

LEASING PROCEDURES – GUIDANCE NOTES FOR TENANTS OF COMMERCIAL PREMISES IN ENGLAND AND WALES

LEASING PROCEDURE

To a prospective occupier, the complexity of the practice for the leasing of commercial premises can be confusing. We therefore set out below a few notes which highlight some of the issues relevant to prospective lessees of commercial premises in England and Wales.

Particular issues which a prospective occupier will need to be aware of will generally entail the need for professional advice from both a lawyer and surveyor.

Care must be taken in the wording adopted in the obligations which a tenant will accept in terms of repairing liabilities. In England and Wales an obligation to keep in repair implies an obligation to “put in repair”. Dependent upon the nature of the property and its condition, this might prove to be particularly onerous and a lessee may wish to seek some protection in the form of a schedule of condition – limiting its obligations to keep the premises in their existing state of repair – unless the landlord is prepared to undertake remedial works or reflect the cost in the terms agreed.

Regard should be had to the length of the lease concerned, given that current legislation provides lessees with statutory rights of renewal (subject to certain conditions - on which comment is made later). Given that tenants may require flexibility, there may well be a preference for a shorter form of lease but perhaps one that provides the occupier as opposed to the landlord with flexibility, i.e. a tenant may not readily wish to accept a lease excluding the security of tenure provisions of the Landlord & Tenant Acts. In the alternative, a tenant may wish to incorporate within a new lease, an option permitting it to terminate the lease at a certain point in the future. Particular care must be undertaken here in the precise wording, given that in certain situations, even minor breaches of a repairing covenant have been held to invalidate a tenant’s purported notice to terminate.

Bear in mind that under the provisions of the Landlord & Tenant Act 1988, where there is provision for a landlord’s consent, such consent may not be unreasonably withheld or delayed particularly in the context of assignment, subletting or alterations.

Restrictions upon the use of the premises also need to be carefully considered and a tenant may generally wish to ensure that there is some flexibility to permit a change of use of its own operations or for an alternative occupier to be able to utilise the premises – always bearing in mind that a restriction upon use may impact upon the level of rent which a tenant will be obliged to pay on review.

Where a lease incorporates provision for payment of a service charge, it is imperative that an occupier secures details of the service charge for the preceding three years and secures an estimate of the anticipated liability for future years. Where a landlord does not willingly disclose such information, then it may be necessary to engage the services of a building surveyor to advise upon the likely costs of future building maintenance which a tenant is accepting an obligation for.

Ensure you fully understand the provisions in respect of the rent review which may require service of counter notices to ensure a landlord's original proposal (at whatever inflated level of rent this may be!) does not become binding upon an occupier.

Bear in mind also that in the event of a landlord refusing to renew a lease to an existing tenant who has the benefit of statutory rights of renewal, compensation may be payable to a tenant forced to seek alternative premises. Likewise, subject to certain conditions, the tenant may be entitled to compensation for the value of improvements undertaken during the lease where the landlord has been formally advised of its intention to undertake works prior to their execution and the statutory procedure has been observed.

In the context of dilapidations which a landlord may require to be remedied or for which a landlord may seek monetary compensation on the expiry of a lease, you should be aware that under the statutory provisions, subject to a need to comply with express obligations, an occupiers liability is limited to the reduction in the value of the freehold reversion caused by any disrepair. In a case where properties are awaiting substantial works of redevelopment or refurbishment, the impact on the landlord's interest of any failure to repair, may of course be minimal and therefore a tenant might successfully challenge any claim in such an instance. Here again, it will be beneficial to seek professional advice or the services of a building surveyor/valuer to advise on the merits of any claim and negotiate upon an occupiers behalf.

Be particularly conscious of the need to effect formal lease documentation before securing any rights of occupation.

In particular, it must be appreciated that whilst English law provides tenants with certain rights, these are generally subject to the provisions set out in the contract, which is a product of negotiation between two parties.

Rent Reviews – Rights & Obligations of lessees

In the 1960's, leases were invariably granted for terms of 21 years incorporating provision for review of the rent payable to an open market value at each seventh year of the term. Current practice generally provides for a review at the end of each fifth year although, in certain commercial situations, a shorter interval between reviews is not unknown.

The principal object of the review is to provide the landlord with an opportunity to review the lease rent at a reasonable interval and provide the tenant with the certainty of a fixed liability (in terms of rent) for the review period (generally five years).

Usually, reviews will provide for an upwards only movement in the rent payable, providing a landlord with the certainty of a guaranteed, minimum income stream. Suffice it to say that this area is fraught with legal complications and lessees are well advised to seek the services of a professional advisor (generally a chartered surveyor who must be experienced in dealing with properties of the type concerned) to be responsible for advising them upon the rental value and for undertaking negotiations on their behalf. The process will, in each instance, be dictated by the provisions of the particular lease, but will normally provide for reference to a third party (in the form of an arbitrator or independent expert) in the event that the lessor and lessee (or their appointed representatives) are unable to reach agreement. In recent years, the process has become increasingly confrontational and particularly where substantial market movement in the level of rental values has taken place, prior to any particular review.

This may be compared to the situation upon lease expiry. Commercial tenants will usually have the benefit of a statutory right to seek a new lease under the provisions of Part II of the Landlord & Tenant Act 1954, unless at the outset of the lease, the parties agreed to "contract out" of the security of tenure provisions.

Even where a commercial lessee retains the statutory right to a new lease, a landlord may seek possession on a number of grounds:

- i) On the basis of a lessee's failure to observe its obligations to repair and maintain the building comprised within the tenancy
- ii) Persistent delay in payment of rent by a lessee
- iii) Other breaches of a substantial nature by the lessee or in its use or management of the building
- iv) That the landlord has offered and is willing to provide suitable alternative accommodation or where the tenancy is a sub-tenancy, the aggregate of the rents reasonably obtainable on separate lettings of the property is substantially less than the rent obtainable on a letting of the property as a whole.
- v) Where the landlord intends to demolish or reconstruct the premises comprised in the tenancy or to carry out substantial works of construction on the holding or part thereof and cannot reasonably do so without securing possession.

- vi) Where the landlord has held the premises for at least five years; that on termination of the tenancy, the landlord intends to occupy the holding for the purpose or partly for the purpose of a business to be carried on by the landlord, or as his residence.

The process of lease termination in such instances may be initiated by a landlord or lessee, either of whom must serve a notice upon the other, giving not less than six and not more than twelve months notice of their intention to renew their lease.

It should also be appreciated that where a lessee wishes to terminate its occupation (having initiated the procedure for lease renewal) it must of necessity, serve a separate notice of discontinuance to ensure its liability is effectively terminated and may not simply vacate the premises to avoid any continuing liability.

Suffice it to say that the procedure is complex and will almost inevitably require both legal and valuation advice at the outset.

Rates

Rates are an annual tax usually payable by the occupier of non-residential property.

The three elements which have to be taken into account in assessing the level of rates payable will be the level of the “rateable value” which is assessed by the Valuation Office – an agency of the Inland Revenue; the level of the uniform business rate (set each financial year by the Government – with different levels for England, Wales and Scotland and the City of London and also the date from which the rates are to be payable – which is of particular relevance in the case of either a new building or one which has gone under substantial alteration.

It should be appreciated that the level of rateable value is capable of being challenged but will usually require specialist advice to achieve a reduction – usually in the form of a representative of the Royal Institution of Chartered Surveyors or of the Institute of Revenues Rating and Valuation. Given that the level of the rateable value following an appeal can be either reduced or increased by the Valuation Office, it is clearly prudent to take advice before submitting an appeal!

The Government has committed to a quinquennial programme of revaluation, the last having taken effect from the 31st March 2005 (being based on rental values as at 31st March 2003) and with a revaluation next due to take effect in 2010.

It should further be appreciated that transitional arrangements apply to the levels of increase in rates payable following the 2005 revaluation which limit the levels of increases and also the levels of decreases in real terms which may be secured by rate payers, following the revaluation, which are as follows:

Under the provisions of the Local Government Finance Act 1988, where a rate payer secures a reduction in its rate liability following an appeal, it is entitled to receive interest on any earlier overpayment, the level of interest paid is prescribed by Government Order but provides for some compensation to the claimant in such an instance.

Service Charges - Rights & Obligations of lessees

In the case of buildings in multiple occupation or those where the landlord maintains common parts or provides services to a number of occupiers, the costs are generally recoverable as a “service charge” under the provisions of the respective leases. The level of these charges will depend not only upon the level of services, but also the nature of the property – its age, character, construction and also the diligence of the landlord or its managing agent in ensuring competitive pricing for the services provides. They are a common feature of the following types of property:

- i) Office buildings – where common services such as lifts, caretakers, heating, toilets, fire alarm systems and other common services are provided.
- ii) Industrial/Warehousing premises – where the landlord may be responsible for the upkeep of the roads serving the estate, the landscaping and maintenance of common areas and even for the provision of certain other services.
- iii) Shopping Centres – where the landlord may take a pro-active stance in promotion of the centre and in its marketing, centre management, maintenance of parking and shopping malls; the provision of additional services such as lifts, escalators, air conditioning, lighting, heating and security.
- iv) Shopping Parades – Where the landlord is responsible for maintenance of communal facilities such as unloading/loading areas, parking areas and service yards.

Increasingly, the level of services is a significant proportion of overall property outgoings and, as such, merits more careful observation and attention than is given by many occupiers. In the context of a short term lease of between 5-10 years, tenants should argue strongly against all embracing service charge provisions which require them to contribute towards the renewal of plant and equipment in a building or for other facilities which may extend the building life well beyond the term of the lease and may find some protection in either limiting the range of services to which they are required to contribute or in some form of service charge “ceiling”. The basis upon which service charges are apportioned does vary, dependent upon the nature of the property, but it is well to ascertain at the outset of the lease, the proportion for which a lessee is responsible in respect of each item of expenditure and the rationale for the basis which has been adopted.

It should further be appreciated that service charges are capable of being challenged and that the Courts have increasingly moved in favour of the tenant in such matters. The ability of a landlord to negotiate leases which ensure full recoverability of all expenditure is proving difficult, although this is naturally dictated by the dynamics in the property market and the negotiating strength of the parties at the outset of any lease.

To a prospective tenant, investigation of likely additional overheads within a service charge is merited, either by way of a building survey or through enquiry of the landlord and existing tenants should remain equally vigilant.

Insurance

Insurance usually allows an owner of the property to fund restoration of the building and its services in the event of its total or partial destruction by some insured risk. Recovery of the cost of insurance from a lessee is normally provided for under the lease although, in certain instances, tenants are allowed to insure direct – especially relevant where the occupant is able to secure significant discounts where – as in the case of multiple retailer groups – they are able to negotiate more competitive insurance cover than most commercial landlords.

Leases will vary as to the level of cover permitted but, as a general rule, the following items should be checked.

- i) Terrorism Cover
- ii) Loss of Rent
- iii) Third Party Cover/Property Owners Public Liability
- iv) Other and Special Risks

It is good practice for a landlord or its managing agent to seek competitive quotations when placing insurance and also to regularly review the building cost insured. Tenants might also find it advisable to ensure that their interest is noted upon any insurance policy to assist them in the conclusion of any claim that may be made.

Rights and responsibilities as between the lessor and lessee e.g. the extent of repairing obligations

Tenants covenants to repair are by no means standardised as the extent of the obligation imposed on a tenant can vary from lease to lease and also from property to property. However, in commercial premises, there are usually two types of repairing covenant – one which is a covenant to repair and the other which incorporates express obligations relating to decoration.

It is important for tenants to be aware that an obligation to keep premises in repair incorporates an implied obligation that the premises will be put in repair. Furthermore, such an obligation can, in certain instances, extend to require tenants to make good what are known as “inherent defects” unless there is an express provision within the lease which removes such an obligation from a tenant. Inherent defects can include defects in design which may be extremely difficult for a tenant to make good. Caution must also be exercised to ensure that a tenant is not obliged to renew as well as repair unless this is within the clear intention of the parties to the agreement, as this may prove exceptionally onerous.

Similar care must be taken in agreeing the decorating covenant to ensure that the frequency of redecoration that is required under the lease, is not unduly onerous.

NOTE:

This document is produced with the intention of providing general information on commercial matters. Coverage of topics is not necessarily comprehensive and does not

purport to give professional advice. If advice is required on any particular leasing matter advice should be sought from a solicitor and/or a surveyor.

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