Getting into residential: Opportunities and potential traps for mixed use investors

Residential is an asset class fuelling economic growth (Town Centre Redevelopment: The New Asset Classes And Trends Driving Economic Growth in London (bisnow.com))

Around £2.5 billion was invested into UK Build to Rent during the first six months of 2022, according to Savills Q2 Market Update. But providing people with safe, comfortable and future proofed homes is a new and potentially complicated game. We look at the opportunities and potential legal traps from our experience with clients in both commercial and residential real estate.

Managing your investment risk

Whether re-purposing existing buildings or building new mixed use schemes, those traditionally operating in commercial real estate often, quite understandably, don't appreciate the intricacies involved in residential. There is a great deal of regulation that can have surprising, and potentially dire, consequences for those not well versed in the area. A few examples of situations where we work with clients to navigate those risks are:

Protecting ownership

Residential, and certain mixed use buildings, comprising flats held on long lease leases are vulnerable to a form of compulsory acquisition known as collective enfranchisement. This widely exercised statutory right empowers leaseholders of flats to buy the freehold and any headlease of their building at price determined by reference to the legislation – typically lower than a landlord might reasonably expect to receive had it sold on the open market. This may present a lost opportunity in realising returns and income. Adopting and implementing

enfranchisement avoidance or mitigation schemes as early as the design and build stage may therefore ensure a developer or landlord is able to retain their asset for the long term. Equally, the complexities and pitfalls of the legislation merit robust and specialist advice from the outset to the conclusion of the process.

Protecting their right to deal with their investment

It would not be unreasonable to assume that as the owner of a development, you are free to deal with it as you see fit. However, that is not necessarily the case. When there is a residential element, there is a risk that the tenants might benefit from a statutory right of pre-emption which could prevent a developer doing things like selling its interest, granting a new commercial lease, or accepting a surrender of a lease without first offering it to the residential tenants. Depending on its plans, a developer may want to structure a development in such a way as to minimise the impact of that statutory right. That is often possible with sufficient forward planning. Irrespective, an owner of a mixed use estate will need to know when the right arises and the process that must be followed where it does.

Ensuring full recovery of costs incurred in managing the development through the service charge

Unlike commercial, for residential, the service charge provisions in the lease are just the starting point. Residential tenants have the right to challenge service charge costs that are not “reasonable” (for example where costs are not apportioned reasonably or are excessive), to be consulted in respect of certain proposed contracts, and to be provided with specific information in relation to the service charge. There are time limits on making demands and strict requirements as to the content of the demands. Failure to adhere to the rules will almost certainly leave landlords significantly out of pocket.

For those prepared to do their homework, this is great part of the sector to be in and does a lot to improve the provision of UK housing. Talk to our dedicated residential asset management team about how we can help with your plans.

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