

Business Leases

Getting the right lease is one of the most important decisions that any business will face.

Whether you are a landlord or a tenant it is important that the terms of the lease reflect the intentions of both parties and provide a workable solution to your business needs. The better the lease the fewer chances of people disagreeing later on.

The main issues in respect of the lease fall into the following categories:

Term

Choosing the right term is important for any commercial lease. As a general rule the longer the term the greater the security for the Landlord and the tenant. But, at the same time a longer term can create a problem for a tenant if they want to move or bring the lease to an end. Most new commercial leases tend to be between five and ten years in length which allows some flexibility but also gives both parties a reasonable degree of security. A lot of smaller businesses and new businesses will want a term of no more than three years to give them greater flexibility and to enable them to terminate the tenancy quickly if things are not working out or where they are successful and want to move to new bigger premises.

A compromise on the term of the lease is to incorporate a break option into the lease which allows a tenant and in some cases the landlord, to terminate the lease early. Break clauses are also useful for tenants in helping to negotiate rent reviews for tenants because they allow the tenant to terminate the lease if they are not happy with the rent reviews. Break clauses can either be at set dates i.e. the first anniversary of the lease or on a rolling basis i.e. at any point after the first anniversary. Usually the Break Option will be subject to a period of notice to allow

the Landlord to get new tenants to take on the lease when the property becomes empty.

Rent and Rent Reviews

Most people will negotiate the initial rent quite carefully when entering into a lease. Tenants must, however, bear in mind that there will be rent reviews during the course of the lease and these rent reviews can be very onerous for unwary tenants.

Broadly speaking rent reviews fall into two types, firstly, open market rent reviews which are calculated by reference to the current rent of similar commercial properties in the area of the premises being let. Generally these rent reviews are negotiated between the landlord and the tenant but where negotiations do not result in any agreement, the matter is referred to a surveyor who will act as an arbitrator between the two parties and settle the rent. This mechanism can prove expensive for the parties so open market rent reviews tend to be applied to leases of larger properties.

The second type of rent review is by reference to an index. Generally the index used is the Retail Price Index although there are other indexes which can be used. The benefit of an indexation rent review is that both parties will know what the rent review is likely to be and can anticipate the change in the rent. Index Rent Reviews also tend to be cheaper to sort out any disputes between the parties because the mechanism for deciding on the rent review is simply referred to the index.

Both landlord and tenant will have their favourite option between the different types of rent review and both are effective methods of rent review. The open market rent review is perhaps the fairer system but

since it requires an independent surveyor to resolve any differences it can be more expensive.

Repairing Obligations

The choice between an internal repairing lease and a full repairing lease will have significant implications. Full repairing leases, as the title suggests, include the requirement to repair and maintain the whole of the property rather than simply the interior of the property. The repairing obligation will include the structure the roof and the foundations as well as the inside and outside of the property. Internal repairing leases generally tend only to cover the interior fittings or finishes of the property and possibly shop fronts. As a matter of common practice internal repairing leases often also include the windows, doors and all fixtures and fittings found inside the properties.

Landlords will generally charge a higher rent for agreeing to internal repairing leases because they retain the obligation to maintain the structure of the property.

However, in both cases we would recommend that tenants obtain a Schedule of Condition when entering into the lease to show the condition of the property at the start of the lease and then to fix the level of maintenance required in the property to the condition contained in the Schedule of Condition. Schedules of Condition can be by reference to photographs or photographs and a written commentary. We would also strongly recommend people obtain full structural survey reports if they are entering into a full repairing lease or if they are entering into an internal repairing lease with a requirement to contribute towards the upkeep of the property

Assignment and Subletting

If a tenant decides they no longer wish to occupy the property during the term of the lease they will need to either assign the lease or to sublet the premises. Usually the assignment or subletting will require the landlord's consent to be obtained before the subletting or the assignment can take place. Landlords will often allow the assignment or the subletting of the whole of the property. However, it is rare and often unpractical for a landlord to allow subletting or an assignment of part of the property.

The assignment of the lease will allow the tenant to transfer the lease to someone else. Once it is assigned the tenant will no longer have any responsibility to pay the rent or maintain the property. However, it is common practice for landlords to require tenants to enter into an Authorised Guarantee Agreement when assigning the lease which means that the tenant guarantees the performance of the terms of the lease by the incoming tenant and it is only when the lease is then assigned to a further person that the original tenant is released from the obligations of the lease. Unsuspecting tenants who enter into an Authorised Guarantee Agreement can find themselves approached by landlords several years after the assignment of the lease for unpaid rent and maintenance obligations. It is therefore important that tenants are aware of their obligations under an Authorised Guarantee Agreement before entering into the lease.

Dilapidations

At the end of the term of the lease commercial landlords will often serve a schedule of dilapidations on the Tenant. The schedule of dilapidations contains a list of repairs required by the Landlord to put the premises into the condition which the Landlord requires before the Tenant is released from their

obligations. Once served on a Tenant the Tenant should seek advice as to how to deal with these dilapidations.

Service Charges

Where a tenant is renting a part of a building or a unit on a business park or shopping centre the Landlord will require the Tenant to contribute towards the cost of maintaining the building or the estate. Service charges are often calculated by reference to the size of property being let either in proportion to the building as a whole or the business park or shopping centre or by usage where there are particular costs created by heavy usage. In either case the lease should contain a list of what services are included within the cost and when the tenant will be requested to pay the service charge. Service charges can be particularly high where the Landlords provide additional services such as cleaning and landscaping or where there are substantial costs in maintaining the structure of the building or any common areas.

Insurance Cover

Most leases will set out what is protected by the Landlord's insurance cover. Tenants need to ensure that the lease provides for a relief from paying the rent where the premises can't be used otherwise they will end up paying the rent without being able to use the premises. Tenants in most cases pay either the whole of the premium in the case of a whole building being let or a proportion of the premium where the property being let forms part of the building.

Where the insurance policy does not provide cover for a certain event tenants must be aware that they may well become liable to repair the damage to the property themselves. It is important therefore that

Tenants obtain and check a copy of the insurance policy schedule carefully to check what is covered.

Land Registry and Stamp Duty

All leases for a term exceeding 7 years must be registered at the Land Registry. They will get their own Land Registry title number and a note of the lease will be registered on the Landlord's title. Where the rent payable under the lease exceeds £150,000.00 (with an allowance made for inflation) stamp duty land tax will be payable on the grant of the lease depending on the amount of rent payable including any rent reviews if the future rent is known. Where the Landlord requires VAT to be paid on the rent, stamp duty is also payable on the VAT part of the rent.

Statutory Rights of Renewal

When taking or granting a lease the phrase "1954 Act" will often be used. The phrase generally refers to the statutory renewal provisions of Sections 24-28 of the Landlord & Tenant Act 1954. These provisions effectively give the Tenant the right to a new lease on the same terms (except for the rent) as their existing lease. The intention of the Act is that it protects the goodwill of the business by allowing the company to carry on trading from the same premises.

If the Landlord wishes to end the tenancy there are some statutory grounds to enable him to do this. However, he will need to pay compensation to the tenant if he wants to end the tenancy by this method.

Alternatively if the parties do not want to include the statutory renewal provisions they can agree to waive them but this must be done at the start of the lease and cannot be excluded mid way through the term. To exclude the statutory renewal provisions of the 1954 Act a provision stating this must be included in the lease and the tenant must complete a declaration

or statutory declaration agreeing to the lease being excluded from the statutory renewal provisions of the 1954 Act.