

IRISH/UK PROPERTY BULLETIN



MORGAN MCMANUS



MORGAN MCMANUS SOLICITORS

01. Editorial
02. Property Syndicates - An Introduction
03. Town Renewal Scheme - A Last Chance
04. Contracts for Sale of Land - Is a Deposit Protected?
05. ROI Landlord Alert - Registration with Private Residential Tenancies Board
06. Recommended Websites

01. EDITORIAL

Welcome to the third issue of the Morgan McManus Irish/UK Property Bulletin. Those of you unfamiliar with our service can learn more about us by visiting our Website at www.morganmcmamus.com. We have offices in Northern Ireland and the Republic of Ireland and also provide legal services in England/Wales. This publication is being delivered to Accountants and Financial Advisors, Banks, Mortgage Advisors, Property Investment Companies and Private Investors. We hope to give you an insight into the information you will need to ensure that you have adequate legal protection when investing in property, whether that property is in Northern Ireland, the Republic of Ireland or in England/Wales. As we practice in all three jurisdictions we are ideally placed to provide a comprehensive comparative analysis – and that is important, particularly where it is your first venture into international property investment.

We know that you will find the Articles in this issue of interest. Fergal McManus of our Clones office covers the issue of Syndicate purchases where a number of people come together to purchase a common property which would in

normal circumstances be too expensive for one individual to purchase. You will note that this is an introductory article and that Fergal proposes to cover matters in greater detail in future issues of this Bulletin. Fergal also covers the Republic of Ireland Town Renewal Scheme. This article was first published on our website in March 2004. The contents of the article still apply although, as is evident from the article, matters for investors hoping to avail of the tax benefits under this scheme are even more urgent than previously as an application for full Planning Permission for the development must be made prior to the 31 December 2004. You will not access this article in this Bulletin but can access it by clicking on the hyperlink through this Bulletin or by going directly to the "Private and Commercial Clients" articles section of our website at www.morganmcmamus.com. Seymour Major of our Enniskillen office cautions purchasers of property on the protection of their deposit, when purchasing property in Northern Ireland.

In the last section of our Bulletin – "Recommended Websites" we hope to help the private investor undertake his own initiative in

sourcing properties and loans. We will be happy to consider any websites which investment companies wish to furnish to us for inclusion in future issues. Simply email details to bmorgan@morganmcmamus.ie.

As well as providing legal advice to the Private Investor, we also act for Investment Companies and can provide very competitive terms, particularly where we are acting for a number of purchasers in a common property, e.g. a number of apartments in the one block. Further details of our ROI service are available from Fergal McManus at our Clones office (e-mail fmcmanus@morganmcmamus.ie) and of our Northern Ireland/UK services from Seymour Major of our Enniskillen office (e-mail smajor@morganmcmamus.co.uk). (See telephone contact details at end of this Bulletin).

Brian Morgan
Editor

PROPERTY SYNDICATES

02. PROPERTY SYNDICATES AN INTRODUCTION

Fergal McManus Solicitor provides an introduction to the issues which prospective members of a Property Syndicate would be considering when forming a Syndicate in expectation of the purchase of a major investment property.

PROPERTY PRICE V. VALUE

It is self evident that more expensive property tends to give better yields than more affordable properties. The "yield" on a property is calculated by expressing the annual rental as a percentage of the value of the property. For instance there are numerous people who will be in a position to finance the purchase of a property for €200,000 whereas there will be a very small number of people that can purchase a property for a €1,000,000 or more. As there are more buyers to purchase lower value properties it tends to be the case that such properties represent less value for money. This arises because there is more competition to acquire such property and in turn this pushes the price of the property upwards often with little regard to rental yield. For example the rental yield on the average Apartment is in or about 3% whereas the average yield on a shop unit is probably double that level. Therefore more expensive property is often better value.

WHY SYNDICATES?

In order to allow investors to participate in more expensive better value property, Syndicates have become a popular mechanism to facilitate this. Effectively, a Syndicate is a group of two or more people who jointly purchase a property together and by pooling their resources are in a position to acquire a property that they might not ordinarily be able to acquire individually. There are effectively two main methods for Syndicates to acquire a property. The first method is to form a Limited Liability Company whereby each Syndicate member's share of the property is represented by the number of shares he or she owns in the Company. The second method is to form a Partnership, which provides a more direct method of ownership.

USING A LIMITED LIABILITY COMPANY

So, to take an example: a syndicate of four individuals wish to buy a commercial property in the Republic of Ireland for €2,000,000 and they agree that they will finance 25% of the purchase price themselves and that they will borrow the remaining 75% from a Bank. As such, each person would contribute €125,000 to the Company and in return they would be allotted, for example, 125 shares each so as to give each of them a ¼ ownership in the Company. The Company would then go to the Bank, borrow the remaining 75% and then the Company would pay the €2,000,000 to the

seller to complete the purchase. The Company would then be registered as owner of the property. In the normal course there will be a shareholders agreement between the Syndicate members regulating how the Syndicate will be regulated. The types of issues dealt with in such Shareholders Agreements are examined below under the heading "Co-Ownership Agreements".

USING A PARTNERSHIP MODEL

The second method is for the Syndicate members to acquire the property as co-owners or partners. To use the example above, the four owners of the property would in effect be deemed to be a Partnership. Each Syndicate member would contribute €125,000.00 to acquire a ¼ share in the Partnership. The Partnership would then go and borrow the balance 75% purchase monies from a Bank and the Partnership would then acquire the property. The property would then be vested in the partners in equal shares in the four names of the partners.

The partners would at the same time enter into a Co-ownership or Partnership Agreement that would regulate the type of matters that would also be covered in a Partnership agreement. If a Syndicate owns properties under a Partnership style arrangement and there is no Partnership Agreement in place, then the provisions of the Partnership Act apply. Many provisions of the Partnership Act are wholly unsuitable for owning a property in a syndicate. As such it is an absolute necessity to have a Partnership Agreement. So, what types of matters should be dealt with in a Partnership or Co-Owners Agreement?

CO-OWNERSHIP AGREEMENT

Whether a syndicate form a partnership or a company the following issues must be regulated:

1. Circumstances in which the member would be required to contribute further capital to the Company or Partnership e.g to improve the property
2. If a syndicate member becomes insolvent or bankrupt.
3. How to decide when the property will be sold – is a unanimous decision required or will a qualified majority suffice?
4. The circumstances, if any, under which a member could be allowed sell his share in the Partnership or Company. The syndicate member will normally be obliged to sell his share to an existing syndicate member or members.
5. What valuation mechanism would be used if one or more members is obliged to sell or wishes to sell his/her share in the

Partnership or Company?

6. What mechanism would be used if there was a dispute between the members of the Syndicate?
7. What happens to a Syndicate owner's share on his death?
8. How will the Syndicate be managed on a day-to-day basis?
9. Will one of the Syndicate members be appointed "Manager" to administer the Syndicate and attend to such matters as preparation of accounts, arrangement of audits, the supervision of the Co-ownership expenditure, keeping records of decisions, completion of leases, engagement of and liaison with Solicitors, Auctioneers, Estate Agents, Architects, Planners and all professionals required, reporting to the AGM, compiling an annual report and organising period meetings of the Syndicate members.
10. How much, if anything, should the Managing Co-owner be paid for administering the syndicate.
11. How to deal with "drawing".

COMPANY V. PARTNERSHIP

The table below sets out the main advantages and disadvantages of each type of ownership. Very often the tax consequences will dictate which type of ownership is best and detailed advice must be taken in this regard. For instance, the tax consequences will vary according to factors such as whether the property is located abroad or if the Syndicate members are resident or domiciled in different tax jurisdictions.

COMPANY ADVANTAGES

1. The syndicate members have the benefit of Limited Liability so that they could not be made personally liable for the debts of the Company.
2. It is a widely recognised and regulated legal structure.
3. The Companies Acts provide suitable framework to deal with many of the likely events to occur in the life of a Company, e.g. death of a member, dispute etc.
4. Corporation Tax of 25% on rental income is less than the higher rate of Income Tax rates which applies to partnerships. (It should be noted that the 12.5% standard rate of Corporation Tax does not apply to rental income).

DISADVANTAGES

1. The Bank may seek that the individual syndicate members guarantee all or a portion of the loan given by the bank to the Company.
2. There is ongoing legal costs in terms of auditing and filing in the Companies Registration Office Returns in order to continue to enjoy the benefit of Limited Liability.
3. There are increasing numbers of onerous legal duties and responsibilities imposed on Directors of Limited Liability Companies.

SALE OF LAND

4. The syndicate members may get exposed to double taxation on the income and profits from the property. For instance in respect of rental income, the Company will pay corporation tax at a rate of 25% and if there is any surplus to be distributed to the members of the Company this would be distributed by means of a dividend which in turn would be taxed in the members' hands at their marginal rate of income tax.
5. On the disposal of the property, once again, the spectre of double taxation arises. The Company would pay Capital Gains Tax on the increased value of the property and in turn if the Company was liquidated the shareholders will pay Capital Gains Tax on the increase in value of their shares in the Company (which would mirror the increase in the value of the property).

PARTNERSHIP ADVANTAGES

1. The property is owned directly by each of the syndicate members and, as such, removes the danger of double taxation which is associated with a Company.
2. It is often easier for a Partnership to raise loan finance than a Company as, in a Partnership, the individual partners are personally responsible for the debts of the Partnership.
3. There is no need for Companies Office registration or production of Audited Accounts etc. in respect of Partnerships and, as such, the ongoing compliance duties are less than that of a Company.
4. There is a greater degree of clarity in respect of the individual syndicate members' personal tax affairs. In our example he/she is effectively in receipt of ¼ of the rental income and is entitled to use ¼ of the tax deductible expenses in arriving at the tax payable for Income Tax. Similar logic would apply for Capital Gains Tax purposes.

DISADVANTAGES

1. The Partnership Act does not provide an appropriate framework for syndicated property ownership and as such a Co-ownership or Partnership agreement is an absolute necessity.
2. Having regard to the personal liability of the syndicate members for the debt owed to the Bank, they may decide to seek non-recourse loan finance. This means that if there is a default in the loan the bank will only be able to pursue the property to repay the debt due to them as opposed to the syndicate members. The costs of non-recourse loan finance tends to be about 1% higher than the cost of normal loan finance.

FLEXIBILITY

In this article we have kept matters as simple as possible by using an example of a €2,000,000 commercial property purchase and having four equal Syndicate members. There are all sorts of variations that can arise. For instance, there is no necessity that the Syndicate members hold the property in equal shares and some Syndicate members may have a greater share than others. The syndicate may decide that they wish to do something more complicated, such as buy a site and develop property on it. Once again the basic structure will be the same but a more sophisticated Co-ownership or Partnership agreement will be required in those circumstances.

LIMITED PARTNERSHIP

There is also the facility to set up a Limited Partnership whereby one of the partners (known as the "General Partner") in such a Partnership assumes all of the risk for the debts of the Partnership and the other partners (known as "Limited Partners") exposure is limited to the amount of money they contributed to the Partnership at the outset. This type of facility provides the benefit of direct ownership for each Limited Partner and the advantage of limited liability. It is most suited to a situation where a Developer wishes to develop a property and is prepared to carry the risks of such development but requires partners to finance the development. The partners in this context would be limited partners and the extent of their liability would be restricted to the amount of money they contributed to the project. Obviously the limited partners would not in the normal course be entitled to as large a share of the profits as the general partner who is carrying the risk on the basis that the party carrying the risk would expect to be entitled to share in the rewards to a greater extent.

CONCLUSION

The intention of this article has been to give you a flavour of the issues and the possibilities when it comes to syndicated property investments. It is vital that specialist legal and tax advice be taken. Such advice can be obtained from Morgan McManus Solicitors. In the coming editions of the Irish/UK Property Bulletin I propose to examine in greater detail some of the topics raised in this Article.

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03. TOWN RENEWAL SCHEME A LAST CHANCE

By Fergal McManus,
Solicitor and Professional Tax Advisor.
This article written by Fergal McManus can be accessed on the articles section of the website www.morganmcmanus.com or, if you have received this Bulletin by email at <http://www.morganmcmanus.com/html/pdf/TOWN%20RENEWAL%20SCHEME.pdf>
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04. CONTRACTS FOR SALE OF LAND. IS THE DEPOSIT PROTECTED?

Seymour Major, Solicitor compares the status of a deposit where it is paid in Northern Ireland as opposed to the position in England/Wales.

In all legal jurisdictions within the U.K. and Ireland, it is standard conveyancing practice that when the buyer and seller of land come to the point of being legally bound by a contract, the buyer pays a deposit as a part-payment towards sale price (usually 10% of the price). In each jurisdiction, the contract is subject to the conditions of sale, which are formulated by the Law Society of that jurisdiction. Those conditions of sale set out the status of the deposit and what happens to the deposit if the parties fail to perform the contract.

Under those conditions of sale, what happens to the deposit if the buyer defaults is similar in each jurisdiction. The buyer will be legally bound, under the contract, to pay the rest of the purchase price on a certain date ("the completion date"). If he misses that date, the seller can then serve a notice to complete. If the buyer then fails to pay the rest of the purchase price within the period of the notice, the Seller can rescind the contract and forfeit the deposit. However, the conditions of sale in Northern Ireland are different from England as far as the status of the deposit is concerned. This has consequences when the Seller defaults on the contract. There are two ways that a deposit can be held under a typical contract for a sale of land – as stakeholder or as agent for the Seller. If a stakeholder holds the deposit,

LANDLORD ALERT

it means that a third party (usually the seller's solicitor) holds the deposit between the time that the contract is formed and the completion date. The stakeholder cannot do anything with the deposit until the parties complete the sale. At that point, he hands over the deposit to the Seller. If there is no completion, he cannot release the deposit until the contract is rescinded. He then hands the deposit to the party, which rescinded the contract because of the other party's default. When a deposit is held as Agent for the Seller, the Seller is entitled to use the money immediately for any purpose whatsoever.

In Northern Ireland, condition 5.2 of the General Conditions of Sale (Law Society of N. Ireland (3rd Edition 2nd revision)) at condition 5.2 states:

"Upon the formation of the contract the Purchaser shall within 5 working days pay such deposit as may have been agreed to the solicitor for the Vendor who shall hold the same as agent for the Vendor"

In England and Wales, conditions 2.2.2 and 2.2.3 of the Standard conditions of sale (3rd edition) state as follows:

2.2.2 If before the completion date the seller agrees to buy another property in England and Wales for his residence, he may use all or any part of the deposit as a deposit in that transaction to be held on the terms to the same effect as this condition and condition 2.2.3

3.3.3 Any deposit or part of a deposit not being used in accordance with condition 2.2.2 is to be held by the seller's solicitor as stakeholder on terms that on completion it is paid to the seller with accrued interest"

In transactions for the sale of commercial property in England and Wales, the Standard Conditions of sale are not used. Those transactions are usually subject to the Law Society's Standard Commercial Property Conditions. Under those conditions, the deposit is held as stakeholder, except in auction sales, where it is held as agent for the Seller.

In summary, the Northern Ireland conditions of sale state that the deposit is to be held as agent for the Vendor. In England, unless the transaction relates to an auction of a commercial property, the deposit is held as stakeholder unless it is used as a deposit on a related residential purchase on similar terms to the present contract. If the deposit is used on a related

purchase, it can be used by the next Seller's purchase under condition 2.2.2 and so on until the solicitor acting at the top of a chain will be bound to hold the deposit as stakeholder under condition 2.2.3. If a seller defaults after making use of the deposit, it is likely to be much more difficult for the purchaser to recover the deposit than if a solicitor is holding it as stakeholder. Why then do the standard conditions of sale in Northern Ireland apparently fail to provide adequate protection for the buyer's deposit? In all probability, the Northern Ireland Law Society has followed 'Wylie on Irish Conveyancing Law' ("Wylie"). Wylie is regarded as the leading textbook authority on conveyancing in both Northern Ireland and the Republic of Ireland. Wylie points out that if the deposit is paid to the Seller, the Buyer has a lien on the Vendor's land for its return (Whitbread & Co. Limited - v- Watt [1902] 1 Ch. 835). A lien is a form of security so that if the Seller became bankrupt, the land could not be sold without discharging the lien. Wylie concludes at 10.066:

"...and in this respect the purchaser is better off than he would be if the deposit were paid to a stakeholder".

It is respectfully submitted that this view can no longer be relied upon as an appropriate standard for modern conveyancing. Firstly, the Buyer could be a very long time recovering the equivalent of his deposit by relying upon a lien. Secondly, there is no reason why anybody, other than the Vendor's solicitor, should act as stakeholder in a typical modern conveyancing transaction. In those circumstances, the Buyer will have the protection afforded by the solicitor's professional status and obligations. In conclusion, it is submitted that if the Northern Ireland Law Society Conditions of sale required the deposit to be held as stakeholder, this would provide a more appropriate balance of business efficacy between the parties. Purchase from a Builder who is a member of NHBC

In contracts that provide that a developer is responsible for building a property for the Buyer prior to completion, it is standard practice that the deposit is held as agent for the Vendor. If the contract provides that the Developer must obtain build mark cover under the NHBC Scheme, the buyer has some protection against fraud or insolvency. The new NHBC policy document, which applies to developments registered after 2003 states "If, due to his insolvency or fraud, the Builder does not start the Home, we will repay you the amount which you paid him under the Contract and which

you cannot recover. If, due to his insolvency or fraud, the Builder starts but does not complete the Home, we will repay you the amount which you paid him under the Contract and which you cannot recover, or pay you the extra cost above the Original Purchase Price for work necessary to complete the Home substantially in accordance with NHBC Requirements. The Cost of any work that we have instructed the Builder to do, and which he fails to complete in accordance with NHBC Requirements within the time set by NHBC."

The amount payable in compensation depends on whether the Developer has started the work. If the Developer has not started work, the compensation is basically the deposit. If the Developer has started the work, then the compensation is either repayment of the deposit or the cost of finishing the project. It does not cover loss of income (for example rental income) because of failure to complete on time.

In conclusion, until there is a change in the Northern Ireland Law Society's conditions of sale, it is submitted that solicitors acting for Buyers in Northern Ireland should, as a matter of best practice, negotiate a condition in the contract that the deposit is to be held as stakeholder unless the Vendor is an NHBC Developer.

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05. ROI LANDLORD ALERT - REGISTRATION WITH THE PRIVATE RESIDENTIAL TENANCIES BOARD

Investors who own residential properties in the Republic of Ireland which are let to Tenants must ensure to register each Tenancy with the Private Residential Tenancies Board within one month of letting. Existing Tenancies must be registered before 1st December 2004- late registrations are subject to a double fee. Registration is a legal requirement. Failure to register may result in a fine up to €3,000. A quick guide to the Act and the Private Residential Tenancies Board is available on the Internet at www.environment.ie. Registration forms may be downloaded from

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that Website or by contacting the Board through their e-mail address at TenanciesBoard@environ.ie. From the 6 December 2004 the Private Residential Tenancies Board will operate a dispute resolution service for landlords and Tenants who find themselves in dispute over any aspect of the Tenancy. This service will be available nationwide.

06. RECOMMENDED WEBSITES

In this section, Morgan McManus features websites which will assist the private investor in seeking properties and loans.

01. www.nationwide.co.uk/hpi.

Here you can log onto the UK Nationwide website and download the latest monthly edition of the House Price Review.

02. www.streetfinder.co.uk.

To ascertain where in the city your investment property is located log onto this website and find out.

03. www.upmystreet.com.

Use the comprehensive property guide provided on this website to ascertain property prices, council tax and other details when moving home or purchasing investment property.

04. www.propertyprices.co.uk.

The house prices fluctuating, wouldn't it be interesting to get an idea how much your property could be worth in, say five years time? Or, if you were looking to move, wouldn't you like to know what is happening to house prices in the areas you are considering. Visit this website, type in the postcode and current value of the house and you will get the prediction of the value in five years time.

05. www.onepointinvestments.com.

This is the new website of Cavan born Ronan Hannan (whose profile we provided in our July Quarterly Newsletter). This website shows investment opportunities which Ronan is currently providing and also gives investment advice. In particular, Ronan provides very cogent reasons as to why investors should continue to invest in the UK property market.

ISSUE

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