

Wake-up call? The Code for Leasing Business Premises

It's taken three editions and a recession for the property industry to finally wake up to the British Property Federation's Code for Leasing Business Premises. Why is the time finally right?

The economic downturn in the early 1990s spawned the first of three codes governing the leasing of commercial premises.

The first edition of the Code, published in 1995, came about following dissatisfaction among business tenants caught up in the recession. Tied to institutional leases, often of 20-25 years, with no break options and upwards only rent reviews, tenants finally revolted.

The Government listened, threatening to bring in legislation to regulate landlords. In response to the criticism, however, the property industry persuaded the Government that it could self-regulate, hence the birth of the 1995 Code.

The Code's guiding principle is to strike a fair balance between landlords and tenants in commercial lease negotiations. It's fair to say that the 1995 Code and the second edition that followed in 2002 went largely unnoticed. However, the third edition of the Code (2007) is starting to be adopted more consistently, due in some part to the difficult economic climate forcing parties to share the risk and liabilities involved in commercial letting.

The economic climate has claimed both landlords and their tenants as victims. Landlords have seen investment values take a hammering, while tenants have struggled to keep their businesses afloat. The Code can help both parties "meet in the middle": it allows landlords to offer tenants more flexible, less onerous lease terms in return for the tenant agreeing to increase the term of their lease. As a result, the landlord secures rent flow and occupancy levels, whilst the tenant reduces overheads.

The 2007 Code is split into three parts. Firstly, the Landlord's Code, which is designed to be used by both parties as a checklist in negotiations. Secondly, the Occupier's Guide, which provides tenants with a useful guide as to how a lease works and offers tips in negotiating a lease. Finally, there is a model set of Heads of Terms.

The Landlord's Code contains provisions that, up until recently, have been very rare within a standard commercial lease. These include Retail Price Index rent reviews as an alternative to upwards only open market reviews, and more flexible repair, alterations and alienation covenants. Whilst some parts of the Code are still unpalatable to landlords, for example up/downward rent reviews, the recommendations are creeping not only into lease variations following re-gearing, but new leases as well.

Tenants approaching the end of their lease, or in a position to trigger a break, need to start thinking about their operational property requirements and, if they wish to remain in their premises, a potential re-gear.

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If a lease re-gear is to work, both parties have to negotiate terms which are mutually beneficial. Tenants must offer something which the landlord wants – a secure, longer-term income stream.

In return, the landlord can put a variety of incentives on the table: a Retail Price Index (RPI) rent review (often subject to a cap and collar) in place of open market review; rent holidays or rent reduction; relaxation of the alienation and repair covenants, service charge caps and reductions in the area let.

For tenants, knowing your landlord is paramount, as it will enable you to ascertain whether they are value driven or income driven. A landlord with multiple nearby holdings will be conscious of any knock-on effect and may need to structure a re-gear/renewal differently in order to preserve headline rents. This may not be an issue for a landlord with a single holding - actual income will drive his investment and he may be happy to secure tenants for an extended period of time in exchange for a rent free period. A professional adviser is essential here, to provide tenants with a steer.

The run-up to a lease expiry or a lease re-gear negotiation is also an ideal time to look at other terms, not just rent and lease period. For example, are there restrictions on subletting? Is the permitted user restricted? Is the hypothetical term to be assumed at rent review onerous? Are there time of the essence clauses? Is your current lease of the whole of the property but now you only need a lease of the ground floor? Can the upper floors be separately accessed - if so would the landlord be willing to grant a new lease of just the ground floor and take the upper floors back? e.g. Is there a residential flat above the shop - will the landlord take control of this element and grant a lease of the space that actually meets your occupational needs? There are numerous scenarios which can be subject to negotiation and landlords and tenants, with the input of professional advisers, should be able to agree something that works for both.

The previous government was so disappointed with the take-up of the Code that it had threatened the property industry with corrective legislation. Arguably, the current trend of flexible, tenant-friendly leases is not so much driven by the Code, but by economic pressures. However, the upshot is that the Code is finally finding its rightful place and professional advisers for both landlords and tenants are beginning to regard it as a blueprint.

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