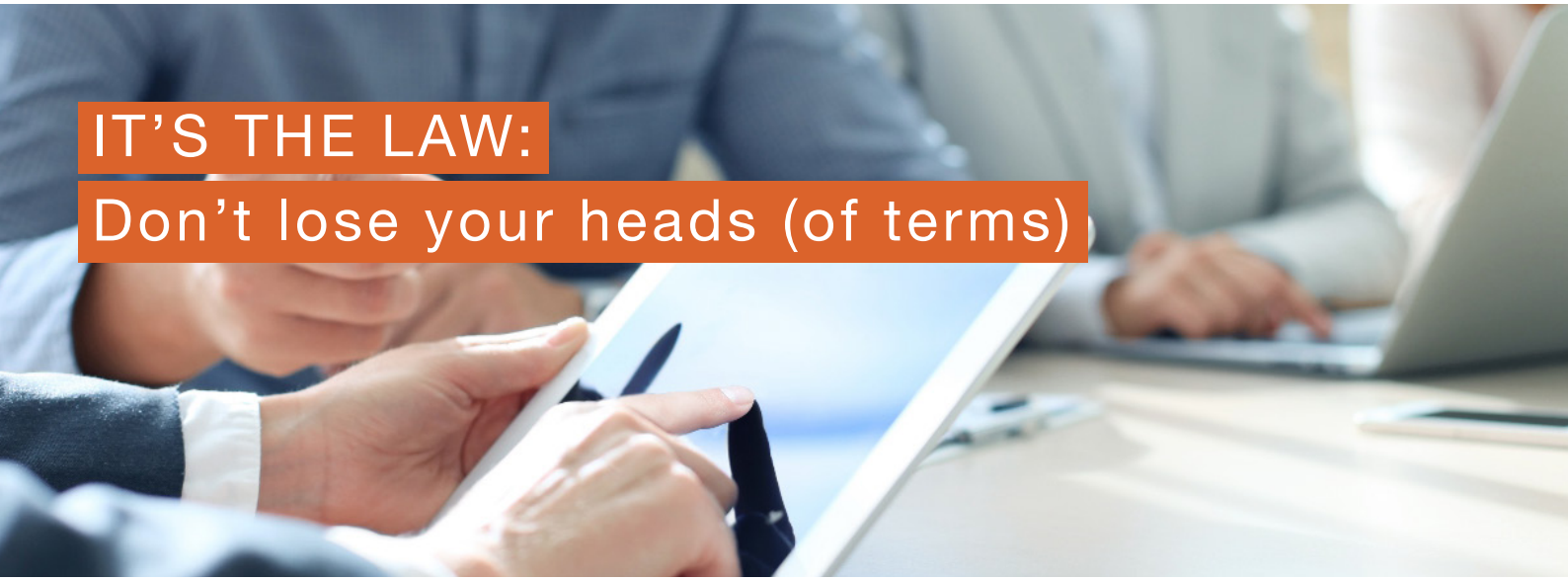
Devonshires



IT'S THE LAW:
Don't lose your heads (of terms)

It's a bit of magic (not)

There's nothing technical or magical (and not really that much legal) about Heads of Terms. But a decent set can help in getting a transaction to run smoothly. Their purpose is to record the main terms of the deal. Technically you don't actually need Heads of Terms at all. There's no law about it. But, they do have a number of advantages.

Focus: They help focus everyone. It's not uncommon for two people to leave a meeting, each with a very clear, but different, understanding of what was agreed. Setting words down to paper highlights these crossed wires.

Memory: You'd be amazed at the number of times people have a quite vivid memory of the start of a heated discussion on a point, but can't remember where the discussion ended. Writing it down preserves the evidence.

Instructions: A set of agreed Heads are a great way for both sides to ensure that their respective solicitors are given a consistent understanding of the deal at the outset.

Getting into a bind

Heads of Terms relating to property transactions are rarely binding. And that's a good thing. The whole point is that they describe the main deal structure without having to go into the finer details which would be needed before a binding commitment could be entered into. But that can be a trap for the unwary. If you want obligations to bind (such as a promise to contribute towards abortive costs if the transaction doesn't proceed) then you'll need to go a step further – either by way of a side letter or even a short agreement.

Leave it out mate!

What you put in and what you don't is an art rather than a science. Too much detail and you end up wasting time discussing things that the solicitors could deal with in the background. Too little, and you miss fundamental points which will come back to bite you.

Here's our checklist of questions you might want dealt with within a set of Heads of Terms on a property transaction.

Party time

Who is buying and who is selling. Not always as easy as you might think given the plethora of group structures. Consider who you are doing business with and what happens if they don't (or can't) perform. Will anyone's obligations be guaranteed – e.g. by a Parent Company Guarantee or a bond.

The property

What property is being sold?

Is it a sale of whole or a sale of part? If of part, will the Buyer need rights over the land kept back by the Seller. Equally, will the Seller need to keep rights over the land being sold? Will there be any shared facilities like play areas, service media or bin stores. Who will maintain those in the future and who will pay for that maintenance?

Freehold or leasehold

Is the interest being sold freehold or leasehold?

If leasehold: What is the length of the lease? What is the rent? Is the rent subject to review? Who maintains the buildings?

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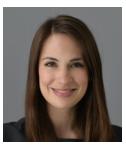

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Who insures the buildings? What use is permitted? Can the tenant freely dispose of the lease or do they need the landlord's consent?

Show us the money

What price is being paid? Is the price fixed or might it fluctuate? Is there a deposit? Will that be held as stakeholder (meaning it gets kept safe by the Seller's solicitor) or will it be released as agent (meaning the Seller can spend it)?

When will the price be paid? Is it all in a lump sum or will it be paid in stages? If there are development obligations on the Seller and multiple payments are going to be made as development progresses, the Buyer needs to be wary of making significant payments before they become owner of the land. Even after completion, the Buyer needs to think carefully about the payment profile. If, for example, the Buyer is taking a number of units in a tower block, those units will have very little market value until they are pretty much fully built. If the Buyer overpays and the Seller becomes insolvent the Buyer may end up having paid money for flats that have little prospect of being habitable in the foreseeable future. And as the flats are part of a bigger tower the Buyer may have little realistic prospect of completing the build itself.

Will overage be payable in the future? If so, on what basis? If overage will become payable, how will payments be protected? A legal charge? A restriction on the Buyer's title?

Tick tock timing

What are the target dates for exchange and completion?

Is the contract conditional on anything? Receipt of satisfactory planning for example. Who has to do what to try to get the condition satisfied? If the condition fails, who can terminate and when? What happens to any deposit?

Taxing matters

Has the Seller opted to tax (or will they)? Generally a land transaction will be exempt from VAT unless the Seller elects, in which case, it will be subject to VAT. Usually at 20%. That can cause Registered Providers difficulties, as they often have limited ability to recover VAT.

In limited situations the Buyer can disapply that election, if the Seller cooperates. But that can cause the Seller difficulties, as it means they won't be able to recover the VAT that they have incurred in relation to the site.

Sometimes the circle can be squared if you delay completion of the land acquisition until the building works are part way through (what is known as Golden Brick). At that stage of construction the VAT rate will drop from 20% to 0%. Meaning that Buyer doesn't actually pay any VAT but the transaction is technically VATable, meaning the Seller can reclaim its input tax.

Construction

If the transaction involves development works, there are a whole host of additional things to think about.

The very basics are: Who will build? What will they build? When will they build it? What happens if they are late? Will they pay Liquidated and Ascertained Damages (LADs)? Will collateral warranties be provided? Will the construction obligations be documented by way of what is known as a JCT Building Contract or will the obligations be contained within a Development Agreement? Will the Buyer be able to request a variation to the works part way through?

Due diligence/planning

Will the Seller be sharing any surveys or reports with the Buyer?

If the Buyer wants to be able to rely on these (i.e. sue the consultant who prepared them if they turn out to be wrong), it will need a duty of care letter or collateral warranty. The Buyer may also need a copyright licence (if it wants to copy the information contained in the report). And, in both cases, the Buyer will need to think through whether its own contractor will also need duty of care and copyright (particularly if the works are being procured under a design and build contract).

Buyer's need to be careful when relying on reports commissioned by others. What is revealed in a report will often depend on precisely what question has been asked. There is a world of difference between an environmental report that answers the question "is the land contaminated" and one that answers "is the land contaminated by arsenic". In the latter case, a clean bill of health does not necessarily mean that the land is free of all contaminants. Remember, the Seller rarely has much of a duty to disclose problems.

Similar considerations apply if the Buyer wants to rely on a planning permission secured by the Seller. The Buyer (and maybe its contractor) will need duty of care and copyright from the Architects. The Buyer will need to be careful to make sure that the scheme permitted can physically be built.

The dotted line

Do Heads need to be signed? The answer is almost certainly no. However, making sure that someone senior in each organisation has signed them gives some comfort that the organisations have thought the deal through and, whilst maybe not contractually committed to it yet, do probably intend to try to follow through.

The tiny print

Find out more

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