

The issues covered here are governed by individual lease terms and can be somewhat complex hence the 'health warning' at the end of this Fact Sheet.

Definitions:

'Rent reviews' are a mechanism set out in a lease to bring the rent initially agreed at lease commencement into line with market rents periodically during the term of the lease.

'Lease expiries' occur at lease end and the procedures to be followed depend on whether the lease is 'inside' and 'protected' by the security of tenure provisions of the Landlord and Tenant Act 1954 (as amended) 'the Act' or 'outside' of those provisions.

'Lease Breaks' or 'Break Options' can be negotiated at the start of a lease to give either party the right to terminate the agreement before expiry. As such they can be 'landlord only', 'tenant only' or 'mutual'. Once exercised, they cannot be rescinded or withdrawn.

Background:

It is important to note that these aspects need to be considered when acquiring or negotiating for property. How they are included or documented has an impact on the value, use and occupation of the premises including future investment decisions. Equally, it is important to understand the business, valuation, legal position and position of your landlord well in advance of one of these 'lease events' arising.

If you are acting without professional representation, all discussions and correspondence by you as 'principal' should be clearly understood and stated to be 'subject to contract' unless you confirm otherwise. Contractual settlements can be created verbally as well as in writing.

Appointing an Advisor:

If you are seeking to appoint a property professional you should give them a clear brief and ask for Terms of Engagement which include their scope of services, how fees and expenses are to be remunerated; including abortive fees in the event of termination. In particular, what fees will be due in respect of a negotiated settlement and what fee basis (generally time charged) will apply if you need a third party or court determination. The Terms of Engagement should include termination provisions, Professional Indemnity insurance (PI) and the firm's complaints handling procedure (CHP).

Terms should be agreed by you in writing. Your advisor should confirm whether they have any conflicts of interest (such as in interest in the property or a related or competing instruction) and, if one were to arise, how that would be dealt with. You should be prepared to provide information in accordance with the requirements of the Money Laundering Regulations, namely providing proof of identity, address and sources of funds as appropriate. The professional may ask who your other professional advisers are.

Rent Reviews:

These are generally 'upward only' at 3 or 5-yearly intervals by reference to the start of the lease. The rent to be assessed is generally the 'rack rented' 'market rent' that would be agreed between a 'willing landlord' and a 'willing tenant' on an 'arms-length' basis.

Clearly with an existing lease in place, this is not an arms-length transaction and the terms of the lease and hypothetical assumptions set out in the rent review clause mean that the rent actually agreed is rarely in line with market rent. The rent review mechanism needs to be understood. It may or may not require the landlord to serve a trigger notice and then call on the parties to negotiate the rent by a certain date, not always the rent review date. There will be a dispute resolution procedure to determine the revised rent in the event that the parties cannot agree.

That procedure may be triggered by one or other or both of the parties and may allow them to appoint a third party to determine the review. That third party may be to act as an Arbitrator or Independent Expert. If the parties do not agree the appointment of a third party then most likely it will be made by the RICS Dispute Resolution Services on behalf of the President of the RICS. It is important to remember that costs over and above any rent review negotiation fee will be incurred once a Third Party is appointed. The costs of an Independent Expert are generally borne equally between the parties as set out in the lease but the costs of Arbitration can be awarded by the Arbitrator as part of his final Award.

For these reasons the deployment of one or other of the processes can form part of the negotiation process in any rent review. Generally, 'time of the essence' is not stated unless it can be deemed to be because of the existence of a break clause for example. It is therefore important to take early professional advice (6-12m) ahead of any rent review.

Rent reviews are to be based on factual comparable evidence related to recent transactions at the rent review or valuation date. There is a 'hierarchy of evidence' that has weight, with open market lettings of a similar property at the valuation date being the 'best' evidence with lease renewals, rent reviews and arbitration awards having increasingly lesser 'weight'. Comparable evidence is often hard to come by and therefore your adviser has to make adjustments in relation to the subject property, the terms of the lease, the timing of the transaction or the background to the settlement. As such, there is a largely subjective element that allows for interpretation.

Therefore, the courts are prepared to allow a valuation 'tolerance' (which can be 10-15%) when considering the standard of valuation advice provided. Landlords equally wish to allow room for negotiation particularly in a rising market and therefore it is well worth investigating the landlord's basis of value. You should be able to understand upon what evidence the proposed rent is based, the floor area that it applies to for comparison purposes and any adjustments made. Your adviser should be able to agree or counter these arguments by providing any advice on value or recommending settlement. If the matter proceeds to a third party process, your valuer's duty of care switches from giving you best advice to acting as an independent expert and giving an honest opinion to the 'court'. This may have some bearing on recommending and making 'without prejudice save as to costs' offers of settlement to avoid the third party costs and risks.

Lease Expiries:

Leases are for a fixed period and give exclusive use of a property. They can be verbal agreements or made in writing through correspondence. Over three years length and they must be by deed.

As advised, leases can be inside or outside 'the Act'. Landlords perceive protection of the Act as a hindrance – it reduces 'flexibility' and adds to cost and time, and, as with rent reviews, often leading to below 'rack rented' market rents. Therefore, where possible they may refuse to grant leases within the Act.

This means that tenants do not have a statutory process to renew the lease, to seek independent adjudication of lease terms in accordance with the Act and level of market rent in particular and compensation in the event that the landlord will not grant a new lease on prescribed terms. In these situations it is imperative that the tenant seeks early advice and has a contingency plan for business continuity. It may be a reality that the landlord will keep his 'cards close to his chest' until close to the expiry date to gain commercial advantage.

If a lease outside the Act is not renewed by the expiry date then the landlord has the right to recover possession or dictate the terms that it requires. Dilapidations will apply.

Assuming the lease is inside the Act, it will continue on the same terms and conditions until it is brought to an end in accordance with the Act. The tenant has to be using the premises for its own business purposes to be protected. A flat over a shop occupied by a residential sub-tenant not connected with the business may be excluded from any renewal.

A business tenant may decide to give up its right to a new lease by vacating the premises before the expiry date. It should give at least 3 months' written notice under S.27 of the Act to expire on the expiry date for the avoidance of any doubt. If the business tenant does not vacate on the expiry date then the lease will continue until 3 months' written notice is given to the landlord. A Dilapidations liability will apply after the expiry of the lease if the lease terms concerning condition have not been complied with.

A landlord may serve a 'Trigger' notice to terminate the current lease either on a 'hostile' basis objecting to a new lease being granted or 'friendly' basis setting out the terms by which a new lease will be granted.

The earliest date by which a new lease can take effect is 6-12m from the date of the landlord's notice and not earlier than the contractual expiry date. It is always worthwhile getting the validity of the notice checked upon receipt as it may be invalid and need reserving.

"The landlord can only seek to terminate a protected lease, other than by agreement, on grounds within S.30 (a) to (g) of the Act. These include failure to comply with repairing covenants; persistent late payment or non-payment of rent; other breaches of the lease; if a renewal would create an uneconomic use of part of the property, restricting the landlord's ability to re-let it more economically as a whole; possession is required for redevelopment purposes or the landlord needs the property back for its own business use or use as a residence. Any tenant receiving a 'hostile' notice should seek early professional advice, in relation to the validity of the landlord's notice and grounds for possessions, timescales and statutory compensation." The landlord has to show the intent to redevelop but not necessarily have full plans or planning permission in place. In these cases a short term lease 'outside' the Act may be possible.

Compensation is payable in the event that the tenants lease is not renewed on this ground, or the landlord wants the premises back. The statutory compensation is 1 X Rateable Value if the business has been in occupation for less than 14 years and 2 X Rateable Value if more than 14 years.

The tenant may also serve on the landlord a Tenant's Request for a new lease at a market rent. The earliest date by which a new lease can take effect is 6-12m from the date of the tenant's notice and not earlier than the contractual expiry date. It is always worthwhile getting the notice prepared and served by a solicitor to ensure that it is validly served.

The terms for a new lease set out in either a friendly S.25 or S.26 Notice should be in accordance with the Act, namely on the same terms and conditions as the existing lease save as for rent, possibly uprated into a modern form. The general length granted would not be more than 14 years.

It is possible that a landlord would seek to have a lease brought in to line with modern practice, particularly if it could be shown that it is disadvantaged by allowing certain terms to continue. A fixed service charge granted in a weak market may not be renewable indefinitely, for example. The landlord should acknowledge the Tenant's request and the parties should negotiate settlement. In the event that terms have not been agreed by the expiry date, the tenant must apply to court for a hearing unless the parties both agree to a further extension of time for negotiations in order to retain its protection under the Act.

There are provisions for the parties to apply for an interim rent assessment otherwise the new terms of any lease will start as agreed between the parties or 3 months from the date of a court determination. In the event that your adviser acts in respect of the application to court, then their duty is to the court as an Expert Witness.

Lease Breaks:

These can be complex or may be quite simple to effect. Early advice is essential.

A simple break clause requires one party to give notice on the other that the lease will end and that vacant possession is to be given on that date, possibly with all rents demanded paid up to date, for the break to be effective. A more complex provision may require the tenant to have materially complied with all the terms of the lease. The definition and consequences of material compliance need to be understood and risk assessed.

In such cases, there is the risk of a dispute after the premises have been vacated when the break clause is deemed to be not operated. In addition to early advice, an early dialogue is essential with the landlord to 'prior agree' what works and standard of work is considered acceptable, or to negotiate a cash settlement in lieu of these works.

Time needs to be allowed to address reinstatement issues if the break is conditional on this work being materially completed or otherwise to reduce a dilapidations claim which may arise after a break has been affected. Tenants are always best placed at the Heads of Terms stage if they wish to avoid future problems with break clauses and by taking proper professional advice.

This fact sheet is for guidance only and should not be relied upon. You are strongly recommended to seek independent professional advice from a suitably qualified surveyor, solicitor or other relevant professional in any matters related to a property contract.