

INTRODUCING LEGAL INDEMNITY INSURANCES

Legal problems relating to the development, purchase or re-mortgaging of land or property can be wide-ranging and sometimes very complex.

Legal indemnity insurance is a single-premium contract to protect the purchaser from the possibility of third party claims arising from shortcomings in the conveyance. These can often relate to ownership, lost documents, access, poorly worded legal documents or perhaps a restrictive covenant that imposes specific restrictions.

These details are often only discovered at a late stage in the proceedings and may prevent the purchase of a property or development work from going ahead. Legal Indemnity products transfer the risks to the insurer, enabling the property purchase or development work to proceed.

The two most frequently purchased legal indemnity products are Defective Title and Restrictive Covenants. We are grateful to First Title Insurance Plc, a leading provider of these insurances, for their collaboration in this newsletter.

DEFECTIVE TITLE

Defective Title insurance protects property owners from unexpected third party challenges against any defects in title, which may affect an owner's ability to use or develop the property. The cover provided by title insurance enables land to be purchased, sold, developed, mortgaged and used, notwithstanding a range of title defects; these include restrictive covenants, restriction of rights or defects in the legal access to land to name a few.

Title Insurance has a dedicated purpose: to remove risk and enable property transactions to happen quickly and at a lower cost.

Defective Title Indemnity policies include cover for the loss in market value of the property, damages and the legal expenses that are involved should a claim arise. A single one-off premium is required and the insurance is open-ended. As well as the current owner of the property, policies also protect future proprietors and mortgagees.

The following list shows some of the many defective title policies available, but it is not exhaustive:

- Lost or missing Title Deeds.
- Lack of legal right of way to a property.
- Insufficient legal easement for services to a property.
- Possessory Title/Adverse Possession/Squatters Rights.
- Deed of Gift or sold at undervalue/Property subject to S339-342 Insolvency Acts.
- Land subject to rights or other interests e.g. rights of way, easements and charges.



RESTRICTIVE COVENANTS

Title to land is often subject to restrictions regarding the type of property which may be built or its permitted use. Insurers are happy to consider covering restrictive covenants for properties with existing breaches or where a development or a change of use is intended. In either of these cases, insurance can help to protect the owners against losses and provide security for future purchasers.

Cover includes:

- Compensation to parties with the benefit of the covenant to allow the development to proceed.
- Court awarded damages.
- Demolition and works costs if the development cannot proceed.
- The loss in market value of the insured property.
- Legal Defence costs.

The policy will provide insurance for the owner, mortgagees and future purchasers of the property. The interest of lessees can also be covered if required. Cover is usually open ended and a one-off single premium only is paid.

RIGHTS TO LIGHT - DARK DAYS AHEAD FOR DEVELOPERS?

Despite our fair island containing some of the most glorious countryside and open space, many of us insist on living in a single corner. There are, no doubt, various complex reasons for the concentration of our population, but as our numbers swell (along with sea levels) there is mounting pressure to generate more and more living and working space from the same portion of mud. The pressure is pushing land use in a very clear direction – skywards.

Of course, the U.K. has its fair share of historic tall buildings – for example, St. Pauls, the mills of the industrial revolution and the three Graces in Liverpool – but never in our history has there been such pressure to maximise land use. Moreover, in this climate, landmark buildings, offices and multi-storey residential buildings are becoming ever taller to accommodate more people on the same footprint. Planning authorities are also acutely aware of their duty to facilitate the provision of new offices and homes to meet the targets handed out by central government.

While modern methods of construction help architects to maximize height, neighbours more frequently find that these constructions maximize their loss of light. It is established law that we all have a right to receive daylight through the windows of our homes and offices. A right accrues in a number of ways, being either expressly granted when the building was first built, or accumulated over time. When compared with other property rights, there have been relatively few high-profile attempts to enforce rights to light.

So, why are the courts beginning to fill with applications for injunctions to stop interference with light? Well, the typical building height is on the up – developers couldn't build the obelisks that we now see springing up all around us sufficiently cheaply to warrant their use in anything other than landmark projects. Add to this the fact that many disputes involving issues of light have, in the past, been settled long before court because the degree of interference caused to the light in question was relatively small.

Rulings in a number of reported cases have highlighted the right to receive light. This is good news for the individual; many of us are oblivious to our ancient property rights until they receive publicity in the daily paper. However, for developers, commercial and residential alike, high profile rulings of this nature are problematic; they risk hampering ambitious and well intended regeneration schemes by providing yet more ammunition to the NIMBY (Not in my Backyard) crowd.

DO THESE RECENT DECISIONS ENLIGHTEN, OR CAST A SHADOW OVER, DEVELOPERS AND THEIR LOOMING PROJECTS?

The rulings in these cases reassert that an injunction is the proper remedy for someone whose light is interfered with. A developer who interferes with other peoples' rights to light faces the prospect of

having to down tools or, in the worst- case scenario, bring down an offending building so as to re-establish the light. This should not come as a great surprise – the draconian injunction has always been the normal means by which the courts will protect an individual's property rights. However, in legal circles it was felt there had been a shift in the courts favouring compensation as a remedy, unless the interference with an individual's light was severe. Some felt that the courts were beginning to acknowledge that Developers play an important role in the regeneration of our towns and cities. In fact, the courts have clarified that unless a developer has acted entirely reasonably throughout a project, they will be held accountable. Developers will not be allowed to prevail over individuals' rights to light by assuming that the court will allow developers to pay for the interference post facto with compensation .

Rulings such as these frequently serve a different cause – that of the NIMBY brigade, intent either on protecting their own back yard without regard for the greater good served by developments or, worse, ransoming developers for their hard-earned profits.

Even the compulsory purchase route may not afford developers the protection they need. A recent ruling now suggests that while there is statutory protection from an injunction during the construction phase of a development, the subsequent use of a development which interferes with an individual's rights to light will constitute an actionable interference for which an injunction or compensation may be sought by individuals affected.

So can insurance help? Certainly, insurers are not going to insure a behemoth that will plunge neighbouring properties into pitch darkness. However, insurers can assist with those projects in which the degree of interference is not entirely unconscionable but the developer cannot risk the time, money or uncertainty of entering into lengthy negotiations with scores of adjoining owners, some of whom may have an agenda far less well-meaning than that of a developer looking to invest in an area and help regenerate it by providing new and exciting living and working space.

DEVELOPERS POLICY

CASE STUDY: RIGHTS OF LIGHT

The client: A property developer and their mortgagee.

The property: A large piece of undeveloped land.

The development: A commercial development with an estimated developed value of £350-400 million.

The problem: The site was bare land with the benefit of planning permission for a large commercial development. A light survey carried out by a specialist surveyor revealed that the development would infringe the rights of light enjoyed by a number of commercial and residential properties in the vicinity of the site to a point where the most likely remedy to these infringements will be an injunction.

The planning history of the site stretches back over many years and there is evidence of material objections to each of the relevant planning applications from the persons most likely to be affected by the development.

The developer is proposing to amend the scheme, which has the benefit of the most recent planning permission, and design something completely new. The policy has therefore been taken on a pre-planning basis.

The Solution: By looking beyond the legal implications of insuring such a risk underwriters knew that the site is in an area where the affected owners are less likely to pursue legal action either because of the cost and time implications or because they own commercial premises and may therefore be more willing to accept compensation for their loss of light.

Insurers worked closely with the light surveyor to develop an understanding of how they assess the compensation amounts set out in their report and through the combination of a deductible and an appropriate premium have managed to mitigate some of the risk.

Providing cover on a pre-planning basis has enabled the exchange of contracts to take place and the developer to keep to their development timetable.

The underlying aim for any developer is profit. Primarily delays, funding issues, and cash flow obstruct this aim.

In today's current climate, delays can occur from any source (nervous lenders, sub-contractors etc.); cash flow is (and will always remain) a concerning issue, and lenders are becoming increasingly nervous about the current market and to whom they lend.

Taking into account the above factors, developers and their advisors are looking at ways to speed up the development process in order to eliminate delay, limit costs and raise potential profit. In order to realise these objectives, they are looking to obtain insurance to progress from day one (purchasing potential development site) to completion of the build and sale on with minimal disruption (to increase profitability).

Any title risks associated with the development site will affect the developer from day one. As a result, many developers (and increasingly their lenders) require insurance to cover the level of investment from this point through to the planning stage and beyond. Unfortunately, with many insurers, providing cover from day one on a pre-planning basis can be a costly affair (it is often based on the full developed value and the insurer does not have the benefit of possible objectors at the planning stage – thereby increasing the potential risk (and cost) to the insurer).

The alternative for many insurers is to offer insurance based on a capped value rather than the gross developed value of the project. Unfortunately, this can be unattractive to a number of lenders due to the risk of underinsuring and the risk to their return of investment. Problems can therefore ensue with the lender refusing this potential cover, which may further delay the project (thereby increasing the costs to the developer).

The Developer's Policy is a 2 stage policy which enables cover to be drawn down in 2 stages, at the outset of policy coverage (stage 1) and following the grant of planning permission (stage 2). The payment of the premiums for stage 1 and stage 2 are therefore staggered which assists the developer with any cash flow issues. The policy also enables the developers to place cover from Day one with the requisite comfort that this brings. Further, as the indemnity level is for the fully developed value, any lender can seek comfort in the fact that the full amount of their loan has been covered.

CASE STUDY - DEVELOPER'S POLICY

The client: A firm of solicitors whose client was a local developer.

The property: Land being used as halls of residence for a local university.

The development: The developer was paying a substantial sum for the piece of land and the ultimate aim was to submit a planning application to build numerous houses on the site.

The problem: There were various historic restrictive covenants noted on the title deeds to the land that would have restricted the developer's proposed development of the site. One of the restrictive covenants stated that no buildings should be constructed anywhere on the property save in accordance with plans approved in writing by the original vendor.

The proposed development was likely to have a gross developed value in excess of £15 million. Clearly, the developer wanted to protect against this potential financial interest as did his mortgage lender! Therefore, a pre-planning title insurance policy was required because although they did not have planning permission to implement their plans they still wanted to protect the financial interest they had in the land.

A pre-planning policy is always more expensive than a post-planning policy as the underwriter does not have the benefit of viewing objection letters raised to the submitted planning application that could flush out any beneficiaries of the restrictive covenants. Therefore the risk is greater as it cannot be fully assessed.

The solution: The developer did not want to pay the cost of a full pre-planning policy, as the concern at the back of their mind was that they might never obtain planning permission. The solution was to offer the client The Developers Policy whereby they would pay 40% of the total premium upfront and were covered for the full value of the development from day one. In the event that they obtained planning permission they could decide whether to pay the remaining 60% of the premium and enable cover to continue or not pay the remaining amount and cover would then fall away.

The benefit to the client was that their mortgage lender was satisfied their interest was protected and also the developer could go on to the site and start preliminary works such as erecting site notices knowing that they had the benefit of a title insurance policy should these preliminary actions notify a potential beneficiary of the covenants.



OLYMPIC FEVER TO SPARK TITLE INSURANCE BOOM

Title insurers are expecting a boom in business in the lead up to the 2012 Olympic Games, as property developers capitalise on the thriving commercial opportunities in London's surrounding East End.

This investment hotspot is becoming increasingly attractive to both commercial and residential investors; however, the potentially lucrative returns must not overshadow the fact that the Olympics site has remained underdeveloped for decades meaning that, in many cases, land ownership has never become an issue until now.

A one-off premium buys a title insurance policy which gives an owner perpetual cover against the known title defect, and/or protects a lender until the loan is repaid. Should an onerous encumbrance contained in the title deeds be enforced, the title insurer's standard policy provides cover for the legal costs, which could include the cost of an out of court settlement, as well as compensating loss in the value of the land.

Although key Olympic sites are likely to be acquired and developed with the protection of compulsory purchase powers, peripheral businesses, such as bars, restaurants and hotels, are exposed to the full force of title problems, such as a lack of documentary evidence of ownership of land, or burdensome restrictive covenants.

England is a minefield of ancient laws, which occasionally rear their ugly heads, to potentially scupper profitable deals – or put them on hold, at least.

A recent case, which engaged the attention of title insurers across the U.K., involved a company buying a piece of land with the intention of opening a pub there. Apparently unaware of a condition dating back to the nineteenth century, which stated that no alcohol was ever to be consumed on that site, the company faced severe delays and subsequent financial difficulties; all of which could have been avoided with the employment of title insurance.

In short, title insurance protects owners from unexpected third party challenges, based on defects in title that may affect an owner's ability to use or develop the property. The cover provided by title insurance enables land to be developed, mortgaged and used, notwithstanding a range of title defects.

As with most types of insurance, title insurance mitigates risk. For example, no matter how diligent lenders or solicitors are, fraud and forgery appears to be an ever-present fact of life. As a result, lenders are increasingly turning to title insurers to cover the risk that fraud and forgery presents to them and complement the service provided by their solicitors. In this way, if the lender incurs a loss at the hands of fraud and forgery, the claim will be paid within weeks or months. Indeed, enlightened solicitors are also using title insurance to achieve better, faster and cheaper completions for their lender clients.

The importance of providing such cover must not be underestimated, as identity theft and related frauds are the fastest growing crimes in the U.K. In 2002, according to Cabinet Office figures, fraud cost U.K. taxpayers £1.3 billion. Interestingly, no further data has been officially released since, but it is goes without saying that when property prices again start to rise, fraud and forgery will also continue to escalate.

Title insurance helps property developers to balance return with risk, while enabling the project to be completed as quickly as possible, at the lowest cost, but without compromising on security or quality. Whether it is obstructive ancient laws, land ownership disputes, or fraudulent activity which threatens to hold-up development, title insurance can help to mitigate the risks. At risk from all of the above and time-sensitive, as well as scrutinised by the world's media, the Olympic Park in London is expected to spark a significant surge in title insurance business over the next couple of years.

WHAT DO I DO NEXT?

Willis places a significant volume of this type of insurance with several leading insurance companies including First Title Insurance Plc.

Please contact your usual advisor at Willis for assistance in any general or specific enquiry, or any of our personnel listed overleaf.

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