

Development Agreements

SWORDERS IN-DEPTH ARTICLES

IT'S YOUR OPTION – OR IS IT? An Agent's View

Most of us have heard a horror story about Landowners who have lost out on badly drafted Option Agreements. However, there are alternatives, including Promotion Agreements and their derivatives, that more adequately protect Landowner's interests. So why have Options not died out in favour of potentially safer Promotional Agreements?

Those who favour Option Agreements argue that where the terms appear similar, housebuilders will often pay significantly more up front money for an Option Agreement. This is largely the case, but the underlying reasons are worth examination. For a housebuilder, an Option includes the ability to secure land for their 'development pipeline' at a time to suit them, and minimising the price they pay when the Option is exercised.

The fundamental reason for this is because an Option is a one-sided contract where the Landowner is bound to sell the property to the developer but the Developer has no obligation to purchase. This means the Developer's and the Landowner's interests are misaligned, as the Developer will by trying to buy the land as cheaply as possible.

This reason alone should be sufficient reason to persuade Landowners, their Agents and Solicitors to seek, if at all possible, to secure a Promotion Agreement as an alternative. The land under a Promotion Agreement is sold to a third party in the open market and therefore both the Landowner and Promoter want the same thing – the maximum land value achievable.

The clearest way to see this is to look at some example situations you might come across when negotiating an Option Agreement.

VALUATION CLAUSE

Valuation clauses often have caveats that effectively exclude special purchasers. This can substantially under value the land by comparison to a sale in the real open market as in reality in the open market the majority



of interested purchasers will have a special interest in acquiring the land – whether because they have an available workforce which requires allocating to a new project or because they have another site closeby which can offer economies of scale or be protected by the acquisition of a potentially competing site.

Often quite massive discounts can be "hidden" by the valuation assumptions required by apparently innocuous phrasing and equalisation clauses.

TIMING OF SALE

It is in the Developer's interest to exercise the Option at the lowest point in the market, in direct opposition to the Landowner's interests, that are best served by waiting for the market to recover. A Promotion Agreement ensures that the Landowner and Promoter both want to maximise value.

TRIGGER FOR SALE

The trigger for sale is generally 'satisfactory planning permission', with the definition of 'satisfactory' varying from one agreement to the next, but often being outline planning permission. The first issue is that if the Developer



can start buying land with outline planning permission, there must be a detailed master plan and design and development brief. Land with only outline planning permission is likely to have a much lower value than land with detailed permission, or with a detailed framework plan. However, even if an Option includes these safeguards it is almost impossible (and very expensive for the Landowner in professional fees) for the Landowner to argue that the planning permission obtained is the 'best' permission for the land in question. The Developer may well, after purchase, improve the value of the permission. Even in a situation where restrictive covenants are imposed in favour of the Landowner at the point of sale (in order to attempt to capture some of this uplift in value), in reality these covenants can be difficult and complex to enforce. It is far more satisfactory to ensure that both the Developer's and Landowner's interests are aligned – where the Developer has as much to gain from maximising the value of the planning permission at the point of sale as the Landowner does.

So is the solution just to insist on a Promotion Agreement? Unfortunately there are many pitfalls that are common to both Option and Promotion Agreements. There is not sufficient space in this article to consider them all here, but the following situations are common:-



EXPOSURE TO ABORTIVE COSTS

A tactic used by some Developers is to agree a very brief Heads of Terms of Agreement, offering an undertaking to pay the Landowner's reasonable legal costs if the matter proceeds in line with the Heads of Terms. Then whenever the Landowner's Solicitor seeks to subsequently negotiate inclusion of a clause that the Developer does not like, the Landowner becomes exposed to the risk of paying their own professional costs if the matter then becomes abortive. It is crucial that your Agent produces detailed Heads of Terms covering all aspects of the Agreement.

AGENT'S ADVICE

Some Developers offer Landowners' Agents introductory commission – the Agent, in introducing the site to the Developer, can be offered a commission by that Developer if a deal is concluded. Similarly, some Agents approach Landowners offering an interested Developer whose details are conveniently withheld unless the Landowner is prepared to retain that Agent to act. The independence of the Agents in these two scenarios should be carefully considered and most Landowners would be better advised to use their existing Agent who they can trust. That Agent should be prepared to seek independent guidance from a third party specialist if required.

Don't be afraid to ask Agents if they act or sell newly built houses for any of the parties they introduce as a significant number of Agents are convinced they can do so without a conflict!



LEGAL ADVICE

No matter how astute the Landowner's Solicitor, their role should not be expected to extend to advising upon the commerciality of the deal and therefore they can't be expected to identify commercial pitfalls.

So, if I'm covered on the above should I be alright?

The answer is unfortunately no, as these are only a few of the pitfalls and also the subtle wording that Developers often include within Agreements needs to be looked at closely by both your Solicitor and an experienced Agent to make sure you are adequately protected. Ask yourself if your Agent is sufficiently experienced to properly represent your interests. Remember that negotiating Development Agreements can be a fraught process with the Developer constantly attempting to manipulate the Agreement. A common tactic with Promotion Agreements is to seek a first refusal or similar clause – this turns a Promotion Agreement into an Option.

But don't Developers pay less for a Promotion Agreement?

Under a Promotion Agreement the Promoter's incentive comes entirely from the percentage of value of the site that they receive on sale (as opposed to securing a Development pipeline at a satisfactory discount to market value). You would therefore expect to receive a lower upfront sum for a given percentage of final value. This is inevitable if you deal only with Housebuilders as a Promotion Agreement takes away their opportunity to acquire at one value and sell on at another and removes both their land banking and house building opportunities. However, other long term investors can both match and, in many cases, exceed the commercial terms offered by housebuilders, and you should not limit your field of search to Housebuilders and Developers.