

## Your Lease - What does it all mean?

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Your lease is a substantial document. What follows is an attempt to explain some of the standard terms of a lease. It does **not** replace you reading it, in full, and satisfying yourself that you understand it and agree to each of the provisions. We will advise you separately of some of the ways in which your lease may depart from the description here. You must ask if you have any doubts.

Your lease may not include all these clauses, and they may not be in this order.

This document is based upon a Code of Practice for Commercial Property Leases.  
Due acknowledgement is given.

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1. Period of the Lease
  1. The lease will usually be for a fixed number of years agreed by you. It will run from a date in the lease which will not usually be the date the lease is signed.
2. Right to Break
  1. Some leases contain a clause (called a 'break clause') giving one or both parties a right to end the lease before the end of the term. Break clauses are often limited to defined circumstances e.g. when the landlord wishes to redevelop, or after the outcome of a rent review. The right to break is often conditional upon an absolutely strict performance of the obligations in the lease. Break clauses have strict timetables for serving notices. There may also be penalties imposed for exercising the break. A landlord seeking to break a lease may also have to comply with Part II of the Landlord and Tenant Act 1954.
3. Repossession
  1. The lease will contain a clause allowing the landlord to repossess the property if the tenant is late paying the rent, or breaks any of his obligations or becomes insolvent. The operation of forfeiture clauses requires technical legal knowledge and should not be undertaken without professional advice.
  2. When a landlord seeks forfeiture the tenant may seek to retain the property despite the breach. Tenants who are threatened with repossession or whose property is actually forfeited will need specialist advice if they wish to keep or regain possession.
4. Renewal under the Landlord and Tenant Act 1954 Part II
  1. Under this Act business tenants are given some security, in the form of a new lease at an appropriate rent to follow the current tenancy.
  2. A landlord can sometimes oppose a new tenancy, for example, a history of non-payment of rent or other breach of obligation; the provision of alternative accommodation; redevelopment or substantial reconstruction; or the landlord's wish to carry on its own business in the property. Disputes about new tenancies that cannot be settled by agreement are referred to the Court, but the Court has power to refer the question to an

arbitrator if the parties agree (High Court) or at the request of either party (County Court).

3. The parties can contract out of the provisions of the Act regarding security of tenure and rights of renewal with the Court's approval before the lease is granted.
4. Guidance on the workings of this Act is contained in the Office of the Deputy Prime Minister's 'Guide to the Landlord and Tenant Act 1954' ([www.communities.gov.uk/documents/citiesandregions/pdf/131176.pdf](http://www.communities.gov.uk/documents/citiesandregions/pdf/131176.pdf))

## 5. Rent

1. The lease state will how much is payable, and when, and what might happen if payment is late, e.g. a high rate of interest may be charged or the lease may be taken back or 'forfeited'
2. Sometimes a 'headline rent' is mentioned when discussing lease terms. This means the rent reserved in the lease, but ignoring any incentives for the tenant such as rent free periods.

## 6. Rent Review

1. Leases normally contain detailed provisions for how the rent is to be reviewed. Generally these will not refer to the performance of the tenant's own business. The new rent is more likely to be the letting value of the property in the open market with vacant possession at the date of review. Although there are exceptions, the figure is normally arrived at by looking at recent open market lettings, rent reviews and lease renewals of similar properties in the area let on similar terms.
2. These transactions are called 'comparables'. Appropriate adjustments are made to comparable rents to reflect the exact circumstances of the property or the lease terms for which the review is being carried out.
3. While the rent should be agreed if possible, it is important to provide carefully in the lease for how the rent will be decided if the parties cannot agree. Solicitors and property advisers will advise on such questions as to whether the lease should provide for an arbitrator to be appointed in the event of a disagreement, or an independent expert, or whether alternative dispute resolution procedures (ADR) should be considered (see section 16 below).
4. The following are examples of ways in which the rent can be revised:
  - i. 'Upward only'

The rent cannot be reduced below the rent already being paid but either increases or stays the same depending, essentially, on how much the property could be let for at the date of review. This is commonly called an 'upward only' clause.

ii. Minimum base rent

The rent cannot fall below the rent first payable at the beginning of the lease but subject to that can go up or down depending on the market value at the time of the review.

iii. Open market value

The rent goes up or down (or stays the same) depending only on the market value at the review date.

iv. Turnover rent

A 'turnover rent' is normally either a combination of a base rent and an element reflecting the tenant's turnover, or a simple percentage of turnover.

v. Index linked

The rent is 'index linked', i.e. normally it changes from year to year in line with an agreed index such as the Retail Price Index.

vi. Fixed increases

Here the lease simply sets out when and by how much the rent will increase.

5. Not all of these alternatives will be available in every case. Choices available will depend on the strength of the tenant's financial standing, the prevailing rental market, the length of lease available and any other particular circumstances of landlord and tenant or the property.

7. OUTGOINGS OR ADDITIONAL COSTS

1. The costs incurred by the owner (e.g. for repairs, rates and insurance premiums) are usually charged to the tenant in addition to the principal rent, either individually or by way of a 'service charge', especially in a building in multiple occupation.
2. Several leading property industry and professional bodies have agreed a Guide to Good Practice in relation to service charges which is available free

8. REPAIRS

1. The standard of repair which has to be achieved is judged by the wording of the lease, and the general age, condition, quality and location of the property. More specific words

like 'rebuild', 'renew' and 'replace' are sometimes used which may make the obligations more onerous.

2. When a tenant takes on an obligation to keep property in repair, that will include an obligation to remedy any disrepair existing at the beginning of the term as well as disrepair occurring while the lease is running. There is often a requirement on the tenant to redecorate periodically inside and out.
3. The landlord may want to include a power to carry out the repairs at the tenant's cost if the tenant fails to do so.
4. Where the tenant is required to carry out initial improvements and repairs there may be implications for tax and rent review, and professional advice should be sought.

#### 9. INSURANCE

1. Most leases state who has to arrange insurance and who pays the premiums. A provision may be agreed which stops the insurance company from taking over the landlord's right to sue the tenant, where the tenant's negligence has caused the damage, e.g. by fire, and the insurance company has paid the claim.
2. Where the landlord insures, the lease usually provides for payment of rent to cease ('abate') until the property has been reinstated after damage by insured risks. Sometimes the period of abatement is limited to the period for which the landlord is insured for loss of rent (e.g. three years).
3. Tenants should take out their own insurance against loss or damage to their contents as well as business insurance (loss of profits etc.) and any other consequential risks not covered by the landlord's policy.

#### 10. VAT

1. Depending on the VAT status of the particular property, the tenant may be expected to pay VAT on rent and on costs incurred by the owner and charged to the tenant. A property which was originally not subject to VAT may become so for reasons beyond the tenant's control and professional advice may be needed.

#### 11. Assignment and Subletting (or Alienation)

1. There are two main ways in which the tenant may pass on the lease obligations to a third party:
  - a. 'assignment' (selling, giving away or paying someone to take over the lease);
  - b. 'subletting' (remaining as tenant of the lease with the lease obligations, but granting a sublease to another tenant who undertakes the same or similar obligations).

2. Leases usually restrict to some extent the tenant's right to assign the lease to a new tenant, or to grant a sublease or share the premises. The assignment of only part of the premises is usually absolutely prohibited.
3. Often the lease provides that the tenant has to obtain the landlord's consent to a transfer or a sub-letting. This consent will usually depend on the potential assignee passing some form of test by meeting certain conditions. In some cases the tests take the form of the landlord exercising a subjective judgement and in most of these cases the landlord's consent must not be unreasonably withheld and the landlord cannot demand money (apart from reasonable expenses) as a condition of granting it. In other cases the landlord will have set objective tests where the landlord has no discretion, the tests simply being met or not. The reasonableness of these latter tests cannot be referred to the courts.
4. If the landlord wants to prohibit transfers, prospective tenants should think carefully before agreeing, as there will be no possibility of escaping from the obligations of the lease throughout its term unless the landlord subsequently gives consent.

## 2. Use of Premises

1. Most leases restrict the use(s) to which the premises may be put but, if the landlord does not require a restriction, the tenant is free to use the premises in any lawful way. However, many tenants and landlords find that very restrictive clauses are not in their interests. The tenant often wants flexibility and will have trouble in transferring or subletting the premises to someone in another trade or profession if the range of permitted uses is too limited. Very restrictive clauses may not suit the landlord in many cases, because they may have a depressing effect on rent at review or when the lease comes up for renewal. The landlord cannot demand a premium for agreeing to a change of use unless the lease absolutely prohibits a change of use.
2. Leases sometimes contain clauses requiring the tenant to keep the premises open for business at all times specified or at all times permitted by law, including Sundays. Failure to comply with such a clause can result in liability for damages.

## 3. ALTERATIONS

1. Most leases restrict the tenant's right to alter or extend the premises. Structural and external alterations are often absolutely prohibited, while non-structural, internal ones may be allowed with the landlord's written consent. Where consent is required the law implies that it shall not be unreasonably withheld.
2. In some circumstances, even where the lease absolutely prohibits certain alterations, it is possible to apply for a court order allowing the tenant to make alterations in the nature of improvements but the landlord can offer to make the alterations in return for a reasonable rent increase.

#### 4. GUARANTORS & SURETIES

1. The 'guarantor' (sometimes called a 'surety') agrees to be responsible for everything the lease requires the tenant to pay or do if the tenant (or any later tenant) fails to meet those requirements. Guarantors will want to negotiate an agreement that they will automatically be released from their obligations if the tenant is permitted to transfer the lease, but this is not always possible.
2. Sometimes landlords accept a cash deposit as security either with or without one or more guarantors. In this case there should be a properly detailed written agreement covering such matters as the amount deposited; whether it can vary (e.g. after rent review); who holds it (e.g. the landlord's solicitor or managing agent); and how and when moneys can be paid over to the landlord or returned to the owner, especially if there has been a change of landlord.

#### 5. PRIVACY OF CONTRACT

1. Whether or not privity of contract obligations apply to a business lease will depend on whether it was granted before or after the 1st January 1996.  
Old Leases (before 1996)
2. These have privity of contract liability but there are three important changes, described in paragraphs 15.3 to 15.5
3. From 1996, these leases are still subject to privity of contract, but the potential liability is reduced in one important respect - where the tenant's liability has increased as a result of the landlord exercising an absolute discretion to permit a change to the lease (e.g. the landlord has allowed a change of use from shop to office and there has been a consequential increase in rent), the former tenant will not be liable for that element of the liability attributable to the change.
4. The landlord must serve notice of any potential claim against a former tenant or former guarantor for rent, service charge, specified liquidated damages or interest (i.e. liabilities which can be calculated as opposed to those which cannot, like liabilities for dilapidations), within six months of the current tenant's default. Failure to do so means the landlord cannot recover that amount from the former tenant or guarantor.
5. A former tenant or guarantor who duly pays such a claim will be able to require the landlord to grant him/her an 'overriding lease'. This will enable the former tenant to reclaim control of the premises and to take action to try to mitigate any loss.

New Leases from 1st January 1996

6. Tenant privity of contract is abolished for these leases. However, an outgoing tenant can be required to guarantee its immediate assignee. The guarantee, however, can only cover the performance of the assignee and it must end at the next assignment.
  7. Landlord privity of contract can be brought to an end, but only if the tenant agrees or if the Court decides that it should.
  8. The three changes described in paragraphs 15.3 to 15.5 also apply to these leases.
6. DISPUTE RESOLUTION
1. There are two kinds of procedures - formal procedures and informal ones.

Formal procedures

2. Unless some alternative means of dispute -resolution is specified in the lease, the only formal procedure available is to take the matter to Court. The two most commonly used alternatives to proceedings in Court are: arbitration; and decision by independent expert.
3. One or other of these alternative procedures should be specified for the settlement of rent reviews which cannot be agreed. They may also be used to settle other problems as well, for example, service charge disputes or questions about repairs.
4. Awards by arbitrators and determinations by independent experts have some things in common, but in other important respects they are quite different. The main points of comparison and difference between the two are as follows:

	Arbitrator	Expert
a)	Appointed in the first place by agreement between landlord and tenant	Appointed in the first place by agreement between landlord and tenant
b)	If an appointment cannot be agreed, appointed by an independent person, usually the President of the RICS	If an appointment cannot be agreed, appointed by an independent person, usually the President of the RICS
c)	Professionally qualified in the subject matter of the dispute and skilled in arbitration law and procedure	Professionally qualified in the subject matter of the dispute with particular knowledge of the type of property and the locality
d)	is bound to decide the dispute according the evidence submitted, and is not entitled to carry out own investigations or research	Is expected to carry out own investigations. May rely upon evidence submitted by the landlord and/or the tenant but is not bound to have any regard to it
e)	Is bound to conduct a hearing at which both parties are present if either side requests one	Need not hold any hearing
f)	Must conduct the arbitration in a fair and just manner	Must act with due care and diligence but is not bound by the rules of natural justice
g)	In particular must ensure that each side has full details of the other side's case, and the opportunity to answer it in writing or orally at a hearing. An arbitrator will usually give directions at the beginning as to how this is to be achieved	Has a discretion as to whether there should be procedures for the disclosure and rebuttal of any special case advanced by landlord or tenant.
h)	Can order one side or the other to pay all or part of his and the opposing side's costs	Cannot order either party to pay all or part of his and the other side's costs unless the lease provides otherwise
i)	May be required to give reasons for decision	Usually does not have to give reasons for decision
j)	Decision may be appealed to the High Court on a point of law under the Arbitration Acts	Decision absolutely binding on all questions of fact and law unless clearly outside his terms of reference.
k)	Is probably immune from claims for damages for negligence in the conduct of the reference and his decision	May be liable in damages for professional negligence in carrying out his duties

7. Each of these formal procedures can involve landlords and tenants in considerable legal and other professional fees and costs. Informal preliminary procedures can be more economical although costs will still arise.

#### Informal Procedures (Alternative Dispute Resolution)

8. Informal dispute resolution, as between landlords and tenants, consists of the appointment of an independent person who will attempt to mediate between the parties informally to effect a compromise.
9. The appointment of an independent mediator may be made without prejudicing either side's right to resort to formal procedures if mediation fails. One option is to provide in the lease that compulsory mediation must be attempted before formal procedures are brought into play. Provision could be made for the mediator to be appointed by an independent authority such as the President of the RICS or the President of the Law Society if the parties cannot agree upon a suitable person.
10. Alternatively a mediator may be appointed by agreement between the parties or by an independent authority to deal with a particular dispute which has arisen, even though the lease does not require such an appointment to be made.
11. The mediator who consult both parties separately and advise them on the mediator's view of the strengths or weaknesses of their case, and work towards a settlement on that basis. The mediator may or may not see both parties together. Mediators should be able to keep costs down and achieve an outcome within a short time-scale and by a particular date; but if mediation fails, delay and cost will have been incurred before the formal procedures of arbitration or reference to an independent expert can be put in place.