

# Leasing Business Premises

This Fact Sheet highlights some of the principal issues to consider from a Tenant's point of view when negotiating a new Lease or taking an existing Lease of business premises:

## **The Property**

Tenants need to invest adequately in finding the right property for their business. A couple of factors to consider are location and the prospect for business development - are the premises accessible to transport networks, markets and suppliers?

It may not be sensible to take a building with limited room for expansion if significant growth is anticipated in a short period of time. Conversely, it may be inappropriate to take premises with too much space if personnel requirements are likely to be reduced, for instance, because of technological development.

Once the right location and building have been identified, care needs to be taken to ensure that the legal description of the property is accurate. The Landlord and the Tenant need to know exactly what is let. This will often have an impact on the Tenant's ability to carry out alterations and on the extent of the Tenant's repairing obligation (see below for further details).

The Tenant should ensure that it will be granted all appropriate service rights (e.g. drainage, electricity, telephones etc). The Tenant should also consider whether it needs any specific rights such as the right to use adjoining car parking areas.

## **The Rent**

Rent is likely to be a significant overhead and needs to be considered carefully. Tenants should therefore check that the rent that they will be expected to pay is in line with market levels for comparable properties. Where a Tenant is entering into a Lease for a relatively long term (e.g. 10 years or more), the rent will normally be reviewed on a periodic basis (e.g. every five years). The true intent of a rent review provision should be to take account of inflation and genuine movements in the value of the property. However, many existing Leases contain upwards only rent review provisions (i.e. the rent will not fall below the amount originally agreed or subsequently increased at an earlier review) and this will be to the disadvantage of a Tenant in a falling rental market. In a soft letting market, an incoming Tenant should resist this Landlord's requirement and seek instead an upwards or downwards rent review.

Whilst the open market rent review procedure is adopted in many cases - the parties first of all try to agree a rental figure and in default refer it to an independent Surveyor to determine the market rent of the premises based on comparable evidence for similar premises - there are many different ways of reviewing the rent. One popular mechanism is index linking. Each method has its own advantages and disadvantages.

## **The Term**

The Tenant needs to consider carefully how long it wants to be committed to the premises. The Landlord will normally want the term to be as long as possible in order to maintain the attractiveness of the property as an investment with a long term rental stream. Conversely, the Tenant will be looking for as much flexibility as possible to allow for business contraction and expansion. A Tenant should therefore seek a break clause to allow it to terminate the Lease at some point during the term. Break clauses often require the Tenant to give the Landlord notice of its intention to terminate the Lease. Moreover, the ability to terminate will, in many cases, be conditional upon the Tenant having complied with its Lease obligations (e.g. compliance with repairing obligations). Wherever possible, the tenant should resist this requirement. However, if the tenant has no alternative, he must ensure that the condition and any time restrictions are fulfilled. Otherwise, the ability to break the Lease will be lost. An expensive mistake for the Tenant! Tenants taking existing leases should also ensure that any Tenant's break clause is not limited to a named Tenant (e.g. the original Tenant only).

## **Repair**

Tenants will normally have to assume some liability to be responsible for the repair and maintenance of the premises. A large bill for outstanding repairs (known as dilapidations) at the end of the Lease can give a Tenant a nasty shock! It is therefore crucial that a Tenant knows exactly what is his responsibility when he takes on the Lease. Normally, a Tenant of a multi occupied building will be only responsible for the interior of the premises with the Landlord being responsible for the exterior and structural parts of the building, recovering a proportion of the cost of such repair through a service charge. Where stand alone premises are fully let to a single Tenant, the Tenant will normally be responsible for the repair of the whole of the property.

The Tenant should also bear in mind the standard to which the premises are to be maintained. If second-hand premises are being taken, it is wise for the Tenant to limit its repairing obligation by reference to a Schedule of Condition. If not, the Tenant may unwittingly discover that it is obliged to give back the premises in a better condition than they were in when it took the Lease!

## **Alienation**

This principally means the ability to assign the lease or sub-let the premises. The Landlord will want closely to control the ability of the Tenant to transfer or sub-let the premises in order to preserve its investment. Conversely, the Tenant will want to be able freely to dispose of the premises by assignment or by sub-letting. As a minimum, the Landlord will normally require the Tenant to obtain its consent to any assignment or sub-letting. The situation is complicated by the *Landlord and Tenant (Covenants) Act 1995*. Notwithstanding assignment, Tenants who entered into Leases before 1996 will remain liable to their Landlords for any future breaches of the Lease terms by virtue of privity of contract (i.e. continuing liability). The situation is reversed for Leases completed after 1 January 1996. The 1995 Act provides that in these latter circumstances, an outgoing Tenant will be released from its obligations on assignment. However, a Landlord can stipulate in the Lease that the outgoing Tenant is to guarantee the obligations of its immediate successor. For sub-leases, the Tenant does of course remain liable to comply (or procure compliance) with its obligations. Landlords still want to retain some control

over the sub-lessee because if the Tenant disappears, the Landlord may well wind up in a direct relationship with the sub-tenant.

### **Alterations**

Normally, there will be some restriction on a Tenant carrying out alterations to the premises. Often, a Tenant who is only let part of a building will not be permitted (nor entitled) to carry out structural alterations. However, such a Tenant will usually be entitled to carry out non structural alterations with the Landlord's consent. A Tenant who is taking the whole of the building should press for the ability to carry out any alterations subject to Landlord's consent.

### **Use**

The Tenant will need to ensure that in negotiating a new Lease or taking an existing Lease, its intended business use will not fall foul of any user restrictions. Quite apart from the Lease terms, the Tenant should check that its intended use complies with planning control.

### **Insurance**

Normally, the Landlord will assume the obligation to insure the premises (collecting the insurance premiums from the Tenant) in order to maintain control over insurance so as to protect its investment. The Tenant should require the Landlord to insure the premises in their full reinstatement value. The Landlord will then be obliged to make up any shortfall in the event that there is an insurance casualty if the Landlord has failed to take out adequate cover. A Tenant should also ensure that the Lease includes a rent suspension clause in the event of the premises being damaged or destroyed, particularly as the Tenant will often be required to reimburse the Landlord the premium that it pays against loss of rent in such circumstances.

### **Service Charge**

A Landlord will often agree to provide services to Tenants of multi-let premises. Care should be taken in identifying the services which the Landlord is to provide (e.g. repair and maintenance of structural parts, cleaning, lighting and heating of common areas such as corridors). The Tenant should consider whether the proposed Landlord's services are necessary, adequate and cost effective. The Tenant should also check that the method of payment for the services is fair and appropriate (e.g. a straight forward proportion of the total cost of the services, such proportion being equal to the proportion that the floor area of the premises bears to the floor area of the whole building).

### **Forfeiture**

It will be normal for a Lease to include a right for the Landlord to terminate the Lease if the Tenant breaks its obligations or in circumstances where the Tenant becomes insolvent. There are, however, complex legal rules which allow a Tenant to apply to the Court for relief against forfeiture.

## **Guarantors**

Where a Tenant is a new limited company with no assets, a Landlord will often require the Company's Directors (normally at least two) to guarantee the Tenant's obligations. Following a recent fundamental change in the law, a Guarantor will remain liable to the Landlord under his guarantee despite the insolvent Tenant's liquidator having disclaimed the Lease. Directors should therefore think very carefully before giving guarantees, as their personal assets (including the family home) may be at risk.

## **Statutory Rights**

Normally, business tenancies will not automatically terminate at the end of the contractual lease term but will continue until they are bought to an end in accordance with the provisions of *The Landlord and Tenant Act 1954*. The 1954 Act lays down a procedure (containing strict time limits) which allows a Tenant to seek a renewal of its Lease. However, a Landlord is entitled to object to the granting of a new Lease if it can establish one of seven grounds for objection (e.g. the Landlord intends to demolish the premises). Where the Landlord is able to object to the grant of a new Lease, the Tenant may, in certain circumstances, be entitled to statutory compensation for disturbance. It is possible for the Landlord and Tenant to "contract out" of the 1954 Act with the sanction of the Court. However, these are valuable statutory rights which a Tenant should not give up without some trade off being given by the Landlord.

There are many complex issues to consider when dealing with business lettings which arise from the conflicting interests of Landlord and Tenant. Appropriate professional advice from a Solicitor or Surveyor should always be sought before taking on what is always likely to be a major business commitment.

## **Further Information**

Surveyors in your area can be tracked down via the RICS *Chartered Surveyor Directory*.