

Pay attention

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Dividing the risks and rewards between landowners and developers needs careful documentation, warns Karen Mason

The size and nature of any development will usually determine who is responsible for infrastructure costs, which can either make or break a greenfield scheme.

Access and services costs will always be a significant issue to resolve before the viability of any scheme is considered. It is not unusual for a landowner to deal with these two issues before placing development plots on the market, and if a solution is already in place the value of the development land will usually be considerably enhanced.

However, the real impediment to the landowner in resolving infrastructure issues will be the detail of the proposed scheme. Often, they may not have the funds or the expertise to work up a detailed scheme, which would mean front loading costs without a particular end user in mind.

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The expenditure on infrastructure will also only be worthwhile if the enhanced development value is available to the landowner. There is no point having high-quality roads and services if you do not get planning consent for the projected development.

Therefore, the negotiations invariably include the developer putting in the infrastructure, with the landowner making a contribution by either a reduction in the price or even delayed payment. Unless the landowner has large pockets they will not be able to fund the infrastructure works without planning consent for the development.

The costs that need to be shared relate to access and the provision of services. However, for larger developments amenity costs may also have to be shared if additional elements are required to obtain planning consent. This could be car parking, road works or other improvements to make the scheme viable or attractive to the local planning authority.

Sharing value

Overage is a mechanism by which the seller of land can share in the increase in its value by receiving a payment in excess of the initial purchase price from the buyer after completion. Payment is usually triggered by a specified event, for example, obtaining planning

permission or completion of the development.

From a developer's point of view, it is also a method of improving the initial cash flow of a proposed scheme and sharing the risk of developing the land. From a landowner's point of view it is definitely a case of 'jam tomorrow', so they should not get too distracted by the promise of an overage when negotiating the initial price.

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The biggest risks with overage are policing it, protecting it, and accepting that you may not get any more money at all. You need to make sure this is taken into account in establishing the price.

In any agreement containing overage provisions, the parties will need to settle on the regular reporting to enable the landowner to police the provisions. Clear trigger points for payment also need to be agreed to make sure that both parties are clear about when this is due and when it will be made. If you are using a formula, a worked example in the document is always a good idea.

There are numerous established methods for securing and enforcing overage agreements that can protect the seller, although none are entirely satisfactory. The drafting should be crystal clear about when, how and by whom the overage payment is to be calculated. Definitions of the land, the sale price, the overage period, the specified trigger events, the obligations of the parties and available remedies in the event of a dispute are also vital.

Clawback on development

If land is being sold prior to development, the financial outcome of the scheme will probably not be ascertainable at that stage. Until planning consent is obtained, neither party will know for certain the number of units, the rental or sale values and therefore the true development value of the land. The landowner may therefore be happy to defer payment of the full price until this is determined. Equally, the developer will always be happy to take the cash flow advantage of deferring payment on part of the price.

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While it is common to see overage payable to the seller, it is unusual to see clawback by the developer because most would not pay any part of the price that is uncertain or unascertainable. If overage or clawback is agreed, the key consideration will be how the payments due from the developer can be protected. The best form will usually be a legal charge, but if the developer is borrowing to pay for the land this may not be available. If not, a second charge behind the senior lender may be on offer.

Some form of restriction limiting dealings without consent against the title is probably the most common protection used, although a restrictive covenant or creating a ransom strip are other possibilities. However, whatever method is used, it will have to be monitored and progress checked from time to time.

A key area of dispute will also be what costs or deductions can be made to arrive at the overage payable. It is important to agree these in advance and make sure that every head of expenditure that is to be an allowable deduction is agreed by both parties and set out in the provisions.

Deferred payments

Housebuilders, in particular, like to defer payments until their unit sales have been completed and they can accurately determine their profit. But remember, the period from negotiation through to completed sales will usually be many years. If acting for a landowner, try to agree a formula that does not require you to wait until the last house is sold to get your money.

Some sales will certainly be required but payments can be made on the basis of the first slice with final reconciliation at the end. The developer will, understandably, want to wait until all sales are concluded and all costs are in. As ever, the final bargain will depend on the negotiating skills and power of both parties and will be a balance of their interests at the time the transaction terms are agreed.

The words 'development risks' can conjure up images of delayed construction works and misconceived architectural plans. However, it does not have to be fraught with mishaps if both parties set out their positions and these are mapped out in the agreement. There are plenty of challenges facing a landowner in selling to developers. However, with careful consideration of the risks and good planning the arrangement can bear fruit for both parties. Good advice at the earliest opportunity is a must.

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