



Working together  
to succeed

## Overage - a survival guide

Overage is an increasingly common feature of any land sale. It comes in many shapes and sizes and masquerades under a variety of names, including 'clawback', 'uplift' and 'kicker' (occasionally these names have distinct meanings).

The concept is simple: to allow the council to enjoy a 'slice of the action' should the land value be enhanced by a future grant of planning permission, or if a buyer or a future developer achieves an unexpected level of development profit. In times of difficult market conditions, falling values and scarcity of comparables overage allows a council to share in any short-term increase in property values.

Overage is a legal minefield:

- developers are rarely anxious to pay, and considerable sums of money may be at stake, raising the prospect of litigation
- there are no 'standard' overage agreements; the lawyer starts with a blank sheet of paper and must capture a unique commercial deal
- familiar legal mechanisms are unsuitable for implementing typical commercial terms. So creativity is required to ensure positive payment obligations cascade down to future owners, and enforceable security is achieved for a liability which may never be triggered
- there is frequently scope for argument - for example over valuations or allowable development costs
- there are hidden traps around VAT and SDLT and CGT.

## Overage and the development timeline

The key to understanding overage is the development timeline. For example, what are the current development opportunities? When is likely to be the best prospect of achieving an implementable planning consent and profitably developing the site?

As a site progresses along the development timeline, the subject of the overage agreement tends to become more focused.

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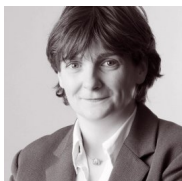
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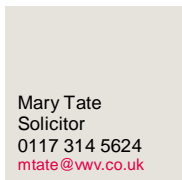
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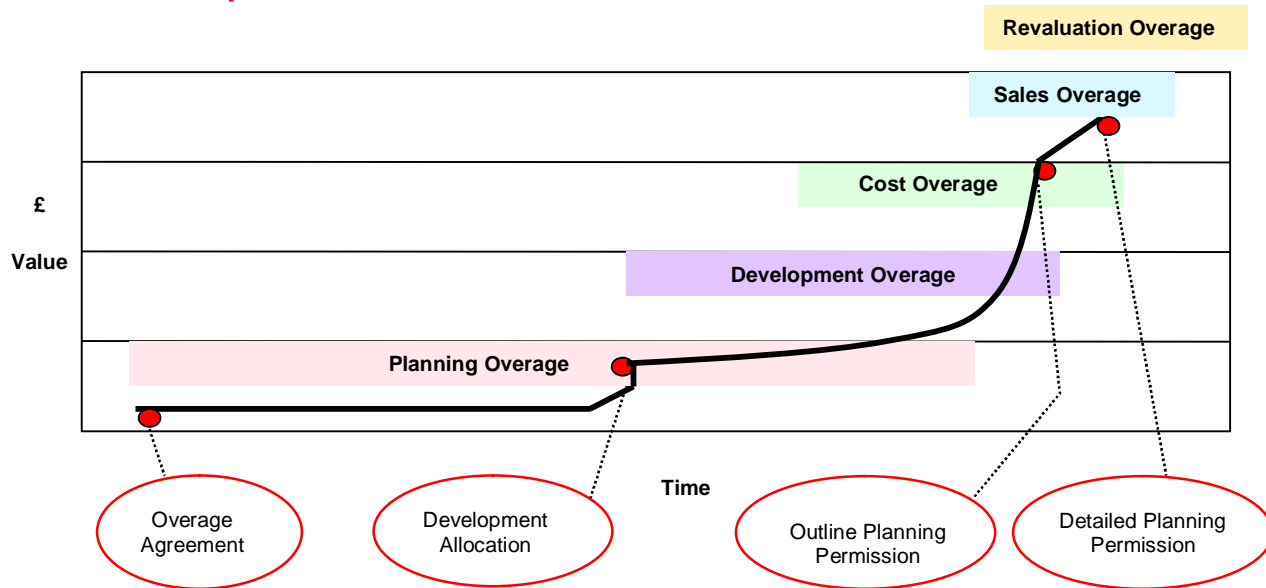
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## The development timeline



## Categories of overage

There are no hard and fast rules, but the following are the most common categories. Deals frequently involve a combination of several overage categories.

### Planning overage

**Typical scenario:** sale of agricultural or industrial land, where there is a long-term (but currently remote) prospect of residential or retail development over the next 20 - 30 years.

**Mechanism:** the seller receives one or more payments based on the enhancement in land value resulting from the grant of planning permission.

#### Key issues:

- identifying the overage payment trigger. Will it be the grant of planning permission (and if so, whether detailed, outline or reserved matters), or implementation, or the sale of the property with the benefit of planning permission?
- will there be 'one bite of the cherry', or a number of incremental overage payments as the planning status of the site is enhanced over many years?
- should planning costs be deducted prior to an overage distribution (arguably if the developer has taken the planning risk, it is reasonable that these should be treated as a priority payment).

### Development overage

**Typical scenario:** sale of land with a planning allocation, but uncertainty over issues such as planning, infrastructure, land assembly or remediation costs; and/or the likely quality of tenant and consequent investment value.

**Mechanism:** the seller shares in any development profit for the whole project.

#### Key issues:

- defining the scope of receipts, permitted items of development expenditure and developer's margin on cost
- open-book accounting and access to the buyer's records to assess / verify overage calculations
- treatment of sales of undeveloped land: will sales receipts form part of the overage pot, or will overage obligations cascade to future developers?
- a longstop/ deemed disposal date.

## Cost overage

**Typical scenario:** sale of land with a planning allocation or a planning permission, but uncertainty over a specific issue cost item such as remediation, ground stability, resolving title constraints or the level of section 106 contributions.

**Mechanism:** the seller shares in any specified cost savings - e.g. remediation costs, or a reduction in an anticipated Section 106 requirement.

### Key issues:

- agreeing the threshold/provisional sum
- ensuring costs are competitively market-tested
- if there is more than one cost item, whether costs should be aggregated
- ensuring the seller shares in the benefit of tax incentives available to the buyer/developer - e.g. land remediation relief.

## Sales overage

**Typical scenario:** sale of an 'oven-ready' site to a developer, where the seller wishes to share the benefit of any unexpected increase in anticipated plot sale prices.

**Mechanism:** the seller shares in any sales revenues over an agreed threshold - expressed either as a capital sum for the completed development; or an amount per square foot of floorspace of any units sold.

### Key issues:

- defining what constitutes 'sale proceeds'- e.g. treatment of sales incentives or valuation of part-exchanges
- (in the context of a 'per square foot' threshold) floor area definitions and treatment of car-parking spaces
- achieving flexibility for interim payments and deemed disposal if the developer retains the last plots
- the extent to which there is any obligation on the developer to undertake the development, and in what timeframe
- whether the 'threshold' is linked to any specification (otherwise the developer may be at risk if he incurs additional expenditure to enhance the specification and achieve higher sales prices).

## Revaluation overage

**Typical scenario:** sale in a falling or flat market where the seller looks to benefit from property price inflation over a short timescale - say to three to five years - as values return to 'normal' levels. This allows the seller to achieve something approaching the price he would have achieved had this particular deal been agreed in a more favourable economic climate.

**Mechanism:** The simplest approach is to link the price to an agreed index. Alternatively the property is revalued at an agreed date. Either way the buyer pays a (probably high) percentage of the increase at the agreed date.

### Key issues:

- any valuation formula will need to provide for a number of 'assumptions' and 'disregards', to replicate the current circumstances of the transaction
- for example, assumptions as to vacant possession and standard of repair of the property and disregards for the buyer's physical improvements or any new planning permission
- if the property is sold as an investment with an occupying tenant, assumptions will need to address the identity and covenant strength of the tenant and the unexpired residue of the lease term.

## Issues common to most overage deals

- What are the current prospects for development and what is the likely timescale for achieving a future development allocation?
- Is overage the best tool to extract value from the disposal? Consider alternative mechanisms such as the grant of an option, a joint venture agreement, self-promotion of the site, or a conditional sale agreement. Any of these may offer better value and give the Council greater control over achieving value.
- What is the trigger, and does it cover all eventualities (e.g. profit on a sub-sale)?
- What are the tax consequences for both parties, particularly CGT, SDLT and VAT?
- What type of overage is appropriate (depends on the development timeline)?
- What is the overage period (consider this in the context of the planning status of the property)?
- How will the cash be generated in order to fund the overage payment?
- How will the overage be valued?
- What is the percentage of overage payable. Will it be fixed, or varied over the overage period? Any percentage must allow the developer sufficient incentive to take the cost risk in obtaining planning permission, and extracting the maximum profit from any development.
- Consider the covenant strength of buyer. Is the arrangement intended to be personal or should it bind successors in title?
- What is the best method for enforcing payment, and taking security? The buyer's funder's requirements may well conflict with the need to protect the Council's future entitlement to cash.
- Should there be any obligations on the buyer/developer to promote the allocation of the site, make a planning application, or even undertake the permitted development?

## Top survival tips

- Understand the key commercial issues.
- Focus on the substance of the deal, not the label.
- Identify what additional expertise is required - planning, tax, valuation, legal?
- Drafting an overage agreement is about capturing a unique commercial deal. So start with a blank sheet of paper, identifying the key commercial issues before turning to previous examples.
- Assume the buyer will exploit any loophole.
- If the drafting is clear, but not what you intended, don't assume the court will come to your rescue.
- Take a second opinion and use a worked example.
- Report to your client department on the potential limitations of the arrangement and the risks of non-recovery.