UNDERSTANDING LEASES

GENERALLY

What is a lease?

A lease is the grant of a right to the exclusive possession of land for a determinable period of time. A lease is both a contractual relationship and an estate in land. There are many types of leases and ways of describing them.

One of the key elements of a lease is exclusive possession. A person has exclusive possession if it can exercise the rights of the landowner and exclude both the landlord and third parties from the land except to the extent the landlord has reserved rights of entry for example to carry out works.

Possession is not the same as occupation. A tenant may have possession by virtue of being able to receive the rents and profits of the land but the person in occupation could be the undertenant to whom the tenant has granted an underlease.

What the document is called does not determine what it actually is so a lease may be created notwithstanding the express terms of the contract if exclusive possession is granted. A document may describe itself as a licence but actually be a lease.

What is a licence?

In essence a licence is simply permission for a licensee to do something on a licensor's property. The permission given to the licensee prevents the permitted act from being a trespass.

A licence is by definition not a lease : it is a personal right or permission that offers no security. It also does not create an estate in land.

A licensee's occupation is precarious so that if the landowner sells the land even to a group company the licence will end although the licensee may have a right of action against the original licensor for breach of contract.

The distinguishing feature of a lease as opposed to a licence is that the tenant has exclusive possession of the let property. There have been numerous cases over the years on the lease/licence distinction but the leading case is still the House of Lords decision in Street v Mountford (1985).

"If the agreement satisfied all the requirements of a tenancy then the agreement produced a tenancy and the parties cannot alter the effect of the agreement by insisting that they only created a licence".

Will labelling an agreement a licence make it a licence?

The House of Lords held that the court should look at the substance as well as the form of the agreement in deciding whether an agreement is a licence or a tenancy. Parties cannot turn what is in reality a tenancy into a licence by calling it a licence and case law illustrates that the courts are prepared to look beyond the label given to a document. However the terms of the agreement are not irrelevant. The Court will analyse the substance of the rights and obligations contained in the

agreement. Where the document has any of the following characteristics it may indicate that a licence is not a licence:

1 it grants exclusive possession. Generally a tenancy is created where there is exclusive possession; or

2 it is for a fixed term;

3 it reserves a rent.

The fact that the licence is for a fixed period of time does not necessarily prevent it from being a licence as a licence can be for a fixed term. Similarly if the licensee is required to make a payment under the licence which the parties call a licence fee this will not necessarily prevent the arrangement being regarded as a licence.

Examples of situations where a licence to occupy can be used

Some examples of where a licence to occupy may be encountered include:

1 as a concession arrangement in a department store;

2 where serviced office space is made available for a short period of time;

3 between a seller and buyer during the period between exchange and completion of a sale contract;

4 between a prospective landlord and tenant between exchange of an agreement of lease and a grant of a lease.

What is a tenancy at will?

A tenancy at will exists where there is a tenancy on terms that either party may determine the tenancy at any time. It may be express or implied and may be hard to distinguish from a licence to occupy. A tenancy at will cannot be assigned. It is a personal relationship between the original landlord and tenant.

Tenancies at will are often used where the parties are in negotiation for a lease to be granted for a fixed term and want to document a short term occupation or arrangement pending completion of the lease. If not properly drawn up what is intended as a tenancy at will may instead be a periodic tenancy for which longer periods of notice would be required to terminate.

Payment of rent

The periodic payment of rent will not of itself make a tenancy a periodic tenancy. There is case law to the effect that rent paid periodically will not prevent the arrangement from being a tenancy at will (Cardiothoracic Institute v Shrewdcrest (1986)) the reservation of rent and its payment on a quarterly basis did not prevent the agreement being a tenancy at will. Hagee (London) Limited v A B Erikson and Larson (1976) an express tenancy at will may have effect as such even though an annual rent is reserved. Javad v Aqil (1991) where a party is allowed into possession and pays rent by reference to

a period then "failing more" the sensible and reasonable inference is that the parties intended a periodic tenancy. However frequently there will be "more" and the inference will then depend on a fair consideration of all the circumstances. The periodic payment of rent is only one circumstance "albeit a very important one".

Termination

A tenancy at will may be terminated by either party: the intention to terminate must be intimated either expressly or impliedly by the terminating party to the other.

A tenancy at will is terminable by the landlord demanding possession or the tenant giving up possession. The landlord's demand may be written and formal or may be implied for example by the landlord demanding the keys. No time period need be specified: the landlord may state that the tenancy is at an end and that possession is to be given back immediately. However where a landlord has determined a tenancy at will the tenant at will has a reasonable time to enter the property after the termination to remove its goods.

A notice by the tenant without it also giving up possession is not enough to terminate the tenancy.

A tenancy at will is a personal relationship between the original landlord and tenant and is determined by a transfer of the reversion. Where a new tenancy is granted for example a longer fixed term lease the tenancy at will automatically ends.

Security of tenure

A tenancy at will is not a tenancy within part 2 of The Landlord and Tenant Act 1954. Where the parties are considering a tenancy at will to avoid giving a business tenant security of tenure an alternative is a fixed term tenancy for six months or less and therefore outside the security of tenure provisions of The Landlord and Tenant Act 1954 or a contracted out lease. However this is likely to take longer to prepare and agree than a tenancy at will.

What are the differences between a lease, licence and tenancy at will?

A lease or a tenancy confers on the grantee an interest in land; a licence does not. A licence is a personal privilege it makes lawful that which would otherwise be unlawful. A licence entitling the licensee to use the land for the purpose authorised by the licence does not create an estate in land.

The tenant who has exclusive possession of land is able to exercise the rights of an owner of land. The land subject to the tenancy becomes the tenant's land albeit temporarily and subject to restrictions. A licensee lacking exclusive possession cannot really call the land its own. A licensee with a right to occupy land does however have sufficient interest to maintain an action for trespass against a third party whether it is necessary to give effect to its rights under the licence.

Why is the distinction between a lease, a licence and tenancy at will important?

A licence and a tenancy at will do not confer security of tenure under part 2 of the LTA 1954. Under part 2 of the LTA 1954 a tenant occupying premises for the purposes of its business generally has a statutory right to renew its tenancy at the end of the term. The landlord can only oppose renewal on certain limited grounds.

The right to a new lease applies to all tenancies where the property is occupied at the end of the term by the tenant for the purpose of the tenant's business subject to certain exceptions. Consequently this makes licences and tenancies at will attractive options where an occupier is seeking a short term occupational arrangement.

Leases that do not fall within the ambit of the LTA 1954

It is possible to grant a lease that is not protected by the security of tenure provisions conferred by part 2 of the LTA 1954. This can be done by either (i) excluding the lease from the ambit of the security of tenure provisions conferred by the LTA1954 or (ii) granting a lease that is exempt from the renewal provisions conferred by the LTA 1954 by ensuring that the lease satisfies the provisions contained in section 43 of the LTA 1954.

Section 43 sets out the tenancies to which the renewal provisions under part 2 of the LTA 1954 do not apply. These tenancies include:

1 certain leases of agricultural holdings;

2 farm business tenancies;

3 mining leases;

4 certain tenancies for six months or less;

5 leases where the tenant occupies by reason of an office or employment;

6 a home business tenancy;

7 leases of certain railway property;

8 leases of certain military establishments.

Section 43(3) of the LTA 1954

This provides that: "This part of this Act does not apply to a tenancy granted for a term certain not exceeding six months unless: (a) the tenancy contains provision for renewing the term or for extending it beyond six months from its beginning; or (b) the tenant has been in occupation for a period which together with any period during which any predecessor in the carrying on of the business carried on by the tenant when in occupation exceeds twelve months". Not all tenancies of six months or less are excluded.

A short term tenancy of six months or less will be protected by the LTA 1954 if either (a) the tenancy contains provision for renewing the term or extending it beyond six months or (b) the tenant has been in occupation for a period exceeding twelve months. This includes occupation by a predecessor in the same business as the tenant. Note that the grant of a lease for a term of less than six months containing a right to renew or extend does not contravene section 43 provided that this does not make the overall term longer than six months.

A landlord should not use a short term tenancy where a tenant is taking over an existing business which is already operated from the premises in question for more than a year as this would not fall within the exemption conferred by section 43. The High Court in Cricket Limited v Shaftesbury plc (2000) held that any period of occupation by the tenant as a tenant at will following the expiry of the term does not count for the purposes of calculating whether the twelve month period has been exceeded under section 43. When calculating the twelve months of occupation in respect of a predecessor in title it does not appear to matter whether the predecessor in title occupied the premises as freeholder, tenant or licensee although this has never been judicially considered.

How many short term leases can be granted before contravening section 43 of the LTA 1954?

A tenant can safely be granted a fixed term not exceeding six months. This can safely be followed by a further term of just less than six months. It is uncertain whether a third tenancy of just less than six months can safely be granted because it is unclear whether the period of twelve months occupation by the tenant (and any predecessor) should be calculated by reference to the start or the end of any third tenancy. This uncertainty means that the safe course of action is to grant only two short term tenancies in reliance on section 43.

Access arrangements pending a binding contract under the LTA 1954

It is not unusual for the parties to be in the process of agreeing documentation such as a lease and pending completion of the contracting out formalities under the LTA 1954 and completion of the lease the tenant requires early access to the property to start trading or fitting out. Although early access may still be granted under the terms of a licence or a tenancy at will one point to bear in mind if the lease is to be excluded from the ambit of LTA 1954 is that the contracting out formalities under that Act must be completed before the prospective tenant becomes bound to take the lease.

Indications in the agreement pointing to a lease and to a licence

Where there is a written agreement documenting rights of occupation it is a question of construction as to whether there is a tenancy or a licence to occupy. The Court will consider the agreement as a whole.

Clauses in an agreement which may indicate a licence

A clause providing that the occupier should not interfere with the owner's right to possession and control of the premises was held to be inconsistent with the grant of exclusive possession.

A clause entitling the owner to require the occupier to transfer his occupation to other accommodation selected by the owner was held to negate the grant of exclusive possession.

A provision prohibiting the use of the property for a period in each day or granting the right to use the property only for a part of each day is held by the courts to be an indication that exclusive possession has not been granted. However case law has not always arrived at the same result and there have been a number of cases where the hours of access granted to an occupier of premises have been restricted but the courts have held that the occupier had exclusive possession and consequently a tenancy.

Clauses in an agreement which may indicate a lease

There are other types of clauses in documents which may indicate that exclusive possession has been granted.

Where a landowner reserves in the agreement specific rights of entry to view or repair it is a strong indication of the grant of exclusive possession and a tenancy. The House of Lords has held that if a document grants exclusive possession for a fixed or periodic term at a rent then it points to a tenancy rather than a licence.

Where a clause gave the owner limited rights to enter the property that indicated exclusive possession as did a clause prohibiting assignment or underletting.

A covenant for quiet enjoyment and a forfeiture clause points towards a tenancy.

Which arrangement is binding on successors in title and third parties?

A lease or a tenancy binds a purchaser of the reversion.

The situation is a little more complicated in the case of licences which are only personal interests and do not create a proprietary interest in land. Licences in the true legal sense of the word will not be overriding interests as they confer purely personal rights and not property rights. However the precise position is unclear but the general view is that a contractual licence is a personal interest only and is only enforceable against the licensor. A contractual licence even if its existence is known does not bind a buyer except in very special circumstances where the Court is prepared to find a constructive trust.

An assignment by either the landlord or the tenant determines a tenancy at will and the tenant is under a duty to vacate once it has knowledge of the assignment.

What are the advantages and disadvantages of each arrangement?

Advantages of a lease

Upon expiry of a short term lease which complies with either section 43 of the LTA 1954 or which is properly contracted out of the security of tenure provisions conferred by part 2 of that Act the landlord is entitled to possession of the premises. The landlord will be protected from spurious claims by a tenant that it can remain in the premises following lease expiry. These can be expensive and time consuming to defend and can delay the landlord developing plans for the premises.

1 A lease confers a secure period of income for the landlord.

2 Flexibility for both parties can be introduced into the lease by the insertion of a mutual rolling break clause.

3 A lease offers security and certainty for the tenant as an occupier of land. The landlord generally has limited rights of access.

Disadvantages of a lease

1 Leases even for a short term tend to be longer documents than a licence to occupy or a tenancy at will. It takes more time to negotiate the terms and document. The costs associated with producing a lease are likely to be higher than those associated with producing a licence or tenancy at will.

2 SDLT or LTT (Welsh land transaction tax) may be payable on the lease.

Advantages of a licence

1 Generally a licence is a shorter document than a lease and can be prepared and completed more quickly and therefore more cheaply.

2 There is a little more security where an occupier occupies premises as a licensee rather than as a tenant at will as a tenancy at will can be determined instantly.

3 The circumstances in which a party may determine a licence depends on the terms of the licence and the licensor will not necessarily be able to determine the licence at will.

4 A contractual licensee is entitled to the occupation that the contract provides and where the contract is determinable on notice the licensee is entitled to the notice that contract provides.

5 As a licensor cannot determine a contractual licence in breach of contract proceedings for possession must not be brought before the licence has expired.

6 An arrangement which properly constitutes a licence to occupy is outside the ambit of the LTA 1954 and confers no security of tenure on the licensee.

7 There is no SDLT or LTT payable.

Disadvantages of a licence

1 Despite the document being labelled a licence if exclusive possession is in fact granted there is always the risk for a landowner that the arrangement may later be challenged by the occupier. If this arrangement has lasted for more than six months or is on a periodic basis a landowner could be exposed to a claim that the licence is really a lease which is protected by the security of tenure provisions conferred by the LTA 1954.

2 An occupier generally does not have the same degree of control over the land as it would have if it were granted a lease. A licence is a personal privilege: it makes lawful that which would otherwise be unlawful.

3 A licensee's occupation is precarious. If the landowner sells the land even to a group company the licence will end although the licensee may have the right of action against the original licensor for breach of contract. The licence offers no security.

Advantages of a tenancy at will

1 A tenancy at will is generally a short document and can be prepared and negotiated very quickly and cheaply.

2 A properly drawn up tenancy at will is outside the ambit of the LTA 1954 and confers no security of tenure on the tenant.

3 The tenancy at will favours the landlord in retrieving possession of the premises from the occupier. The landlord may state that the tenancy is at an end and that possession is to be given back immediately.

4 There is no SDLT or LTT payable.

Disadvantages of a tenancy at will

1 Tenancies at will can be determined instantly; that is the very essence of the arrangement. Consequently they may not offer enough security and certainty for an occupier of land.

2 Because the arrangement can be determined instantly by the occupier from the landlord's perspective they do not confer a secure period of income which can be relied upon.

3 A tenancy at will could quite easily end up being a periodic tenancy in which case the tenant will have immediate security of tenure because its periodic tenancy cannot fall within the section 43 exemption.

PROVISIONS OF A LEASE

"TERM" AND "CONTRACTUAL TERM"

Unfortunately the word term can cause some confusion in leases because it is used to refer to:

1 the period of time for which the lease is granted, the contractual period;

2 the estate granted which is the contractual period and any statutory continuation of it; and

3 a provision in the lease.

Defining "Contractual Term" and "Term"

Business leases may be protected under part 2 of the LTA 1954.

Certain business leases do not have protection. These include:

1 tenancies at will;

2 tenancies for a term certain of less than six months but there are some exceptions.

If a tenancy is a business tenancy and is protected under the LTA 1954 then the tenant has certain rights which include:

1 the right to renew the tenancy at or after the end of the contractual term although this may be defeated by the landlord in certain circumstances; and

2 the right to remain in occupation at the end of the contractual term.

If the tenant does not renew the lease the lease continues and can only be terminated in accordance with the statutory procedures. This is generally referred to as the right for the tenant to hold over.

The landlord and tenant may agree that the LTA 1954 will not apply to the lease. There is a formal procedure that must be followed usually referred to as contracting out. Where the parties have contracted out the lease is often referred to as a contracted out lease or an excluded lease. Contracting out is only permitted where there is to be a lease for a fixed term of more than six months (unless the tenant or a predecessor in business has been in occupation for more than 12 months). A periodic business tenancy for example one granted from year to year or month to month may be protected under the LTA 1954 but it cannot be contracted out.

Making sure the Parties and Guarantors are bound for the whole length of the lease

If the lease has security of tenure under the LTA 1954 the lease continues on the same terms until the lease is properly brought to an end in accordance with the requirements of the LTA 1954. Where a lease has been granted for a fixed period the parties will have certain rights and obligations which will last until the end of that period. If the lease might continue after the end of the contractual period the parties will want to make sure that those rights and obligations continue during the statutory period of holding over.

The landlord also needs to make sure that it can enforce its rights under any guarantee agreement (including an authorised guarantee agreement) in respect of any defaults by the tenant during the statutory continuation period. To do this the landlord must make sure that the tenant is bound by its covenants throughout the statutory continuation period so that the guarantor's liability can also continue.

To address this issue it is helpful to distinguish between the following:

1 Contractual term being x period for example five years. This is sometimes referred to as the initial term; and

2 Term being the whole period during which the tenant legitimately has the right to occupy that is the contractual term and any statutory continuation period.

Thomas-Van Staden Trap

If the parties wish to exclude the operation of the security of tenure provisions of part 2 of the LTA 1954 it is important to avoid the Thomas-Van Staden trap of inadvertently granting the lease for a period that is not determined certain.

This trap involves granting the lease for the term which is then defined as x period (the contractual period) together with any period of statutory continuation.

Where a lease includes wording that indicates that the lease may continue after the end of the contractual term the lease will not have been granted for a term certain and therefore it cannot be contracted out of the security of tenure provisions of the LTA 1954 even if the parties follow the exclusion procedure to the letter.

If the lease is not protected under the LTA 1954

A lease may not have security of tenure under the LTA 1954 either because it did not qualify for such statutory protection in the first place or because the parties followed the requisite procedures to contract the lease out of the statutory protection.

If the lease does not have security of tenure there is no need to worry about defining the term to make sure that the parties continue to be bound during any period at the end of the contractual period. There is no statutory continuation period so the issues identified above do not arise. Once the lease term comes to an end the tenant should cease to pay rent and should vacate the premises.

In practice however it often happens that the parties are happy with their arrangements and the tenant may remain in occupation and continue to pay rent. The landlord may not object to the tenant's continuing occupation and may accept the rent.

If this happens then technically a new lease is created (rather than the old lease simply continuing). The new lease will either be a tenancy at will or a periodic tenancy. If the lease is a periodic tenancy it may be protected under the LTA 1954. The terms of the new lease can be determined by a Court from all the circumstances including the provisions of the original lease.

Length of the Contractual Term

Considerations that will influence negotiations

How long the term of the lease should be is essentially a matter for negotiation between the parties.

The code for leasing business premises in England and Wales 2007 (Lease Code 2007) states that the length of the term of the lease should be clear but does not give any further details on how this recommendation could be met.

The lease negotiations may be influenced by the following considerations:

1 Statutory requirements. For example a lease of less than six months generally cannot benefit from the protection given by the LTA 1954 and a lease granted for a term of seven years or less does not generally require substantive registration at Land Registry.

2 Duration of a superior lease. If there is a superior lease the underlease must come to an end before the superior lease. It is a common law rule that if a tenant grants an underlease for a term that is equal to or longer than the term of its own lease, the grant will usually operate as an assignment.

3 Management concerns. In some cases the length of leases may be affected by management issues. For example if the landlord has a building that is let in parts to different tenants the landlord may want all the leases to end on or by the same date so as to allow the landlord to know when the property will become free of tenants and can be sold with vacant possession, redeveloped or refitted or reoccupied by the landlord.

While the leases would all end on the same date they might start at different times even if the term is expressed to be calculated from the same starting point. The effectiveness of this

strategy largely depends on the leases being contracted out of the security of tenure provisions of LTA 1954 so that the tenants cannot remain in occupation at the end of the contractual term and cannot renew their leases. Also the tenants must all be willing to take leases that end on the landlord's required date.

In agreeing the term, the parties may wish to acknowledge that circumstances may change and may wish to negotiate a break clause to bring the lease term to an end at an earlier date.

Start and Finish Dates must be certain

A lease is a form of contract and the same rule applies as with any other contract. A provision in the lease that is not sufficiently certain may not be legally enforceable.

The start of the term of the lease must be certain. If it is not clear when the term commences the lease will not be effective.

The end of the term of the lease must also be certain in a case from 1944 where the lease had been granted for the duration of the war, this did not pass the certainty test.

Apart from the need for certainty it is important to know the start and end dates of the lease term for other reasons. Those dates may have an effect on a number of other matters relating to the lease including:

1 the dates of any rent reviews which are often based on when the lease started;

2 when the premises must be redecorated;

3 information that must be included in notices served under the lease such as a notice exercising a break clause or under statute for example under the LTA 1954; and

4 the date on or by which a notice must be served such as one exercising a break clause or triggering a rent review.

The term cannot begin until the lease is completed

A lease term cannot begin until the lease is completed because the grant occurs at that point. However the lease may specify that the term is calculated by reference to a start date that precedes the grant of the lease so for example a lease granted on 12 February 2018 could state that the lease is granted for a term of ten years from and including 1 January 2017.

Some rules on interpretation

There are some general presumptions that follow from the use of "on" and "from" but these presumptions can be displaced by for example making it clear that the rent is due for a particular date.

Where a term is expressed to be for a period beginning on a particular date that date is generally taken to be included in the term. A term of five years beginning on 25 March 2009 will begin on 25 March 2009 and will end on 24 March 2014.

Where a term is expressed to be for a period from a particular date that date is generally taken to be excluded from the term. So a term of five years from 25 March 2009 will begin on 26 March 2009 and will end of 25 March 2014.

Where the term of a lease is for a period from and including a particular date that date is generally to be included in the term.

Fractions of a day are generally treated as a whole day. It is therefore irrelevant if the term begins on and includes 24 June 2008 but the tenant did not have access to the property until 2.00pm on that date.

Perpetually Renewable Leases

A perpetually renewable lease will be created if the lease contains an option for renewal using these or similar words "on the like covenants and provisions including this option". This situation usually arises by accident. To avoid the consequence a perpetually renewable lease is converted into a lease for 2,000 years on the original terms and at the original rent.

ALTERATIONS

If a lease is silent on the question of alterations then the tenant is free to carry out any it chooses subject to:

1 the tenant's implied obligation not to commit waste. A tenant commits waste by doing an act that permanently alters the nature of what is being demised although whether or not an alteration has this effect is a question of fact;

2 the works not going beyond the boundaries of the demised property. A tenant can, as a starting point, only make alterations to the property (as let): it cannot alter a structure that is outside the demise.

However, most leases include tenant covenants restricting alterations to the demised premises. The type of alterations allowed will depend in part on the nature of the demise and on the extent of control that the landlord wishes to exercise.

The landlord's main and related concerns are to protect the reversionary value of the premises and to prevent (permanent) alterations that would make the premises difficult to let or lower its letting value after the end of the term.

The tenant's main concern is the ability to have the demised premises configured to its needs. Fitting out works will often have to be carried out. The tenant will also want sufficient flexibility to adapt the premises in the future either for itself or for any potential assignee or subtenant.

As with all covenants relating to the state and condition of the premises it is important to consider these provisions in the light of:

1 the nature of the particular property. Relevant factors may include the property's age, method of construction, use and location;

2 the extent of the demise. If the tenant only has an internal demise the alterations clause will naturally be more restrictive; and

3 the length of the term.

Controlling Alterations

A common restriction is that alterations to the exterior and/or structure of the demised premises are prohibited but non-structural alterations to the interior are allowed with the landlord's consent (not to be unreasonably withheld). Leases also normally restrict the tenant's ability to alter the service media serving the premises, especially the electricity supply.

Normally the lease will not permit the tenant to make any alterations outside its demise.

Note however that certain works do not amount to alterations so replacing plant was held not to amount to an alteration.

Prohibited Alterations

Section 3 of the Landlord and Tenant Act 1927 allows tenants of premises that are used for a trade or business to carry out improvements even if forbidden to do so by the lease.

The landlord should be aware that if it does allow the tenant to carry out an alteration in spite of a prohibition in the lease, this would constitute a relevant variation for the purposes of section 18 of the Landlord and Tenant Covenants Act 1995. Certain guarantors and former tenants are not liable to pay any amount to the extent that the amount is referable to a relevant variation and a relevant variation is a variation of the lease in respect of which the landlord has an absolute discretion to withhold its consent.

Alterations which may be carried out with the landlord's consent

Where the landlord's consent is needed for improvements, that consent must not be unreasonably withheld (section 19(2) of LTA 1927). However, not all alterations will qualify as improvements for the purposes of that section. Therefore, where landlord's consent is required for alterations, the tenant should ensure that the lease expressly states the consent should not be unreasonably withheld.

The tenant may also want to provide that landlord's consent should not be unreasonably delayed.

The lease may also include certain obligations regarding the way in which the tenant should carry out alterations. For example the lease may require the tenant to carry out any permitted alterations:

1 Using good quality new materials which are fit for the purpose for which they will be used.

2 In a good and workman like manner.

3 To the reasonable satisfaction of the landlord.

The landlord should take care when granting licence for alterations that it does not impliedly release the tenant from any other obligations under the lease.

Alterations for which consent is not required

The tenant may wish to have the ability to carry out certain alterations such as erecting demountable partitioning without having to obtain landlord's consent. Where this is acceptable for the landlord the lease should contain any requirements the landlord may have regarding the way in which the tenant should carry out such works.

Even if consent is not necessary, the lease should require the tenant to notify the landlord of any alterations carried out. The landlord may also want the tenant to provide plans as such information is useful for management purposes and may well be needed for insurance purposes.

Statutory provisions relating to Alterations

Landlord and Tenant Act 1927

This gives the tenant certain rights:

1 where the landlord's consent is needed for improvements then that consent is not to be unreasonably withheld;

2 in certain circumstances a tenant could carry out improvements even if forbidden to do so by the lease; and

3 in certain circumstances a tenant can obtain compensation at the end of the term for improvements that have been carried out.

Statutory obligations to carry out Alterations

Certain statutes that require an owner or occupier (sometimes in its capacity as an employer) to carry out works to their premises will override or modify any relevant restrictions in the lease. Examples include:

1 The Equality Act 2010;

2 The Health and Safety at Work etc Act 1974; and

3 The Environmental Protection Act 1990.

Electronic Communications Apparatus

If the tenant wishes to install certain electronic communications apparatus at the premises, statutory rights for the telecoms operator under the Electronic Communications Code may apply. Such rights:

1 Override the provisions contained in the lease that relate to the installation, maintenance, adjustment, repair, alteration or use of electronic communications apparatus.

In leases for a year or more, any prohibition or restriction on such matters is treated as if it were a covenant not to do those acts without consent and that the landlord may not

unreasonably withhold that consent. The question whether the consent is unreasonably withheld has to be determined having regard to:

(a) all the circumstances; and

(b) the principle that no person should unreasonably be denied access to an electronic communications network or to electronic communications services.

2 Restrict the ability of the owner of the premises to require the apparatus to be altered or removed.

Relationship with other clauses in the lease

Signage Clause

One type of alteration the tenants would normally expect to make to the premises is to erect certain signs.

Provisions relating to signage may be included within the alterations clause or dealt with separately.

Yield up Clause

An obligation on the tenant to reinstate alterations is often included in the yield up covenants. This may mean that the landlord would not have to pay compensation for improvements under the LTA 1927.

Compliance with Laws

Clauses dealing with statutory provisions may be relevant to alterations:

1 The tenant may be obliged to carry out certain alterations if these are required by statute.

2 Where planning permission is required to authorise the works, landlord's consent may be needed for the tenant to make such an application.

3 The tenant will usually be required to comply with any relevant statutory provisions relating to the carrying out of the alterations, examples include, building regulation and fire safety legislation.

Use Clause

The use clause may include certain restrictions which are designed to prevent damage to the demised premises. For example, a tenant's covenant not to overload the structural parts of the building may restrict certain alterations.

The parties should carefully consider the permitted use in Mount Eden Land Limited v Bolsover Investments Limited (2014). The lease did not prohibit residential use but contained a covenant preventing alterations without the consent of the landlord. By section 19(2) of the LTA 1927 that covenant was subject to a proviso that the landlord's consent was not to be unreasonably withheld.

The tenant proposed to convert the building into residential flats. The landlord argued that if the alterations were made and the building converted into flats it could be compelled to sell its freehold in a collective enfranchisement claim which would mean losing control of the building with a detrimental effect on its overall estate. The High Court said that in each case it was a question of fact depending on all the circumstances whether the landlord had acted unreasonably. Although the possibility of leasehold enfranchisement was a relevant factor in this case it was wholly speculative.

Rent Review provisions

Where the lease includes market rent review provisions, the effect of alterations carried out by the tenant on the rent will normally be disregarded unless the works were carried out under an obligation to the landlord such as a tenant's covenant to comply with legislation affecting the premises. Otherwise the tenant will not only have paid for the works but is also at risk of paying an increased rent based on better premises than were originally demised.

Insurance obligations

The lease will usually require the tenant to comply with any requirements and recommendations of the insurers that relate to the premises. For example, before starting certain types of alterations to the premises, the tenant may need to provide the insurers with details of the works and obtain their consent. The failure to notify the insurer of proposed building works may amount to a breach of the insurance policy. If damage then occurs while the works are being carried out this could cause significant problems for the property owner.

Third Party rights

The landlord's title to the premises may be subject to restrictions or covenants that limit alterations. The lease will generally contain a tenant's covenant to comply with those restrictions or covenants.

Code for Leasing Business Premises in England and Wales 2007

The Code recommends that the landlord's control over alterations and changes of use should not be more restrictive than is necessary to protect the value of the property and any adjoining or neighbouring property of the landlord.

The Code provides that:

1 the landlord's consent should not be required for internal, non-structural alterations unless the alterations could affect the services or systems in the building. Where consent is not required the tenant should notify the landlord of any internal, non-structural alterations it has carried out;

2 reinstatement at the end of the term should only be required where reasonable. The landlord should notify the tenant of its requirements for reinstatement at least six months before the end of the term.

The Code requires landlords when dealing with an application for consent to:

1 give the tenant where practicable an estimate of the costs involved when the tenant applies for consent;

2 request any necessary additional information from the tenant within five working days of receiving the application;

3 consider at an early stage what other consents may be required, for example, from a superior landlord or mortgagee and apply for these; and

4 make decisions on consents for alterations within 15 working days of receiving full information from the tenant.

TENANT'S COVENANT TO REPAIR

Full Repairing Lease

In a lease of the whole of the property the term "full repairing lease" indicates that the tenant has full responsibility for the repair of the whole property. The tenant will normally be directly responsible for carrying out the repairs and will bear the cost of such repairs.

If the demised premises formed part of a larger property, a full repairing lease places direct responsibility for repairing the demised premises on the tenant and also makes the tenant indirectly responsible for the cost or a proportion of the cost to repairs to the structure, exterior and common parts of the property through the service charge.

Repair

The tenant will usually covenant to keep the demised premises in repair. A covenant to keep the covenant in repair includes an obligation to put the property in to repair if it is in disrepair at the start of the lease. The rationale for this is that if the tenant covenants to keep property in repair the tenant cannot perform this covenant unless the tenant first puts the property into repair.

Before taking the lease, the tenant should inspect the property and the building of which it forms part for disrepair and then assess the potential repair costs either to be borne directly by the tenant or indirectly through the service charge.

Many leases require the tenant to keep the demised premises in good repair, good and tenantable repair or substantial repair. It is uncertain whether the additional words add anything to the obligation to repair and there is case law to suggest that generally they do not (Proudfoot v Hart (1890)). However the construction of the repairing covenant will depend on the length of the term, the location of the property and the nature of the tenant. The tenant should consider restricting its obligations to simply keeping the property in repair to avoid assuming a more onerous standard of repair.

The covenant that requires the tenant to keep the property in good repair and condition is more onerous than one that specifies good repair alone.

Repair and decoration are closely related and the two are often combined in a single clause.

The state of repair of a property can cause disputes at the end of the lease term when the tenant has to yield up the property to the landlord.

There may also be an issue if the lease is a business lease and is renewed under the LTA 1954.

Meaning of Repair

Before an obligation to repair can bite, the property must be in disrepair. This means that the physical condition of the property must have deteriorated (Post Office v Aquarius Properties Ltd (1987)).

In Lurcott v Wakely (1911), the Court described repair as "restoration by renewal or replacement of subsidiary parts of a whole. Renewal as distinguished from repair is the reconstruction of the entirety meaning by entirety not necessarily the whole but substantially the whole".

It is a question of fact and degree in each case whether the works constitute repair. Is what the tenant is being asked to do repair or would the work result in the tenant giving back to the landlord a property that is wholly different from that demised? (Ravenseft Properties Ltd v Davstone (Holdings) Ltd (1980))

The standard and nature of the work that the tenant has to carry out depends on the age and nature of the property at the date of the grant of the lease (Lister v Lane (1893)), so if the property is an old building a covenant to repair it will not require the tenant to modernise it.

The landlord and tenant handbook (Woodfall) suggests that the correct approach to assess whether works go beyond repair is to:

1 look at the particular building;

2 look at the state which it was in at the date of the lease;

3 look at the precise terms of the lease;

4 conclude whether on a fair interpretation of those terms in relation to that state the requisite works can fairly be determined repair.

A duty to repair does not equate to a duty to make safe if there is no disrepair.

Repair or Renewal?

Where the tenant covenants to renew the property this will extend to a rebuilding of the whole if that is necessary (Lurcott v Wakely (1911)). However a covenant to renew may be considered onerous and therefore disadvantageous to the landlord at rent review (Norwich Union v British Railway Board (1987)).

Repair or Replace?

Where the tenant is responsible for carrying out repairs it would normally be for the tenant to choose the method of repair. Similarly the tenant can decide whether to repair the damage or replace the

damaged part of the property whether or not either option is viable (Riverside Property Investments Ltd v Blackhawk Automotive (2004)).

Repair or Improvement?

In some cases it may be unclear whether the proposed works are repairs or improvements. In Gibson Investments Ltd v Chesterton plc (2002) the High Court held that where works remedy disrepair but also create something recognisably different from what would have resulted if the disrepair had merely been remedied and the works increased the letting value the difference constitutes an improvement.

Meaning of some of the words and phrases conventionally used in Repairing Covenants

Some leases use alternative or additional words and phrases beside the word repair, to impose a repairing obligation on a tenant or on a landlord in the case of retained or commons parts.

Meaning of "to keep in good condition"

An obligation to keep the property in good condition can require works to be carried out even if there is no disrepair (Credit Suisse v Beegas Nominees Ltd (1995)).

It is also worth noting that sometimes an obligation to keep in good condition imposes a liability less than repair. In Firstcross Ltd v Teasdale (1983) the High Court held that a tenant of a flat who had covenanted to keep in a good and tenantable condition was required to do no more than use the flat in a tenant like manner.

"To maintain"

A repairing obligation to maintain is ambiguous because the obligation to maintain derives its meaning from the context in which it is used.

It may refer to something less than repair and only require maintenance of premises in the state they were in when demised.

Alternatively it can bear a wider meaning and be construed by reference to the purpose of the object requiring repair. So in Haydon v Kent County Council (1978)) the Court held that a duty to maintain a highway was defined as including repair:

"applying the primary canons of construction to what is an ordinary phrase, the ordinary meaning of to maintain is to keep something in existence in a state which enables it to serve the purpose for which it exists".

Physical extent of the obligation

The scope of the tenant's repairing obligation will usually coincide with the physical extent of the demised premises. Where a whole building is demised the tenant's repairing obligation will extend to the whole building.

Difficulties may arise where the demised premises are part of a larger property. In such cases each tenant will usually be responsible for repairing its demised premises and the landlord will maintain the exterior, structural and common parts of the building and recover the cost of doing so through the service charge.

It is good practice in a lease of part to include the detailed definition of the demised premises which specifies exactly which parts of the building are included in the demise and are therefore the tenant's responsibility under its repairing covenant.

A number of cases considered the problems that can arise where the repairing responsibilities are poorly defined.

1 Petersson v Pitt Place (Epsom) Limited (2001), a dispute arose of the landlord and the tenant were responsible for the same repair work – a lease will be construed if possible to avoid landlord and tenant obligations from overlapping.

2 The opposite problem arose in Jacey Property Company Limited v Desousa (2003) where there was a gap in the responsibility for repairs – the Court will not rewrite the lease to fill that gap.

3 Marlborough Park Services Limited v Rowe and another (2005), a dispute arose between the landlord and the leaseholder of the maisonette as to whether joists between two floors of the maisonette were part of the main structures of the building – the Court of Appeal held that the meaning must be taken from the particular lease in which they are found and the surrounding fact and circumstances.

4 Gavin and another v Community Housing Association Limited (2013), the landlord was not under any obligation to repair the retained parts of the property and the Court of Appeal refused to imply such a covenant.

Mechanical, Electrical Services and Plant

The parties should consider the application of the repairing covenants to mechanical, electrical services and plant.

The repairing covenant may expressly refer to these or similar items. If plant and machinery are annexed to the land and have become fixtures the repairing obligations will apply to them. However a repairing obligation which was drafted for a building may not adopt the most appropriate language for a repairing obligation in relation to plant and machinery. If this is the case it may be better to impose a tailored repair obligation in relation to plant and machinery using wording which focuses on the function rather than or as well as the physical condition.

Whether an object has become part of the land depends on the degree of annexation to the land. In answering this question:

1 common sense may assist; and

2 the subjective intention of the parties is irrelevant.

There are additional considerations to be taken into account when dealing with mechanical electrical services and plant:

1 Mechanical – They frequently have a shorter lifespan than the actual building.

2 Finding an exact or approximate replacement can be difficult or impossible.

3 An element of improvement is often inevitable due to difficulties in finding an exact replacement and technological advances for even if a duplicate original item is available changes to regulations or codes of practice may mean installation is not possible without major changes or additions elsewhere in the building.

4 The market may consider the machinery to be old fashioned or likely to cause future problems. So even though there may be nothing wrong with its current performance, it may be necessary to replace it with something more modern to let the premises.

Is it sensible to rely solely on a covenant to repair the mechanical electrical services and plant?

Although a landlord should always seek to impose a covenant to repair them under a conventional repair obligation there is no requirement to carry out any works until there is damage or deterioration. It is not sufficient that an item is old fashioned or less sufficient than its modern equivalent. So:

1 underground fuel tanks which were old but not defective were not in disrepair (Mason v Totalfinaelf UK Ltd (2003));

2 a covenant to keep plant in good and substantial repair and condition was satisfied by a system in good working order (Ultraworth Ltd v General Accident Fire & L:ife Assurance Corporation (2000));

3 In Fluor Daniel Properties Ltd and others v Shortlands Investments Ltd (2001) the High Court held that the landlord's repairing covenant extended some way beyond pure repair but it nevertheless presupposed that there was a disrepair (or in the case of air conditioning systems some malfunctioning) which needed to be repaired. The landlord could not recover the cost of replacing the air conditioning system by virtue of this covenant because the air conditioning system was not in disrepair.

Words and phrases that are frequently used in the context of mechanical, electrical services and plant in addition to an obligation to repair therefore include:

1 a covenant requiring maintenance;

2 a covenant to keep in working order or to keep in good operating condition; and

3 a covenant to keep the machinery so that they are capable of functioning.

Schedule of Condition

The tenant may wish to limit its repairing obligation to keeping the demised premises in the same state as they are in at the grant of the lease. This is particularly so when the premises are in a poor state of repair as the covenant to repair would require the tenant to put the premises into repair.

Inherent Defects

An inherent defect or latent defect is one that is due to a defect in the design or construction of a building or material used which existed on completion of the building works but was not apparent on inspection.

If any inherent defect does not cause any damage to the property the tenant will not be required to remedy the defect under the repairing covenant. Post Office v Aquarius Properties Limited (1987), weak concrete had allowed water into the basement of the property but no damage had been caused. The tenant's repairing obligation did not extend to installing water proof tanking in the property as there was no disrepair.

However if the inherent defect causes damage to the property the tenant will be required to repair the damage. The tenant's covenant to repair may include remedying the inherent defect in certain circumstances for example where this is the only means of effecting a repair of the property.

Particularly where the property is newly built the tenant may exclude liability for:

1 disrepair caused by inherent defects;

2 remedying the inherent defect itself.

There is no statutory definition of inherent defects so this would need to be defined in the lease. Depending on the nature of the property a definition of inherent defect might refer to damage caused by defects in:

1 design;

2 materials;

3 workmanship;

4 supervision of contractors;

5 site preparation works.

From a tenant's perspective the exclusion should be coupled with an obligation on the landlord to be responsible for such repairs at its own cost rather than through the service charge.

Insured Risks

It is usual for the tenant's repairing obligation to exclude damage caused by an insured risk. However the tenant would normally be responsible for repairing damage caused by an insured risk if the insurance monies cannot be recovered because of an act or omission of the tenant.

Approval of Works

If the tenant's covenant requires repairs to be carried out to the satisfaction of the landlord's surveyor, the surveyor is entitled to prescribe the work to be carried out as well as the method of repair (Mason v Totalfinaelf UK (2003)).

This removes the tenant's ability to determine how to carry out the repairs and should normally be resisted by the tenant.

Compliance with Laws

The tenant may be under an obligation to carry out repairs that are necessary to comply with statute.

Lease Code 2007

The Lease Code 2007 states the tenant's repairing obligation should be appropriate to the length of the term and the condition of the premises at the start of the lease.

Breach of the Repairing Covenant

If the lease does not contain a clause allowing the landlord to enter the property to carry out repairs that are the responsibility of the tenant and reclaim the cost of doing so from the tenant the landlord's entry onto the property may:

1 constitute a trespass;

2 breach either an express or implied covenant for quiet enjoyment.

If so the tenant may be able to obtain an injunction to prevent the landlord entering the property.

Advantages of a Right to Enter

The main advantages for the landlord are that it allows the landlord to:

1 ensure that any repairs are done without the restrictions of The Leasehold Property Repairs Act 1938 and section 18 of the LTA 1927;

2 protect its investment while making immediate repairs that are necessary to preserve the value of the property or a larger complex of which the property forms part;

3 remove any possible liability it might have to third parties as a result of the dangerous state of the property;

4 repair the property to the standard it requires and to the satisfaction of its own surveyor;

5 comply with notices served by the local authority relating to the condition or repair of the property.

Disadvantages of a Right of Entry

The main disadvantages for the landlord are that it may have to:

1 make the practical arrangements for the repair work to be carried out;

2 deal with possible arguments that:

(a) the notice served on the tenant complaining of breach of its covenants was invalid;

(b) entry to the property was premature and therefore a trespass;

(c) the work carried out was outside the scope of the clause;

(d) the cost of the repair work was unreasonable; or

(e) the landlord's workman damaged the tenant's possessions;

3 use its own money to carry out the repairs which it will then have to recover from the tenant;

4 face a possible damages claim if the right of entry has not arisen or has been exceeded; and

5 be liable to third parties under section 4 of the Defective Premises Act 1972.

Leasehold Property (Repairs) Act 1938

A landlord's right to claim damages for breach of a repairing covenant by its tenant is restricted by section 1 of the LPRA 1938.

If the lease was granted for a term of at least seven years and has at least three years left to run a landlord is not allowed to bring an action for damages unless it:

1 has served a notice on the tenant under section 146 of the Law of Property Act 1925 in relation to the breach of covenant;

2 served the notice at least one month before bringing the action; and

3 referred to the tenant's right under the LPRA 1938 in the notice itself.

The tenant then has 28 days to serve a counter notice on the landlord. If it does so the consent of the Court is needed for the landlord to take any action to forfeit the lease or to claim damages for the breach of the repairing covenant.

Jervis v Harris clauses

In this case (1995) the Court of Appeal held that where the landlord was entitled to enter the property to carry out repair works itself and recover the cost of doing so from the tenant the landlord's claim was one for payment of debt and not for damages. As such section 1 of the LPRA 1938 did not apply and the Court's consent was not required before the landlord could take action.

For the avoidance of doubt and to apply the decision in Jervis v Harris a lease should state that the cost of the work carried out by the landlord is to be treated as a debt due from the tenant to the landlord.

However if the tenant refuses entry to the landlord the landlord will not always be entitled to an order for specific performance to enable it to enter the property and carry out the works. In Hammersmith LBC v Creska (No 2) (2000) the Court held that an order was refused because the repair works were of no use and the landlord had not suffered any loss. In Zinc Cobham 1 Ltd (in administration) and others v (1) Adda Hotels (2) Puckrup Hall Hotels Ltd and (3) Hilton Worldwide Inc (2018) the High Court refused to make an order for specific performance where the tenant failed to comply with covenants to trade, operate and maintain their hotels in accordance with specified standards. Damages were instead awarded in lieu of specific performance.

It is therefore prudent for a landlord to resist any attempt by the tenant to limit the landlord's right of entry to those instances when works are required to rectify material or substantial disrepair.

Section 18(1) of the LTA 1927

This states the damages available for breach of a repairing covenant are:

1 limited to the diminution in the value of the reversion caused by the breach;

2 not recoverable where the property is to be pulled down or where structural alterations are to be carried out at the end of or shortly after the end of the term.

Following Jervis v Harris, it appears that the limitation imposed by that section does not apply where the lease provides for the landlord to enter the property to carry out repair works and recover the cost from the tenants since such a claim is for repayment of a debt rather than a claim for damages.

Section 4 of the Defective Premises Act 1972

Where a lease expressly or impliedly gives the landlord the right to enter the property to carry out any form of maintenance or repair, the landlord may find itself liable to third parties under section 4. That section provides that from the moment the landlord is or has by notice put itself in a position to exercise the right to enter the property and carry out work or maintenance work then the landlord will be treated as having an obligation to the tenant for that particular maintenance or repair. The obligation will last for as long as the landlord is in the position of being able to enter the property to carry out such works. In Hannon v Hillingdon Homes Ltd (2012) the High Court held that the landlord was liable under section 4(1) and 4(4) of the DPA 1972 to a third party injured in a fall at the landlord's property due to the absence of a bannister. The bannister had been removed by the landlord's tenant.

However the landlord will not owe the tenant a duty under the DPA 1972 in relation to any defect in the condition of the property arising from or continuing because of the tenant's failure to carry out an obligation expressly imposed on it under the lease.

Moreover the landlord's duty does not extend beyond the duty to repair and maintain to become a duty to make safe.

This does not make specific provision for remedying breaches of a tenant's repairing covenant under the lease. However it does recommend the landlord should handle the faults promptly and deal with tenants and any guarantors in an open and constructive way.

USE

Leases of commercial property usually include restrictions on:

1 the purposes for which the tenant can use the property;

2 the right for the tenant to request a change to the permitted uses.

The tenant's use of the property may be further restricted by:

1 restrictive covenants on the landlord's title;

2 statute;

3 competition issues;

4 further provisions in the lease covering general conduct.

The need for restrictions on use will be affected by many factors including the following:

1 the nature and location of the property including planning restrictions and restrictive user covenants effecting the landlord's title;

2 estate management considerations; and

3 protection of the value of the landlord's investment in the property.

The need for restrictions has to be balanced against the tenant's need for flexibility. The tenant must ensure that the use permitted by the lease is wide enough for the tenant's immediate business purposes and possibly for any anticipated use. The tenant may also need to consider the use from the perspective of potential assignees and undertenants. The more restrictive the use the more difficult it may be to assign the lease or to underlet.

Both the landlord and the tenant need to consider the impact that the user provisions may have on rent.

Restricting the Use

Positive or Negative?

The user clause may be expressed in either of the following ways:

1 Positively – the tenant shall use the property for the permitted use.

2 Negatively – the tenant shall not use the property for any purpose other than the permitted use.

There is a possibility that if the user clause is expressed positively it may be construed as an implied keep open obligation meaning that the tenant cannot cease actively using the property for the defined use. For this reason tenants will generally prefer the use clause to be expressed negatively.

Although a positive keep open obligation gives the landlord the right to damages if the tenant is in breach it will not give the landlord the right to an injunction (Co-operative Insurance Society Ltd v Argyll Stores (Holdings) Ltd (1997)).

Expressing use by reference to the Use Classes Order

It is common to find that uses are expressed by reference to the Town and Country Planning (Use Classes) Order 1987.

If this is done the lease should make it clear that the reference is to the Use Classes Order in effect at the date the lease was granted. The Use Classes Order is amended from time to time and future amendments may bring into a particular use class a use that would be unacceptable to the landlord or exclude a use that previously the tenant would have expected to have been included.

Leases often include a general interpretation provision that any references to statutes include any future amendments made to the statute during the term of the lease. If the use class and the leases drafted by reference to the Use Classes Order the general interpretation clause should be amended to exclude the Use Classes Order from such interpretation.

Estate Management

The landlord may agree to certain restrictions on the use of neighbouring premises for good estate management purposes. Typically this will be in the context of a shopping centre where a tenant may want assurance that there will not be a competing store in the immediate vicinity. For example a greetings card shop tenant may want a restriction on the landlord's ability to let another unit to another greetings card shop tenant.

This restriction may be contained in the lease or in a separate agreement or side letter. It is important that the landlord and any managing agents keep all central records of this sort of restriction and ensure that the leases of the neighbouring property properly prohibit the restrictive use.

Statutory Restrictions on Use

There is no implied covenant by a landlord that the property can be lawfully be used for a use permitted by the lease. Usually there will be an entire agreement clause which will expressly exclude any warranty or representation that the property may lawfully be used for the permitted use.

The tenant must comply with the law and generally this will be supported by a provision in the lease requiring the tenant to comply with all laws. This gives the landlord a right to claim any damages if there is any loss suffered as a result of a breach by the tenant.

One of the most obvious examples of use being restricted by statute is the requirement that use is authorised by planning permission. If the use is not authorised the tenant may face enforcement action. It will not be a defence to enforcement procedures that the lease permits the actual use.

Competition Issues

Restrictions on use and change of use can raise competition law issues for example:

1 certain restrictive covenants may be prohibited by the Competition Act 1998 and will be unenforceable;

2 The Groceries Market Investigation (Controlled Land) Order 2010 prevents certain large grocery retailers from entering into restrictive covenants that may restrict either grocery retailing or agreements having equivalent effect.

It is therefore essential to consider whether competition issues affect a use clause and where relevant to obtain specialist advice on whether the clause is or will be enforceable.

Competition Act 1998

This introduced two prohibitions:

1 The chapter 1 prohibition prohibits agreements between undertakings which may affect trade within the UK and which have as there object or affect the prevention, restriction or distortion of competition within the UK.

2 The chapter 2 prohibition prohibits the abuse of a dominant market position which has or is capable of having an effect on trade within the UK.

Removal of Land Agreement Exemption

Prior to 6 April 2011 land agreements were excluded from the scope of the chapter 1 prohibition (but not the chapter 2 prohibition) however this exclusion ceased to apply from 6 April 2011. Companies must self-assess land agreements for compatibility with competition law in the same way as they must assess other types of agreement.

General Conduct Restrictions

Typically a lease will include prohibitions to prohibit:

1 illegal use;

2 nuisance use. This is wide and potentially open to abuse by the landlord. It is unlikely to be seen as compliant with the 2007 Lease Code;

3 breach of load bearing limits in the property;

4 use that overburdens machinery equipment or services.

Allowing Changes of Use

The 2007 Lease Code provides that changes of use should not be more restrictive than is necessary to protect the value at the time of the application of the premises that any adjoining or neighbouring premises of the landlord.

What this means will depend on:

1 the nature of the property, whether that property stands alone or is part of an estate and whether the landlord owns adjacent or neighbouring property;

2 the length of the lease, whether the lease can be renewed and whether there are rent review provisions;

3 the particular tenant.

It is likely that it will be reasonable for the landlord to withhold consent where:

1 the change of use is likely to reduce the rent obtainable on review or on a renewal;

2 the change of use is likely to reduce the future value of the property for example the change of use to an abattoir or possibly a dry cleaners;

3 the landlord wishes to ensure a good mix of tenants.

It may be unnecessary to put anything in the lease that specifically deals with permission to change use. However the lease may not comply with the 2007 Lease Code if it:

1 is silent about changes of use;

2 states that the use can be changed with the landlord's consent but does not go on to say that the landlord cannot unreasonably withheld consent.

Any change of use provision should be read in the light of the LTA 1927:

1 If the lease does not expressly state that the landlord's consent cannot be unreasonably withheld the landlord's right to refuse consent is unfettered. Section 19 of the LTA 1927 does not imply the consent for a change of use cannot be unreasonably withheld.

2 If the tenant can change the use with the landlord's consent the lease is deemed to provide the landlord cannot make a charge without consent if the change of use will not involve a structural alteration to the property.

If a change of use is permitted with the landlord's consent this should be expressed so that the landlord's consent is required rather than the landlord's approval is given.

Impact of User on Rent

In general the wider the user clause and the greater the extent to which changes of use are permitted the greater the rent that the landlord would be able to achieve at rent review.

If the lease can be renewed at the end of the contractual term the renewal is likely to be on substantially the same terms as the original lease with the rent being set at whatever is the market rent on renewal. If the user clause in the lease is wide it is likely that the user clause in the renewal lease will be equally wide and this will be reflected in the rent set for the renewal lease.

ALIENATION

Restrictions on Assignment

In the absence of any express restriction the benefit of a lease is freely assignable (transferable to another party) however most commercial leases contain restrictions on the tenant's ability to assign the lease. This enables the landlord to keep control over the identity of the tenant and to check that it is likely to be able to meet its commitments under the lease.

An assignment in breach of restrictions contained in the lease would still be effective to transfer the legal estate but would constitute a breach of the lease. The remedy for the breach would be a claim in damages against the assignor (and possibly the assignee) and/or forfeiture. In addition in the case of a new lease this would be an excluded assignment and the assignor would not be released from the tenant covenants under section 5 of the Landlord and Tenant Covenants Act 1995.

If the lease contains an absolute or qualified prohibition against assignment an assignment by operation of law may also breach the restrictions in the lease. An assignment by operation of law can for example occur where a tenant grants an underlease for a term that is as long as or longer than the term of the tenant's own lease.

Assignment Clauses

Leases normally absolutely prohibit assignments of part but will allow the tenant to assign the whole of the lease with the landlord's consent which is not to be unreasonably withheld.

If the lease permits the tenant to assign with the landlord's consent it is implied that the landlord's consent cannot be unreasonably withheld under section 19(1) of the LTA 1927. This provision does not prevent the landlord from requiring payment of a reasonable sum in respect of any legal or other expenses incurred in connection with the provision of consent.

A covenant not to assign or underlet any part of the premises will prohibit an assignment or underletting of the whole.

A covenant not to underlet or part with the possession of the premises will not prevent the tenant from underletting or parting with a part of the premises.

An assignment of part is usually prohibited under the terms of the lease due to the complications that arise over apportionment of rent and other payments and the grant and reservation of cross easements.

Landlord's consent to an assignment is typically given by way of a formal licence to assign. If the lease does not make it clear that a former licence is required then the landlord may be held to have given consent to the assignment in correspondence either from itself or from its agents. This was the case even though the correspondence was marked subject to licence.

Statutory Duties relating to Consent

The LTA 1988 imposes certain duties in relation to consents for assignment. Where a tenant covenants not to assign the lease without the landlord's consent and that consent is not to be unreasonably withheld the LTA 1988 imposes the following statutory duties on the landlord:

1 to give consent except where it is reasonable not to do so;

2 to give consent within a reasonable time;

3 to give the tenant written notice of the decision.

If consent is given subject to any conditions the landlord must specify those conditions. If consent is refused the landlord must give the reasons for the refusal;

4 to pass on the application to anyone else whose consent is needed under the lease.

Section 1(3) of the LTA 1988 requiring the landlord to respond to applications for consent to assign within a reasonable time does not apply unless the tenant has served the landlord with an application for consent to assign.

Unless the lease contains an express provision allowing the landlord to charge for giving a consent section 144 of the LPA 1925 will apply and the landlord will not be able to charge for its consent to the assignment. Section 144 of the LPA 1925 does not prevent the landlord recovering its reasonable legal and other expenses when giving consent.

Consent not to be delayed

It is not necessary to include an express obligation not to delay in the lease as this is already required by statute.

Section 19(1A) Agreement

In section 19(1A) of the LTA 1927 as inserted by the LTCA 1995 allows the landlord and the tenant to agree specific:

1 circumstances in which the landlord may withhold consent to an assignment; and

2 conditions subject to which any such consent may be granted.

When an agreement has been made in accordance with section 19(1A), the landlord will not be unreasonably withholding consent or imposing an unreasonable condition if it acts in accordance with that agreement. Section 19(1C) of the LTA 1927 permits conditions that depend on the landlord's or any other person's determination and therefore allows an element of discretion or opinion rather than

being objectively proved. This allows the landlord to reserve a degree of final judgment as to the suitability of the assignee. However section 19(1C) also limits such subjective conditions. They are only permitted if the terms of the lease ensure that either:

1 the power to determine the matter is exercised reasonably;

2 provision is made for the decision to be referred to an independent person if the tenant is not satisfied with the initial determination.

The agreement between the landlord and the tenant must specify that it is made for the purpose of section 19(1A) of the LTA 1927.

Conditions for Consent

Authorised Guarantee Agreement

Authorised Guarantee Agreements (AGA's) were introduced by the LTCA 1995. To qualify as an AGA the agreement must satisfy the requirements of section 16(2) of the LCTA 1995 which means that:

1 the tenant must guarantee the performance by the assignee of the covenants from which the tenant has been releases;

2 the agreement must be entered into the circumstances set out in section 16(3) of the LTCA 1995; and

3 the provisions of the agreement must comply with section 16(4) and 16(5) of the LTCA 1995.

An agreement is not an AGA and is void to the extent that it purports to impose on the outgoing tenant;

1 any requirement to guarantee the liability of anyone other than the assignee; and

2 any requirement relating to a period after the assignee has been released by virtue of the LTCA 1995.

This means that:

1 an AGA cannot include liability in respect of a successor in title of the assignee;

2 liability under an AGA cannot be expressed to survive an amalgamation or reconstruction of the assignee as a result of which the assignee becomes a different legal entity; and

3 liability may extend after assignment by the immediate assignee if (and only if) that assignment is an excluded assignment and it is only the immediate assignee's continuing liability which is guaranteed not the liability of the further assignee under the excluded assignment.

The tenant must have covenanted in the lease not to assign without the consent of either of the landlord or some other person. It is irrelevant whether the lease states that such consent is not to be unreasonably withheld or whether this requirement is implied by section 19(1) of the LTA 1927.

Consent must be given subject to a lawful condition that the tenant enters into the AGA. To be lawful a condition must either have been the subject of a section 19(1A) agreement or be reasonable under the general rules of reasonableness. The AGA must be made pursuant to that condition. Because of the way section 16 of the LTCA 1995 is drafted a lease will often set out an agreed form of AGA or state that any AGA:

1 relates to all the tenant covenants;

2 last for the whole period if the assignee is liable;

3 includes both guarantor and principal debtor liability; and

4 is otherwise in a form reasonably required by the landlord.

The Lease Code 2007 recommends that AGAs should only be required if at the date of the assignment the assignee (together with any guarantor):

1 is of lower financial standing than the assignor and its guarantor:

2 is resident or registered overseas.

It also recommends that for small tenants the rent deposit should be acceptable as an alternative to an AGA.

Content of the AGA

The LTCA 1995 does not define an AGA. Instead it describes what an AGA must do, what it may do, what it must not do and the circumstances in which it can be entered into. These provisions are largely contained in section 16 of the LTCA 1995.

In an AGA the outgoing tenant guarantees the performance of any tenant covenant to any extent by the assignee. Leases will usually provide for a full AGA in respect of all the tenant covenants and for the whole time that the assignee is liable.

New Lease on Disclaimer

An AGA may require the outgoing tenant to take a new lease if the original lease is disclaimed.

If the original lease is excluded from the LTA 1954 a landlord's warning notice will need to be served on the tenant in respect of the new lease that the tenant will be obliged to take.

The statutory notice procedure must be followed before the tenant becomes contractually bound to take the new lease. There is some controversy over when this occurs. It would be any of the following:

1 when the tenant enters into the original lease agreeing that the landlord may impose an AGA on assignment;

2 when the tenant enters into the AGA;

3 when the landlord calls upon the tenant to enter into the new lease following disclaimer.

Guarantors of the Outgoing Tenant

The Issue raised by Good Harvest

In Good Harvest Partnership LLP v Centaur Services (2010) the Court held that an AGA entered into by a tenant's guarantor to guarantee the obligations of the incoming tenant as a pre-condition to a consent to assign was void under section 25 of the LTCA 1995. Such a condition would have imposed obligations on the tenant's guarantor equivalent to those which section 24 released. To hold the guarantor liable would frustrate the aims of the LTCA 1995.

The Issues raised by K/S Victoria Street

K/S Victoria Street v House of Fraser (Stores Management) Limited (2010) confirmed Good Harvest to the extent that K/S Victoria Street agreed that any agreement that requires the tenant's guarantor to guarantee the obligations of an assignee of the lease will be void.

K/S Victoria Street concerned an agreement by a tenant's guarantor that it would guarantee the specified assignee's liability at such time as the lease was assigned. A distinction between the future guarantee in this case and the Good Harvest actual guarantee appears to make no difference to the analysis.

The Guarantor cannot take an assignment

In EMI Group Limited -v- O&H Q1 Limited (2016) **t**he High Court considered the validity of an assignment of a new lease by a tenant to the tenant's guarantor and held that under the LTCA 1995 a tenant may not assign its lease to its guarantor. The assignment is void by virtue of section 25(1) of the LTCA 1995 as it frustrates the purpose of the LTCA 1995. The assignment does not take effect to vest the lease in the assignee. The lease remains vested in the tenant and the guarantor remains bound by its guarantee.

Guarantors of the incoming tenant

The landlord may impose a condition that the assignee provides its own third party guarantee.

If a guarantor is provided on assignment and the original lease is excluded from the LTA 1954 the landlord will need to follow the statutory notice procedure in relation to the guarantor and the new lease it may be required to take on disclaimer. This should be done before the guarantor enters into the guarantee or becomes contractually bound to do so.

Circumstances for Refusal

The landlord may refuse consent if there are arrears of rent or other money due under the lease.

The landlord is not precluded from withholding consent where reasonable or from granting consent subject to any other reasonable conditions simply because such a circumstance or condition is not the subject of an agreement under section 19(1A) of the LTA 1927. This point is implicit in the LTA 1927 but for the avoidance of doubt leases expressly set this out.

The Lease Code 2007 provides that leases should not refer to any specific circumstances for refusal although a lease would still be code compliant if it requires that any group company taking an assignment when assessed together with any proposed guarantor must be at lease to equivalent financial standing to the assignor together with any guarantor of the assignor.

Restrictions on Underlettings

Leases often restrict the tenant's ability to underlet the property. The imposition of such restrictions enables the landlord to keep control over the identity of the undertenant. This is important because a head landlord may come into a direct relationship with an undertenant:

1 if the headlease is surrendered

A surrender is subject to the rights of undertenants and it does not extinguish an underlease (Mellor v Watkins (1873-1874) even if the underlease was granted in breach of covenant (Parker v Jones (1910))

2 if the headlease is forfeited and the undertenant successfully applies for relief against forfeiture

An undertenant has a right to apply for relief from forfeiture under section 146(4) of the Law of Property Act 1925 and the court has a wide discretion as to the terms on which it may grant relief to an undertenant

3 In certain circumstances on a renewal of the undertenant's lease under the LTA 1954

4 If the headlease is disclaimed in the event of the tenant's insolvency

Following disclaimer of the headlease the undertenant can remain in possession of the property for the term of the underlease provided that the undertenant complies with the covenants in the headlease including payment of the headlease rent

Leases normally permit the tenant to underlet the whole of the property with the landlord's prior consent which is not to be unreasonably withheld

It is less common for leases to allow underlettings of part

Underlettings of part

A landlord may not want the tenant to have the ability to underlet part due to:

1 Potential estate management problems

The more occupiers in a property the more complicated the management of that property becomes. Dealing with these issues is usually time consuming and expensive. It is far simpler for a landlord to deal with one tenant. Whilst the tenant has a lease of the property the tenant is usually responsible for managing the undertenant of the whole or undertenants of part. However if the landlord comes into a direct relationship with the undertenant these management issues can end up being the landlord's problem

2 A sub-division of the property that may render it unmarketable

If the landlord does not control the manner in which a tenant can underlet the premises in the lease a tenant could sub-divide and underlet the property in a manner that may suit the tenant and the undertenant at the time of the underletting. However in the long term the premises could end up being difficult to let because they may have been sub-divided in a manner that is not appealing to other occupiers.This could make the premises unmarketable. Again if the landlord comes into a direct relationship with the undertenant this becomes the landlord's problem.

To prohibit an underletting of part clear words are needed. A covenant not to underlet or part with the possession of the premises will not prevent the tenant from underletting or parting with a part of the premises (Grove v Portal (1902))

Statutory Duties relating to Consent

The same statutory duties apply to landlord's in respect of applications for consent to underlet as apply to applications for consent to assign

Underleases

When granting an underlease it is essential that the tenant makes sure that the underlease will expire before the tenant's own lease expires. If the tenant grants an underlease which expires at the same time as or after the tenant's own lease the tenant will have disposed of the whole of the residue of its estate and the grant of the underlease will take effect as an assignment by operation of law regardless of the parties' intention.

Practical Implications

If a tenant grants an underlease for the whole of the residue of the term of the tenant's own lease the tenant will have divested itself of all its interest in the land. The following consequences flow from this:

1 The tenant will not have a right to possession of the land at the end of the term of the underlease.

2 The covenants and conditions in the lease will pass in the way they would on assignment of the lease as opposed to the grant of an underlease. If the lease is a new tenancy the assignment will be an excluded assignment because it is by operation of law. The tenant as assignor will remain liable under the lease until the undertenant assignee has assigned the lease unless that subsequent assignment is also an excluded assignment.

3 If the tenant's lease contained an absolute or qualified prohibition against assignment the assignment by operation of law may result in forfeiture proceedings and/or a claim for damages.

4 There is no landlord and tenant relationship between the tenant as assignor and the undertenant as assignee. The tenant can however sue for the sum agreed to be paid as rent under the underlease. This means that the assignee is potentially liable to pay double rent both to the landlord and to the tenant/assignor.

5 The status of the relationship between the assignee and the landlord during any period after the tenant's lease has expired but before the expiry of the term of the so called underlease is unclear.

Lease Code 2007 and underleases

The Lease Code 2007 provides that if subletting is allowed the sublease rent should be the market rent at the time of subletting. Subleses to be excluded from the LTA 1954 should not have to be on the same terms as the tenant's lease

INSURANCE

Insurance arrangements and the Lease Code 2007

Insurance arrangements will generally be determined by what the landlord and tenant agree and set out in the lease. This may be influenced by the Lease Code 2007

This provides:

"Where landlords are insuring the landlord's property the insurance policy terms should be fair and reasonable and represent value for money and be placed with reputable insurers

Landlords must always disclose any commission they are receiving and must provide full insurance details on request.

Rent suspension should apply if the premises are damaged by an insured risk or uninsured risk, other than where caused by a deliberate act of the tenant. If rent suspension is limited to the period for which loss of rent is insured, leases should allow landlords or tenants to terminate their leases if reinstatement is not completed within that period.

Landlords should provide appropriate terrorism cover if practicable to do so.

If the whole of the premises are damaged by an uninsured risk as to prevent occupation, tenants should be allowed to terminate their leases unless landlords agree to rebuild at their own cost."

The insurance requirements in the Lease Code 2007 marked a departure from long standing practice in relation to the reinstatement and termination provisions. The Lease Code 2007 is not complete in that on its own it does not adequately cover what should happen with insurance and reinstatement in all circumstances.

Who should insure and be obliged to insure?

The following are the issues that will determine who should take out insurance:

1 Who has an insurable interest

Insurance is taken out to protect the value of an asset by a person who has an insurable interest in that asset. In many long residential leases, where a premium is paid, there are three parties to the lease: the landlord, the tenant and the flat management company. The management company has no freehold or leasehold interest in the building, nor any right to acquire such an interest, but it is the party that gives most of the typical "landlord"- type covenants such as the covenant to repair. The management company therefore incurs the "loss" if the building is damaged by fire, as it will be obliged to repair. This is sufficient to qualify as an insurable interest so that the management company can insure the building in its name (rather than insuring in the landlord's name as the landlord's agent).

Contrast this with the position of a managing agent who is not party to the lease and is not bound directly by the covenant to repair, but is employed by the landlord to manage the building and organise the discharge of the landlord's obligations. The managing agent has no insurable interest and must, as the landlord's agent, organise any insurance in the landlord's name. There are complicated rules governing disclosure and agents, which can have surprising results and may result in invalidation of the insurance.

It is possible that more than one person may have an insurable interest in property, for example: landlord and tenant; landlord and funder; tenant (of a long lease, for which it pays a premium) and funder.

Even though the tenant(s) may have insurable interests, the landlord will not want to risk double insurance arguments with its insurer if the tenant has also insured the property. Invariably, if the landlord is to insure, the landlord will prohibit the tenant(s) from taking out separate buildings insurance in respect of the demised premises.

2 Who should retain control over insurance

Generally, a landlord of a multi-tenanted building will not permit any of the tenants to take out their own insurance of their demised premises, but will structure the leases so that the landlord will:

(a) Insure at the tenant's expense

(b) Make all insurance claims

(c) Apply insurance monies received to repairs and reinstatement

Having more than one party involved in insuring the same property is not practicable, even if they each have an insurable interest in their demised premises:

(a) Buildings insurance is about reinstatement and it would be impracticable for each tenant to be responsible for rebuilding its particular unit, especially given that leases in a multi-tenanted

building are generally drafted to demise the internal parts, leaving the external and structural parts retained by the landlord.

(b) As soon as two or more insurers are involved in claims arising from the same event causing damage to the same building, there are issues around double insurance and contributions, irrespective of whether there is indeed double insurance. The inevitable arguments would result in claims being refused or taking a long time to process.

(c) If several parties insure parts of a building, there will be multiple applications for insurance. Each application would be based on disclosures supported by warranties and conditions, but there may be no consistency between these. This might lead to insurance claims being refused or taking a long time to process.

3 Who is responsible for reinstatement and repairs

The issue of who retains control over insurance is linked to who is liable to reinstate. Buildings insurance is primarily about enabling reinstatement in case of damage or destruction. It is often a term of the insurance policy that reinstatement is required so that the insured cannot unilaterally elect to claim the cost of reinstatement, keep the money and not reinstate.

The landlord of a multi-tenanted property will want to retain control over reinstatement of the structure, external parts and common parts of the building or estate and this will be reflected in the leases. If the landlord is obliged to reinstate, the landlord will need control over the insurance to make the insurance claims for reinstatement in the event of damage or destruction.

Whatever is decided, it is essential that there is an obligation to insure on either the landlord or the tenant. If there is no obligation and insurance is arranged voluntarily, there will be no liability for ending voluntary cover (Argy Trading Development Co Ltd v Lapid Developments Ltd (1977))

If there is a breach of an obligation to insure the appropriate measure of damages may be the cost of reinstatement (Burt v British Transport Commission (1955))

If the Landlord insures

The most common position is that the landlord will insure in its own name and will recover the cost of insurance from the tenant or tenants.

In this event the most common situation is as follows:

1 The landlord insures the building (including the tenant's demised premises) in the landlord's name to the reinstatement value, together with loss of rent for a specified period (typically three years) and will recover the cost, or an appropriate proportion of the cost of doing so from the tenant.

2 Unless the policy is in joint names, the interest of the tenant and of any mortgagee of the tenant may be noted on the landlord's policy. The lease will prohibit the tenant from insuring the demised premises against the same risks in its own name. This may be a problem if the

tenant has a valuable interest in its demised premises (because it has paid a premium for the lease).

3 The tenant will be prohibited from doing anything that may vitiate the landlord's insurance.

4 The tenant will be liable for all repairs to the demised premises unless the damage is covered by insurance. If the damage is covered by the insurance, the landlord will be liable to make a claim under insurance and then to apply the insurance monies received in reinstatement of the demised premises.

This is perhaps one of the most complex aspects of insurance provisions because so often leases determine liability for repairs and reinstatement by reference to whether the damage was caused by an "insured risk", rather than by reference to whether the damage was insured or not.

Damage may be caused by an "insured risk" but may not actually be covered by the insurance contract (and, therefore, insured) for a number of reasons, for example:

(a) the landlord declined to insure against the insured risk in breach of its insurance obligations;

(b) the insured risk was not one that was covered, or not covered on acceptable terms, in the insurance market (and so there may have been no obligation to insure against it);

(c) the insurance policy limited the cover in respect of an insured risk;

(d) the insurance policy was vitiated by the fault of the tenant, the landlord or a third party.

This is an area that often causes problems, particularly as insurance companies have sought to limit cover with more exclusions and conditions.

(a) If the demised premises are destroyed or damaged by an insured risk to an extent that they cannot be occupied by the tenant, the rent will be suspended (usually for the period of the loss of rent insurance).

(b) The tenant may have negotiated with the landlord that if the demised premises cannot be reinstated, either within a specified period (usually the loss of rent insurance period) or at all, then the tenant (or perhaps either the landlord or the tenant) can terminate the lease. By itself, this will not offer adequate protection for the tenant (or any lender taking security over the tenant's lease) where the tenant has paid a premium for the lease. In such circumstances the tenant will also need an obligation on the landlord to apportion the insurance monies between the landlord and the tenant.

(c) In addition, a modern lease will usually prescribe how damage is to be dealt with if caused by an uninsured risk, where insurance is not generally available in the open market or not on reasonable terms. A good example of this is flooding. A tenant will resist liability for repair in such circumstances, and will argue for a rent suspension. Increasingly landlords are willing to take some of the risk on uninsured liability.

What if the tenant needs to protect the value of its investment?

Where the landlord insures, the tenant may be concerned how to protect the value of its investment where it has paid a premium for its lease, given that the lease is likely to prohibit the tenant from taking out its own buildings insurance. This issue will be particularly significant if the tenant has borrowed money to pay the premium.

The tenant will primarily be concerned to be able to influence and insist on timely reinstatement (so restoring the valuable asset that it had). It might try to secure this by being a joint insured, but this is not often agreed by the landlord. Instead, the tenant should ensure the lease is drafted to:

1 Oblige the landlord to provide adequate insurance cover on reasonable terms.

2 Oblige the landlord to make claims on the insurance policy and to repair and reinstate (not merely lay out the proceeds of insurance in reinstatement), so that the landlord will take the risk of the insurance proceeds being inadequate and make up any shortfall out of its own funds (see Landlord's obligation to repair and reinstate).

3 Provide for rent suspension whilst reinstatement takes place and the tenant is prevented (by the damage) from occupying or using the property.

4 Make it impossible for the insurer to exercise subrogation rights against the tenant. This may be achieved by a specific waiver of subrogation, or by agreeing to note the tenant's interest on the policy.

If reinstatement is impossible or takes too long, then the tenant may want the right to break the lease (and be free to organise alternative accommodation). Alternatively, if the rent payable under the lease is only a ground rent, for example, the tenant may take the view that it is worth continuing the lease so that landlord is forced to buy the tenant out if it wants to redevelop the land.

If reinstatement does not take place and the lease has a capital value the tenant will also want to secure payment to it of the insurance proceeds (or a significant part of these) as part compensation for the loss of the tenant's investment. This may be achieved by an agreement that the tenant should be a joint insured (since an insurer must involve all insureds in the settlement agreement and pay out). Alternatively the landlord may simply covenant to divide the insurance proceeds between itself and the tenant in such circumstances (with a reference to an independent arbitrator if the relative shares are not agreed).

In either case, the divided insurance proceeds may not equal the value of the "lost" investment. Where reinstatement is not possible, the amount paid out will not necessarily be benchmarked to the reinstatement cost or value. Instead the insurance proceeds may be paid out on the fall back general "indemnity" principle, which means they are calculated by reference to the value of the building materials that the landlord has lost in the destruction (for example, bricks, steel, roofing materials). The insurance proceeds will not be geared to the market value of the interests in the property held by landlord and tenant before the destruction (which are in the aggregate likely to be far higher than either reinstatement cost or indemnity cost)

The tenant should always consider arranging business interruption insurance so that it will be able to relocate and trade from different premises if it cannot operate from its original, damaged, property.

This is particularly necessary if the tenant cannot immediately terminate the lease of the original property. Business interruption insurance will cover the cost of moving the business to temporary accommodation, including the associated legal costs, new stationery, removal costs and some fitting out works.

If the tenant insures

Unless the landlord has charged its reversionary interest and needs to comply with the lender's insurance requirements, the landlord may be happy for the tenant to insure in the situation where each of the following apply:

1 The tenant occupies the entire building.

2 The lease is granted for a premium, at a nominal rent and for a long term.

3 The lease imposes all reinstatement and repairing obligations on the tenant and requires the tenant to deliver the building back to the landlord at the end of the term in a proper state of repair.

In this situation, the landlord can rely on the tenant's obligations to protect the value of the landlord's long term investment until the lease expires. The landlord may still require the insurance to be in the joint names of the landlord and tenant or may want to have its interest noted on the tenant's insurance

A lease may be silent on the question of insurance, leaving insurance to the tenant's discretion. If this is so, the landlord will have no protection in the event that the property is damaged, the tenant defaults on its repair obligations and the tenant proves to be of no financial substance.

Joint insurance

Joint insurance in the names of both the landlord and the tenant is not common. This is principally because it is a nuisance for the landlord making a claim. The tenant must be involved in agreeing the payout and receiving payment, and the landlord loses control of the insurance claim. This can be a particular problem in a multi-let building where there will be more than one tenant: if each tenant were jointly insured, there would be many different parties involved in the insurance negotiations.

Where joint insurance is agreed (because both the landlord and the tenant have a capital interest in the building), the landlord and tenant will need clear rules detailing disclosure and, most importantly, how any proceeds of an insurance claim might be split between the parties in the event that the proceeds are not used to reinstate the building following damage or destruction.

Where joint insurance is agreed (whether true joint or composite insurance), the landlord may wish to write the policy not only in the names of the landlord and the tenant, but also anyone else reasonably specified by the landlord. This allows the landlord to add on its mortgagee and other tenants to the policy as joint/composite insureds at a later date.

Noting

Noting means that the insurer puts a note on the insured's policy to record the fact that another party has some interest in the property and should be kept informed of any claim or any event affecting the

status of the insurance. Noting may be done generically (for example, all tenants in the building are noted as a class) or specifically (the individual tenant's name is noted).

There have been some suggestions that noting an interest on an insurance policy creates joint insurance, but this is not generally accepted. It is best to assume that noting has no legal effect. The fate of the parties whose interests are noted follow the fortunes of the insured. If the policy becomes void, for example, the parties whose interests are noted have no indemnity. Noting should mean that the person whose interest is noted is kept informed if certain things happen that affect the insurance policy, but it is prudent not to rely on this. There does not seem to be any redress if the insurance company does not give the notifications.

Subrogation

Where an insurer has paid out money to an insured, the common law rules on subrogation allow the insurer to recoup all or some of that money from any third party who caused or contributed to the loss. The rules on subrogation mean that once an insurer has paid out under an insurance contract, the insurer can "step into the shoes" of the insured and acquires the following rights:

1 The right to use the insured's name to proceed against any third party who was responsible for causing the loss.

2 The right to claim from the insured any sums received by way of compensation from that third party.

Subrogation can cause a problem in the context of leasehold property. Where the landlord insures at the tenant's expense and structures the lease so that in effect the insurance is for the joint benefit of the landlord and the tenant, subrogation would allow the insurer to sue the tenant for the cost of reinstatement where the damage was caused by the tenant's fault. Assuming that the tenant has not caused the damage maliciously, subrogation in these circumstances leaves the tenant in a difficult position. It cannot insure to protect itself against its own negligence or misfortune, must pay for insurance from which it is intended to benefit and also pay for the damage if a subrogation claim is made against it. Subrogation can effectively negate the benefit of insurance for which the tenant has paid.

For commercial property, the insurance policy may contain a generic waiver by the insurer of its subrogation rights against tenants.

In the absence of a generic waiver, the tenant may try to negotiate with the landlord to secure a specific waiver by the insurer of the insurer's subrogation rights against that tenant. Even if the landlord can secure this from its current insurer, it will not be able to dictate that future insurers will do likewise. The landlord should, therefore, avoid any obligation to secure such a waiver.

The obligation to insure

Should not be dependent on the tenant paying for insurance

Should not be absolute. Exclude where it is beyond the landlord's control and may be subject to any exclusions limitations conditions and excesses imposed by the insurer and/or where it is not available eg terrorism or flooding

Should set out clearly what is to be insured and to what value. Eg the premises, the building, the estate/centre, contents, business interruption, public liability, plate glass, loss of rent, mechanical breakdown of plant and equipment, tenant's fixtures and fittings, alterations and improvements

Insurance risks

Insurance is taken out to cover the loss caused to the insured property by such insured risks as are agreed between the insurer and insured.

There may be a tension between the landlord and tenant over what risks are covered because of the cost implications. In practice, however, most landlords and tenants will want all the "usual" risks covered, and the cost of the insurance is then passed to the tenants through the insurance rent or service charges.

It is common to require the insuring party (landlord or tenant) to insure against a list of risks set out in the lease. Typically, a definition of Insured Risks might read:

"Insured Risks: fire, lightning, explosion, impact, earthquake, storm, tempest, flood, bursting or overflowing of water tanks or pipes, damage to underground water, oil or gas pipes or electricity wires or cables, subsidence, ground slip, heave, riot, civil commotion, strikes, labour or political disturbances, malicious damage, aircraft and aerial devices and articles dropped accidentally from them, and such other risk against which the Landlord may reasonably insure from time to time, and Insured Risk means any one of the Insured Risks."

Some leases may list terrorism as an Insured Risk. Some do not: they view the risk as the fire or flood or explosion and the cause of that as terrorism. Should terrorism cover once more become difficult to obtain or prohibitively expensive, the landlord can always invoke the protection of that part of the insurance clause which excuses it from insuring where cover is impossible or only available on unreasonable terms.

So long as the insuring party has an obligation to insure against the primary important risks, it is generally acceptable to allow the insuring party to insure against any other risks that they may reasonably wish to cover. This gives the insuring party the flexibility to add risks to reflect changes in insurance practice, circumstances likely to lead to damage and the requirements to have a block policy that might cover a portfolio of properties, some of which may have specific requirements for insurance risks covered.

The Pool Re reinsurance scheme covers damage to commercial property and/or consequential business interruption, caused by any risk (except war and hacking and virus damage to computer systems) resulting from an Act of Terrorism (as defined). The terrorism cover offered to the landlord by its insurer may mirror this reinsurance cover, but this is not inevitable. The insurer may offer wider or narrower terrorism cover.

Terrorism cover is an extension of the cover provided by a standard buildings insurance policy. It cannot be obtained as a standalone policy from Pool Re.

An insured who selects their insurance with an insurer that reinsures with Pool Re will be bound (by the rules of the Pool Re scheme) to insure all its commercial properties against terrorism with Pool Re

insurers (although different properties can be so insured through different Pool Re insurers). It will have to warrant that it has done so.

Reinstatement value or reinstatement cost

The parties to a lease need to be clear on the amount of cover. Real property is normally insured for an amount equal to either the reinstatement value or the reinstatement cost. The difference between is as follows:

Reinstatement value is the value selected by the insured. It should be based on the estimated amount that it would cost to rebuild the property so that it is exactly the same as it was before it was damaged or destroyed, or as near as reasonably possible.

Reinstatement cost is the actual cost of reinstatement of the property, whatever that turns out to be. The insured does not have to provide a value. The policy simply covers the actual cost of reinstatement. This means that the premium may be greater than the cover for reinstatement value. The parties must decide whether this is reasonable in the circumstances. Almost certainly, reinstatement cost insurance will require actual reinstatement as a condition of any insurance money being paid out.

The reinstatement cost or reinstatement value will almost certainly be less than the market value of the property.

This is important to understand and is of particular significance if the insured property cannot be reinstated for whatever reason. In such circumstances, the insurer may not simply pay out a cash sum equivalent to the anticipated cost of reinstatement. Where the sum received is less than market value it may not be sufficient to:

1 pay off any loan secured on the property; and/or

2 buy an equivalent interest in an equivalent property.

Tenant's obligation to pay the insurance cost

Where the landlord insures, whether in the landlord's sole name or in the joint names of the landlord and the tenant, the landlord will want to pass on the full cost of insurance to the tenant or tenants in occupation of the building. This will include the cost of the following:

1 Premiums.

2 Fees and other expenses.

3 VAT

4 Excess payments due in respect of any insurance claim.

The tenant should be obliged to pay these sums on demand. Each of these sums, except the excess payments, will typically be expressed to be paid as "insurance rent".

The landlord is not obliged to procure insurance at the cheapest cost, (Havenridge Limited v Boston Dyers Limited (1994)).

What proportion?

If the tenant is to pay a proportion of the premium, the parties need to decide whether this is a fixed percentage or a fair proportion. The choice is up to the parties, but they should bear in mind the following:

1 A fixed percentage gives the parties a clear calculable figure up front. The lease should ideally indicate:

2 how that percentage is calculated (perhaps by reference to the percentage of the landlord's building that is demised to the tenant); and

3 whether that percentage can be changed if circumstances change and, if so, how.

A fair and reasonable proportion is more flexible but time could be spent arguing what that proportion should be. The landlord may want to include further provisions to make it clear that the proportion is ultimately determined by the landlord, although this may be opposed by the tenant. The parties should avoid too complicated a mechanism for determining the proportion. If this is a problem, it will generally be preferable to go for a fixed percentage.

Discounts and commission

It is for the parties to agree who should have the benefit of any discount or commission that the landlord receives for arranging the insurance.

The Lease Code 2007 only requires a landlord to disclose any commission it receives, not necessarily to distribute that commission between itself and its tenants.

It may be reasonable for the landlord to have the full benefit of any commission or discount if:

1 The landlord does work on behalf of the insurer in terms of claims handling or risk management.

2 The landlord's "buying power" ensures a lower premium than that which the tenant might have been able to negotiate.

3 The landlord insures using a block policy, which a commercial landlord with a number of properties is likely to do. The way that a block policy generally works means that, for a premium, the landlord can insure a portfolio of properties up to an agreed combined value. Properties are added to, and removed from, the list but the premium does not change. It may not be possible (or appropriate) to attribute any part of any commission payment to a particular property.

The tenant may argue that the landlord has the "buying power" only because it is the landlord that tends to arrange the insurance in its own name. The tenant is being asked to reimburse a cost and, arguably, that should be the actual cost to the landlord.

Expressed as insurance rent

The sums that the tenant is required to pay the landlord in respect of insurance are generally expressed to be "insurance rent". This will include the premium and may also include fees and other expenses and VAT, but not usually any money due in respect of excess payments.

The reason for reserving these sums as rent is that if these sums are not paid, they can be treated as rent for the purposes of recovery. Also the landlord can forfeit the lease for non-payment of insurance rent without having to serve a notice under section 146 of the LPA 1925.

Repairs and reinstatement

Both the landlord and the tenant are primarily concerned that if their property is damaged, it is repaired or reinstated as quickly as possible. The obligations on each party to repair and reinstate must be considered alongside the insurance obligations, because the two sets of obligations are so closely related and it is imperative that the obligations fit together properly.

If the landlord is obliged to reinstate (rather than simply apply the insurance monies in reinstatement) then it will have to do so regardless of the shortfall, and it will be the landlord that will be out of pocket.

If the landlord is obliged only to apply the insurance monies in reinstatement, it is likely that reinstatement will not have been completed. The tenant may in practice have to provide funds to complete the reinstatement, or sue the landlord (for failure to insure correctly, for example, by underestimating the sum insured) and apply the damages obtained in completing the reinstatement.

If the lease provides that the tenant must reinstate and the tenant does not do so within a reasonable period, acceptance of rent may prevent the landlord from forfeiting the lease for that failure.

Rent is defined in leases to include the basic rent for the demised premises and other expenses such as insurance rent and service charges. Loss of rent insurance is primarily focused on the basic rent because it is the loss of this income that landlords are primarily concerned to address.

There may be circumstances where the parties want to widen the loss of rent insurance and rent suspension provisions to cover service charges. This will be where the service charge will include significant expenses that will still be incurred even if the building is destroyed. This may be so in relation to industrial or business parks or retail centres where common areas still require maintenance and repair. If the parties intend to extend loss of rent insurance and rent suspension to service charges, the provisions of the lease should be checked carefully.

Rent suspension

If the demised premises, or the means of access to them where this is over the landlord's property, are damaged or destroyed so that they are unusable by the tenant, the tenant will not want to pay rent. This is generally covered by a rent suspension (cesser) provision, under which the tenant is relieved of the obligation to pay rent for the duration of the rent suspension period, and the landlord takes out loss of rent insurance to cover that period. During the rent suspension period, while the tenant is not paying rent, the landlord will receive an amount equal to the rent through its loss of rent insurance.

The loss of rent insurance cover and the rent suspension provision should both cover the situation where there is a rent review during the rent suspension period, so that the landlord can recover the increased rent following a review. The tenant will need to ensure that it will still have full rights to negotiate any rent review that occurs during a rent suspension period.

The tenant will also need to make sure that if the rent suspension period kicks in during any rent free period, the tenant will not be disadvantaged. If, for example, the tenant has negotiated a six-month rent free period and the property is burnt down in the first month of occupation, the rent suspension provisions will mean that the tenant need not pay rent until the property is reinstated. For at least part of that time, if the property had not been damaged by fire, the tenant would not have been paying rent anyway because of the rent free period. By the time reinstatement is complete, it is likely that the original rent free period will have expired. If rent starts immediately following reinstatement, then the tenant will not have had the benefit of the intended six months occupation rent free.

To avoid this, the tenant needs to make sure that on completion of the reinstatement and the end of rent suspension, the tenant should have the benefit of the unused balance of the rent free period before the liability to pay the rent commences.

Termination in the event of damage or destruction

The traditional approach taken in leases on termination rights is to provide two opportunities to terminate:

1 A right for the landlord only to terminate where the demised premises have been destroyed or damaged so as to be unfit for occupation and use and the landlord cannot practicably reinstate within an agreed period (which should not exceed the rent suspension period and may be significantly less).

2 A right for the tenant (and sometimes the landlord too) to terminate the lease if the landlord has not completed reinstatement by the end of the rent suspension period. This effectively gives the tenant a sanction it can apply against a landlord that is being slow with reinstatement.

The landlord will want a clear statement in the lease that on termination of the lease, all insurance monies will belong to the landlord. This is a point for the tenant to negotiate, particularly where it has paid a premium for its lease. The insurance monies are unlikely to be sufficient to compensate both the landlord and the tenant for their respective capital investment in the insured premises

SERVICE CHARGE

Function of the service charge

A service charge is a mechanism contained in a lease of a centre/building/estate that allows the landlord to recover its running costs from the tenants

An "institutionally-acceptable" lease of a Centre must contain a service charge so that the costs of running the Centre can be wholly recovered from the tenants, leaving the landlord with a "clear" rent. This means that the landlord can keep the whole of the rent (subject to tax) and is not obliged to spend any part of it on the maintenance and other expenses of the building.

The landlord regards the primary purpose of the service charge provisions as enabling it to achieve a "clear" rent. The landlord therefore wants all expenses to be paid by the tenant.

The tenant regards the primary purpose of the service charge provisions as setting out the landlord's duties in relation to the services. The tenant therefore wants to remove from the service charge provisions all those items that it thinks should be paid for by the landlord

Service charges for residential property are subject to extensive legislation. At present, there is no statutory intervention with service charges for commercial property (other than the six month time limit on claiming against a former tenant under the LTCA 1995, which applies to all rents). Accordingly, in relation to a lease of non-residential property, the parties are free to negotiate whatever service charge provisions they wish. The ultimate form of service charge clause will depend on the bargaining power of each party to the lease.

There are particular issues where premises comprise partly residential and partly commercial premises.

Although there is no statutory control over service charges in the non-residential sector, there is a voluntary code of practice.

Main elements of a service charge clause

The provisions of a basic service charge clause in a commercial lease can be divided into the following four elements

1 A definition of the services for which a charge can be made

Normally divided into those that the landlord covenants to provide eg repair of the main structure and roof; and those it may (but is not under an obligation to) provide eg promotions and advertising

The definition of services may include a sweeper clause, allow the landlord to vary the services, exclude the cost of certain services, make provision for certain income to be credited to the service charge account eg car park income

2 The tenant's obligation to contribute to the cost of providing the services, including the method of calculation of the tenant's proportion of the overall cost of the services

There may be caps of the amount payable by a tenant. The method of calculation may be by fixed percentages, floor area, weighted, rateable value

3 The landlord's obligation to provide the services

This may be in the service charge clause or landlord's covenants. The obligation may be best, all reasonable or reasonable endeavours. There may be exclusions of liability where beyond the landlords control eg due to strikes or until the tenant has notified the landlord in the case of wants of repair

4 The mechanics of the service charge including provision for preparation of the service charge accounts dates for payment and provisions in case of dispute

RICS Professional Statement

Service charges in Commercial Property 1st edition September 2018 is effective for all service charge periods commencing from 1 April 2019. It replaces the existing Service Charge Code

The Statement includes mandatory requirements and best practice. RICS expects that its members engaged in activity relating to service charges will comply with the whole document. It is not acceptable simply to comply with the mandatory obligations and, if members depart from the best practice requirements, they should do so only for justifiable reasons.

Importantly, the Statement cannot override the terms of an existing lease. Nor will a failure to comply with the Statement negate or limit a tenant's liability to pay service charge under the lease.

Examples of the mandatory requirements are:

1 All expenditure that the owner and manager seek to recover must be in accordance with the terms of the lease.

2 Owners and managers must seek to recover no more than 100% of the proper and actual costs of the provision or supply of the services.

3 The owner and manager must ensure that service charge budgets, including appropriate explanatory commentary, and an approved set of service charge accounts showing a true and accurate record of actual expenditure, are provided annually to all tenants.

4 A service charge apportionment matrix for their property must also be provided annually to all tenants.

5 Service charge money must be held in one or more discrete bank accounts.

It is not all landlord's obligations - where acting on a tenant's behalf, practitioners must advise their clients that, if a dispute exists, any service charge payment withheld by the tenant should reflect only the actual sums in dispute.

RICS members and regulated firms must comply with the mandatory obligations

Examples of the core principles are:

1 All costs should be transparent so that the parties are aware of how they are made up

2 Management fees should be on a fixed-price basis with no hidden mark-ups.

3 The basis and method of apportionment of costs should be demonstrably fair and reasonable.

4 When issuing statements of accounts and/or certifying expenditure, managers should do so in a non-partisan spirit, acting as experts.

5 In addition to the manager's certificate, annual statements of expenditure should be supported by an independent review of the service charge accounts.

6 The Industry Standard Cost Classifications should be used in reporting budget and actual expenditure.

7 All new leases should make provision for either party to require the resolution of disagreements through alternative dispute resolution.

8 Controversially, managers should issue budgets to tenants, including explanatory commentary and apportionment matrix, at least one month prior to the start of the service charge year.

9 Detailed statements of actual expenditure, together with accounting policies and explanation, should be issued within four months of the service charge year-end.

Some of these Core Principles will impact on lease drafting and in particular exclusions from what should be charged to tenants through the service charge.

So according to the Principles tenants should not be charged for:

1 Initial costs incurred in relation to the original design and construction of the fabric, plant or equipment.

2 Any improvement costs above the costs of normal maintenance, repair or replacement. However, service charge costs may include enhancement of the fabric or plant, where such expenditure can be justified on a cost-benefit analysis.

3 Future redevelopment costs.

4 Costs and fees relating to the owner's investment interest, such as asset management and rent collection and matters between the owner and an individual tenant.

5 Costs attributable to void premises and the owner's own use of the property.

Finally, Appendix D of the Statement contains commercial property service charge handover procedures, which will be helpful in a purchase situation.

TYPES OF LEASES

Headleases and Underleases

A headlease is a lease granted out of the freehold and an underlease is one granted out of a headlease.

As a matter of law, there may be any number of underleases sometimes described as sub-underleases and sub-sub-underleases and so on but each underlease must expire before the one out of which it is granted. If it does not, then the grant operates as an assignment not as an underlease.

Fixed Term Leases

A fixed term lease is one that is granted for a stated number of years. A whole number of years is not necessary for example a term of five years and six months is still a fixed term of years.

Leases of commercial property are commonly granted on the basis of a fixed term. A fixed term lease of a commercial property will generally be a business tenancy within the LTA 1954 as long as a tenant is in occupation unless it has been contracted out.

If granted for more than three years the lease must be by deed.

Periodic Tenancies

A periodic tenancy is one that runs by reference to a stated period (a week a month a year) until it is terminated by either party giving notice.

The express terms of the tenancy may set out the length of notice to be given. In the absence of express provisions, the common law provisions will apply.

To end the yearly periodic tenancy six months' notice must be given expiring at the end of the first year of the tenancy or any other year of the tenancy.

If the periodic tenancy is for less than a year, the length of notice to be given must correspond to the period of the tenancy. Therefore:

6 to end a weekly periodic tenancy at least a week's notice must be given expiring at the end of a week;

7 to end a monthly periodic tenancy at least a month's notice must be given expiring at the end of a month; and

8 to end a quarterly periodic tenancy at least a quarter's notice must be given expiring at the end of a quarter.

In the absence of a written tenancy agreement a periodic tenancy will usually be for the same period as that in respect of which the rent is paid. If rent is paid monthly the periodic tenancy will be a monthly tenancy.

Because each party has the right to terminate at the end of any period the tenancy satisfies the requirement for certainty of the term and a periodic tenancy is also a term of years absolute for the purpose of section 1 of the LPA in 1925.

A periodic tenancy does not have to be in writing or by deed if the tenant takes possession the rent payment period is not longer than every three years which is very unlikely and the rent is the best rent reasonably obtainable without taking a fine. This means the periodic tenancies can often arise informally or unintentionally. If a person is given exclusive possession in return for a periodic payment a periodic tenancy will generally be created.

A periodic tenancy cannot be contracted out. Therefore if a periodic tenancy is if commercial premises and a tenant is in occupation the tenancy will generally be a business tenancy and the tenant will have a right of renewal under the LTA 1954.

Tenancies at Will

A tenancy at will exists where there is a tenancy on terms that either party may terminate the tenancy at any time.

A tenancy at will can be terminated by the landlord demanding possession or by the tenant giving up possession.

No time period for the demand for possession need to be specified. The landlord may state that the tenancy is at an end and that possession is to be given back immediately. Even so a tenant at will should be given a reasonable time to vacate the property after the termination. Notice by the tenant purporting to terminate the tenancy at will without it also giving up possession is not enough to terminate the tenancy.

A tenancy at will is essentially a personal relationship between the landlord and tenant and is generally regarded as a bare tenure and not an estate in land.

A tenancy at will is determined by a transfer of the reversion or by the death of either party if an individual. A tenancy at will cannot be assigned by the tenant.

Tenancies at will are often used where the parties are negotiating for a lease to be granted for a fixed term.

Tenancies at will are not business tenancies within the LTA 1954.

Reversionary Leases

A reversionary lease is in strict technical terms one that takes effect when an existing lease has expired. However the expression reversionary lease can also mean any lease where possession is delayed to a future date.

A reversionary lease will be void if it is granted for a term that will not begin for more than 21 years after the date of the lease.

The grant of a lease that takes effect in possession more than three months after the date of the grant is compulsorily registerable at the Land Registry however long or short the term of the lease.

A reversionary lease is not the same as a lease of the reversion which is also known as a concurrent lease or an overriding lease.

Business Tenancies and Contracted Out Leases

Business tenancies are leases that fall within Part 2 of the LTA 1954.

If a lease is a business tenancy this has important implications for both the tenant who has certain statutory rights to remain in the property and for the landlord who may not be able to recover possession of the property at the end of the contractual term.

If a tenancy is a business tenancy within the LTA 1954 then:

1 The tenant need not vacate the property on the contractual expiry date of the lease. Instead a continuation tenancy will automatically arise under section 24 of the LTA 1954 also known as the tenant holding over.

2 The tenant has a right to renew the tenancy at the end of the contractual term although this may be defeated by the landlord in certain circumstances.

3 If the tenant does not renew assuming the tenant remains in occupation at the end of the contractual term the lease can only be terminated in accordance with the statutory procedures. Until so terminated the tenant may remain in occupation.

4 The tenant has a right in certain cases to compensation for improvements it has carried out to the property if the landlord defeats the tenant's renewal rights.

5 If the tenant wants to enter into an agreement to surrender the lease the statutory notice procedure must be followed for the agreement to be valid.

Institutional and FRI Leases

An institutional lease is the expression commonly used to describe a lease that is acceptable to a landlord that is an institution, typically a pension fund or insurance company.

Institutional landlords own property for investment and/or business purposes and require the property to provide a secure and predictable income. To achieve this objective an institutional landlord will want to make sure that all the costs associated with the property will be paid by the tenant and that he will not have to pay for repairs or deduct business rates or any other expense from the rental income. The institutional landlord wants the rent it receives to be pure profit often referred to as a clear rent.

In terms of the lease documentation the requirement for a clear rent translates into a lease that:

1 will have an upwards only open marker rent review to protect the landlord's income stream and the investment value of the lease;

2 will be a full repairing and insuring lease (FRI lease). This means that:

(a) all the repairing liabilities are borne by the tenant with the cost of repairs to common parts being recoverable from the tenant through the service charge; and

(b) the costs of insuring the property and any building of which the property forms part are recoverable from the tenant.

Traditionally an institutional FRI lease was granted for a term of 25 years although in some sectors the usual term would be even longer. This was the norm in the 1980s but lease terms have become much shorter with the average length now being around five years.

Commercial Leases

The expression commercial lease describes a lease of a property that is used for a commercial purpose. Typically the expression will be used to describe a fixed term lease of commercial premises

which is either a business tenancy within the LTA 1954 or has been contracted out. It may be an institutional FRI lease but not necessarily so. The Lease Code 2007 will be relevant in the lease and the negotiations leading up to it but the lease will not necessarily be compliant.

Agricultural and Residential Leases

Agricultural and residential leases have been heavily regulated over the years.

Agricultural leases are governed chiefly by the Agricultural Tenancies Act 1995 and the Regulatory Reform (Agricultural Tenancies) (England and Wales) Order 2006.

Regulation of residential leases is many and varied and includes statutory security of tenure rights to buy implication of terms and rights to enfranchisement and renewal.

New and Old Leases

The LTCA 1995 introduced a distinction between what are now referred to as old and new leases.

A lease is a new lease for the purposes of the Act if it was granted on or after 1 January 1996 unless it was made pursuant to either:

1 an agreement entered into or an option or right of first refusal granted before 1 January 1996; and

2 a Court order made before 1 January 1996.

Anything that is not a new lease is an old lease.

The main difference between old and new leases relates to the liability of the original tenant:

1 Old leases – the original tenant remains liable throughout the term of the lease even if it has assigned its interest (privity of contract applies);

2 New lease – the original tenant and each subsequent assignee will generally be released from liability on assignment.

Leases by reference to type of rent

Leases are often described by reference to the way in which the rent is calculated and paid.

Ground Rent

A ground rent is a rent that reflects only the value of the ground and not of any building on it. For example when a tenant has built the building it will as a starting point pay only a ground rent.

A ground rent will also be payable where a long lease is granted at a premium for example 125 year lease of a residential property.

Ground rents ae often set at a fairly nominal level.

Rack Rent

A rack rent is the full open market rent of the property. It is the most that can be obtained in the market (the going rate). Most leases of commercial property are granted at rack rents. The best open market rent review clause is a rack rent.

Turnover Rent

In these leases the rent is calculated as a percentage of the tenant's turnover of the premises.

Turnover rents are fairly common in the retail sector. They enable a certain amount of risk sharing between the landlord and the tenant. There are relatively high compliance burdens in relation to SDLT and LTT in connection with these leases. The results are a significant management burden on the tenant to demonstrate turnover to the landlord.

RPI Rent

An RPI rent is a rent which increases in line with the retail prices index. RPI leases are common in some European jurisdictions but less so in England and Wales. Although both landlord and tenant benefit from not having to spend time and money negotiating and settling open market rent reviews which party benefits as to the level of rent depends on how open market rent inflation or deflation compares with the RPI.

Side by Side or Geared Rent

Side by side rent or geared rent (as it is otherwise known) is commonly seen in a joint venture context where the head landlord often the local authority lets land to a developer investor and will then develop and underlet the land. The head landlord will typically receive the basic ground rent and a share of the income from the underleases. This structure has become less attractive because of the financial and compliance burdens of SDLT and LTT.

Operating Leases and Finance Leases

Accounting standards distinguish between finance leases and operating leases:

1 A finance lease substantially transfers to the tenant all the risks and rewards of ownership of the property which is the subject of the lease. In the accounts of the landlord and the tenant such leases are capitalised which means that an asset value and a liability value of the lease are calculated and stated in the balance sheet of the landlord and the tenant respectively.

2 An operating lease does not transfer substantially all the risks and rewards of ownership to the tenant. In accounting for an operating lease the leased property is treated as an asset of the landlord. The Tenant simply recognises the rental payments as an expense on its profit and loss account. A rack rent lease will typically be treated as an operating lease. This is generally seen as preferable to the tenant because it would not want the liability of a finance lease appearing on its balance sheet.

Licences to Occupy

A licence to occupy is by definition not a lease.

Richard Miles

Gowling WLG (UK) LLP

1 November 2018