R F P G – SEMINAR

Commercial Leases – Points to cover in negotiating and revising the documentation

Client's expectation re outcome – Is it a landlord's or tenant's market? To what extent does location play a part? Are you to go in with a full blown F R I lease expecting to have to yield on various points, or do you present a "reasonable" lease (and thus have given away more than you might have had to)? If it is a shortish term, would a missive of lease be ok instead?

Repairs – a Full Repairing and Insuring lease is one where the landlord insures at the cost of the tenant and the landlord makes good insured risk damage or destruction, with the tenant paying the excess on the policy and the landlord pays for any under insurance on his part because he has failed to insure adequately, and the tenant accepts the property as being in good repair and condition at the start of the lease and has to repair and maintain it in good repair and condition and has to rebuild and replace it however it is damaged or destroyed, including any latent or inherent defects and including anything becoming worn out through the passage of time or use. And that the lease continues despite any damage, destruction or deterioration of the property

However, many leases nowadays qualify the repair obligation in two respects – firstly by a schedule of condition, and secondly by "uninsured risks".

Schedule of Condition - to identify defects and wants of repair in the premises so as to exclude these from the tenant's liability. Photos, words, or both?

It is important that the landlord insert a provision in the clause that the landlord is not required to make good any want of repair or defect that is shown in the schedule of condition, or else he will not have displaced the common law liability that a landlord has to repair and keep In good repair.

If a want of repair or defect is shown in the Schedule of Condition, is it "static" i.e. it is not going to get worse, or is it something that is likely to get worse? Who if anyone, is to be responsible for this?

Uninsured Risks - a definition of "uninsured risk" to mean "any risk that is not insured against" effectively renders useless the whole repairing obligation, as it transfers all repair liability back on to the landlord.

Compromise is to define uninsured risks as "any risks expressly specified in the definition of the insured risks which (i) are not insured because insurance is not available at all, or are not available in the UK insurance market (at economic rates); or (ii) are not insured or fully insured by reason of a policy exclusion, such that the full cost of reinstatement is not recoverable by the landlord under the insurance policy".

However, what if the list of insured risks is quite narrow? The landlord may give himself the *right* but not the obligation, to insure against certain risks. In such a case, the "optional risks" would not be insured risks unless the landlord chooses to insure them, and would thus not fall within "uninsured risks" if these are not insured, in which case the tenant is left with liability for these. So it is really better for there to be an open and honest discussion between the solicitors for the landlord and the tenant to ensure complete understanding on both sides.

Notification by tenant to landlord – time period for landlord to choose whether to make good; time period for tenant to consider, if landlord does not choose to make good – right to terminate. The clause will usually also provide for automatic termination of the lease if the premises are not able to be used or occupied within three years of occurrence of the uninsured risk damage.

Rent review

Open Market Rent - usually "upwards only". -
Stepped rents, so that the rent increases to specific amounts at periodic intervals. – useful for unusual premises, bigger LBTT liability at starts
Linked to inflation, sometimes with cap and collar.

usually there is provision for the parties to agree on a different index to be used if the specified index is unable to be used, with such index being determined by an arbiter or expert in the absence of the parties reaching agreement. Be careful to understand the difference between (a) rent increasing by a percentage equal to the increase in the index, and (b) rent increasing by a percentage equal to the percentage increase in the index!

Ultimate fall back to OMV review.

When providing for inflation linked increases, it is quite common to insert a cap and / or a collar. There is a huge difference between rent being increased by 3% over a 5 year period, and it being increased by 3% per annum compounded over the same period.

When dealing with inflation or compound increases in rent, take time to do a worked example showing your understanding of what is intended

The courts will step in to give commercial business sense to the clause, but the courts will not rewrite a clause that is so uncertain as to be unworkable.

In *Webber v Halifax Building Society*[1] the lease provided for valuation on the basis of the premises being a "developer's shell", but the tenant was to provide his own shop front and interior fixtures and fittings. The court held that it would be open to the tenant to argue that a deduction should be made to reflect the cost and time of fitting-out.

A lease will often state an artificially (but not ludicrously) high rent as being payable from the start of the lease, so as to set a high "base rent", when in actual fact a lengthy rent free period, or a lump sum payment, may have been given by the landlord as a "bribe" to take on the lease. This is called a headline rent.

The compromise that seems to be fair to all is to disregard any rent free or other inducement that is equivalent in value to the time and cost likely to be taken by an incoming tenant to fit out the premises. Therefore the grant of a two or three month rent--free period would not generally have an adverse affect on the market rent obtainable for the property, and the tenant can rest assured that he will not be paying extra rent to reflect the value of bribes given to other tenants but which the tenant in question has not received for entering into the lease.

Church Commissioners for England v Etam Plc.[2] The rent review clause in this lease said that the surveyor was to disregard any rent free period or other inducements given on the

[1] Webber v Halifax Building Society (1985) 273 E.G. 297; (1985) 1 E.G.L.R. 58.

[2] *Church Commissioners for England v Etam Plc*, 1997 S.L.T. 8.

open market to tenants of comparable properties. At the start of the lease in question the actual tenant had not received any sweetener. The Court said that rent reviews should be based on the reality of what has been paid in true economic terms and not the fiction of what may be stated in a lease.

In *Broadgate Square Plc v Lehman Brothers Ltd*[3] the lease provided for the rent to be reviewed to the best yearly rent reasonably to be expected after expiry of a rent--free period of such length as would be negotiated in the open market on a letting of the whole of the premises, between willing parties, with vacant possession without fine or premium. The court held that reference to the rent--free period being of "such length as would be negotiated in the open market" made it impossible to restrict the words to only rent--free periods for a tenant having to move in.

The courts will try to construe headline rent clauses so as to favour the tenant wherever possible. In *Co--operative Wholesale Society Ltd v National Westminster Bank Plc*[4] where the Court of Appeal in England held that the wording of the clause meant that it was necessary to assume that any rent--free or concessionary rent period or other inducement had already been given, i.e. before the hypothetical lease was agreed. Therefore the valuer would not be comparing like with like if he simply took the headline rent from a comparable property that provided for a rent--free period after commencement of the term. The court said that the effect of the provision was that the hypothetical tenant was to be treated as already being in occupation, so he could not argue for the equivalent of a rent--free period for fitting--out. Therefore the clause only succeeded in denying the tenant the right to claim discount for the time and cost of fitting--out; it failed to remove the discount for other inducements.

Licences - the specific and actual benefit of any licences, consents or permissions obtained by the tenant should be disregarded. This is because the tenant has added value himself. However, the landlord should ensure that although the specific terms of the actual licences etc obtained by the tenant are disregarded, there is specific wording contained in the rent review clause that a licence, permission or consent to use the premises for the permitted use is assumed to be in existence.

Statutory works - Tenants sometimes try to include a disregard of works done to comply with statutory obligations. The landlord should not accept such a provision, as the premises may well not be able to be used if these works are not done. Therefore if the works have been done but are to be disregarded, the tenant could argue for a reduction in any uplift otherwise achievable, because these works are deemed not to have been carried out.

Sub-letting

Why sub-let? Shorter term and/or covenant not great.

Tenant remains fully bound to the landlord If the lease prohibits sub-letting at less than passing (current) rent, than he can not do this, and this is adverse to the tenant as it restricts the marketability of the premises for sub-let.

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[3] *Broadgate Square Plc v Lehman Brothers Ltd* [1995] 1 E.G. 111; [1995] 1 E.G.L.R. 97.

[4] *Co--operative Wholesale Society Ltd v National Westminster Bank Plc* [1995] 1 E.G. 111; [1995] 1 E.G.L.R. 97 (this case has the same reporting date as *Broadgate Square Plc v Lehman Brothers Ltd*, because that case, along with this case and two others, were all heard together by the Court of Appeal in England).

The landlord can deal with this problem by ensuring that the draft lease that is issued to the tenant states in the rent review clause that there is a disregard of all sub-leases and rents payable under sub-leases in respect of the premises. However this does not protect the landlord in respect of rent review negotiations for other nearby units or properties.

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