruling in Stanton v Callaghan [2000] QB75, where an expert’s immunity from being sued for breach of duty was upheld. Jones removed that 400-year-old protection for such witnesses. Beware the Ides of March.

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Related competencies include Building pathology, Housing maintenance, repair and improvements, Landlord and tenant

Any questions?
Would you like Mike’s expert opinion on any issues from your daily work? These will be included in future issues. email queries to jambose@rics.org
The third edition of the RICS Service charge residential management code, the ultimate authority for those involved in the management of long-leasehold residential property in England, was published last summer. But why did it take so long?

Many readers will remember that the Competition and Markets Authority (CMA) had produced a report on the role of the residential managing agent, and RICS, its working group and the Department for Communities and Local Government (DCLG) felt that it would be better to wait until it could review its recommendations, incorporating those that were considered appropriate. The government was also keen to include some of the report’s recommendations in the new edition of the code.

The code is approved by the Secretary of State for Communities and Local Government under section 87(7) of the Leasehold Reform, Housing and Urban Development Act 1993 and came into force on 1 June 2016. As a statutorily approved code, its contents carry considerable weight.

Approval does not make any breach a criminal offence or create a civil liability, but it can be used for evidence in courts and tribunals when deciding cases for all agents, not just RICS members. RICS may also use it when it brings disciplinary measures against regulated firms and members.

There are two main pathways under the code. Those that contain the word “must” indicate a legal obligation or a statutory requirement, while the word “should” on the other hand indicates best practice, that is, members should comply or explain why they have not.

As the code states: “There is often a very close correlation between a statutory requirement and best practice. It should be understood that non-compliance with best practice is a serious matter and practitioners would need to justify the reasons for not following best practice.”

Key changes

The main differences from the second edition are as follows:

- an improved contents list that includes chapter headings, subsections and page references
- a more structured order for chapters
- legal references now highlighted in the text
- a new chapter on ethics
- greater guidance on declaring commissions, including insurance and other income, specifying amounts
- a requirement to declare to your client and leaseholders any links you have with any proposed company, individual, contractor or supplier, financial or otherwise
- guidance that the format of annual statements or annual service charge accounts should follow TECH 03/11 – which is issued jointly by the Institute of Chartered Accountants and other professional bodies, including RICS – unless the lease makes alternative requirements
- much more on health and safety and risk management
- more detail and advice on termination of management contracts and handovers
- more on the right to manage and live–work units
- a consolidated chapter on service charges
- a new appendix entitled “Information leaseholders can expect to receive during the ownership of a flat”.

The ethics chapter covers much more than the performance and service standards that the public expects to receive from a professional managing agent and ensures that you act professionally at all times; it also covers the Equality Act 2010, guidance on working with vulnerable customers and your additional responsibilities if you employ staff.

Chapter 5, “Complaints and disputes”, gives guidance on the different forms of alternative dispute resolution (ADR) and mediation available. Increasingly, courts and tribunals are recommending that disputing parties seek ADR before cases are heard as this can prove more cost-effective. One of ADR’s greatest benefits is that it introduces an independent party who can look constructively at the issues of a dispute outside the often confrontational atmosphere of a tribunal or courtroom.

You may wonder why the code contains links to organisations’ websites but not, more helpfully, to actual documents; for example, it links to www.icaew.com but not the TECH 03/11 guidance. Because this is an approved code, it is not possible to change anything without it being approved again by the Secretary of State.

So while the Institute of Chartered Accountants in England and Wales’ url is unlikely to change, where it places the document on the website could, so the kind of specific link that you may think would help could turn out to be a hindrance.

I can also assure you that going through all the hoops put in place by the DCLG and the CMA is unbelievably time-consuming – I speak from experience.

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Related competencies include
Conflict avoidance, management and dispute resolution procedures, Landlord and tenant, Property management
personal property
arts + antiques
Secret commissions and poorly defined relationships in art transactions pave the way for litigation, warn Pierre Valentin and Azmina Jasani.
The highly publicised ongoing dispute between Dimitry Rybolovlev and Yves Bouvier has recently sent shockwaves through the art world, again raising concerns and questions about the opaque nature of the sector.

In January 2015, Rybolovlev filed a criminal complaint against Bouvier in Monaco alleging that he had fraudulently made a secret profit of around $1bn from the sales of 38 paintings acquired by Rybolovlev over the course of a decade. In addition to the criminal suit, Rybolovlev also issued civil proceedings against Bouvier in Hong Kong and Singapore. Discovery proceedings are also ongoing in a New York federal court.

The central question at the heart of this multi-jurisdictional dispute is whether Bouvier was buying the paintings as Rybolovlev’s agent and was thereby required to disclose his profit in relation to each sale to his principal, or whether Bouvier was selling the paintings to Rybolovlev at arm’s length, with each party acting in its respective self-interest. This issue, which is a question of fact and not law, has been and continues to be the subject of considerable litigation in the art world.

Complex transactions

Due to staggering sale prices and the desire for confidentiality, fine art transactions are becoming increasingly complex. Direct sales by an owner to a buyer are few and far between, and it is now customary to expect multiple parties to be involved in a given transaction of high-value art, with the buyer likely to be anywhere between two and ten parties removed from the owner.

In fact, nearly every transaction between Bouvier and Rybolovlev involved a chain of intermediaries, including dealers, finders and agents. Such a chain makes it difficult to track everyone involved, the price paid, or the commission or profit earned by each party in the chain. Bouvier, for example, paid a commission to Tania Rappo, among others, for each relevant acquisition by Rybolovlev. Rappo, who had introduced Bouvier to Rybolovlev, was Rybolovlev’s trusted confidante and a godmother to his daughter.

Parties involved as intermediaries in an art transaction usually act in one of three ways: they buy to resell, they act as a dealer acting in his own best interest. As an agent, they do not make a profit on a resale but instead take a commission. As an agent, they do not make a profit on a resale but instead take a commission. As an agent, they do not make a profit on a resale but instead take a commission. As an agent, they do not make a profit on a resale but instead take a commission.

Agents

Where a party sells on behalf of the owner or for an agent acting for the owner, they act as an agent and do not make a profit on a resale but instead take a commission. As an agent, they do not make a profit on a resale. However, a hallmark of agency is the bundle of fiduciary duties owed by the agent to their principal, including the obligation to account for any commission the agent makes when conducting the principal’s business.

As a matter of English law, a commission made by the agent when acting on the principal’s behalf belongs to the principal, unless the principal has authorised the agent to keep such a commission for their own account. As a corollary obligation, the agent must disclose to the principal any undisclosed commission or profit earned by everyone involved, the price paid, or loss on the resale and must account for two transactions: the purchase from the owner, possibly through one or more agents, and the resale to the buyer, again, possibly through one or more agents. A party buying to resell also acquires ownership of the art and thereby assumes risks, although generally for a very short period of time if the purchase and resale occur simultaneously.

In principle, someone buying to resell does not owe fiduciary duties to either the original owner or the buyer. They act in their own interest, with a view to maximising their own profit. Bouvier claims that his relationship with Rybolovlev was one of seller to buyer, whereby he bought the paintings and resold them to Rybolovlev, making a profit that he was very much entitled to make as a dealer acting in his own best interest.

Direct sales by an owner to a buyer are few and far between behalf of the owner, or they act on behalf of the seller.

Reselling

Where a party buys to resell, they act as principal in the transaction, make a profit or loss on the resale and must account for two transactions: the purchase from the owner, possibly through one or more agents, and the resale to the buyer, again, possibly through one or more agents. A party buying to resell also acquires ownership of the art and thereby assumes risks, although generally for a very short period of time if the purchase and resale occur simultaneously.

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Difficulty arises when relationships between multiple parties are not properly defined by means of contract, and where it is unclear whether a party is acting as an agent or at arm’s length. Although legal contracts are becoming prevalent in high-value fine art transactions, deals continue to be concluded without any written agreements, making the issue ripe for litigation.

Indeed, only the first four of the 38 paintings acquired by Rybolovlev were documented in writing. Rybolovlev and Bouvier did not enter into any agreements for the remainder, even though the sale price for some of those paintings was considerably more than $100m. Rybolovlev insists that Bouvier was very much acting as his agent and that he expected Bouvier’s commission to be no more than 2% for each of the sales, citing the fees charged for the logistics services provided in relation to the first four paintings purchased by Rybolovlev.

Bouvier on the other hand maintains that he was simply acting as a dealer and in his own self-interest, and that he owed no fiduciary obligations to Rybolovlev. Courts will need to parse many emails and other pertinent evidence to determine whether an agent–principal relationship existed between them.

allegations of fraud. If the commission is disclosed but the principal has not authorised the agent to retain it, the commission is generally referred to as an unauthorised commission.

Intermediaries

Finally, a party involved as an intermediary in an art transaction can act on behalf of the buyer, either directly acting for them or through an agent. Like the agent acting for the seller, an agent for the buyer cannot make a profit but can take a commission and does not acquire ownership of the artwork. Similar fiduciary principles to those described above also apply to an agent acting for the buyer.

Rybolovlev claims that he appointed Bouvier to buy for him as his agent and, as a result, Bouvier owed him fiduciary duties including the obligation to account for any commissions that he made. According to Rybolovlev, Bouvier’s failure to disclose these commissions to him essentially amounts to secret commissions, which are illegal and to which Bouvier is not entitled.

Defining relationships

Difficulty arises when relationships between multiple parties are not properly defined by means of contract, and where it is unclear whether a party is acting as an agent or at arm’s length. Although legal contracts are becoming prevalent in high-value fine art transactions, deals continue to be concluded without any written agreements, making the issue ripe for litigation.

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Difficulty arises when relationships between multiple parties are not properly defined

It is important to point out that, although a legal contract often helps create certainty, it does not fully shield parties from litigation and liability, especially if the contract is poorly drafted. In *Accidia Foundation v Simon C. Dickinson Limited* [2010] EWHC 3058 (Ch), Accidia engaged an art dealer named Daniella Luxembourg as its agent to sell a drawing attributed to Leonardo da Vinci. In turn, Luxembourg enlisted Simon Dickinson to help her find a buyer.

Dickinson, through his dealership, successfully sold the drawing for $7m and paid $6m to Luxembourg. Luxembourg deducted her commission of $500,000 and paid Accidia $5.5m for the sale. After the sale, Accidia discovered that the drawing was sold for $7m and sued Dickinson for $1m. Accidia was under the impression that Luxembourg's commission would be split between herself and Dickinson.

At trial, the court reviewed three sets of agreements – one between Accidia and Luxembourg's company, recording the fact that Luxembourg was acting as Accidia's agent; another between Dickinson's company and the buyer of the drawing, which provided that Dickinson was acting as Accidia's agent; and yet another between Dickinson and Luxembourg, which provided that Dickinson was acting as agent for the buyer. The difficulty with these contractual arrangements was that Dickinson had no direct connection with Accidia, yet his company purported to act as its agent, while the evidence did not point to Dickinson having acted as agent for the buyer but as having sold the drawing to the buyer at arm's length.

In the end, the court found in favour of Accidia on the grounds that Dickinson had presented itself to the buyer as agent for Accidia. Accidia had ratified the sale of the drawing made by Dickinson's company in its name, and that company had made an unauthorised commission for which it was accountable to Accidia.

Dickinson argued that it was standard practice for an art dealer to sell at any price above the owner’s agreed return or net price and retain the difference as their commission without having to inform the owner or the owner's agent of the actual price paid by the buyer.

The argument would have been viable if Dickinson's company had bought the drawing to resell, thereby acting on its own account. Unfortunately for Dickinson, the agreement between Dickinson and Luxembourg recorded an agent–principal relationship between Dickinson and Accidia, which created a duty on part of Dickinson to seek Accidia's informed consent and disclose its commission.

Indeed, the court confirmed that “an agent is liable to account to his principal for the full price received, must not profit from his position as agent except with his principal's consent, and that an agent is not entitled to retain a secret commission or profit.”

Keeping a clear view

Both Rybolovlev's litigation and Accidia impart some important lessons.

First, it is imperative that each party carefully considers its role in a given transaction and clearly communicates its understanding of the role to all other parties involved.

Second, it is imperative that parties enter into written agreements outlining the scope of the services they will provide and the capacity in which they will perform those services.

Third, if by acting as agent intermediaries carry fewer risks, in particular the risk of buying without being able to resell at a profit, they take on fiduciary duties including the obligation to account for any money they make when conducting the principal's business. Intermediaries who decide to act as agent yet seek to maximise their own return without proper disclosure and authority expose themselves to significant risks.

Fourth, operating on blind trust is not an option when millions of dollars are at stake. It is utterly baffling why Rybolovlev agreed to purchase a Gustav Klimt painting from or through Bouvier for $183m, a Leonardo for $127.5m and a Rothko for $189m all without a single written contract.

Fifth, if parties enter into a legal agreement it is important to ensure that the agreement reflects their intentions accurately. Dickinson's company, for example, could not have intended in a single sale to act as agent for Accidia, with which it had no direct relationship, and as agent for the buyer.

Sixth, even if an agreement explicitly provides that parties do not act as an agent and principal but as a seller and buyer, it is important not to behave in a way that creates a fiduciary relationship, as courts often analyse the actions and conduct of the parties to assess the existence of an agency relationship.

Finally, a chain of intermediaries carries serious risks if these intermediaries have no or little visibility over relationships further up the chain. Risks include the owner of the artwork not having authorised their agent to delegate their authority to sub-agents or the owner having capped all commissions at a certain amount. A sale by an unauthorised sub-agent, or the total commission earned by a string of agents exceeding the maximum commission allowed by the principal, can lead to significant financial losses for the intermediaries involved.

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Arts specialists met at RICS in October to discuss burning issues in arts ethics. Claudia Conway reports on the debate

Kicking off the conversation

In October, RICS hosted a lively morning of discussion on ethics and the arts business. Ken Creighton, RICS Director of Professional Standards, opened the event by asking “Should we create an international standard for arts and antiques?”

The response was far from equivocal. There were many talking points and important issues raised in relation to an international market that was worth $63.8bn globally in 2015.

Patrick Le Gant from the Association of Professional Art Advisors and Mark Dodgson of the British Antiques Dealers Association introduced their respective organisations. Dodgson then discussed the difficulties faced by the British Art Market Federation in devising some basic principles for the way in which members should operate given the huge variety of items and contexts involved – the federation was only able to apply very general principles to the full gamut of its membership.

For Dodgson, arts and antiques do not represent a new asset class, as some are suggesting, but are chattels, and thus governed by existing laws; what is important, he stressed, is that professional bodies reinforce their standards, giving confidence to consumers.

Next, lawyer Karen Sanig offered her perspective on the complexities of working in an area covered by a variety of international legislation, and where the laws that do come into play are not specific to arts and antiques. She also said she does not believe that the whole market can be regulated, but that existing laws could be applied with more vigour.

The art market, she said, is “super self-regulating” – which also means that any poor behaviour on the part of professionals affects the reputation of the entire trade. More could be done to educate buyers, with many still not understanding that auction houses are the agents of the seller, or that possession does not necessarily indicate legal ownership.

The latter can be a particular problem, she said, when an item has passed through multiple jurisdictions with different laws on ownership – an artwork considered stolen in one country may be seen as having acquired good title in another when it has been purchased by an unknowing party, for example.

Conflicts of interest are often inherent in the market as it stands. Auction houses have legal documentation that spells out their relationship with the client, but such arrangements may not exist between other professionals and their clients. Duncan Hames of Transparency International offered an impassioned plea to stamp out corruption and outlined the role professionals can play in doing so. Corruption, he said, causes suffering all around the world, and professionals must be aware when particular clients’ wealth seems unexplained or shrouded in secrecy.

He went on to explain the standard sequence of activities by which money is laundered, and the requirements of the Money Laundering Regulations 2007. He summarised that arts businesses must take pre-emptive measures to avoid reputational damage, challenge secrecy and understand the concept of beneficial ownership.

Discussion

Art consultant Selina Skipwith then led discussion with the panel and attendees.

The description of objects was a hot topic for discussion – auction houses need to ensure such descriptions give all the details needed and that they are accurate. Valuation also provoked reflection – in a context where there may be few comparables, where details are hidden in private treaty sales and where valuation can be especially contextual and subjective, on what basis should objects be valued?

Buyers’ expectations also proved a lively issue. Some do not understand that just because they are prepared to pay a certain sum for a painting, for example, this does not mean that its value or that of the rest of the artist’s oeuvre will increase.

It was agreed overall that RICS and arts bodies must keep the conversation with one another going, in order to reassure the market that professionals are acting ethically and find ways to instil confidence in clients. Clearly there is much for RICS to do in finding the best way to support the arts and antiques professions, and interesting possibilities as work continues on conflicts of interest.

Acknowledgements

Many thanks to Claire Grindley and Selina Skipwith for organising this event. The Personal Property Journal will report on these issues and further discussions in future.

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