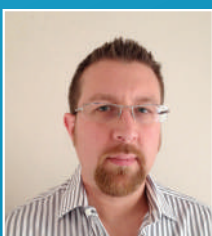


Obtaining a commercial advantage and avoiding liability

Reducing property occupier costs, avoiding unforeseen liabilities and ensuring the use of premises remains flexible to service the needs of the business (and in some cases to maximise trade) have always been vital. In an increasingly competitive and cost sensitive environment, where landlords are seeking to maximise their return from their tenants, these requirements are all the more important.

Being aware of the practical implications and allocation of liability hiding behind lease provisions is key to achieving these goals. This book explains what all businesses should be aware of, the hidden liabilities and the requirements and provisions to insist upon when taking a new lease.

This advice is designed for those engaged in negotiating, or entering into, commercial leases and focuses on the practical and real implications of lease terms (without the use of jargon or reciting the law underpinning lease terms and principles) in order to give a commercial advantage and avoid liabilities. This advice is the same advice I give to my clients every day.



About the author

I qualified as a lawyer in 2000 and subsequently became a partner specialising in commercial property, with a split specialism between commercial and retail and restaurant leases. I have worked for Plc's, private companies, hedge funds and many well known retail and restaurant chains.

A Tenant's Practical Guide to Commercial Leases By Stuart Darlington

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By Stuart Darlington

If you would like to contact me, or if you have any queries, please email me at darlingtonproperty@gmail.com

£7.99



The essential guide to the practical considerations to be taken into account when entering into, or negotiating, general commercial leases (including specific considerations relating to retail and leisure premises).

A Tenant's Practical Guide to Commercial Leases

By Stuart Darlington



First published in Great Britain in 2013 by Stuart Darlington

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Introduction

This book is a short practical guide to general commercial leases which contains commercial and practical considerations that should be taken into account when entering into, or negotiating, a new lease. It explains the practical effect of the underlying law (without a technical explanation of the laws that apply) and the main issues to look out for, in order to be able to manage the risks and costs inherent in commercial leases and to attain the required flexibility of use.

This book is for occupiers and their property managers. It explains the main areas of concern and common issues for tenants that apply to general commercial leases, including offices and retail and restaurant leases, but it does not cover residential, agricultural or other specialist leases and is not intended to be a legal guide or give legal advice.

I qualified as a lawyer in 2000 and subsequently became a partner specialising in commercial property, with a split specialism between commercial and retail and restaurant leases. I have worked for Plc's, private companies, hedge funds and many well known retail and restaurant chains.

The content of this book is the same advice I give my clients on a daily basis, practical and commercial and in plain English, without reference to legal terms or jargon.



Parties and security

2.1 The tenant

As you will know the financial standing of the tenant company is key to the landlord and will dictate whether the landlord requires any form of security for the tenant's compliance with the lease obligations. Some occupiers prefer to hold their property in specific property/lease vehicles to segregate their lease liabilities from their trading activities. However, where a shell company is used, or where the property holding company has little trading history or does not have a decent financial position, the landlord is likely to require some form of security, most commonly either a rent deposit or a third party guarantee and sometimes, less commonly, a bank guarantee.

2.2 Rent deposits

Depending on the size of the rental and other liabilities under the lease, landlords will commonly require rent deposits, the physical holding of money being preferable to having to take legal action against a guarantor for payment under a guarantee where the tenant company defaults.

Market conditions and the economy will have a bearing on the deposit sum and the perceived time it may take a landlord to re-let the property in the event of tenant insolvency. In hard times deposits are typically 6 to 12 months but in good times are often 6 months and under, however the size of the deposit sum will ultimately depend on the financial standing of the tenant and any other security requested or offered.

Often landlords will insist that the deposit includes sums equivalent to lease service charge and insurance premiums, as well as the rent, for the same period. From the landlord's perspective they don't want any short fall of any sums due. From a tenant's perspective deposits are dead money and a cash flow issue, especially as the interest earned will often be nominal.

In addition, compounding this issue, landlords will often require that an amount equivalent to VAT is added to these sums so the landlord doesn't suffer a tax shortfall either. The issue for the tenant, as well as this adding a further (at current rates) 20% to the deposit sum, is that VAT is not recoverable by the tenant unless and until the event of default and drawdown by the landlord. Until drawdown the initial payment of the deposit sum is not a tax point and VAT is not recoverable. Effectively this will inflate the deposit by 20%.

If the addition of service charges, insurance payments and a further 20% to the deposit was not enough deposit deeds commonly provide that the deposit must be topped up by a proportionate sum if the VAT rate increases and if the basic rent is increased upon rent review. So if VAT rises by say 5% and the rent is increased by 10% on review a tenant could find themselves obliged to pay in a further 15% of the deposit sum.

Rent deposits are also not fixed sums as some may think. They routinely provide for a top up and repayment of any amount withdrawn in the event of default. The deposit is therefore not capped at the original deposit but is actually an infinite rolling sum.

Unless otherwise specified the interest earned on deposits will usually be nominal. It is often a fight to ensure landlords agree to procure a commercial rate of interest as they have little incentive to seek a reasonable rate as it is not their money. However, if a deposit is sizeable, given that the deposit should remain the tenant's money until withdrawn it wouldn't seem unreasonable for at least a commercial rate of interest to be paid.

Some deposits provide that the interest is only returned when the deposit is refunded but it is not unreasonable to require that, as long as the repayment of interest does not cause the deposit fund to be below the original level, interest is returned at least annually (sometimes 6 monthly if the deposit sum is large).

Two fundamental issues then remain. The first is who owns the deposit when paid to the landlord. As it is the tenant's money it would seem an easy question but some deposit deeds provide that the sum when paid becomes the landlord's property. The result is that if the landlord becomes insolvent the deposit sums will be subsumed in the landlord's own

monies and will be lost. The tenant will be unable to recover them. For that reason care should be taken to ensure that deposits are held either on trust for the tenant or the deposit deed states that the deposit remains the tenant's money subject only to the landlord's rights of drawdown in the event of default. Even the biggest landlord is not immune from insolvency and a landlord that is large and financially stable when the lease is entered into could also sell the property to a more risky landlord during your lease term.

The second main point is when the deposit should be returned to the tenant. As well as ensuring it is repaid when the lease comes to an end or is transferred to a third party, it should be considered whether it would be reasonable for it to be returned early during the term. If the tenant's financial position improves to a stage where it would not be reasonable for a deposit to have been requested, it would not seem unreasonable for it to be returned. The two most common release tests (which must be written into the deposit deed in order to apply) are:

- Where the net profits of the tenant (less common but more beneficial is to use EBITDA rather than net profit) exceed three times the annual basic rent (and possibly service charge) for three consecutive years.
- Where gross profits exceed five times the annual basic rent (and possibly service charge) for three consecutive years.

A consideration here where the tenant is not a newly formed company is to ensure that the years used to fulfil the test do not have to start during the term so any prior years or part years where the test may have been fulfilled can be counted so as to ensure an earlier release.

It should be noted that some deposit deeds provide that the deposit is held over and applies even if the tenant transfers the lease to a third party but (as is often the case) the tenant is required by the lease to stand as guarantor to the incoming tenant until that tenant itself assigns the lease or the lease comes to an end (called an Authorised Guarantee Agreement ("AGA" for short)). In this case landlords seek to ensure the deposit is also used as security for the tenant's performance of its obligations as guarantor. However, this is now seen as unreasonable and landlords usually agree to remove this from the deposit deed but care should be taken to ensure that it is.

Finally, landlords often want to hold on to the deposit as long as possible after the release event in order to assess and cover any possible breaches. Tenants conversely want their money as soon as possible. A compromise is usually found.

2.3 Third party and bank guarantees

Less common than rent deposits are guarantees. There are two main forms of guarantee, the bank guarantee and the third party guarantee.

The bank guarantee is the least common of the two and is effectively where a bank guarantees a capped sum in the event the tenant defaults. Every bank has their own form of guarantee and banks do not usually like to agree any changes to that form, which is usually written in terms of absolutes and not always that reasonable from a tenant's perspective. On that basis they can take a while to negotiate.

Landlords usually prefer to hold the cash themselves as opposed to relying on a claim against a tenant's bank for payment and the disadvantage for the tenant is that usually the tenant is required to hold funds within a bank facility equivalent to the sum guaranteed by the bank. Therefore from a cash flow perspective this form of security does not differ a great deal from giving a rent deposit.

Third party guarantees are the more common form of guarantee. These would include director's guarantees but these are never advisable, and few people ever agree to give them in the modern age as they obviously impose personal liability upon that director which defeats the object of limited liability company status.

Most third party guarantees are given by group, or related, companies, in which case the common terms of most guarantees would not seem unreasonable. Generally they provide that the guarantor stands liable for any default or debts of the tenant under the lease as if it were that tenant itself, without any need for the landlord to first take action against the tenant. These guarantees are usually deliberately wide and uncapped making the guarantor liable for all costs, losses and expenses of the landlord involved in any breach or non payment of sums by the tenant.

However, there is one limitation upon open ended liability that often applies where the tenant becomes insolvent and the administrator or liquidator disclaims (terminates for being an onerous contract) the lease. In that case, leases often state the landlord can require the guarantor to take a new lease for the residue of the term remaining and otherwise at the same rent and terms as the terminated lease. If the landlord does not require the guarantor to take a new lease the lease may usually require the guarantor to pay all sums that would otherwise have been due for a certain period. 6 months used to be common but 12 is more recently the norm.

The law surrounding guarantees also provides that in some circumstances where the guarantor pays all sums due under the guarantee they themselves can call for a lease of the premises but where the defaulting tenant remains as the guarantor's subtenant.

A final couple of points to note in respect of third party guarantees are that the guarantor will be bound by any lease variations made between the landlord and the tenant, provided they are not materially prejudicial, and leases often provide that the guarantor cannot participate in any rent review and therefore will not have an input into any rental increase although the guarantee remains unaffected by it.

Although the subject of some debate, and where the law is not all that clear (and is likely to be subject to change), for all intents and purposes the guarantor can be required to guarantee the tenant's own obligations under an Authorised Guarantee Agreement ("AGA" for short). Where the tenant transfers their lease to a third party the lease will usually provide that the tenant must stand as guarantor for that incoming tenant until that tenant either transfers the lease itself or the lease comes to an end. This is the AGA. Therefore under the guarantee provisions a landlord can often require the guarantor to guarantee the tenant's performance under that AGA. Effectively the guarantor will not be released just because the tenant has transferred the lease.

Premises

It goes without saying that making sure that the premises are correct is obviously key both in terms of the rent being paid and the premises required and expected. The premises are usually described by reference to a plan or plans and care should be taken to ensure that they are correct. If the premises consist of different floors it must be ensured that the plans together show the whole premises without any stairs, doorways or passageways that are required being omitted. If any plant areas, loading bays or external seating areas (for restaurant premises) are to be included it must be ensured they are included in the plans.

Conversely, care must be taken to ensure that the plans exclude any areas for which the tenant does not want to retain liability such as any service ducts, structural parts (unless a lease of the whole building) and any plant or plant areas not exclusively serving the premises. Any such parts that the tenant does want the benefit of must either be included in the premises or a right to use them must be granted.

The tenant will be liable for the repair and maintenance of the extent of the premises that are let so usually unless a tenant is being let a whole building the tenant should only take on liability for the internal most parts of the premises. Taking on liability for the roof, structure, exterior and foundations could be a costly repairing liability. It should also be considered that alterations and works will usually only be permitted by a lease to parts of the building that are let to the tenant. For example, if it is intended that works and alterations will be needed to external parts then the tenant will want those parts to be included in the extent of the premises let. In retail and restaurant premises the shop front must be specifically let to the tenant so it can be altered and replaced, whereas for a floor in an office building the tenant would not want to be responsible for any external parts.

Where the tenant is taking on the internal parts only, the premises are usually described so as to include the areas to make up the boundaries of the premises and other parts included. For example:

- The inner surfaces of all structural walls bounding the premises;
- All internal non structural walls within the premises;
- The surfaces of any load bearing walls within the premises;
- All flooring and raised floors down to the floor screed, but excluding any part of the structure below;
- All ceilings and suspended ceilings up to but excluding the structural slab above;
- All doors and windows (care should be taken here especially in office premises of a floor in a building many floors up where there is an inability to access these areas to ascertain their state of repair);
- The shop front and fascia.

A survey is always advisable (at least a walk through survey even if not a full structural survey where the tenant is being let the whole building) particularly because the law implies into the obligation to keep the premises in repair an obligation to first put them in good repair. Therefore the tenant will be liable for any pre existing disrepair or inherent or latent defects unless the lease expressly excludes it. A survey should reveal these defects (unless a new build). In addition any mechanical and electrical apparatus serving the premises should be inspected for the same reasons and also because such plant and machinery may not have a long useful life and is usually expensive to replace.

On a final point, any sweeper provision in the description of the premises, which seeks to include any fixtures, fittings and fit out of the tenant, should be resisted. Otherwise, anything the tenant installs in the property becomes the landlord's property and therefore is incapable of being removed. This is a real issue in restaurant property (and should be considered for all other property) because restaurant leases are usually sold at a premium and the fixtures and fittings carry a value on sale. But with this clause in a lease these items would be owned by the landlord and so the tenant would be unable to recover any value for them. This could cost the tenant tens, if not hundreds, of thousands of pounds.

Rent

4.1 Basic rent and payment

As well as the amount of the basic rent any other incentives will also contribute to the financial package as a whole. Such incentives include rent free periods, reduced rent periods, fit out contributions, other capital contributions and even reverse premiums paid by landlords for tenants to take leases.

The size and detail of the incentive will very much depend upon the location of the premises, demand, other market forces, norms and conditions and the individual tenant and how much the landlord wants the tenant in their property. For example, in bad times in poorly performing shopping centres some landlords have allowed some tenants to occupy rent free provided the rates are paid. In other cases no rent free or incentive of any kind was offered at all in highly sought after areas.

There are various important points to consider in relation to the tax treatment and consequences of incentives but they are outside of the scope of this book and tax laws are often the subject of change.

In terms of rent free periods, it is only reasonable to require the landlord to agree that in the event that any rent suspension provisions apply (usually in the event of damage by insured and/or uninsured risks- see chapter 6) the rent free period will be extended pro rata by one day for each day that rent would have otherwise been payable had the rent suspension provisions not applied. Essentially, if the lease provides the rent is suspended in certain circumstances, and that suspension applies during the rent free period, then the rent free period should be extended. The tenant should not lose out just because the rent suspension occurred during its rent free period. That rent free would have been given as an incentive and the assumption of the tenant would have been that it would apply during periods it could use the premises and not during periods of damage when the rent suspension should otherwise cover this.

The method and frequency of rent payments also needs some thought. Traditionally the basic rent will be payable quarterly in advance and often on the usual “quarter days”. These days are 25 March, 24 June, 29 September and 25 December. Many retailers now require that the rent is payable only monthly in advance in order to preserve cash flow but there is some resistance to this by some landlords (either because of a reluctance to depart from the norm, due to their own banking requirements and mortgage payments or because quarterly in advance payments give more security than monthly payments) and this is not always agreed.

Although most tenants are diligent, a grace period for the payment of all sums, including rent, should be negotiated in case mistakes are made with the rental payments. A grace period of 7 to 14 days for payment after the due date is not uncommon. Grace periods are especially important because otherwise interest will become due from the due date, if the rent or other sums are not paid on time. Interest is most often calculated at a certain percentage (anywhere from 2 to 5%) above bank base rates. Care should be taken to ensure that any interest will not be compounded (often monthly or quarterly) as this is an unfair penalty and landlords do usually agree to remove this from their leases.

4.2 Turnover rent

Turnover rent is usually only charged upon retail or restaurant premises and never on office or other commercial premises. It is usually paid in addition to the base rent and is commonly expressed as either the higher of the base rent or a certain percentage of gross turnover or, alternatively, the amount by which a certain percentage of turnover exceeds the base rent. Both of these are of course the same. Turnover rent is essentially a top up on top of the basic rent payable by the tenant, the idea being that the landlord shares in the tenant’s good fortune of being present in a well managed and well performing shopping centre, building or arcade.

Usually to offset the turnover top up, so that the landlord shares the risk for a poor performing centre, the base rent is discounted from its open market rent. The percentages can change but typically the base rent will be 80% of the open rent and the common turnover rent percentage is 10% of gross turnover.

It should be remembered that if the base rent is 80% of open market rent then on rent review the rent should also be reviewed or increased to only 80% of open market rent and not 100%. Otherwise, the landlord takes no risk for a poor performing centre and will be guaranteed the market rent as well as sharing in the good performance of the tenant.

Turnover rent provisions will define what is included in gross turnover. The definitions do not tend to vary greatly between one lease and another and the general principle is that any turnover derived from business originating on, fulfilled from (where originating elsewhere), or from people reporting to, the premises counts towards gross turnover. The definitions do tend to include turnover that otherwise should not be included in the gross turnover that is used to calculate turnover rent and so the following should be noted and where appropriate excluded in the lease:

- Where a restaurant is operated from the premises it is fundamental that tips, gratuities and service charges paid by customers are excluded from the calculation of the gross turnover. For many restaurants, service charges can be 12.5% or more and so failure to exclude these items could increase gross turnover by the same amount and therefore the turnover rent. It is important that these tips, gratuities and service charges are not stated to have to be paid to staff, or the exclusion limited in any other way, as restaurateurs often treat tips in different ways which result in a landlord contending those sums themselves were not physically paid to staff (even where a like sum was later paid in one form or another) and so should be included in gross turnover.
- For retailers and any multiple restaurant operating a takeaway service it should be ensured that internet sales not originating from the unit are excluded from the gross turnover rent, even where the order is received and processed at another site but the order is fulfilled from the unit. Most landlords would dispute this and would require that any order, whether fulfilled or received from the premises, should be counted towards gross turnover. If there is no other way around this, some tenants ensure that any order received at a central head office number is fulfilled from the nearest unit (where not fulfilled from a central warehouse) where the lease of those premises does not contain a turnover rent.

- Most companies will offer a staff discount and it should be ensured that any sales are counted towards the gross turnover at only the discounted price. The lease must state this.
- The majority of companies also use gift vouchers as part of their marketing. It must be ensured that the price of those gift vouchers is included only at the point of sale and not also when redeemed (or vice versa) to ensure their value is not counted twice.

In terms of the payment and accounting for turnover rent, leases will commonly require the turnover rent is paid quarterly in arrears on the usual quarter days, with a reconciliation at the end of each year, with any balance charge or balancing credit being due.

However, from a tenant's perspective, and certainly in terms of cash flow, the ideal arrangement is payment of turnover rent annually in arrears. This ensures that the landlord is not holding any interim on account payments for between 3 and 9 months, which will affect cash flow, and also ensures any seasonal variations in trade are averaged out. Otherwise, during peak trading times, such as Christmas, a huge turnover rent could be due at the end of that quarter which would otherwise not have been payable if trade for the whole year had been averaged out.

For the same reason, the turnover rent accounting year must commence on the term commencement date and should not be calculated by reference to the landlord's accounting year as this is likely to result in the initial and final years of the term being short years where seasonal trading variations will not be averaged out.

However, a tenant may decide not to average out seasonal variations but instead to ensure that the turnover rent accounting years coincide with their own financial accounting years. Otherwise, as many leases will require the turnover accounts to be externally audited, this would require auditors to be appointed twice, once for the company's own financial accounting and then again to certify turnover accounts. The problem is removed if the landlord will agree to an internal accountant certifying turnover, but this is often not agreed for obvious reasons.

The argument against quarterly on account payments of the turnover rent, from a tenants' point of view, is that the basic rent is already a minimum rental level and payable quarterly so why should a payment on account of turnover rent be paid when the turnover rent threshold for the year may not be met. Conversely landlords will want to protect their own cash flow and will want to ensure that if something happens to the tenant they have received their turnover rent already.

However, care must be taken to ensure that any on account payment is not expressed as a minimum payment of turnover rent, which has been seen in some leases, and that any overpayment is returned at the end of the turnover rent year.

Most leases will require the turnover accounts to be externally audited which is an additional cost. A certificate supported by these accounts will usually be required to be supplied within a certain period of the end of each turnover year (with interim quarterly reports) and it should be ensured that practically the tenant is capable of arranging for an audit and preparation of that certificate. A common time period is 30 days after the end of the turnover year but some tenants do require 60 days. Landlords are reluctant to agree long periods without a good reason.

There are usually penalties for the late supply of turnover rent certificates and in some leases those payments are harsh. They can range from a percentage of turnover rent to forfeiting the difference between the open market rent and the reduced basic rent (usually about 20%) for the period the certificate is late.

Landlords can often call for an audit of accounts at any time under the lease provisions and the cost of the audit is usually payable by the tenant where the difference between the gross turnover stated in the tenant's certificate (or interim report), and that discovered by the audit, is 1% or more. This is not uncommon but the percentage should be changed to two or three percent (one percent is unreasonable) and it should be stated that the landlord pays the costs where the difference is within those tolerances.

One important consideration often forgotten is whether the tenant requires that any information passed to the landlord is confidential and must not be disclosed, unless otherwise required by law or the landlord's professional advisers and mortgagees (on a confidential basis). Most tenants do require this but do

not object to the landlord disseminating the information as part of trading figures for the whole shopping centre or building and on a no names basis.

Some leases provide for an increased amount of on account turnover rent to be paid where the sum of prior payments of basic rent and turnover rent are deemed too low. This should be resisted as it will result in the landlord holding higher interim payments where, upon the reconciliation at the end of the turnover year, the tenant may not be liable to pay turnover rent or turnover rent at such a rate. This is effectively a cash flow point.

On a final point, some turnover rent leases include provisions that either impose the turnover rent percentage on any new tenant to whom the lease is transferred or allow the landlord to pick and chose the rent that is to be paid by that incoming tenant.

Where the turnover rent is imposed on any incoming tenant either this will be at the same percentage as that previously or there will be a formula for determining that percentage if the landlord and new tenant cannot agree. The issue here is that often the original turnover rent percentage was negotiated between the landlord and the original tenant and was suitable to that tenant, their expectations, projected trade and trading profile. That percentage may not necessarily be appropriate for the new incoming tenant. Any formula used to set the turnover rent percentage is also fairly arbitrary and may result in an inappropriate figure. The effect of this is that it may deter a potential purchaser of the lease to take it, without first agreeing a percentage with the landlord which does rely on the landlord's co-operation. This ultimately will affect the exit options from the lease.

Some leases provide that the landlord can choose what the rental mechanism is under the lease, so the landlord can choose that the same basic and turnover rent (with the same percentage) is payable, or that the same basic rent and turnover rent is due (but with a different turnover rent percentage either to be agreed or decided by reference to a formula or arbitration, or in some cases just decided by the landlord) or that a straight open market basic rent is due without any turnover rent element, but for which a rent review would then be needed. All of this at the very least creates uncertain for any incoming tenant and at worst allows the landlord to dictate the rent. Again this may deter a potential purchaser

of the lease and ultimately will affect the exit options from the lease.

4.3 RPI increases

Rents will not usually remain static under a lease where that lease exceeds 5 years in length (sometimes 3 years). After that period leases tend to include either set increases in rent, increases by reference to a published index or a rent review.

The most common is to adjust the rent pursuant to a review and valuation of the lease in the open market, which is explained below.

Less common are increases in line with a published index but some leases do contain them. These increases are usually annually and track either the Retail Prices (All Items) Index or the Consumer Prices Index. It is thought that the latter will involve a lower increase than the former and is therefore more favourable.

Whichever index is used the lease must provide for what happens when that index ceases to be published. Most leases provide that the increases will be what they would have been under the Index but that is more than likely unrealistic to expect to be able to calculate that.

One final thought to bear in mind is how that Index is used to calculate the rental increase. Great care should be taken to make sure that any increase is not compounded. This occurs where the increase in the Index is applied year on year. To avoid this, the rent should at any given year only be increased by the increase in the Index calculated by reference to the Index figure in the month immediately before the start of the lease term as compared to the Index figure immediately before the relevant anniversary of the term in question.

The lease must not provide that the rent is increased in year one by the increase in the Index and then in each subsequent year increased by the increase in the Index since the previous year. This is what results in compounding of the increases and an increase in the rent higher than that which would otherwise more correctly be achieved.

4.4 Rent review

The most common method of increasing the rent during the term is an open market valuation of the rent at five yearly intervals (or occasionally every three years).

Although detested by tenants most rent reviews are on an upwards only basis. That is to say the rent is increased to the higher of the basic rent then payable under the lease at the time of review and the open market rent. Therefore the basic rent cannot go down if market rents are in decline and will not be set at less than the then current rent.

That is not to say that upwards and downwards rent reviews do not exist but they are very rare. If ever agreed by the landlord there would be some cost involved for the tenant such as an initially high rent or some other compensation due to the landlord.

Bear in mind that as stated above the rent must only be reviewed to 80% (or some other appropriate percentage) of the open market rent if the lease provides for a turnover rent.

It would be sensible to negotiate a right to terminate the lease once the revised rent is known and the rent review is settled so that if the rent is set too high on review there is an exit and any such break would also give the tenant a substantial bargaining position in any rent review as the landlord will be aware that if he seeks too high a rent the tenant will terminate the lease. However, for the exact same reasons the landlord will resist this.

The rent review is essentially the valuation of a hypothetical lease in the open market at the review date, but assuming and disregarding certain things about the lease. Below are the most common assumptions and disregards and associated issues with them. The basic starting point is that the rent review provisions should reflect reality and should not assume or disregard any matters to create an artificial position. For example, onerous lease clauses should not be deemed to be excluded from the hypothetical lease and the lease should not be deemed to include more beneficial provisions than exist.

Common assumptions are:

- that the premises are let on the open market without a fine or premium. This basically means that the lease is valued in the open market and without any capital sum being paid by either the landlord to the tenant or the tenant to the landlord as this would distort rental levels.
- with vacant possession. It is only reasonable that the premises being let are assumed to be empty, as otherwise it could be assumed the tenant or any subtenant or other party is in occupation which could either have the affect of driving down the rent (to the landlord's detriment) or the landlord could contend the tenant who is already in occupation would pay far more for the premises than any other party, therefore driving up the rent (to the tenant's detriment).
- by a willing landlord to a willing tenant.
- for a term commencing on the relevant Review Date and either equal to the unexpired residue of the term or say 10 or 15 years (depending on the actual length of the term- the hypothetical term should never be assumed to be longer). Generally, the tenant will be concerned to ensure that the term deemed to be remaining is the shortest possible and the landlord will want to assume the longest possible term remains. The reason behind this is that the basic principle (although the issue is more complicated than this) is that the shorter the assumed term the lower the rent that can be demanded because of the certainty of rental income a longer term provides. In reality this will actually depend on a number of factors, including the type of property (retail, restaurant, office etc).
- that the letting is of the premises as a whole. This could be for both parties benefit as it is conceivable that splitting the premises into parts and letting to a number of different tenants could either increase or decrease the rent compared to letting the premises as a whole.
- on the same terms and conditions as are contained in this lease. Obviously the tenant wants all onerous terms and all obligations contained in the lease to be assumed to be in the hypothetical lease being valued as without them

the value of the rent could be higher than would otherwise be achieved. Conversely the hypothetical lease should not be assumed to contain any artificial terms which could be construed as beneficial to the tenant as this would also increase the rent. However, great care must be taken here to ensure the lease sets out the frequency of rent reviews (usually five years). The reason for this is that many leases will actually set down the dates by reference to actual dates (i.e 29 September 2018 and 2023 for example) rather than referring to a review “on the fifth and tenth anniversaries of the term”. The issue with fixed dates is that, referring to the example above, the lease could have been for a term of 15 years with these fixed review dates. If the hypothetical lease assumes a 10 year term remaining, but the terms of that lease are the same as in the current lease this would include these fixed review dates. Therefore, on the review in 2023 the lease would be deemed to be for 10 years but without any rent review at all as the review date of 29 September 2023 would already have passed. A 10 year lease without rent review would be valuable to any tenant and would therefore increase the rent on review. Therefore, any hypothetical lease must contain “rent reviews on every fifth anniversary” to avoid this.

- that the premises are ready for immediate occupation and use ready to receive the incoming Tenant’s fitting out works. This stops short of assuming that the premises are in a shell and core condition ready for fitting out (which would be the tenant’s preference) but does ensure that the premises are effectively empty and in a condition ready to be fitted out. The point here is that the premises should not be deemed to be fitted out before the tenant takes the lease as fitting out works are time consuming and costly. It would be very valuable to a tenant (in terms of both time and capital outlay saved) if those works had already been carried out for the tenant, which would therefore drive up the rent on rent review.
- that the premises may lawfully be used for the use permitted by the lease. This essentially assumes that all necessary statutory consents for the use of the premise are in place. Therefore, if the parties know that this is not actually correct then this should be deleted. It may be that the tenant is taking a risk that use will not be challenged by the local authority for example.

- that the tenant has complied with all his covenants and obligations under this lease. It is only fair that the landlord should not be penalised for any tenant breaches of the lease. Some leases assume that the landlord has complied with all of its lease obligations but this should be resisted. It is not reasonable, if a landlord has allowed the building to fall into disrepair for example, that this is ignored when valuing the premises and the lease on rent review. Similarly, some leases seek to ignore the presence of any works or development ongoing on any parts of the building or shopping centre etc. Again this should be deleted for the same reason. A common compromise for both clauses is to ignore temporary breaches where not persistent, or temporary works, so the landlord is not unfairly penalised.
- that, if any part of the premises or any amenity serving it shall have been damaged or destroyed, they have been repaired and reinstated. Leases will usually contain rent suspension provisions in the event of damage so no rent is payable during periods of damage, but the landlord will require that once the damage is made good, and the rent becomes payable again, that this is at the full rate due on review. Therefore it is only reasonable to ignore any damage upon valuation.
- that no works have been carried out to the premises by the tenant during the Term which would diminish the rental value of the premises. This is only reasonable.
- that the hypothetical tenant will have had the benefit of such period (commencing on the grant of the hypothetical lease) free of rent or at a concessionary rent as he might be expected to negotiate in the open market for fitting out, so that any such rent period will have expired. There are three related points here.
 1. It is common for tenant's to be granted a rent free period or other concession at the commencement of the term. Some landlords seek to exclude the whole of any such concession and therefore reserve a "headline" rent. Effectively by ignoring any concession the aggregate rent across the term will not be reduced by any rent free period and so the corresponding annual rent payable will be higher than would otherwise have been achieved

on review. This is unreasonable as the tenant will be penalised for something common in the market which should be a benefit. However, a common compromise is that rent free periods commonly given in the market for fitting out purposes only should not be taken into account but any other concessions that would be offered are taken into account on review. The reason is that it is usually expected that a tenant will receive around three months rent free in order to fit out (the tenant being unable to use the premises until it has fitted out and so is reluctant to pay rent during that time) but anything above this is really an incentive given by the landlord. It would be unfair on the landlord to be penalised on rent review by having that incentive taken into account and thereby reducing the aggregate rents and accordingly the rent when valued on review.

2. Only rent free periods for the “period” of fitting out should be disregarded and not rent free periods or concessions for the “purposes of fitting out”. The point here is that fitting out is thought on average to take about three months and so three months worth of rent free period will be disregarded. However, rent free periods or concessions given for the “purposes” of fitting out could be huge. Fitting out is expensive and time consuming and so any rent free period or concession equivalent to that cost is likely to be large and disregarding such large rent free periods offered in the market (which would otherwise have had the effect of reducing the rent) would cause the rent to be higher than that which would otherwise be obtained on review.
3. A similar point arises in respect of disregarding rent free periods for the period of fitting out. As explained above, fitting out usually takes around three months and so it is fair to disregard three months of rent free period. However, disregarding anything in excess of that period is likely to increase the rent on review as landlords can sometimes offer extended rent free periods described as for fitting out when in fact they are for a combination of the fitting out period with a large element as an incentive. Disregarding any such large incentive offered in the market would cause the rent to be higher on review. Therefore, the length of fitting out periods disregarded should be limited to three months.

Common disregards are:

- the fact that the tenant, their sub-tenant or their respective predecessors in title have been in occupation of the premises. This is for the tenant's benefit as this discounts a special bid that would be made by the tenant or their subtenant in order to remain in occupation which would drive up the rent on review.
- any goodwill attached to the premises by reason of the carrying on at the premises of the business of the tenant, their sub-tenants or their predecessors in title in their respective businesses. This is a variation on the same point as above.
- any improvement, alteration or addition carried out by the tenant, his sub-tenant or their respective predecessors in title, at their own cost, with the written consent of the landlord (where required) and otherwise than in pursuance of an obligation to the landlord. Essentially, if the tenant has paid for, and carries out, works to the premises he should not be penalised on review by the tenant's own works increasing the rental value. However, if the landlord paid for the works, or the tenant had a contractual obligation to the landlord to carry them out, it is not unreasonable for their value to be taken into account. Similarly, if the works required the landlord's consent under the lease and this was not obtained, and therefore the works were carried out in breach of the lease, it is not an unreasonable penalty for their value to be taken into account on review.
- Works carried out by the tenant to comply with statute. The issue with taking into account the value of tenant's works carried out pursuant to an obligation to the landlord (as explained above) is the lease will require the tenant to comply with statutory requirements. Therefore, any works the tenant carries out to comply with statute will be taken into account on review and could increase the rent by quite a margin. For example, disabled accesses, fire safety systems, works to comply with health and safety legislation and various other works required as a result of statute could all add up to a significant value. Rentalising them would be unreasonable where the tenant has paid for these works already. However, a landlord would want a reciprocal assumption that where such works are to be disregarded the premises are still assumed to be

compliant with statutory requirements as otherwise this would reduce the value of the premises and drive down the rent.

Care should be taken as to the effect of any unusual assumptions or disregards or those that depart from the norm.

The review mechanism will typically provide that the parties can agree the rent at any time but in the event that by the review date, or three or so months before or after the review date, the rent has not been agreed either party can refer the review to either an expert valuer or an arbitrator. There are pro's and con's for expert determination and arbitration. Most notably arbitration is likely to be more expensive and time consuming than expert determination. The lease will usually provide for reference to one or the other if the rent cannot be agreed but the lease should not allow the landlord to decide as the landlord will chose the mechanism most advantageous to him at the time.

If at the review date the reviewed rent has not been ascertained the previous rent at the then current level will continue to be payable and subsequently upon the determination of the new rent the balance of any increase due will be payable from the review date to the quarter day after determination.

Interest will also be payable on the rental increase. Two points should be considered. Firstly, the interest rate should be no higher than base rate as anything more would be a penalty as the timing of a prompt rent review is not in the tenant's control.

Secondly, interest should not be due on the rental increase for the period from the review date all the way through to the next payment date after the review because the rent would only have been due in instalments. Therefore, it is far fairer for interest to become due on the rental uplift from the date each instalment would have become due on each subsequent quarter day. For example, if the rent review is settled say nine months after the review date, the interest should not be due on the whole balance for nine months, but rather interest should be due for nine months on the rental instalment that would have been due on the review date, six months of interest should be due on the rent due on the next quarter day after the review date and three months of interest should be due on the subsequent quarter's rent.

On a final point, rent reviews quite often provide that the rent on review must be the “best” rent obtainable in the market. This should not be agreed as the word “best” would take account of any special over bidder who may pay an unusually high price. This should be excluded.

Service charges

5.1 Usual expectations and mechanism

Unless the property let is a lease of a whole building, the lease will most likely contain service charge provisions of one of the following two types, as outlined below. If a property is a lease of a whole building it may still contain provisions requiring the tenant to contribute a fair proportion of the costs of repairing and maintaining items used in common by the building with other nearby premises, such as common passageways or service yards, etc. These provisions are normally no longer than a paragraph but the fundamental point here is to ensure that the proportion payable is on a fair basis and that there are no costs payable for rebuilding, replacing or upgrading any such areas or common parts. Costs charged should be for repair only.

If a service charge applies, an older and much less common mechanism is for the lease to contain very short provisions, very similar to the above, whereby the tenant is to pay a fair proportion of any costs and expenses incurred in keeping any unlet parts of the building in good repair and condition. Again, the important considerations here are that any costs attributable to any refurbishment of the common parts, or replacing, rebuilding or bettering the common parts (otherwise than where required in order to repair them) are excluded and that any proportion payable is fair and reasonable (more on this below).

The modern and now most common form of service charge mechanism is for detailed provisions to be set out in the lease setting out exactly what the landlord's obligations are, the services for which the landlord can charge and how the proportion is calculated. This mechanism normally expressly provides that the landlord may employ third parties as managing agents in order to carry out the services or procure their carrying out, and may charge the cost of employing those managing agents.

In terms of the landlord's obligations, care should be taken to ensure that these include the following:

- an obligation generally to keep the building in good repair and condition and properly decorated where necessary;
- the above obligation must include an express obligation to keep the roof, structure, foundations and exterior, and any conducting media serving the premises, in a good state of repair and condition;
- if the premises are connected to a common heating and air conditioning system the landlord must be obliged to provide heating and air conditioning to the premises at least to reasonable temperatures and at reasonable times, if not 24 hours a day, 7 days a week where required. Linked to this, the landlord should be obliged to provide heating and air conditioning to any common parts necessary;
- the ability to service the premises and accept deliveries of goods, etc. (e.g. in the case of restaurants or retail premises) is essential; the landlord must be obligated to keep service corridors and loading bays, etc. open and accessible 24 hours a day, 7 days a week or during any hours essential to the tenant. If this is not provided in the list of rights granted to the tenant, the landlord must be under an obligation to keep such areas open in the services it provides.

The above are, of course, a list of the minimum services one would expect to be provided in a multi-let building or shopping centre. These obligations are often caveated by the landlord not being responsible for any failure to provide the services where this is as a result of anything which is outside the reasonable control of the landlord. This is not unreasonable.

Some landlords also seek to exclude any liability in relation to any act or omission (whether it be damage caused to the premises, injury caused to staff or a failure to provide services) caused by its agents, contractors, third parties or employees, etc. Most landlords these days are companies and therefore act only through the medium of their employees or agents, and therefore these sort of landlord's liability exclusions should be strongly contested. Otherwise, this is likely to release the landlord from any liability in terms of service charges or otherwise in terms of

lease obligations, unless otherwise prevented by law (for example, the landlord cannot exclude liability for death or personal injury).

The service charge proportion payable by the tenant is also fundamental. Different leases contain different provisions as to how the tenant's proportion is calculated. This is obviously crucial and must be checked carefully but the fundamental principle must be that the proportion must be fair and reasonable in all the circumstances. It is suggested that even if a different mechanism is used to calculate the service charge there should be an overriding provision providing that, notwithstanding whatever other method of calculation is used, the proportion charged to the tenant must at all times remain fair and reasonable. Therefore, if the mechanism used to calculate the service charge apportionment payable by the tenant becomes unreasonable for any reason in the future, the tenant won't be bound by it.

A common method of apportionment is on a floor area basis, so the tenant pays a proportion of the service charge incurred by the landlord which relates to the proportion which the internal floor area of the premises bears to the aggregate internal floor areas of the lettable parts of the building. Here it should be ensured that within this calculation are included the floor areas of all unlet units so that the tenant does not pay an additional amount in respect of vacant premises within the building or the shopping centre, etc.

Other services charges can be calculated by reference to the proportion the rateable value (used to calculate the business rates payable for the premises), not the premises, bears compared to the rateable value of the lettable parts of the building or shopping centre as a whole. Again, the same point applies here in relation to unlet parts.

Some leases provide for a straightforward percentage to be payable, calculated on some other basis, and again the concern here is to ensure that whatever percentage or basis is used is fair and reasonable. Sometimes percentages are calculated on a "weighted floor area" basis. This method of apportionment discounts the percentage an occupier will pay where the premises exceed a certain size, to reflect the benefit of the services provided. The floor areas are divided into bands, with a progressive discount, the idea here being that large units receive a higher discount as, in reality, the cost of providing services to

them is less per square foot than providing the same services to smaller units. An example of this weighted banding is below:

- first 500m² at 100%;
- next 1000m² at 80%;
- next 2000m² at 70%;
- next 3000m² at 60%;
- excess over 6,500m² at 50%.

An important point to bear in mind is that often, although premises may be in a multilet building, those premises can in fact be virtually self-contained for service charge purposes. For example, a ground floor shop unit may benefit only from the repair and maintenance of the roof, structure, foundations and exterior but may not otherwise benefit from any other services carried out or from any service corridors, loading bays or any office or residential common parts above where that unit, for example, fronts onto a highway and access is direct from the highway. Many leases have been seen which seek to charge a proportion of the cost of repairing and maintaining office or residential common parts, or maintenance of corridors and loading bays and various other parts of the building from which premises don't benefit or which it is physically impossible for the tenant to use. In those circumstances an exclusion should be added to the lease providing that the tenant won't be liable for those costs on the basis that the premises are, to all intents and purposes, self-contained.

In terms of the actual service charge mechanism, the older, more general service charge provisions are often on an ad hoc basis whereby the landlord can recover a fair proportion of the costs incurred from the tenant as and when the landlord incurs those costs. It should be noted that the advantage to this is that tenants often go for years without any service charge costs having to be paid but the disadvantage obviously is that if and when something requires to be repaired, the tenant could receive a sudden and unexpected large service charge bill (e.g. if the roof requires to be repaired or replaced).

More commonly in modern leases, a fair proportion of the estimated service charge costs are required to be paid by the tenant by way of an interim service charge, usually at the same time as the rent is payable (usually quarterly in advance on 25th March, 24th June, 29th September and 25th December). After

the expiration of each accounting year (this is usually the landlord's financial year) the landlord or his accountant will issue a certificate evidencing the actual total service charge expenditure incurred. The tenant would then receive either a demand for a balancing charge (if the amount paid on account was not sufficient) or would receive a balancing credit in respect of any overpayment of service charge.

Care must be taken to ensure that at the end of the term of the lease any excess payments made in respect of the period after the end of the term should be repaid to the tenant, and also that any balancing credit due once the accounts have been reconciled after the end of the term should also be refunded to the tenant. It should be noted that leases usually allow a landlord to demand irregular payments in respect of any expenditure required to be incurred where the service charge sums held by the landlord are not enough. These payments can be required to be made at the same time as the on-account service charge or often at any other time when needed by the landlord. Obviously, care should be taken to ensure that any such payments are reconciled against the end of year accounts.

It should be noted that there is usually no requirement on the landlord to have the service charge accounts audited. Those accounts are normally drawn up by the landlord's internal accountant and leases usually state, unless in the case of any obvious error, the landlord's certificate is final and binding. Obviously, this reduces the scope to object to any certificate issued by the landlord or to object to how the landlord has exercised his discretion in providing the services.

Linked to the above is that often a tenant's right to object to any service charge on the basis of how the landlord has exercised his discretion in providing services is excluded in the lease. For example, just because the tenant believes the services could have been provided at a lower cost would not in itself be a ground to object, unless the landlord had acted in bad faith.

Any right to object to any service charge is normally subject to the tenant first having to pay any service charge due (and being unable to withhold it) and subsequently contesting any item of service charge within a short period of time after the issue of the certificate. Such clauses aren't uncommon but the devil is usually in the detail. Where any objection is required it should be made quickly.

5.2 Exclusions

The services which the landlord is obliged to provide are obviously stated above but, essentially, usually include maintenance and decoration of the building and its common parts, together with ancillary services. However, there are a number of services which it is felt by tenants would be unreasonable for the landlord to recover. Below are some examples of these.

(a) Reserve and sinking funds– there are subtle differences between the two funds but generally they are used over time to build up a fund that can be used to pay for, or contribute to, large items of future expenditure (such as repair or replacement of parts of the roof, structure, foundations, exterior or essential plant and machinery). The issue here is that some tenants don't like to pay into these funds because if the money has not been expended by the time that the tenant transfers the lease to a third party or the lease comes to an end, those sums won't be refunded. The landlord's argument here is that the tenant during the term of the lease will have had the benefit of the items for which payments have been made and which may require future repair or replacement and therefore it is not unreasonable for a tenant to contribute. Tenants often see this as lost money which will benefit others when they have parted with the lease or the lease comes to an end. However, a disadvantage to the tenant is that without a reserve or sinking fund the tenant will often receive a large and unanticipated service charge bill for the repair and replacement of significant items which may be required, where there is no such fund to pay for it.

(b) The cost of original construction and equipping of the building/shopping centre and remedying defects in that construction– obviously if the building or the shopping centre in which the premises are situate is recently constructed it would be unreasonable for a landlord not to exclude the costs of constructing or equipping the building from the service charge. The tenant wouldn't want to find himself having taken a lease, only later to have to contribute to the building's initial construction or fitting out. However, landlords often object to the exclusion or remediation of defects in that construction, but from a tenant's point of view the landlord should have warranties and should be able to pursue any contractors involved in construction. Even if that contractor goes bust, the landlord should have ensured that the contractor has insurance in place to back up those warranties, so there should be no need for a landlord to charge the cost

of remedying defects through the service charge. However, some landlords do insist that, as an alternative to this, whilst the landlord can recover these costs, they must also credit to the service charge fund any compensation or other sum received from contractors but, conversely, they can charge to the service charge the costs of taking action against any contractors for the remediation of defects.

(c) The cost of any works carried out by the landlord under any agreement to grant the lease- sometimes landlords will agree to carry out certain works to the premises before the lease is granted to the tenant. In that case it is only reasonable that any such works cannot be charged via the service charge (unless it is expressly agreed otherwise between the landlord and the tenant as part of the deal).

(d) Refurbishment of the building or replacing, renewing and rebuilding, unless necessary by way of repair– essentially the landlord should not be able either to upgrade or modify its building or their common parts or to refurbish them at the tenant’s cost. This is usually a point of contention in most service charge provisions, but eventually most landlords do concede this exclusion as being reasonable. If a landlord won’t agree to this in some form or another, it should be asked what the landlord then intends. A specific question should be raised of the landlord to ask what works or refurbishment they plan in the next few years and whether they anticipate any major works or expenditure being incurred. However, this will not protect the tenant after the first year or so.

(e) 50% of advertising and promotion– this applies only to shopping centres or other parades of shops and restaurants and is particularly relevant in relation to turnover rent leases where both landlord and tenant benefit from any landlord’s successful marketing of the shopping centre. In this case the landlord should bear some of the cost of advertisement and promotion and the whole of the cost should not solely be passed on to the tenants.

(f) Costs of lease renewals, rent reviews, lettings, and collection of rents and arrears– effectively all of these things are the landlord’s administrative expenses in relation to other tenants of the building and therefore should not be charged to the tenants through the service charge.

(g) Enforcing any covenants of tenants or occupiers of the building (unless for the benefit of the majority of the tenants) - the landlord should not be able to charge the costs of any litigation, legal advice or court proceedings against other tenants through the service charge unless, for example, that tenant was causing a nuisance which was affecting the other tenants and the cessation of which would be for the benefit of the majority of the tenants of the building.

(h) Management charges exceeding between 10% and 12½% or which are not otherwise expressed to be “reasonable” – leases often provide that landlords can charge for employing managing agents to perform, or procure the performance of, the services and it is thought that anything over between 10% and 12½% is unreasonable. If this limit on management fees does not apply (this cap should include the aggregate of the fees of managing agents or any fees of the landlord for performing this role itself) then those fees should be expressed to be “reasonable” costs.

(i) Contesting legislation or laws in relation to the building (unless for the benefit of the majority of the tenants in the building) – a tenant would not want a landlord being able to contest any legislation or law relating to the building where solely to protect the value of his own asset and it would not otherwise be for the benefit of the majority of the tenants. In the latter case, however, such costs would be reasonable to be passed on to the tenants.

(j) Void units– the service charge proportion or cost payable by the remaining tenants should not be increased because of unlet premises within the building where those parts of the building are either designed or intended for letting.

(k) Remediation of damage caused by uninsured and/or uninsured risks– if any damage to the building is covered by the landlord’s insurance then the landlord should not charge the cost of remediation to the tenants, for obvious reasons. The tenant will no doubt pay a proportion of the cost of insurance and therefore should benefit from it and should not have to pay twice by having to pay the cost of remediation through the service charge. Similarly, if the landlord is unable to insure against a particular risk (uninsured risks), the tenants of the building should not be used as an insurer of last resort and be made to pay for the cost of remediation of damage through the service charge.

(l) Remediation of pollution or contamination which existed, or the cause of which arose, prior to the date of commencement of the lease (including removing or management of asbestos) – such costs could be costly and it is not reasonable for a tenant to have to pay the costs of historic pollution or contamination.

(m) That either income from the common parts should be credited to the service charge or the costs of services provided to the common parts should be excluded from the service charge– this really applies only in relation to shopping centres or other mall-type developments where the landlord can derive income from any unlet common parts, such as income derived from creches, car parks (where customers are charged for parking), or where carts, kiosks and barrows, etc. are placed in malls of shopping centres and are rented out to produce income for the landlord. In these cases, either the cost of preparing the areas or parts of the development from which income is derived should not be charged through the service charge, or the income derived from those parts should be credited to the service charge, at least insofar as a fair proportion of the costs of repair and maintenance would otherwise be charged to those areas.

(n) The cost of services from which the tenant does not benefit, where the premises are more or less self-contained – this is explained in more detail above.

(o) The cost of remediation of inherent or latent defects – just in the same way as the landlord would demand that a tenant is responsible for any defects in the premises which existed prior (and occurred during) the term of any lease (the tenant having a chance to have a survey carried out of the premises before it takes the lease), it would follow that it would seem only reasonable that the landlord should bear the risk of any inherent or latent defects in the building before a tenant takes a lease of premises within that building. In reality, however, landlords rarely agree to this exclusion of cost from the service charge, although it would be reasonable to seek to negotiate this where it is known that a building is old and does contain inherent or latent defects which may need to be remedied during the term of the lease and which could be expensive. A survey of the premises is most definitely recommended before any lease is entered into but at least a “walk through” survey of the building of which any premises form part, by a qualified surveyor, is also recommended where practical and realistic, and particularly where that building is older.

5.3 Caps

A well advised tenant would seek to negotiate an annual cap on the service charge due under the lease to cap the tenant's liabilities and give certainty. However this will depend on demand for the property and the tenant's bargaining position. Further, caps are often not given for leases with longer terms as they are usually only given for short terms leases under five years (or often only for the first few years of a longer term lease).

Caps are usually subject to some kind of increase each year and do not usually remain fixed for every year the service charge is capped. Increases are usually according to either the Retail Prices Index (RPI) or the Consumer Prices Index (CPI). The latter is more preferable for a tenant as it is thought that the increases are likely to be lower than those using RPI. However, RPI increases are more common.

There are a few important points to note about service charge caps as set out below.

- Each annual date of the increase must be linked to anniversaries of the term start date and not the landlord's service charge accounting dates. Otherwise, unless the landlord agrees that the first period before any increase is well over a year, this would result in a premature increase in the cap.
- Great care should be taken to make sure that any increase in the cap is not compounded. This occurs where the increase in the Index is applied year on year. To avoid this, the cap should, at any given year, only be increased by the increase in the Index calculated by reference to the Index figure in the month immediately before the start of the lease term as compared to the Index figure immediately before the relevant anniversary of the term in question. The lease must not provide that the cap is increased in year one by the increase in the Index and then in each subsequent year increased by the increase in the Index since the previous year. This is what results in compounding of the increases and an increase in the cap higher than that which would otherwise more correctly be achieved.

- The service charge cap must be reduced pro rata for any part year during the term as otherwise in the first and last years of the term the whole year's cap would apply to those periods of less than a year, which effectively increases the cap, by potentially a large percentage depending on how short the period is.
- All costs payable to any merchants or tenants association must be included in the service charge cap (especially marketing and promotion costs which are often charged through the tenants association band therefore not included in the service charge to which the cap applies).
- All contributions to a reserve and sinking funds (see above), which are sometimes otherwise excluded from the list of service charge costs to which the cap applies.

Insurance

6.1 Usual expectations

In cases where the tenant is taking a lease of the whole building, leases can require the tenant to insure the building (with the landlord named as a beneficiary and interested party) or can require that the landlord insures and the tenant reimburses the landlord the cost. In straightforward occupational lease (as opposed to investment leases) it is not common for the tenant to insure and therefore the following concentrates on provisions requiring the landlord to insure.

Where the landlord insures he will seek to reimburse the cost from the tenant. In a multilet building the tenant should ensure that the proportion is a fair and reasonable proportion of the cost of obtaining that insurance. Landlords do not usually accept any watering down of what they can and cannot insure and the terms of insurance, so the tenant has little control over the cost of that insurance. However, tenants should assume that a landlord will seek to obtain the best and most comprehensive form of insurance he can obtain, particularly where the tenants are paying the costs.

The lease must contain an obligation on the landlord to insure the building against a comprehensive list of risks (see below) and the landlord must covenant to make good and repair any damage caused by those insured risks, including an obligation to rebuild the whole building where necessary and obtain any planning and other consents that may be required to allow rebuilding. The landlord must be obliged to use reasonable endeavours at least to obtain the necessary consents and to seek to reinstate. As the tenant pays a proportionate part of the cost of insurance and will have expended a fair amount of money on fitting out the premises and employing staff, etc., it is only reasonable that the landlord is actually obligated to make good any damage caused so that the tenant does not have to relocate. However, it should be noted that the landlord's insurance will often not include the tenant's fit-out and so a tenant must insure this against damage himself.

In terms of the value of reinstatement, landlords are usually fairly insistent that the value of the building to be insured is at their discretion and that the landlord can recover the cost of any valuation of the building for this purpose (although this should be capped for every 2 or 3 years to prevent the landlord from obtaining valuations too frequently). Landlords will insist that the value they can insure against (which will obviously have a bearing on the cost of insurance) does include sums for the full reinstatement value of the whole building if destroyed, site clearance, the cost of employing architects and other professionals and the cost of obtaining all necessary planning and other consents. This is not unreasonable.

In addition, the landlord will want to insure against loss of rent for the period it would take the landlord to make good any damage. 3 years is seen as the norm but in some large buildings or shopping centres, for example, landlords insist on at least 5 years loss of rent insurance. Any longer than 5 years for a shopping centre or large development should be resisted and any longer than 3 years in a standard office building should be rejected as being unreasonable. Obviously, the longer the period of loss of rent insurance, the higher the cost of insurance, for which the tenant pays a proportion. However, the length of period insured should relate directly to the length of rent suspension period as set out below.

The landlord will also require loss of rent insurance to take into account the likely and anticipated rental increases on rent review over the term. This is not unreasonable but landlords usually seek for this to be at their discretion.

6.2 Rent suspension and termination

The tenant should be keen to ensure that the lease contains a suspension of rent in the event of damage or destruction by an insured risk of either the whole or a part of the property. These are fairly standard clauses but the amount of rent suspension is usually linked to the extent of damage and accordingly the whole of the rent will not be suspended if only a small proportion of the premises is damaged or destroyed. Rent suspension will apply only in the event that the premises or the relevant part are incapable of occupation and use, which is only reasonable. It would not be reasonable to suspend rent where the part affected is still capable of being used.

However, it should be ensured that not only the principal rent is suspended but also any service charge due should also be suspended (to the extent of the damage or destruction). If the tenant cannot use the whole part of the premises then any service charge should not be payable for the same reason as the rent should be suspended, and any insurance payments should also be suspended. Most landlords agree to suspend the service charge payments but some landlords dispute that insurance payments should still be made during any period the premises cannot be used as the development or the premises will, to some extent, still need to be insured. From a tenant's point of view, the tenant should not have to pay any sums due under the lease if he cannot use the premises.

One point to bear in mind is that the lease must provide that in the event the rent is suspended due to damage or destruction by an insured risk, during any rent free period under the lease then that rent free period should be expressed to be extended pro rata for each day of that rent suspension. Rent free periods are inducements to enter into the lease or otherwise for fitting out so if the premises cannot be used, or fitted out, the rent free period given for that purpose should be extended. If the rent was not due in any event, the tenant should not lose his rent free period simply because damage occurred during its rent free period. Care must also be taken to ensure that the lease does not state that the rent is suspended only to the extent that the landlord's insurer pays out for loss of rent insurance, as this could mean that the tenant's rent is not suspended in the event of any vitiation of the landlord's insurance, either by the landlord himself or by other tenants or occupiers. The period of loss of rent insurance should be for the period set out in the lease and no shorter, unless of course insurance is vitiated by the tenant.

Another pitfall to avoid is that often the rent suspension and termination provisions (see below) are linked to damage or destruction to the premises only. In a multilet building or shopping centre this can be an issue as, where there is substantial damage or destruction to the remainder of the building or development but in fact there is little or no damage to the premises, the premises either may still be incapable of use (the rent should be suspended in any event if access is prevented) or the tenant may be unable fully to trade from the premises in the event of shop or restaurant premises. Substantial damage or destruction to the remainder of the building is not only likely to affect the safety and integrity of any other premises not otherwise damaged in the building but also it will

affect how employees or clients of the business being carried on at the premises, or customers (in the case of shops and restaurants) perceive the premises and their willingness to visit them. Effectively, just because the premises themselves are not damaged, in the event of substantial damage to the remainder of the building the premises may still be incapable of full and beneficial use.

The lease should also provide that, in the event that any damage or destruction has not been made good so that the whole of the premises are again fit for occupation and use for the business of the tenant, at least by the expiry of the loss of rent period against which the landlord should have insured, the tenant may terminate the lease. Otherwise, as loss of rent periods are usually capped at a finite length of time (between 3 and 5 years), the tenant could find himself in a position where the loss of rent insurance period has expired and rent again becomes payable (plus, potentially, service charge and insurance) when the premises are still incapable of use but the tenant cannot terminate the lease. Therefore the right to terminate must tie in with the expiry of the loss of rent insurance period. Care must also be taken to ensure that notice can be served at any time prior to the expiry of the loss of rent insurance period to terminate the lease on the expiry of that period and not just that, for example, 6 months' notice (as is common) must first be served but only after the expiry of that period, as this would leave the tenant paying 6 months' worth of rent and service charge.

A lease should also provide that in the event the rents are suspended, any rent, service charge and insurance rent paid in advance under the lease in respect of the period of rent suspension should be refunded, otherwise, under an archaic law dating back to the 1800s, the landlord is not obliged to refund any rent paid in advance, even if the rent is suspended or the lease terminated.

There are also one or two ancillary points to note:

- some leases oblige the tenant to take out plate glass insurance in the joint names of the landlord and the tenant. Many retailers and restaurant chains object to this and would rather have their own block insurance on which they do not want every landlord noted or, simply, they refuse to insure against damage to plate glass but make good that damage when it occurs;

- many tenants do not like the standard lease provision requiring the tenant to comply with all insurers' requirements as a tenant would then be bound to carry out any works that the insurers may require, even if unreasonable. We are aware of at least one client who was forced to comply with an insurer's requirement to install a very expensive sprinkler system in restaurant premises without any real justification, the cost of which ran into tens of thousands of pounds. However, from a landlord's point of view, it cannot have one tenant of a development or a building refusing to comply with insurers' requirements and therefore invalidating the landlord's insurance policy. This would be the subject of negotiation;
- many tenants refuse to comply with the requirement to connect to or install fire safety and other similar systems, as required by the landlord, but instead require simply that their obligation extends only to having to comply with fire safety, and other health and safety laws. That would seem only reasonable.

6.3 Uninsured risks

The tenant must ensure that the landlord is obliged to insure against a reasonably comprehensive range of risks as otherwise, where the landlord is not obliged to insure against any of the customary risks usually insured, the tenant will be liable for damage to the premises caused by a risk that is listed in the lease and the rents will not be suspended and the tenant will not be able to terminate the lease.

The usual risks customarily insured are set out below:

- fire
- explosion
- lightning
- earthquake
- storm
- flood
- bursting and overflowing of water tanks, apparatus or pipes
- impact by aircraft and articles dropped from them
- impact by vehicles
- riot

- civil commotion
- subsidence, landslip and heave
- terrorism (but see below)
- any other reasonable risks against which the landlord decides to insure against from time to time.

In every lease there then arises the question of “uninsured risks”. Landlords are concerned that, in the event that insurance becomes unobtainable (such as insurance against flood in a flood risk area), or insurers impose conditions, exclusions, limitations and non-nominal excesses, under the terms of the lease they will, nonetheless, be obliged fully to insure those risks. These will either place the landlord in breach of the lease if he cannot obtain insurance or force the landlord to take out insurance, the cost of which would ordinarily otherwise be prohibitive, where objectionable to the tenants in the building.

For that purpose, landlords seek to exclude any obligation to insure against any risks, exclusions, limitations, conditions or non-nominal excesses which cannot be insured on normal commercial terms at reasonable premiums in the market. However, in order to do so, the lease usually caveats the list of risks against which they must insure in this way.

An unfortunate but deliberate side effect of this is that effectively it makes a tenant liable for any damage caused to the premises by risks to the extent against which a landlord cannot insure and, in that event, the rents will not be suspended and the tenant will not be able to terminate. Clearly, this is an unacceptable position for tenants.

The prime risk in question here is terrorism, as it is thought that this will become either prohibitively expensive in the future or may be uninsurable. There may be other risks which may become uninsurable in the future, such as flood (as explained above), or subsidence, landslip and heave where property has suffered from any of those matters previously, or any other risks where insurance is unavailable.

From a tenant’s perspective, whilst it is one thing for a landlord not to be obliged to insure against any risk for which insurance is unobtainable, or where premiums are excessive, it is not acceptable for a tenant to have to subsume the risk of

damage by risks against which the landlord cannot insure, as it is not acceptable for a landlord to use the tenant as an insurer of last resort. If the landlord cannot obtain insurance for a particular risk with their weight of buying power, it is unlikely that the tenant will be able to obtain insurance.

Accordingly, the tenant should ensure that any damage by such an uninsured risk should simply be treated as if it were caused by an insurable risk so that the tenant's liability is excluded. Effectively, a tenant should properly require that in the event of damage by a risk against which the landlord cannot insure, or to the extent of any exclusion, limitation, condition or non-nominal excess, the rent, service charge and insurance rent will be suspended, the tenant will be able to terminate the lease if the damage is not reinstated by the expiry of the loss of rent period and the tenant is not liable for the damage.

The only consideration in relation to the above is that landlords usually require that if there is substantial damage to the building as a whole, then within either 6 or 12 months after the date of damage the landlord can terminate the lease. This would not seem unreasonable.

Some landlords seek that tenants take on liability for damage to the premises where it is not substantial damage, and the landlord accepts liability only for that which is substantial. Most tenants consider that this is unreasonable on the basis that tenants only pay rent in order to be able to use property or to trade from it, in the case of shops and restaurants, so they should not be liable for damage and rents should not continue to be payable if they cannot fully and completely use those premises. Tenants also see the risk of not being able to obtain insurance for a particular type of damage as a landlord's risk inherent in property ownership.

Use and rights

7.1 Use

It is imperative that the use permitted under the lease is the use to which the tenant will, in fact, put the premises as otherwise it is open to the landlord to prevent any unauthorised use, or require a premium for it.

As well as the main use to which the premises are likely to be put, care should be taken to ensure that the permitted use includes any ancillary uses which may be required, such as use of any parts of the premises for storage, any staff facilities, staff kitchen or (in the case of retail, restaurant and warehouse leases) offices. Otherwise, just because these uses are ancillary, it will not be implied that the landlord has consented to them and that the premises may be used for these ancillary uses under the lease.

The main use is normally described by reference to the Town & Country Planning (Use Classes) Order 1987, as subsequently amended and by reference to the Use Classes set out by that order.

It is not the point in this book to set out in detail the various different Use Classes and the law relating to planning uses but in general the following are the most common Use Classes and their uses:

- Class A1 – retail shops
- Class A3 – restaurants
- Class A4 – bars and pubs
- Class A5 – takeaways
- Class B1(a) – offices
- Class B1(b) – research and development
- Class B1(c) – light industrial
- Class B2 – general industrial
- Class B8 – warehousing, storage and distribution

In relation to defining the permitted use under a lease by reference to these Use Classes and by legislation, care must be taken to ensure that any reference does not include any subsequent updated or replacement legislation. It is common for most leases to provide that reference to any legislation will include any future replacement or amended legislation but, in relation to use, this should be avoided. Otherwise, if legislation and the description of Use Classes changes, this would obviously alter the permitted use under the lease and a tenant could find himself occupying premises for a use which was permitted at the outset, only for that use to be prohibited due to a change in law at a later time.

In addition to providing the permitted use for the premises, leases often set out quite a long list of prohibitions, all of which are standard and fairly reasonable; for example, use of commercial premises for residential purposes; keeping animals on premises; using premises for a charity shop or discount store; for the sale of pornographic items; as a bookmakers or for the sale of alcohol in the event of non-restaurant premises, are all common restrictions. Again, care must be taken that none of these restrictions interferes with or prohibits the intended use to be carried on from the premises.

Linked to this is that some retail leases often contain exclusions on the type of uses to which premises may be put, revolving around the sale of certain goods where the landlord has promised another tenant within a shopping centre that he will not let other premises where any goods sold would conflict or compete with another shop. For example Apple quite often requires a landlord to enter into a restriction that they will not let any other shop to a business which sells Apple items and occasionally items that compete. The list of restrictions must be checked carefully to ensure that this won't prevent the use intended and, further, that it won't restrict the potential pool of buyers for the lease if the lease becomes surplus to requirements. If restrictions are too widely drafted, in some cases this can greatly reduce the number of potential buyers and therefore narrow or remove exit options.

Some retail leases often provide that premises may not be used for any other use which conflicts with the principles of good estate management or the landlord's policy of tenant mix. The former is reasonably acceptable but, in relation to the latter, questions should be asked whether a landlord does have any current policy in place and the tenant will need to see a copy of it. Often this is not the

case and such provisions would act as an arbitrary veto in favour of the landlord against any future use and could make the lease incapable of being transferred to a third party or being sold. At the very least any reference to tenant mix must be limited to a policy that is “reasonable”.

Restaurant tenants need to be particularly careful about any restrictions as to the emission of noise, smells or fumes from premises. Often leases can be very restrictive in this area, which could actually indirectly prohibit a tenant from using the premises. Noise, fumes and smells are always likely to escape from restaurant premises no matter how good the extraction or ventilation equipment, so a compromise usually needs to be found to satisfy the concerns of the landlord in relation to any neighbouring occupiers, and also to ensure that the provisions are not unduly restrictive so as to prevent use.

7.2 Keep open clauses

Some retail and restaurant leases provide that tenants must keep the premises open for trade during either the normal hours in the locality (or a shopping centre) and that the shop front must be kept attractively laid out and lit during those times. These clauses should always be resisted where the lease does not provide for a turnover rent, and in these cases it is thought that such provisions are difficult to enforce as it is difficult for a landlord to prove the loss that has been suffered.

The position is slightly different with turnover rent leases as obviously the landlord will be deprived of the turnover rent payable in respect of lost turnover during days when the premises are closed. For that reason, keep open clauses, to a certain extent, are not unreasonable in turnover rent leases. However, there are two areas of concern, as below.

The first is that often leases provide that if the tenant is in breach of the keep open provisions a penalty rent is payable. Often these penalties are harsh and go further than simply compensating the landlord for lost turnover rent, or lost open market rent, but essentially provide for the landlord to be paid punitive damages. This is not acceptable. For example, some leases, instead of providing that a full open market rent is payable for each day the premises are closed when they should have remained open, will instead provide that 100% of open market rent should be paid in addition to lost average turnover rent

for those days closed or, 125% of open market rent is payable. Clearly, any such punitive damages are unreasonable, although there should be no objection to compensating the landlord for the rent which otherwise they should have received had the premises remained open for trade as required under the lease.

The second area of concern is that there should be some instances noted under the lease when the premises may be closed. The usual exclusions are:

- where to do so otherwise would be unlawful due to any law or statutory requirement (for example, health and safety);
- in the event of damage caused by an insured or uninsured risk it is impossible or impractical to keep the premises open for trade;
- during any reasonable period prior to disposing of the premises (either by way of transfer to a purchaser or the grant of a sublease) as time will be required for one party to wind down its business and vacate and for the other party to move in;
- during any reasonable period for carrying out any works, alterations, fitting out, refurbishment or repairs where obviously it is not possible to be open during these times, particularly for health and safety reasons;
- any reasonable period for staff training or stock taking. Landlords often, whilst recognising that this is reasonable, will want to impose a cap on the number of days that can be closed per year. Two is not necessarily unreasonable;
- for any other cause beyond the tenant's reasonable control. It would not be reasonable to penalise a tenant if closure was due to a reason beyond the tenant's control, such as strikes or public disturbances, for example;
- some tenants also require that they can close on certain days during the year, for example Easter Sunday and Christmas Day. Believe it or not some landlords refuse to exclude Christmas Day from compulsory trading.

7.3 Tenant's rights

As well as ensuring that the tenant can use the premises for its intended use, the tenant must make sure that it has all necessary and ancillary rights in order to be able to use the premises. Leases normally go out of their way to ensure that no rights are given to the tenant at all other than those expressly set out in the lease, so if the tenant requires any rights of access to the premises over other parts of the building, for example, these must be expressly set out in the lease or the tenant will not benefit from them. In some cases the absence of any required rights may actually prevent use of the premises but, notwithstanding that, the tenant would not be able to terminate the lease and rents would continue to be payable.

Common rights required in leases (but by no means an exclusive list) are as below, but care should be taken to consider the physical circumstances of the premises and any special rights of access or any special facilities that may be required to be used by the tenant:

- rights of support– for technical reasons this must be included in any lease, otherwise the landlord would be free (although subject to other constraints that are not set out here) to remove structural support to the premises from other parts of the building, which could either cause disruption to the use of the premises or could cause damage to them for which the tenant may be liable. This sounds absurd but is fundamental;
- the use of all conduits (wires, cables, ducts, pipes, drains), etc. for the flow of electricity, gas, water, sewage, data and telecommunications services that may be required by the premises. For example, in an office building, the right to use cabling and ductwork for the transmission of data and telecommunications is likely to be vital but without this right the tenant would not be able to use these conduits. Notwithstanding any such rights granted in the lease, if the tenant requires the right to run his own cabling (for example, fibre optic internet cabling) through the ducts in the building, the tenant will need a special form of supplemental agreement (a wayleave agreement) if it is not written into the lease expressly. Therefore, great care should be taken to ensure that this is included in any lease;

- a right of escape from the premises in the case of emergency- this would be required in any lease but particularly in relation to restaurant premises rights of escape are critical as, without adequate rights of escape, this could affect the capacity of the premises and could jeopardise the premises licence (for the sale of alcohol), without which the premises could not trade. Other premises could well be in breach of fire safety legislation without adequate escape rights making them incapable of use. It is always advisable that premises, before a lease is signed, are inspected by a qualified fire risk assessor to ensure that the premises benefit from all necessary rights of escape. Any routes of escape will need to be written into the lease to ensure that the tenant benefits from them;
- rights of access– it goes without saying that for a lease in an office block rights over halls, passages, landings, lifts and entrances and exits must be granted if a tenant is to access the premises. As a reminder, if there are no express rights of access to premises or to cross across any other parts of the building, the tenant will not have this right and the landlord could be free to prevent access. The same point goes for shopping centres and where any intervening land needs to be crossed in order to get to any premises;
- rights of access 24 hours a day, 7 days a week where required– for example, in office premises where late night and weekend working is required and in a shopping centre where a tenant customarily accepts international deliveries at various different times of the day and night;
- rights for shop tenants to use service bays, loading corridors and goods lifts, etc. to convey goods to and from the premises- most leases normally prevent goods being delivered via the common parts and malls, so use of these areas will be key;
- to place the tenant’s signage on the landlord’s totem or directional and advertising signage– in the case of shop premises the tenant will want the ability to do this in order to ensure that customers can find its location;
- to install air conditioning, ventilation, extraction and refrigerant cooling apparatus both on the premises and in a suitable plant area outside the premises, and possibly on the exterior of the building– it is absolutely

vital for most tenants that they have the ability to install air conditioning apparatus as without this premises usually overheat. This is especially the case for shop premises. It is also essential for restaurant premises that air extract ventilation and refrigerant cooling apparatus can also be installed as without this plant and machinery the extraction of fumes and cooking smells are likely to be prevented and this could therefore actually prevent cooking and the use of the premises as a restaurant. Linked to these rights, a tenant would also require the right to connect any air conditioning or other plant and machinery from the premises to any exterior plant or vents via the necessary ducting and cabling across other parts of the building. Express rights therefore need to be written into the lease to ensure that the premises will benefit from these rights.

- The key issue is that whilst the tenant may have rights to carry out works and install plant and machinery within the premises, without any express right the tenant usually will not have rights to install plant and machinery outside the premises. Air conditioning and other extract apparatus by necessity usually work on the basis of an extraction or air conditioning unit within the premises linked to a separate vent or extractor outside the premises either on an outside wall or further away and connected by ducting. Without this express right to do so in the lease there will be no right to install that plant and machinery in any other part of the building, therefore potentially preventing use of the premises.
- As an ancillary right, the tenant must also make sure they have rights to access all external plant and machinery for the purposes of repair, maintenance and replacement as otherwise, again, this right will not be implied.

7.4 Landlord's rights (called "reservations")

Just as a lease usually contains tenant's rights they also usually contain rights reserved to the landlord in respect of the premises themselves.

Many of these are reasonable, such as a landlord's right to enter the premises for the purposes of inspecting and making sure that a tenant has complied with its lease covenants and the premises are in repair. However, even such innocuous rights must be subject to the landlord serving reasonable notice on the tenant

and only entering during reasonable periods and at reasonable hours.

Some of the rights in favour of the landlord could be potentially far more serious in terms of the effect they have on a tenant's use and occupation of the premises, and some of the common rights reserved to landlords and the points to look out for are below, although this is by no means an exhaustive list:

- some leases provide that a landlord may carry out repairs, alterations or replacement of existing pipes, cables and conduits within premises. This is only reasonable but other leases also provide that a landlord may install additional conduits and plant and machinery in the premises. This could be potentially far more disruptive and, more importantly, could actually occupy space within the premises for which the tenant is actually paying rent. In retail and restaurant premises, care should be taken to ensure that no conduits, plant or machinery will be installed in such positions as to reduce floor to ceiling height (tenants usually need this in which to place their own equipment and conduits and false ceilings, etc.) nor reduce the Zone A trading area (being the most valuable part of the premises (and highest rental value) in terms of areas traded from) or otherwise affect the tenant's fit-out;
- some leases allow the landlord to install things on the outside of the premises. Whilst landlords do often need these rights, for example especially in shopping centres where they might need to erect directional signs, lighting, security cameras and various other reasonable items on the exterior of the premises, care needs to be taken here to ensure that nothing is placed on the premises which could interfere with the tenant's signage, shop front, shop front display, shop window or access to the premises. It is also equally important to ensure that no signage may be erected on the premises which either advertises any other tenant in the shopping centre (in respect of retail leases) or any other products or services, as this is obviously competing with the tenant's own branding;
- leases often permit the landlord to close any common parts permanently or temporarily, or redirect them. This should be acceptable only where the lease provides that reasonable alternatives will remain and that the amenity

or access of the premises is not unduly affected;

- leases often contain wide rights allowing landlords to redevelop, or carry out works to, the remainder of the building and will often provide that, despite any interruption to the tenant's use, or where this might prevent a tenant from exercising any other rights required which were otherwise available, no compensation will be payable to the tenant. Obviously this should be resisted and is unacceptable;
- most leases allow a landlord to erect scaffolding around the premises (even in leases of whole buildings). In leases of offices it should be ensured that any scaffolding is not going to restrict access or otherwise use of the premises but, in retail and restaurant premises, scaffolding is far more serious and wider protections are required altogether. Scaffolding erected around retail or restaurant premises can often have such a detrimental effect on trade as to reduce it by more than 50%. Therefore, although a need for a landlord to erect scaffolding in order to repair and maintain the building is recognised, various protections need to be added to leases to protect the tenant's trade. Some of these protections are set out below:
 1. scaffolding should be erected only where reasonable notice is first given to the tenant;
 2. the tenant's reasonable right of representation should be considered as to how to minimise disruption and effect on the tenant's trade;
 3. scaffolding should be in situ only temporarily and should be taken down as soon as reasonably possible;
 4. scaffolding should use the minimum number of vertical poles possible and, where possible, vertical poles should be erected only either side of the shop front and not in front of the shop front or display windows, and any horizontal poles should be above the tenant's fascia signage;

5. no scaffolding must interfere with, or obstruct, access to the premises, the shop front, shop window or tenant's signage;
 6. if tenant's signage is affected, the landlord should allow the tenant to erect reasonable signage on the scaffolding at the landlord's cost;
 7. no scaffolding should be erected during the first 18 months to allow trade to be established from the premises and nor during the months of November to February (in the case of retail premises) or July through to September and December in the case of restaurant premises.
- finally, because landlord's rights are often incredibly wide and include rights to redevelop the remainder of the building, carry out substantial works, and have access to the premises in order to do so, all of which could be potentially incredibly disruptive, it is advisable that the vast majority of landlord's rights are also caveated by the following protection provisions:
 1. the rights shall be exercised only on reasonable prior written notice and at reasonable times (in the case of retail or restaurant premises outside of the tenant's trading times where reasonably possible (save in an emergency));
 2. causing as little damage as is possible to the premises and any tenant's fixtures and (in the case of shops and restaurants) stock, with the landlord making good any damage it does cause;
 3. that where entry is required onto the premises, entry will be exercised only where the right to which it relates cannot otherwise reasonably be carried out without such entry, in order to minimise as far as possible any potential interruption to use or trade;
 4. finally, and the overriding principle which should be insisted upon is, that no materially adverse effect on the tenant's trade (in the case of retail or restaurant premises) or use and enjoyment (in the case of offices and other premises) is caused. The overriding principle which a landlord should be forced to agree, even if it resists all other protection provisions, is that the tenant pays rent in

order to be able to use the premises (or trade from them in the case of retail or restaurant purposes) and if he cannot do so fully because of a right being exercised by the landlord then either the rent should be suspended (landlords will never usually agree to this) or simply the landlord should be prevented from exercising his right where it would affect the tenant's use.

In reality, this may not prevent a landlord from exercising his rights, which may affect the tenant's use, but it may make a landlord think twice about doing so and it would give a tenant a right to approach the landlord and ask for some kind of rent and service charge rebate in the event the tenant could not use the premises for a period of time.

Alienation

8.1 Assignment

The ability to dispose of the lease or allow a third party to occupy is referred to as "alienation". There are various different methods of alienation, which includes assignment (transferring the lease to a third party), sub-letting (granting a lease from the tenant to a sub-tenant), sharing occupation or otherwise allowing another to occupy.

Most tenants would be concerned about their method of exiting the lease, particularly if a lease does not contain a right to terminate the lease, so as to enable the tenant to walk away, or were there are large periods of time between termination dates. For example, some 10 year leases will contain a right to break at year 5 but if the premises become surplus to requirements at any time before or after year 5 the tenant will want an exit route from the lease. Conversely, landlords usually want to keep tight control over their premises and in whom the lease may become vested and, in particular, is likely to want to retain the original tenant as the tenant under the lease for as long as possible, as he was the tenant to whom the landlord initially chose to grant the lease. This chapter deals with various methods of either disposing of the lease or allowing others to occupy, but by far the most common exit method is assignment (transferring the lease to a third party) or sub-letting (the tenant granting another lease to his own tenant).

There are a couple of points of law of which a tenant should be aware. Generally in respect of leases, if a lease is silent in any particular respect then there will be no restriction on the tenant in that regard. For example, if there is no restriction on assignment or sub-letting then a tenant will be free to do that without the landlord being able to prevent it or impose any conditions. If a lease provides that a tenant may assign or sub-let with the landlord's consent then, regardless of whether the lease states this, the law provides that consent must not be unreasonably withheld or delayed. At the time of writing it is typically assumed that two weeks is around the time for a landlord (once he has received all necessary information) formally to communicate whether

or not he intends to give consent.

Most leases will permit an assignment (unless it has been expressly agreed that the rights of occupation contained in the lease are to be personal to the tenant) but not all leases will permit sub-letting. If assignments and sub-lettings are permitted, landlords will often seek to impose various conditions upon any assignment or sub-letting in order to retain control over the premises and for various other reasons detailed below.

Likely conditions (although this is by no means an exhaustive list) are set out below:

- That the tenant will enter into an authorised guarantee agreement (“AGA”) – it should be noted that if the tenant has taken a transfer of an existing lease, either dated before 1st January 1996 or entered into pursuant to an agreement for lease granted before 1st January 1996, then when the tenant assigns that lease to a third party he will still be bound by the covenants and obligations contained within that lease in the event of any default by the person to whom he assigns. Therefore, effectively, the tenant will stand as guarantor for the performance of the assignee to whom he transfers the lease and subsequently any other tenant to whom that assignee itself transfers the lease. Obviously this has serious implications for the tenant as they will remain bound, even though they have parted with the lease.

Presuming that the tenant is either taking an assignment of a lease granted, or entered into pursuant to an agreement for lease dated after that date, or is taking the grant of a new lease, the above will not apply. The law now provides that once the tenant has assigned the lease he will be released from all lease obligations and any breaches by the assignee. The tenant, therefore, will not remain liable for the assignee or any subsequent tenant.

However, the law now provides that, where a lease (dated on or after 1st January 1996 or entered into pursuant to an agreement for a lease dated after 1st January 1996) is silent on the point, the landlord can request that, only where it is reasonable to do so, the tenant enters into an authorised guarantee agreement. An Authorised Guarantee Agreement (“AGA”) is a guarantee given by the tenant to guarantee the performance of the assignee only, until either

the lease comes to an end or the assignee itself assigns the lease. Therefore, that guarantee is limited to the assignee only.

Some landlords insist that the lease will provide that the landlord will be entitled to ask for an AGA from the tenant as of right, and not just in circumstances where it would be reasonable to do so. Obviously this is very disadvantageous for the tenant, so a tenant would want to limit the provision of an AGA to circumstances where it would be reasonable for a landlord to ask for one. This would include where the income and assignee's financial standing were not reasonably acceptable to the landlord.

It should be noted that AGAs are usually wide and uncapped and it is not uncommon for them to provide that, in the event of a default by the assignee, the tenant will be liable for all sums payable under the lease and to indemnify the landlord for all costs and losses he has suffered. AGAs are sometimes capped to some extent but those circumstances are outside the scope of this book.

It is sometimes open to a tenant, who has paid any sums due under the AGA, where the assignee has defaulted, to request that the landlord grants him a new lease for the remainder of the term of the current lease, but subject to the current lease held by the assignee, which becomes a sub-lease (where effectively the tenant becomes the assignee's landlord). The detail and the mechanism for this are also outside the scope of this book.

- Assignments are prohibited unless the assignee meets some financial test – the base position in law is that the landlord cannot refuse consent to an assignment unless it would be reasonable for the landlord to do so. This would include where the incoming assignee was not of reasonable financial standing. However, some landlords often seek to impose further financial tests which could prevent an assignment unless the tenant has a high financial standing.

For example, some leases prevent an assignment unless the assignee is of similar or greater financial standing than the tenant as at the date of application for consent to the assignment. Obviously this could prevent an assignment if the tenant is of great financial standing or, in particular, where the tenant took the lease as a fairly new entity but has since built up substantial accounts and is now of far greater financial

standing. This financial test could effectively make parting with the lease impossible for a well performing tenant, therefore removing any exit options.

Some landlords also seek to impose other arbitrary tests such as where net profits exceed three times the annual rent and service charge, or where net assets exceed five times rent and service charge, etc. Such tests, whilst not necessarily an unreasonable guide, should not form a strict test to be contained within the lease. Any financial considerations or financial performance of the tenant should be assessed within the realms of reasonableness, as the law implies, in the context of all pertinent circumstances, and the lease should not go further than this.

- Prohibition on assignment where a tenant is in breach of a lease obligation –landlords will want to be able to insist that all the tenant's obligations are fulfilled before an assignment. This will enable the landlord to bring pressure to bear on the tenant to prevent any assignment of the lease until the breaches have been made good. The first point to note is that there are always minor breaches of a lease, no matter how diligent a tenant, so any test should, at the very least, apply only to "material" breaches of any lease obligations. However, it is not a reasonable condition to impose in relation to an assignment because any incoming assignee would automatically be bound by the lease obligations and requirements and therefore would be bound to make good any breach of the lease. The landlord, therefore, should not be able to use any breach of the lease as a reason to withhold consent to an assignment. The only exception to this is that it would not seem unreasonable for a landlord to withhold consent where any rent or other sums due to the landlord under the lease remain outstanding (unless where there is a bona fide dispute in relation to any service charge charged by the landlord).
- Prohibiting an assignment where to an inter-group company – some landlords seek to prevent assignment to related or group companies because it can dilute the landlord's security as they see it. Even if the tenant is required to give an authorised guarantee agreement as the finances backing up the guarantee of the tenant and the obligations of the assignee are effectively of the same group, it could be argued that the landlord's security is diluted. However, from a tenant's point of view, any application for consent to an assignment of a group company should be judged on its merits, just as the

assignment to any other third party tenant. If the group company assignee is of decent financial standing to be a tenant under the lease then the landlord should not be able to prevent the assignment. Accordingly, many tenants resist this condition.

8.2 Subletting

As with the comments above in relation to assignment, leases often impose conditions upon sub-letting. Some of the more common conditions (but this is not intended to be an exhaustive list) are below.

- A condition not to sub-let at lower than the market rent or the rent payable under the lease at the time– this is probably the most objectionable condition in relation to sub-letting found in leases. Effectively this prevents sub-letting in a declining market and therefore removes an exit route for the tenant. The point here is that if the lease was entered into at the height of the market but subsequently rental values in the area have dropped, an incoming tenant would be unwilling to take a transfer of the lease at the current rent as the property is effectively over rented. The fact that the lease prohibits sub-letting unless at the higher of the rent then payable under the lease or the open market rent, would prevent sub-letting, as no tenant would take a sub-lease at such a high rent.

The reasoning behind this is that the landlord wants to keep the rents in the area inflated as high as possible as, upon rent review, the landlord's surveyor will produce evidence of the rental values in the surrounding market, to support their contention as to the other tenants' new lease rent, and that evidence will include the rents at which other leases in the building have been let, including any sub-leases. The landlord would not want to find that, upon rent review of any of the leases in the building, the benchmark rent was reduced because of the evidence provided by a sub-letting at less than the rents at which the landlord originally granted his leases.

However, from a tenant's point of view this removes an exit route and therefore the lease should state simply that no sub-letting must be at less than the open market rent. That is obviously reasonable and preserves the rents in the building at the highest that can be achieved in the open market, but does not penalise the tenant by removing one of their exit options.

- A condition that the premises must not be sub-let at a premium – this is fair and reasonable as if a premium is payable for premises this can reduce the yearly rent payable upon rent review. However, this is important in relation to restaurant leases as they usually always carry a value and are usually always assigned for a capital value or premium. If the sub-letting exit route is to remain for a restaurant tenant, the lease must be capable also of being sub-let for a capital value, as otherwise the tenant would not be able to take advantage of the sub-letting exit route and also realise the necessary capital value.
- A condition that any sub-lease must be in the same form as the tenant's lease – the landlord does not want to grant a lease to a tenant which contains the protections which the landlord requires for himself, only then to find that the tenant grants a sub-lease which is completely open and flexible. The point here is that in certain circumstances the landlord can find himself the direct tenant of that sub-tenant on the terms of the sub-lease (further detail on this is outside the scope of this book). On that basis this is not unreasonable but the tenant should consider whether or not there are likely to be any special circumstances in relation to any future sub-letting so the form of sub-lease should be allowed to deviate from the tenant's own lease to a certain extent. If this is envisaged then sub-letting must be permitted on reasonable terms to be approved by the landlord, but not necessarily strictly following the terms of the tenant's own lease. In any event, any requirement for any sub-lease to be along the same lines as the tenant's own lease must exclude from that obligation the payment of the rent under the tenant's lease, as obviously the sub-tenant's obligation will be to pay the sub-lease rent, which may be lower than the tenant's lease rent. Without this provision again the tenant could be forced to seek to sub-let at a higher rent than market rent.
- A condition that any rent review dates must be the same as those in the tenant's own lease – this seems fairly reasonable and, in practice, the review of the rent under the tenant's own lease is likely to take place at more or less the same time as any review of the rent under the sub-lease, even if not as part of the same process. The only point to note here is that it is usual for rent reviews to occur every five years during the lease term but it is unlikely that any sub-letting would take place on one review date and therefore the next review under the sub-lease is likely to be less than five years. In some

cases the review date under a tenant's lease could be only a few months, or only a year or so after the sub-lease was granted. This would mean that a sub-tenant entering into a sub-lease could face a potential rental increase under the sub-lease only a short time after he has entered into the sub-lease, which could well be off-putting to a sub-tenant and therefore could prevent sub-letting at certain times during the term of the tenant's lease. On that basis, this should be resisted but instead any condition on sub-letting should provide only that the rent must be reviewed every five years.

- A condition that the tenant must not vary or terminate the sub-lease – these conditions should not be agreed. If a tenant is able to grant a sub-lease with the landlord's consent then, similarly, the tenant should be able to terminate those sub-leases (without consent) or make variations to them, also with landlord's consent (not to be unreasonably withheld or delayed). Otherwise, the tenant could be left with a sub-lease which cannot be terminated or changed, even where those changes would be reasonable.
- Conditions affecting the review of the sub-lease rent– landlords want control of the evidence available in the market which could affect lease rents on review for leases in the building. For this reason, landlords will want to have control over any sub-lease rent reviews. The tenant should not accept that any sub-lease rent must be the same as the headlease rent, as this could prevent sub-letting, on this basis the sub-tenant would face the risk of paying a rent over and above the open market rent at the time of review.

Landlords often want either a degree of participation in a sub-lease rent review or, at the very least, require that representations a landlord wishes to make to any arbitrator or surveyor determining any sub-lease review, are made or, in some cases, that the landlord has a final sign-off on any sub-lease rent review and that such review cannot be settled without the landlord's consent. At least in the latter case, the tenant must make sure that consent must not be unreasonably withheld or delayed and, to some extent, the other requirements are not unreasonable. However, care should be taken to ensure that, whatever the landlord's requirements, they are reasonable and they must act reasonably.

8.3 Sharing and parting with possession

Often in leases, sharing of the premises with any other occupier or allowing any other occupier to occupy the premises (other than by way of an assignment or a sub-letting) is prohibited. There may be many reasons behind this, such as the landlord wanting to retain control of the premises and also that the landlord approved the tenant and then does not want to see another party in occupation, especially one with whom he may not have any direct contractual relationship and so cannot enforce directly any infringements of the lease. However, from a tenant's point of view, this affects flexibility of the use and there may be various circumstances why an office tenant may want to share occupation with a group or related company or, for example, a retail or restaurant tenant may want to grant franchises of the premises or a retail tenant may want to allow concessions to operate from the premises.

Any special requirements of this nature will need to be negotiated with the landlord and expressly entered into the lease, as most leases will otherwise prohibit sharing or parting with possession.

It should be noted that where a lease allows sharing of occupation, "sharing" is exactly that which is permitted, which does not cover allowing another group company, for example, to occupy the whole of the premises. If that is the intention then that should be discussed with the landlord, but a landlord will usually require that any occupation of the whole by a group or related company, or other third party, is conducted by way of a sub-letting.

Where sharing of occupation is permitted, this is usually only on the basis that it is done by way of a licence only and where no exclusive occupation or possession of any particular area within the premises is given, as otherwise it is possible that any third party occupier could obtain rights of occupation which the landlord could not defeat. This creates further practical problems because occupation on a licence basis necessarily involves the tenant being able to move around the space occupied by that third party (so the occupier is not given exclusive occupation of any particular zone) and that third party not being permitted to partition off any area or exclude the tenant from that area. That could well be unacceptable to that third party, or cause practical issues.

If a landlord permits any concessions to a retail tenant it is likely to be strictly on the basis that the premises retain the overall appearance of a single shop run by the tenant.

8.4 Charging

Charging by way of security to a bank is usually prohibited. Many tenants subsequently require this ability, even where they did not envisage this at the outset, and therefore it is often advisable that this right is added to a lease when it is negotiated.

Charging a lease may occur in a couple of ways. For example, a bank may give a loan on the basis of the tenant entering into a debenture for security, which necessarily brings with it a floating charge over all assets of the company. This would include the lease. Another example is fixed charges, where a bank will sometimes advance finance and require a fixed charge over the property from which the business is conducted, as security.

Charging does not apply all that often to office or retail leases as those leases do not usually command any capital value and therefore have no security value for a bank's purposes. Restaurant leases are obviously different, as they usually carry a capital value and therefore are often the subject of a charge.

8.5 Landlord's rights of pre-emption

Some leases include a landlord's right to take back the premises in the event that the tenant proposes to assign or sub-let. These provisions are not common in office, or any other types of lease, other than retail or restaurant leases, where they are most common to premises in shopping centres or other similar buildings where the landlord wants to retain control over the tenants, brands or mix of uses within the centre or building.

Pre-emption provisions provide that, once the tenant has found a potential assignee, he must then offer the premises back to the landlord by serving notice, giving the landlord adequate time to accept the offer. Only once the landlord has either not responded within a certain period of time, or has confirmed that they do not want to take back the premises, is the tenant then free to assign to

the proposed assignee for (say) six months and on terms no less beneficial to the tenant than the terms offered to the landlord.

The tenant will have a number of concerns in relation to these provisions, as set out below (on a non-exhaustive basis):

- The pre-emption provisions should provide that the landlord must match any premium offered by a bona fide assignee. This is limited to “bona fide” assignee as obviously the landlord does not want a tenant using a related third party to offer an inflated price which the landlord would then have to match. However, the tenant’s concern should be that the landlord has to match the premium by a bona fide assignee, and that premium must include all items for which an assignee would offer to make payment. For example, the lease must state that the landlord has to match any payments for goodwill, fixtures, fittings, fit-out, plant and machinery installed by the tenant, the value of any premises licence (in respect of restaurant premises) and for the lease. Otherwise, unless the landlord is obliged to match any premium for all of these items, the landlord could contend the price offered does not include payment for some of these items and therefore the landlord does not have to pay the full price being offered. That would leave the tenant in the position of having to give up the premises at an undervalue.
- Often, leases provide that, notwithstanding the fact that the landlord is taking back the premises, the tenant will not be released from any past breaches of his obligations under the lease. This could be particularly costly because it would leave the tenant liable (presuming the usual lease terms apply) to redecorate the premises, fully strip out all of its fitting out works to give back the premises to the landlord in shell and core condition, and to make good any disrepair, amongst other breaches. From a tenant’s point of view, that is unacceptable as, if he had been allowed to sell the premises on to a third party, that third party would have taken on this liability, leaving the tenant free of such expense. Therefore, a tenant should ensure that pre-emption provisions do fully release the tenant from all lease obligations, except for any arrears the tenant may owe.
- The whole process of the landlord either accepting or rejecting the tenant’s offer and then completing the transaction should occur during a reasonable

time frame, without undue delay. Obviously the tenant will be paying rent and (in respect of retail or restaurant premises) could be losing trade during any extended period. The usual time periods are about between fifteen and twenty working days for a landlord to accept any tenant's offer and between two weeks and a month subsequently to complete the handing back of the lease to the landlord. Obviously the time period after the landlord has accepted the tenant's offer is important to the tenant, as he needs to ensure that it has adequate time in order to wind down his operation from the premises, relocate staff and move into other premises as necessary.

- As a minor legal point, leases often provide that the premises must be handed back to the landlord free of any third party or other rights and interests. This is only fair and reasonable but only to the extent that any third party rights and interests did not affect the premises when the lease was granted. It should not be a condition that the premises are handed back to the landlord free of any issues that affected the premises when the tenant took the lease.
- On a final point, in relation to any retail and restaurant chains where they have multiple units, they would want to exclude from the pre-emption provisions any sale of the premises where it is part of the sale of the tenant's business. Without this carve-out the tenant could find himself selling off a chunk of its business (including a number of shops/restaurants), only for the landlord to be able to exercise his right of pre-emption, which would interfere with that sale.

Alterations and signage

9.1 Alterations and planning

It is obviously vital in terms of flexibility of use of the premises and to ensure that the landlord cannot prevent the intended use, that the tenant has the necessary right to make changes to the premises and carry out works and alterations to them to make them fit for their own use and to fit their particular needs.

However, the first consideration is that any rights to carry out works to the premises given in the lease are almost certainly described as permitted alterations to “the Premises”. It is therefore fundamental to ensure that either the premises consist of all physical parts of the part of the building being let that the tenant requires for use and to which a tenant would require to make changes or alterations, or otherwise that express rights are granted to carry out works outside of the premises let under the lease. Although there are technical distinctions, it is fundamental as otherwise alterations will be allowed only to “the premises”. This precisely why a separate right is usually required to install air conditioning condensers outside of the premises (see previously).

The basic position is that if nothing is stated in the lease then the tenant can carry out whatever alterations he requires to “the premises”. However, a tenant will still not be permitted, in law, to commit “waste”, which is any damage which lessens the value of the property to the landlord, owner or future owner. Most commercial leases (i.e. those not for a capital premium and not for a term in excess of 25 years) will contain detailed controls over the level of alterations permitted. The more common position is that a tenant will be allowed to carry out internal and non-structural alterations only. This is fairly self-explanatory but, if the premises are either restaurant or retail premises, care should be taken to ensure that alterations can also be made to the shop front and fascia, as this will be important in terms of tenants’ signage requirements and display windows. Care should also be taken expressly to include rights for the erection for any awnings, flags, antenna and aerials (as well as air conditioning) (see previously) as the tenant may

require and to ensure that the lease otherwise does not contain any restrictions on installing any special items required.

Usually where a right is given to carry out certain types of alterations (for example, internal and non-structural) it will be subject first to obtaining the landlord's consent. However, if a landlord's consent is not required in the lease to be given reasonably; the law implies only that a landlord cannot unreasonably withhold his consent where those works amount to improvements. In all other cases the landlord has a complete veto. However, the law does view "improvements" as being viewed through the eyes of the tenant and so the landlord will not be able to withhold his consent where any works would increase the value or usefulness of the premises to the tenant. On a related point the law does not imply that that consent must not be delayed and therefore this must also be expressly set out.

In addition, where improvements are made to the premises, the tenant may be entitled to compensation at the end of the term of the lease but this is now rare, and most leases expressly exclude this.

Many retail or restaurant chains, or those establishing a chain, would be keen to ensure that the landlord's consent is not required to internal and non-structural alterations and alterations to the shop front in line with the tenant's corporate colours, branding and fit-out. However, unless the tenant is a substantial chain the landlord is unlikely to agree this. On occasions where this is accepted by a landlord, a landlord may require that any fit-out and decoration must at least be to the same quality and standard as all the other tenant's outlets or to the tenant's flagship store/restaurant. This should obviously be avoided as the tenant does not want to be forced to carry out expensive refurbishments or decorations simply because they have made changes to another store.

9.2 Signage

Again here, a tenant's ability to install his signage is important and where those premises are retail or restaurant premises is fundamental. This is obviously going to have a huge effect on trade from retail and restaurant premises and the tenant's customers being able to locate the business being operated from the premises. Even where the premises are office premises this is still an important

consideration, as a tenant may want his customers visiting his offices to be able to find them easily.

Again, if nothing is stated in the lease then, unless covered by the alterations provisions (see above), the tenant will be free to erect whatever signage he requires. Again, however, this is limited to the erection of signage on “the premises” and therefore if the premises do not include the shop front and fascia or any other part of the exterior, then no signage will be permitted to be installed in those areas. It is key to ensure that the premises comprise those parts of the premises which the tenant needs to use and on which he will require to erect signage, unless otherwise express rights are granted in the lease to allow signage to be installed outside of the premises.

The usual position is that signage will be permitted with the landlord’s consent. Here the law does not imply that the landlord must not unreasonably withhold or delay his consent and therefore the lease must expressly state this or otherwise the landlord will have an absolute veto over what signage may be erected. It is crucial to ensure that whatever signage is likely to be required is permitted and there are no restrictions in the lease prohibiting it. For example, leases often prohibit the installation of any signage on the exterior or that which can be seen from the exterior without the landlord’s consent, as to which he has an absolute veto. Clearly, it is fundamental that a landlord must act reasonably when giving consent to the erection of a tenant’s trade and brand signage on the shop front, fascia and exterior but almost as important is the ability to erect signage inside the premises, even if it can be seen externally. The common compromise here is that the landlord must not unreasonably withhold or delay his consent, as otherwise this could, in fact, prevent the tenant from fitting out or installing his usual merchandising signage within the shop front.

However, landlords will often be keen to ensure that the shop window is not obscured so as to appear that the premises are occupied by a discount store, or for the purposes of a closing down sale. On that basis it is common to find that the shop windows must not be obscured or obstructed and that only a certain percentage of the glazing may be obscured by signage (often signage is not permitted on the glazing itself), for example commonly around 30%. However, the tenant must be sure that, whatever the percentage stipulated, this obviously allows for his standard signage but, in addition, that the tenant is allowed to

install his sales signage in excess of the percentage description during genuine sales periods whenever they occur within the calendar year. Landlords often seek to confine this to a certain number of periods (for example, sales periods no longer than 2 weeks, 3 times a year) and are likely to impose further percentage restrictions (but more than the percentage restriction outside of sales periods), commonly around 50%, to ensure that a tenant cannot cover the whole of the glazing in signage.

The tenant of restaurant premises must also ensure that he is able to erect menu boxes, menu signs and credit card signs without the landlord's consent, as it would be impractical to obtain consent to every change of signage.

The tenant would also need to consider any special requirements, for example in office premises, whether or not the tenant requires the ability to install brass plaques, not only on the entrance to the premises (which may be in the common parts of a building if the tenant takes a lease of a floor in an office block) but also whether or not the tenant's signage needs to appear on the external entrance to the building itself (so that customers to his premises can find the location) and on any reception directory board indicating the floor of the office building which the tenant occupies. Similarly, a retail or restaurant tenant would want the ability to place their signage on the landlord's totem directional signage within any shopping centre, building or complex, indicating the tenant's location.

Any chain retail or restaurant operator would also want the ability to install his signage without consent where in line with his corporate colours and branding. Again, a landlord is likely to seek to resist this except for the largest of chains.

On a final point, the tenant must be able to install whatever he needs to install where required by statute, for example, signs in the interests of health and safety.

9.3 Yielding up

Most modern leases provide in what condition the premises are to be handed back to the landlord, either at the end of the contractual term of the lease or when the lease prematurely comes to an end.

The vast majority of landlords will seek to insist that any alterations or works (even

where improvements) carried out by the tenant during the term of the lease (or in contemplation of it) are removed at the end of the term and the premises are, more or less, stripped back to a shell and core condition.

From a landlord's point of view this is not unreasonable as most incoming tenants (whether office, retail or restaurant) to whom the landlord may let the premises after the tenant has departed, will have their own fitting out requirements and will want to carry out works to the premises to ensure that they are suitable for their own needs. For that purpose, any incoming tenant would obviously want any previous tenant's fit-out to be removed. Landlords can usually charge a higher rent, or pay lower capital contributions, if they are able to hand over the premises to an incoming tenant in a shell and core condition, ready to be fitted out. It is on that basis that landlords usually insist that a tenant removes his fit-out at the end the term.

However, from a tenant's point of view this is likely to be costly in two ways. First, there is the physical cost of having to strip out any fitting out works, make good any damage caused and freshly decorate the premises, and secondly there is the cost both in terms of the actual time that this could take and in terms of loss of use of the premises or, in the case of retail and restaurant premises, loss of trade. For that reason, tenants are keen to resist the requirement to remove their alterations and reinstate the premises at the end of the term. A common tenant requirement, therefore, is that they need not remove their fitting out works but simply remove loose items, contents and, in the case of retail premises, shelving. However, this is often the subject of negotiation and usually comes down to bargaining position.

A common compromise if the landlord will not agree that the tenant is not obliged to strip out his fitting out works is that the tenant will not be obliged to remove any mezzanine floor it has installed, any amenity block (toilets), any air conditioning equipment and apparatus with more than 5 years' useful life remaining (these items often become obsolete quickly), together with any other specific and substantial items which are likely to benefit the premises and which a future tenant is unlikely to require are removed. Obviously any such large items that a tenant is not obliged to remove could save the tenant a great deal of money. On an associated point, however, a tenant should ensure that the lease expressly provides that any fit-out, alterations or other works carried out and anything

installed in the premises remains the tenant's property, which he is free to remove. Otherwise, in law, anything which is installed in and attached to the property, and not capable of being easily removed without causing damage will, in fact, become the landlord's property. Therefore, any valuable items installed on the premises in that way, would become the property of the landlord and the tenant would not be free to remove them either during or at the end of the term, which could obviously be costly.

If a tenant originally took the premises with a previous tenant's fitting out works already in situ, a tenant should not be obliged to strip out either his own or the previous tenant's fitting out works at the end of the term. It would seem unreasonable to ask a tenant to strip out if, upon the grant of the lease, all of a previous tenant's fit-out were still in situ.

Leases often provide that, even after the term has ended, the landlord can serve on the tenant a "schedule of dilapidations" detailing any disrepair, lack of decoration or stripping out which the tenant has not carried out and which he was obliged to do under the lease. This schedule will be part of a claim by the landlord against the tenant to pay for the costs of carrying out any necessary works to make good any such breach by the tenant. The subject of dilapidations is very detailed and complex and is beyond the scope of this book, except to say that it is often to a tenant's benefit to carry out these works himself before the end of the term, as otherwise the tenant is likely to face a hefty bill. Dilapidations payments are usually the subject of a great deal of negotiation and debate, which could cost time and money, and for which the tenant could pay over the odds. In addition, landlords will seek to charge mesne profits (being the market rent together with lease service charge and other payments that would otherwise be due under the lease) for a reasonable period which it should take the landlord to make good any dilapidations (disrepair, decoration and stripping out of fitting out works) after the end of the term which the tenant should have carried out prior to the end of the term.

However, it should be noted that (and this is a very general explanation of the main principle) since the landlord cannot claim against a tenant any damages for breach of the tenant's obligation (to give back the premises to the landlord at the end of the term repaired, decorated and having stripped out its fitting out works) to the extent that the incoming tenant would not require a discount on

rent owing to the state and condition of the premises (that is to say that if the tenant would pay the full open market rent regardless of the state and condition in which the former tenant has left the premises) the landlord cannot claim for breach of the lease against the tenant. This principle is often particularly relevant where a landlord intends to redevelop or completely refurbish a building or the premises itself at the end of the term of the lease. Obviously, if that is anticipated there is then no loss of value to the landlord and the landlord cannot make a claim against the tenant.

Term

There are various different types of commercial occupational arrangements (leaving aside anything relating to residential accommodation), of which a lease is just one type. Usually the various methods of occupation have differing lengths of term.

Some of the more common types of occupational arrangements are below:

- Tenancy at will – these are usually relatively short documents which allow a tenant occupation but provided that either party can terminate that agreement at will by notice. The notice may be a couple of weeks or immediate, but either way, effectively it is still a tenancy at will. These forms of occupation can, in some circumstances, be implied in law but are used expressly usually for very short periods of occupation. On that basis a tenant should ensure that they do not contain onerous obligations over and above that which should be expected for a short occupational arrangement. For example, a tenant should only be required to hand back the premises at the end of the agreement in the same condition in which he received them but not that the tenant should have to put the premises into any better state of repair or condition. Essentially the tenant's only obligation should be to make good any damage that he himself caused. The tenant should not be responsible for damage caused by any third party (unless connected with the tenant) and, for example, should not be responsible for complying with statutory requirements where this would involve bettering the premises. Each of the provisions of the tenancy will need to be considered carefully to ensure that they do not impose obligations on the tenant over and above that which is reasonable for such a short term occupation.
- A licence – licences are also intended to cover short periods of occupation but most likely slightly longer than a tenancy at will, but the main difference here is that a licence will usually be for a set period of time. However, there is one fundamental issue with licences and that is that,

even though they may be expressed to be a licence, often a licence can be construed in law as being a lease. The issue here is more one for a landlord than a tenant but does have quite a serious knock-on effect on a tenant.

The Landlord and Tenant Act 1954 applies to leases and provides that, unless a landlord can prove certain statutory grounds to refuse, a tenant will be entitled to a new lease at the end of the term of the lease (and therefore cannot be forced to vacate the premises) except where that lease has been contracted out of that Act by following a statutory procedure. This is called security of tenure and effectively gives a tenant rights to a new lease when his current lease comes to an end. This Act, and security of tenure, however applies only to leases and does not apply to licences. The issue that plagues landlords is where a landlord believes he has granted a licence, without any security of tenure, but in fact it is later deemed to be a lease. In this case a tenant can have rights of security of tenure where that tenant has been in occupation of the premises (whether under this licence or any other prior form of occupational arrangement) for in excess of twelve months. Effectively this would mean that where a landlord believes he has allowed a tenant to occupy for a short period the tenant may have rights to stay on indefinitely. This can occur where a licence is granted but which gives the tenant exclusive possession, as described below.

This is therefore an important issue for landlords but this does have a serious effect on tenants. The difference between a lease and a licence is that for an arrangement to be construed as a licence the tenant must not be given exclusive possession of the premises. Therefore licences are usually prepared on this basis and incorporate express terms to ensure that the tenant is not given "exclusive possession". This is where the problems arise. In order for the tenant not to be given exclusive possession the landlord must have rights to relocate the tenant to any other premises (virtually at will) and the tenant must not be able to exclude the landlord from the use of the premises while the tenant is in occupation. Clearly, this is likely to have rather severe implications for a tenant as, practically, most tenants will require the certainty of knowing that they will be in occupation of particular premises, are not going to be relocated and that they do not have to share those premises with a landlord. After all, why else would a tenant be paying a rent or, rather, a licence fee? It is for this reason that often tenants prefer to take short-term leases rather than licences.

One consideration for a tenant will be, however, that Stamp Duty Land Tax is not payable upon a licence but will be payable upon the grant of a lease at approximately (but subject to certain reliefs) 1% of the aggregate lease rents across the duration of the term. That can, depending on the rent, be rather expensive whereas, if the document is truly a licence, Stamp Duty Land Tax would not be due. Serious consideration does need to be given as to whether occupation is actually on the basis of a lease or a licence, as if Stamp Duty Land Tax is not paid on the basis that the tenant believes it occupies under a licence, and this is subsequently determined by the Court to be a lease, the tenant would then be required to pay the Stamp Duty Land Tax which was originally due, together with interest and penalties. In addition, if the arrangement was intentional to avoid paying Stamp Duty Land Tax, the tenant could face prosecution for seeking to defraud the Revenue.

- Commercial leases – commercial leases, by contrast, allow a tenant exclusive occupation of premises to the exclusion of the landlord. Office leases are commonly for periods of five to ten years, and retail leases are commonly for a period of ten years. However, in recent years the trend is for both types of lease to become shorter often containing provisions allowing the tenant to terminate the lease early (a right to break (as referred to in more detail below)).

Conversely, restaurant leases have historically been longer – for around 25 years – but currently anything from 15 to 25 years is not uncommon. The historic reason for this is that a restaurant fit-out is usually far more expensive than fitting out of offices or shops and the longer term is required for accounting purposes in relation to fit-out costs.

- Long leases – usually long leases will be for anything from 25 years and over, commonly 999 years, which essentially is almost as good as owning the freehold title. Usually this applies only to investment leases and those leases will, more often than not, be granted at a large premium.

10.2 Security

As referred to above, any lease within the Landlord and Tenant Act 1954 would entitle a tenant to a new lease once the term of the current lease has expired, unless the landlord can prove certain statutory grounds to refuse.

The grounds under which the landlord may object are as follows:

- serious breaches of the tenant's obligation to repair the premises;
- repeated and persistent delay in the payment of rent;
- where the tenant has committed substantial breaches;
- where the landlord has offered a tenant suitable alternative accommodation suitable for the requirements of the tenant's business and as regards size and the situation of the accommodation and as regards the terms of the current tenancy;
- where a tenant has sub-let a part or parts of the premises;
- where the landlord intends to demolish or reconstruct the whole or a substantial part of the premises;
- where the landlord intends to occupy the premises himself for the purpose of carrying on a business or as his residence.

Where a tenant is denied a new lease because of any of these grounds, where related to the default of the tenant, the tenant is not entitled to compensation but, where a tenant is denied a new lease upon any of the grounds which do not involve the default of the tenant, then the tenant may be entitled to compensation at either 1 or 2 times rateable value of the premises. In order to obtain 2 times rateable value the tenant or his predecessors in title to his business must have been in occupation for the purposes of a business for at least 14 years.

It should be noted that the right of the tenant to compensation can be excluded under the lease but only where the tenant has been in occupation for less than 5 years.

It is also possible for the parties to agree to contract out of the security provisions of the Landlord & Tenant Act 1954 by agreement. This would seem to be contrary to the interests of the tenant so a tenant would usually seek to resist this, but it depends on the bargaining position between the parties. If the parties agree, then a statutory procedure must be followed in order to exclude the lease from the provisions of the Act. In short, this involves the lease citing that these provisions have been followed, which includes the landlord serving a notice on the tenant and either the tenant signing a "simple" declaration, where the notice is served more than 14 days before that declaration is signed, or the tenant

signing a statutory declaration, which must be witnessed before an independent solicitor (not the solicitor acting for the tenant and advising him as to the lease terms) where the notice was served on the tenant less than 14 days before the declaration is sworn.

The actual lease renewal procedure at the end of the term of the tenant's current lease is technical and outside the scope of this book.

10.3 Rights to terminate – landlord's entry and breaches

There are effectively three ways for a lease to come to an end. Firstly, the contractual term may expire, which is self-explanatory. Secondly, the lease may contain a break clause allowing either the landlord or the tenant to terminate the lease at a particular time or, thirdly, most leases provide that a landlord can terminate the lease in certain circumstances in relation to a tenant's default.

Termination relating to a tenant's default is called forfeiture. Nearly all commercial leases will provide that a landlord can forfeit a lease where either the tenant becomes insolvent/bankrupt or has not paid the rent within a reasonable period (typically between 14 and 21 days) or the tenant is in breach of the terms of the lease. As to the latter, landlords do not normally agree that breaches must be confined to "material" breaches so, technically, a landlord could seek to terminate a lease for even the smallest breach but, in practice, this is unlikely and a court would not allow it. In particular, a tenant would be able to apply for "relief". In reality, for a court to allow a lease to be forfeited, any breach must be relatively severe.

If the lease is forfeited due otherwise than to insolvency or bankruptcy, then a tenant can apply to the court for "relief", which is a discretionary remedy whereby the court may, if that breach is made good or any arrears are paid, reinstate the lease, effectively giving the lease back to the tenant. However, this is discretionary and no doubt a court will require that a tenant demonstrates his ability to make future rental payments.

There is no intention here to give a detailed explanation of the mechanism for forfeiture but, generally, forfeiture can occur in one of two ways:

- the landlord can re-enter the premises and change the locks, thereby excluding the tenant from the premises. However, it is important to note that a landlord is not able to undertake this course of action if any person is present on the premises at the time the landlord seeks to re-enter. The tenant can therefore prevent this method of termination of the lease by ensuring that somebody (e.g. a security guard) is present on the premises at all times;
- by applying to the court for an order of forfeiture, submitting evidence of the relevant tenant breach.

It should be noted that, in the case of forfeiture for non-payment of rent or any sums under the lease expressed to be payable as rent, a landlord could forfeit the lease without notice. However, for all other breaches a landlord must first serve a notice on the tenant identifying the breach and giving the tenant a chance to remedy.

If the lease has a capital value and a tenant intends to charge that lease as security for a bank loan, the tenant should ensure that a provision is added to the forfeiture provisions whereby the landlord cannot terminate the lease without first giving notice to the mortgagee and allowing them an opportunity of a month or so to remedy the breach in question. Banks often require these clauses to be present in leases of a capital value if they are going to advance sums on the basis of the lease providing security for payment.

The second method mentioned above of terminating a lease is where a lease contains a right to break. This must be expressly stated in the lease and obviously, therefore, would be agreed upon by the landlord and the tenant. Often leases will provide that they are terminable on, say, the third or fifth anniversary of a ten year term, for example. Retail and office leases for a term of ten years will often contain a break at year five. In poor economic times, tenants should insist that leases contain a break but, in any event, insertion of a break is recommended as this adds flexibility to the lease, giving a tenant an added exit route.

It may be the case that if a tenant requires a fixed term of occupation of, say, five

years, that after the expiration of the fifth year they are unsure as to their plans or whether they will require the premises further, it is a possibility for the tenant to seek to negotiate a rolling break after, say, the fifth anniversary of the term. This would be a tenant's right to break, exercisable at any time upon a certain given period of notice.

Whether the landlord will agree to a break provision is obviously a matter of negotiation as it is preferable to a landlord to keep a tenant on the hook under a lease for as long as possible in order to have certainty of rental income. In some circumstances, however, landlords will also want a right to break where, for example, their plans in the future are unknown or where a landlord may want to redevelop a building at some time in the future and will need to obtain vacant possession of the premises.

However, from a tenant's point of view, break clauses are a minefield of problems. Some of those problems and the points to look out for are set out below:

- Generally – the law in relation to the exercise of break options is very strict. Effectively the lease provisions in relation to the exercise of the break must be followed to the letter and therefore, absurd though it sounds, if a break clause provides that a break notice must be served on rose-scented paper, then that is how the break notice must be served. If a tenant does not comply with the break provisions absolutely, it could well lose his right to break. In instances where the break is a once and for all break at a particular time in the lease, this could be fatal as, if the right to break is lost, the tenant would be on the hook to comply with the lease covenants and to pay the rent for the remainder of the term. That could be incredibly costly.
- Notice – most leases will provide that a tenant's right to break is exercisable upon a certain period of notice. Care should be taken that the lease does not express the period of notice absolutely so that, for example, the lease does not state that six months' notice should be given. If this is the case then precisely six months' notice will need to be given to the landlord (no more, no less), which is virtually impossible to calculate or to ensure that the correct notice is given. The tenant should ensure that the lease states that, for example, "not less than" six months' notice is given in order to enable the

tenant to ensure that more than adequate notice is given by serving seven or eight months' notice, well ahead of the break date.

Again, the notice must be served precisely how the lease requires. There will be various requirements in the lease as to the service of notices and whether they must be served by post, courier, recorded delivery or registered post, for example. These provisions must be followed to the letter. Care should also be taken to ensure that notices are sent to the correct address of the landlord stated in the lease and some leases state a different address for the service of notices. Although it sounds obvious, great care should be taken to ensure that the landlord named in the lease is still the current landlord and that they have not sold the building to another party, on whom notice should instead be served. Failure to serve notice on the correct landlord would mean that notice is invalid. To check the correct landlord the latest rent demand should be checked, as this should state the landlord's name, but also the Land Registry should be searched and the Official Copies of the property obtained to ascertain who owns the building or the premises.

- Conditions – leases usually contain conditions which must be fulfilled before the break date, before a break is validly exercised. Great care must be taken in relation to the acceptance of any conditions as those conditions could make it impossible validly to exercise the break. It is advisable to seek that any break provision is unconditional so that simply the lease is terminated on service of the requisite notice and that no other conditions need to be fulfilled. Some examples of conditions which are imposed on the exercise of the break, and their consequences, are set out below:
 1. that there must be no breaches of the tenant's obligations in the lease– this condition is fatal and in reality is likely to make the break incapable of being exercised. There are always minor breaches of a lease, no matter how diligent a tenant and, for example, a scratch on paintwork or a small amount of damage would count as a breach of the repair and decoration provisions contained in the lease, and would cause the tenant to lose his right to break. Some landlords will agree that this condition is limited to there being no "material" breaches but again this should be resisted. At the very least this gives the landlord cause for argument as to which breaches are material, and could

lead to loss of the right to break but, at worst, could still catch out a tenant;

2. that the premises must be yielded up to the landlord with vacant possession – this is also fatal. Various legal cases have revolved around this phrase and the words “vacant possession”, which it is now understood could involve a tenant having completely vacated the premises, having removed all goods, fixtures and fittings and, quite possibly, having fully stripped out all works carried out to the premises. The issue here is that leaving behind even a couple of loose items on the premises could count as still remaining in possession and therefore a tenant could lose his right to break. This is not a risk that a tenant should take. A similar point arises in relation to the above condition of “material” compliance with lease obligations, as leases quite often contain obligations and provisions in respect of how the tenant is to hand back the premises to the landlord at the end of the term. Any failure to comply with these obligations (such as to redecorate the premises, fully strip out any fitting out works, make good any disrepair) other than that which is minor, could lead to a tenant losing his right to break;
3. that the tenant has paid all sums due under the lease – this sounds reasonable but there are various issues involved. The first is that it may be impossible to know far enough in advance what all outstanding sums there are under the lease in order to make payment in good time before the break date. Any failure to pay any such sums will result in the tenant losing his right to break. For example, although the rent and the payment dates are known, in relation to any insurance charge or service charge those payments are due only on demand by the landlord and are usually of varying amounts. Instances have been known where landlords have submitted balancing service charge accounts or demands for other sums which have become outstanding on the break date or at a time which leaves little or not enough time for payment of those sums before the break date. Failure to make payment would result in a tenant losing his right to break. Advice in these circumstances is often to overpay what a tenant believes

is due to ensure that no sums remain outstanding. Other examples have been seen of tenants forgetting to pay a few hundred pounds of service charge or insurance, etc. and losing their right to break and remaining on the hook for another five or ten years under the lease, at a rental of hundreds of thousands of pounds.

4. It should be noted that, in law, unless the lease states otherwise, a tenant cannot simply make payment of the sums under the lease down to the break date but must pay all sums due up until the next payment date. For example, if rent is payable quarterly and the break date falls half way through a quarter, the tenant would need to pay the full quarter's rent including for that part of the quarter falling after the break date, as the rent would be payable in advance and the due date for the quarter's rent would obviously be before the break date. Again, this would mean that a tenant would need to overpay his rent. The issue here is that, unless the lease states otherwise, there is no entitlement in law to any refund of any overpayment. Therefore it would be key for the tenant to ensure during negotiations that the lease provides for a refund in respect of any sums paid in respect of the period after the break date.

If a condition on payment of sums due under the lease is to be agreed, this should strictly be confined to the principal rent (as this is known and the payment dates are known) and either only the sum due in respect of the period down to the break date is required to be paid, or the landlord must refund any overpayment.

On a final point to note, if it is truly intended that a break should be capable of being exercised in order to benefit the tenant, then no conditions should be attached to that break in order to allow the tenant properly to exercise it. Any conditions imposed are likely to increase the risk upon the tenant that the right to break could be lost. After all, the contractual expiry of the lease is not first dependent upon any conditions, so why should the exercise of a break?

Repair, decoration and complying with law

The overriding principle of English property law is “buyer beware”. The purchaser or tenant must take a property as he finds it, ‘warts and all’. Essentially, it is for the buyer or tenant to carry out his own due diligence in respect of any property and it is not for the seller or landlord to volunteer all and any information about the property and any defects there may be, although that does not relieve the seller/landlord from an obligation to answer truthfully any questions raised by the buyer/tenant.

Leases usually compound a tenant’s liability by a hidden obligation in the lease provisions dealing with repair. Most leases will oblige a tenant to keep the premises in good and substantial repair and condition. Where a lease imposes a requirement to “keep” premises in repair unfortunately the law implies an obligation to first “put” the premises in repair. The result is that a tenant is not only liable for the state of repair and condition of premises during the term but is liable for any pre existing defects and disrepair. It will not matter that defects and damage existed before the tenant took the lease, the tenant will be required on day one of the lease to make good all damage and rectify all defects that previously existed and to subsequently keep the premises in good repair.

Accordingly, in every case (except where the property being acquired is yet to be built) it is advisable to arrange for a survey to be carried out by a qualified surveyor. Where the extent of the premises is of the internal parts and shop front only (plus the shop front in the case of retail or restaurant leases) then only those parts need to be inspected, although it is often advisable that, where practical, the remainder of a building/ shopping centre in which the premises are situate is inspected to ascertain whether any major repairs are needed as, although the tenant will not be responsible for the repair of parts of the building outside of the premises, any major works needed will increase the tenant’s service charge liability.

Where the premises being let are of the whole, including the roof, structure, foundations and exterior, it cannot be stressed how vital a survey is. Any major disrepair or defects in the premises may not be apparent to the untrained eye but could be very costly to repair. For example, major roof defects could necessitate completely replacing the roof.

In addition, a full mechanical and electrical survey of all air conditioning (also air extract, ventilation and refrigerant cooling apparatus in the case of restaurant and bar premises) and lifts and other such plant and equipment is highly recommended. On the same basis as the above not only will the tenant be liable to put these items into repair and the keep them in that state, but usually these items are key to comfortable occupation of premises and can be extremely expensive to repair or replace.

In terms of the actual lease provisions there are a number of other considerations in relation to the obligation to keep the premises in repair:

- Some leases include an obligation within the requirement to repair, to rebuild the premises. From a tenant's perspective this should be resisted for obvious reasons. Accepting liability for keeping premises in repair and for pre existing disrepair is one thing but an obligation to completely rebuild is quite different. Certainly where the premises being let are of a whole building this could be incredibly costly. However, it would seem reasonable where damage or disrepair is due to any act of the tenant, but not where simply to due to the age or character of the building or defects in design and construction (this also links in with the third bullet point below). Accordingly any obligation to rebuild should ideally be deliberately excluded but at the very least be deleted.
- Similarly any obligation to replace any part or parts of the premises or any plant and machinery within or serving it should be deleted where possible or at least limited to replacement only where the item in question is beyond repair. Some leases seek to require a tenant to improve the premises in some way by upgrading the premises or the services by way of repair. Again this could be costly and should be avoided.

- Inherent and latent defects should, where possible, be excluded. This (very generally) means that any defects in design or construction or otherwise inherently part of the premises should not be the tenant's liability. Generally landlords refuse to agree to this, their attitude being that a tenant should rely on the survey that he should have procured before he entered into the lease. However, some defects may not be apparent at the time of inspection and so it would not have been possible for the tenant to be aware of them when entering into the lease and on that basis it would not seem reasonable for a landlord to effectively pass on to a tenant liability for unforeseeable defects and to use the tenant as a form of buildings insurance. This is especially the case in newly built properties where defects may not become apparent for a number of years.

Where the landlord was under an obligation to the tenant to procure the construction of the premises before the lease is granted or where simply the property has been recently built, a tenant would usually expect to receive warranties from the contractor and professional team (architect, mechanical and electrical engineer etc). These give the tenant a right of action against the provider of those warranties in respect of any breach of the terms of the building contract in relation to the contractor and breach of the terms of appointment of the other relevant professionals. It should be noted that it does not give the tenant an automatic right to claim against the provider of the warranty for defects in the works, but it depends on whether the defect is as a result of the breach of the terms of the building contract, in the case of the contractor, or the terms of the appointment in the case of the other relevant professionals. The terms of the building contract or appointment will therefore be key, although it should be noted that usually a landlord will not entertain any input into their terms from the tenant at the time they are being negotiated and so the tenant will not have any control over what the contractor and professionals may or may not be liable for. However, the tenant should at least make sure the building contract is in general JCT form, being a recognised and respected form of building contract (although this will be subject to amendment).

From a tenant's perspective the very least a tenant would want in respect of any new build is warranties. However, the preferred position would be for the landlord to be liable to make good those defects. The issue with

warranties is whether there are any restrictions as to what defects the relevant warrantor may be liable for as contained in either the building contract or deeds of appointment. In addition, the tenant must ensure that where warranties are provided they are backed up by insurance. Otherwise, it may be the tenant has a claim under a warranty but the contractor is either insolvent or does not have the money to pay for the remediation of any defects. However, there is no guarantee that such insurance will be maintained during the 6 year duration of the warranties. If it lapses this leaves the tenant exposed. On that basis, it would be preferable to the tenant if simply the leases provided that the tenant is not liable for any defects.

It should however be noted that any exclusion from the tenant's liability to make good defects will create a void of obligations unless otherwise stated. The tenant will be released from liability but no other party will be liable. From the tenant's perspective this could leave the tenant with defective or dangerous premises but without any ability to procure repair unless he carries the repair out himself, which would force the tenant to take on the liability even if actually excluded in the lease. Therefore, the tenant should ensure that the landlord is made liable for any defects and to procure remediation of them on notice and without cost to the tenant (whether directly or via the service charge). However, landlords are conversely unlikely to agree this except where they have carried out minor works.

Further explanation as to construction contracts and warranties is outside of the scope of this book.

- With all of the above in mind, the safest course of action is to insist that the tenant's obligation is limited to simply preserving the premises in their condition as at the date the tenant takes occupation of the premises. This is usually achieved by a detailed photographic survey being undertaken by one party and agreed by the other, and referred to as a "schedule of condition". That schedule should include, and show, all defects, wants of repair in the premises and the decorative condition. However, landlords will not usually agree to this except where the lease is for a fairly short term and/or where the premises are not in an ideal state and condition and where it would be unreasonable to insist the tenant has to put the premises into repair upon the grant of the lease. A schedule of condition would not preclude the need for warranties for new build properties.

There are a couple of other surveys that are as important as the building survey:

- Asbestos and other harmful materials can be incredibly costly to remove. In the case of asbestos, for example, the premises would be shut down, all fit out work would stop, and the premises would be sealed. The asbestos is then removed by qualified contractors and the premises then left sealed to allow air to settle. An air test is then conducted to ensure that there is no asbestos in the air and that it is safe to breath. Only then can the tenant re-occupy the premises. In some cases asbestos will only be required to be encapsulated and managed where it is in a location where it is unlikely to be disturbed. However, generally removal and disposal is time consuming (which brings with it, its own costs implications) and costly.

The tenant should therefore request a Demolition and Refurbishment Asbestos Survey from the landlord. All owners and occupiers have a statutory duty to have conducted an asbestos survey but there is no requirement as to how intrusive that survey must be. Therefore, landlords may often hold a survey for which only a visual inspection was carried out. This would be insufficient for the tenant's purposes, who no doubt would propose to fit out the premises, as such a visual survey would not reveal the presence of any asbestos within walls, floors and ceilings etc. The tenant's fit out contractor is also unlikely to proceed with any works unless and until a proper Demolition and Refurbishment Survey is provided. Care should also be taken to read any report supplied by the landlord and to ensure it was carried out by a qualified asbestos surveyor and that all areas of the property were surveyed (some reports can omit whole areas from the report where it was not possible to gain access, such as boiler rooms, lift motor rooms and occupied areas etc).

Many landlords do not have asbestos reports for their properties on the basis that they relied upon the fact that a tenant was in occupation and that while that was the case this was the liability of the old tenant. Some landlords do have reports but which are simply not sufficient (i.e are visual surveys only). In this case, it is fundamental that prior to entering into the lease or any commitment to take the lease that the tenant is permitted access to carry out his own survey or the landlord procures a Demolition and Refurbishment Survey. It is too big a risk for a tenant to leave to chance. It would seem only

reasonable that the landlord bears the cost of the survey as it is the landlord's statutory duty.

- The tenant will also be keen to ensure that the premises comply with all fire safety legislation and are serviced by adequate fire escapes. The tenant should either obtain the landlord's fire risk assessment or procure his own from a fire risk assessor. It is vital in terms of obligations in respect of staff and customer safety that the premises comply with all fire safety legislation. This is also particularly important for restaurant premises where any lack of compliance could affect capacity and also endanger the premises license for the sale of alcohol.

Care should also be taken to ensure that all parts of the landlord's property required for use by the tenant as part of the escape route or fire safety systems are in good repair, compliant with legislation and available for use. The lease must also give any necessary rights required to use any such systems or escape routes.

- Finally, anyone selling or letting leasehold property must provide an Energy Performance Certificate ("EPC") to the buyer/tenant by law. However, the legislation governing this does not have any teeth unless an aggrieved party complains to the regulatory body and therefore this is often ignored. However, a tenant should insist the EPC is supplied. The EPC will grade the property in terms of energy performance and make recommendations about how to improve that grade and performance. This has various implications for the tenant. Firstly, poorly performing units will cost more to run. Secondly, it has been mooted that in the future business rates may be linked to energy efficiency so that poor performing units will be pay higher rates. In addition, in future works may be compulsory to poor performing units to increase their efficiency. All these things will have a cost for the tenant.

There are various other ancillary lease provisions that indirectly relate to the tenant's liability for the repair and maintenance of the premises:

- Landlords frequently reserve rights of entry onto premises in the event the tenant has failed to observe his lease obligations, in order that the landlord can rectify that defect. This is only reasonable, but will include any breach of

the tenant's obligation to keep the premises in repair. This issue here is that even the most diligent tenant will be in some minor breach of this provision at some point, and this could allow the landlord constant entry onto the premises. Therefore, the landlord's right to enter should be limited to where the tenant is in "material" breach of his repairing obligation.

- A tenant will usually be obliged to comply with all statutory requirements in relation to the premises and the tenant should note this would include any requirements imposed on the owner or occupier and could be costly. For example, if the premises are not compliant with the Disability Discrimination Act the tenant will be bound to carry out the works. However, again the tenant's survey should pick this up.
- Linked to the above, is that the tenant will usually be obliged to both comply with planning law in respect of the premises but also to ensure the premises continue to have the necessary planning permission for use. It should be noted that the authorised planning use of the premises is fundamental and the tenant's solicitor must check the authorised use at the local planning authority. If the premises are not authorised for the use intended by the tenant the tenant will not be able to use the premises (even if the use is permitted by the lease), the rents will still be due and the tenant will not be able to terminate the lease.

Similarly, if any kit or ducting on the exterior, or any other alterations for which planning permission would be required, does not in fact have planning permission this will be the tenant's liability to resolve and, again, the rents will still be due and the tenant will not be able to terminate the lease.

The tenant must also be sure that either the lease is silent on the matter or where the landlord's consent is required to make or implement any planning application or permission granted that consent cannot be unreasonably withheld, where the tenant believes that he may need to carry out external or other works for which planning permission will be needed, or otherwise the landlord will have an absolute veto.

- Some leases will require the tenant not only to comply with any notices relating to statutory requirements affecting the premises but also to join

with the landlord to contest any notices or legislative requirements. This is essentially required by the landlord to give the landlord the ability to take action to protect the value of his asset. On that basis, and that the tenant is obliged to comply with the notice and with all statutory requirements affecting the premises, it is not reasonable to ask the tenant to join with the landlord in contesting any notice or legislation unless the landlord refunds the tenant's costs of doing so and any such action does not prejudice the tenant's reputation or affect his trade.

- The lease will usually require the tenant to decorate at certain intervals. Five years for the internal parts and three years for the external parts are common. These provisions are reasonably standard except the tenant should ensure that the landlord does not have an absolute veto over colours used, which he will have unless the lease is either silent or states the landlord's consent cannot be unreasonably withheld or delayed.
- The tenant should insist that notwithstanding the lease that the tenant will not be liable (whether by way of remediation, management, or clean up or payment of the costs of such clean up in any way, whether via the service charge or otherwise) for any pollution or contamination which existed or the cause of which arose prior to the grant of the lease (including the removal or management of asbestos). It is not reasonable for any tenant to take on the potential costly liability of historic contamination or for the tenant to pay the costs through the service charge. However, even with a lease containing this clause, this will only govern liability between the landlord and the tenant. It does not exclude the tenant's liability as occupier to the local authority for historic contamination, which is possible (but outside of the scope of this book). In the case of a lease of a whole building that is more likely than where the tenant is one of a number of tenants in a building (although liability is still possible). An indemnity from the landlord would be required but a landlord would be unlikely to agree.

This exclusion should also include the removal of asbestos from the premises and also from any common parts of the building as again it is not reasonable for a tenant to be liable where he takes over premises in an old building which contains asbestos and it is not reasonable for a landlord to use a tenant to bank roll the clean up of its asset.

Miscellaneous

As well as the main areas of concern covered by this book there are also a few other ancillary considerations that could make quite a difference to a tenant.

12.1 Quiet enjoyment

Quiet enjoyment is essentially the tenant's uninterrupted use of the premises for the purpose permitted by the lease. All leases should contain a provision that the tenant will have quiet enjoyment throughout the term of the leases and that the landlord will not prevent the tenant's use or enjoyment of the premises or materially interfere with it.

Care should also be taken to ensure that this extends to the landlord preventing any other person (claiming under or through the landlord's title or in trust for the landlord) from doing so. A tenant would not want to find that whilst this restriction is placed on the landlord, that the landlord can allow any superior landlord or trustee of the landlord to interfere with the tenant's use.

It should be noted that any interference will need to be serious before that interference is counted as a breach of this provision and so the tenant should not simply rely on this to prevent any other rights of the landlord from interfering with the tenant's trade. Specific protections should be negotiated as referred to in chapter 7.

Any such provisions are also usually subject to the payment of the lease rents so whilst the tenant is in arrears of rents or other sums due this protection will not apply.

12.2 Licensing

Some (but by no means all) restaurant leases contain provisions relating to the premises license for the sale of alcohol. The license is an ancillary asset relating to the premises and can represent a substantial amount of the capital value of the premises. Restaurant premises without a premises license are

obviously worth less.

On that basis some landlords add provisions into their leases to protect against the loss of the license or variations to it that could reduce its value. For, example a landlord of premises that holds a premises license with particularly late night/early morning hours would be keen to make sure any variation of the license by the tenant does not shorten those hours as late night licenses are valuable and often few and far between.

However, from a tenant's perspective he will be keen to ensure that these protection provisions do not go too far and interfere with the tenant's use or ability to change the premises license to suit his business. For example (but not an exhaustive list as these provisions always differ from lease to lease):

- Some leases contain provisions that allow the landlord to terminate the lease where some event occurs in relation to the license or curtails what can and cannot be done with the license. For example, leases can be capable of termination where the holder of the license or any designated premises supervisor becomes subject to any conviction that could affect the license, or where the license is lost. From a tenants perspective this is likely to be equally as disastrous to the tenant and the last thing the tenant is likely to need is either to be in breach of the lease or to lose his lease entirely while he is either trying to prevent the loss of the premises license or is seeking to recover it.
- Some lease requirements as to the premises license could affect the tenant's use of the premises or affect the ability to trade effectively. For example, leases can often prevent any variation of the premises license conditions. At the very least the conditions must be capable of being varied with the consent of the landlord who should be obliged to act reasonably. Otherwise the tenant could be stuck with onerous conditions or be unable to change any conditions to suit his business.
- Some leases go as far as to say the premises license belongs to the landlord and is the landlord's property. This should be avoided at all costs as this would prevent the tenant from selling the license as his own asset. The issue here is that, as stated above, the license is an asset and without ownership the tenant could not sell it as part of a sale of his business or the property which

could result in a lower sale price. The compromise is that the tenant owns the license but at the end of the lease term is obliged to transfer it back to the landlord. The landlord may require that if the tenant does not do so the landlord can act as the tenant's attorney to take the necessary action and on that basis may require provisions in the lease that give this authorisation.

12.3 Site Lines, shop front zones, lifts and escalators

There are a few other obligations (as below) that a retail tenant should be keen to impose on the landlord in order to protect his trade. However, many landlords do not agree to the vast majority of these requirements and so success will be depend on the tenant's bargaining strength:

- Not to place (or allow or permit to be placed) anything in the malls and other common parts as to interfere with the line of sight to the shop front and signage of the premises. Obviously, from an estate management perspective and the restrictive affect this would have on the landlord in terms of being able to make changes to his own shopping centre this is something landlords would fight to resist. From a tenant's perspective the more customers that have a direct line of sight to the unit the higher the tenant's trade is likely to be.
- Not to place (or allow or permit to be placed) anything in the malls and other common parts within 5 meters of the shop front. This is called an "exclusion zone". The considerations are the same as for sight lines above, just on a smaller scale. The landlord's concern will be that it may curtail their ability to allow kiosks and other items to be placed in the common parts from which the landlord can derive additional income. From a tenant's point of view any items in the malls in front of the unit could affect visibility of the unit which will affect trade or even worse, could make access to the unit difficult.
- Not to relocate or change the direction of travel of the nearest escalators or lifts or pedestrian walkways. Some tenants, who have occupied units near to escalators, have seen their trade drop off by twenty or more percent where the landlord changed the direction of travel to that escalator. For example, rather than depositing people just outside of the unit, the direction of travel was changed to effectively take people away from the area outside of the unit. However, landlords often don't like tenants interfering with the

management of their common parts.

- Not to install any machinery, apparatus, conduits or other items within the premises which will reduce the trading area (and in particular the Zone A area) nor which will reduce the floor to ceiling height below a certain comfortable size. Some leases allow the landlord to enter to install additional conduits and plant or otherwise carry out works but the tenant should insist this is on the basis that it will not reduce the trading area, decrease the size of areas within the premises that the tenant has to install its own plant and apparatus or otherwise affect the tenant's own fit out.
- Not to disclose any financial information of the tenant except as required by law or otherwise to a bona fide purchaser or mortgagee and in any event on a confidential basis. This is self explanatory. Some leases require the tenant to hand over their trading figures for the unit and otherwise a landlord may have access to other information of the tenant either under the lease (some leases require tenants to divulge their energy efficiency for example) or as part of the letting process. Most tenants view this information as confidential and would not want this being disseminated to the general public or the retail market.
- Not to use the tenant's name, logo or branding save for normal marketing literature in connection with the shopping centre. Obviously the tenant will not want his name and brand being used and associated with things he may not otherwise have agreed. The tenant may want to make this clear in the lease.

12.4 Costs and encroachments

As the tenant will be the party in actual occupation of the premises, most leases will oblige the tenant to procure that no "encroachments" are made as against the premises and to do whatever the landlord requires to defend the premises against these rights. This relates to the acquisition of any rights by any third party such as rights of light or rights of way over the premises.

For all leases except those which are very long (i.e over 25 years) this sort of obligation is not reasonable without a few changes being made to it as below:

- The obligation should only apply where the tenant knowingly allows these rights to be acquired. Any such rights that are acquired over the property can hugely affect the value of a property. The tenant would be liable for the diminution in value if it had infringed the lease obligation which could be costly. Most rights can be acquired either expressly or over time. The tenant does not want to find that it takes on a huge liability gradually over time where it had no idea that this was occurring.
- The tenant should not be liable to take action required by the landlord to defend the premises against rights being acquired where the action being acquired by the landlord would materially adversely affect trade. It is possible, for example that a landlord may require that a tenant creates an obstruction on the premises in order to defeat a right of way, but that could prevent customer access and so affect trade. It is not for the tenant to sacrifice his trade in order to protect the landlord's asset.
- That any such action as above should be at the tenant's cost. This is not reasonable as usually any action required will be in order to protect the value of the landlord's asset and not for the tenant's benefit. It would, however, seem reasonable where the tenant will benefit from the action, or where the necessity for any action is as a result of the tenant's breach of the lease terms, that the tenant pays a fair proportion (in the case of the former) or the whole (in the case of the latter) of the costs of any such action.

Notes