

Completion complications

Property investment In the first of two articles on buying investment property, Anthony Judge and Rachel Wevill consider contractual provisions to deal with apportionment and arrears

A major investment client wants to buy a slightly down-at-heel shopping centre for a bargain price, turn around its fortunes and drive up the income. Maybe it will exercise break notices and attract a more salubrious breed of tenant once it has revamped the premises. The client is thinking big.

Meanwhile, there are around 100 tenants in the centre, most in breach of various covenants under their leases, ranging in severity from internal decoration obligations to non-payment of rent. The lawyer handling the transaction is thinking about (among other things) the completion statement.

On the sale of a shopping centre, there will be tenants who pay quarterly, monthly or when they feel like it. Some are up-to-date with their rent, but there are likely to be arrears, historic arrears, disputes over service charge and a variety of other financial considerations that make the completion accounts and apportionment exercise complicated.

Apportionment of rent under occupational leases

Where tenants are paying quarterly in accordance with the terms of their leases, apportionment can be dealt with in a relatively straightforward way. It could be expressed as follows:

Rent shall be apportioned as at the date of actual completion such that in respect of the rent payable under each occupational lease the buyer shall be entitled to an amount calculated as follows:

(A x B)/365

where:

A is the principal rent payable under the relevant occupational lease as at the date of actual completion; and

B is the number of days from, but excluding, the date of actual completion to, but excluding, the date when the next payment of the rent is due,

and the seller shall be entitled to the balance of the rent payable up to, and including, the date of actual completion.

The situation changes where the tenant has made an arrangement with its landlord or managing agents in order to make payments in smaller increments, usually in order to facilitate the tenant's cash flow. If it has been agreed that the tenant will pay monthly, the formula still works but the calculation at completion is different.



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But what if the tenant has paid less than is due? It would seem fair – and certainly desirable from the seller's perspective – that where only part payment has been made for the relevant period at the date of completion (usually the quarter), it is treated as being paid in full for the early part of the period, rather than pro-rated across the whole payment period. In such a scenario, should completion take place towards the end of a month or quarter, all of the rent in effect belongs to the seller and the balance of the payment will be treated as arrears.

The drafting could read as follows:

...the seller shall be entitled to an amount calculated as follows:

(C x D)/365

where:

C is the rent payable under the relevant occupational lease as at the date of actual completion; and

D is the number of days from and including the date when the last payment of the rent under the relevant occupational lease was due, but excluding, the date of actual completion to, but with the day of completion being split between the seller and the buyer on a 50:50 basis

and the balance of such part paid rent received, if any, shall be allowed to the buyer. If there is no positive balance after such a calculation is made, no allowance will be made to the buyer.

Arrears

Recovering historic arrears for a sub-prime shopping centre may be commercially unrealistic, but theoretically there are a number of ways in which the parties can, in the contract, agree how to handle arrears:

- The buyer agrees to use reasonable endeavours post-completion to collect the seller's arrears (perhaps restricted to the current quarter's arrears);
- The buyer buys the seller's arrears;
- The seller collects the seller's arrears.

There are many issues to consider in drafting these alternatives but, particularly in the first and third of these options, a question arises as to what liability the next payment received from a tenant will be allocated. The draftsman needs to consider *Thomas v Ken Thomas Ltd* [2006] EWCA Civ 1504; [2007] 1 EGLR 31 where it was held that, if the tenant is in arrears and makes a payment to the landlord, the tenant can specify that the payment is in relation to the current rent due rather than the arrears. The landlord is not entitled to appropriate the rent for a particular debt.

Where the seller collects the seller's arrears, the seller is clearly pursuing a debt owed to it. Where, however, the buyer buys (or uses reasonable endeavours post-completion to gain) the seller's arrears, the buyer will be pursuing a debt actually owed by the tenant to the landlord/seller. If the tenant has managed to designate the manner in which the arrears are to be appropriated, the buyer will be fixed with that designation. It may be that the appropriation of payments is dealt with in the lease or has been otherwise agreed between the landlord and tenant, in which case it may be too late for any drafting in the contract to apply. In the absence of any such prior appropriation, however, wording such as the following will help to clarify the matter:

Any sum paid after completion in respect of any amount due under any occupational lease (whether or not paid in respect of arrears) shall be applied in settlement of the arrears under that occupational lease in the order in which they became payable.

The next of these articles will consider the practical and contractual issues that arise when apportioning service charge.

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