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PETA DOLLAR has more than 25 years experience of commercial property law.

After 17 years as a Real Estate Partner at Denton Wilde Sapte, she has recently made a lifestyle change, and is now the Real Estate Professional Support Lawyer at Dechert LLP.

Peta is a member of the Editorial Board of Landlord and Tenant Review and the author of a book Tenants’ Pre-emption Rights: A landlord’s guide to the Landlord and Tenant Act 1987, published by Jordans. She regularly writes and lectures on commercial property topics.
Most contracts for the sale of land will incorporate either the Standard Conditions of Sale or the Standard Commercial Property Conditions. However, there is no obligation (subject to the requirements of the Protocol) to use either of these Conditions in any particular contract, and it is perfectly possible for all the provisions of the contract to be set out in full in the contract document itself, with no reference to Conditions being incorporated. There is also no obligation to use the current edition of the Conditions – when the National Conditions of Sale (20th Edition) was superseded by the Standard Conditions of Sale on 21 March 1990, many commercial conveyancing contracts continued to incorporate the old National Conditions, as the Standard Conditions of Sale were not particularly appropriate for commercial transactions. Similarly, it is still common for commercial conveyancing contracts to incorporate the first edition of the Standard Commercial Property Conditions.

PRACTICE POINT

If one or other of the Conditions is to be incorporated in the sale contract, it is good practice to incorporate a copy of the actual Conditions within the contract itself, particularly where there is to be a substantial period between exchange of contracts and completion. This is not because there is any difficulty in incorporating the provisions of the Conditions by reference in order to satisfy the requirements of Section 2 of the Law of Property (Miscellaneous Provisions) Act 1989, but because it may be difficult to find a copy of an old edition of the Conditions at some time in the future. There are still contracts waiting to be completed (particularly where options have been granted) that incorporate the National Conditions of Sale (20th Edition), and it can take time to locate a copy of these Conditions, now that they have been superseded for more than 15 years. It is also helpful to have all the provisions of the contract physically contained in a single document.
Standard Conditions of Sale

The current edition of the Standard Conditions of Sale is the fourth edition, which came into force on 13 October 2003. The Standard Conditions of Sale are appropriate for residential sale transactions and for some simple commercial sale transactions, and are prescribed by the Protocol.

Standard Commercial Property Conditions

The Standard Commercial Property Conditions are based on the Standard Conditions of Sale, but are more appropriate for commercial sale transactions (particularly the more complex ones) and contain more detailed provisions. The current edition is the second edition.

The main differences between the Conditions

The main differences between the Standard Conditions of Sale (fourth edition) and the Standard Commercial Property Conditions (second edition) are:

**Insurance**: the Standard Conditions of Sale provide for the seller to retain the risk until completion (the buyer has the right to rescind the contract if the property burns down between exchange and completion), but with no obligation to the buyer to insure the property (Condition 5) whereas the Standard Commercial Property Conditions provide for two alternatives (Condition 7), the first being where the seller is under an obligation (under a lease of the property or pursuant to the contract) to insure the property (in which case he must insure, noting the buyer’s interest if so requested, and pay insurance proceeds to the buyer) and the second being where there is no such obligation (in which case the seller is not obliged to insure but where the buyer’s insurance proceeds are reduced, the price is also reduced). There is no buyer’s right to rescind under the Standard Commercial Property Conditions if the property burns down between exchange and completion – in other words, risk passes to the buyer on exchange, as used to be standard practice under the old National Conditions of Sale.
Assignment and sub-sales: although both Conditions prohibit the assignment of the contract (Condition 1.5), the Standard Commercial Property Conditions also state that the seller cannot be required to transfer the property in parts or to any person other than the buyer, whereas the Standard Conditions of Sale do not contain this additional prohibition.

Matters affecting the property: see Practice Point in sub-section on Covenants for Title.

Deposit: although both Conditions (Condition 2.2) provide for the deposit (except in the case of an auction sale) to be held by the seller's conveyancer as stakeholder, the Standard Conditions of Sale permit the deposit to be used as a deposit for the seller's own purchase, so long as it is still held by a conveyancer as stakeholder. In addition, the Standard Conditions provide for the deposit to be 10% of the purchase price plus 10% of the chattels price, whereas the Standard Commercial Property Conditions provide for it to be 10% of the purchase price only.

Leases affecting the property: not surprisingly, the Standard Commercial Property Conditions (Condition 4) contain far more detailed provisions relating to leases affecting the property than do the Standard Conditions of Sale (Condition 3.3). In particular, the Standard Commercial Property Conditions contain detailed obligations for the management of the property between exchange and completion.

Rent reviews: the Standard Commercial Property Conditions contain (Condition 5) detailed provisions where there is a rent review in progress in relation to the property, whether the seller is landlord or tenant in relation to that review, but the Standard Conditions of Sale contain no such provisions.

Apportionments: the Standard Commercial Property Conditions contain (Condition 8.3) far more detailed provisions in relation to apportionments than do the Standard Conditions of Sale (Condition 6.3), in particular relating to the apportionment of sums the amount of which is not known at completion, and relating to sub-leases of the property.

Superior landlord's consent: the Standard Commercial Property Conditions contain (Condition 10.3) far more detailed provisions in relation to the obtaining of any necessary consent to assign
the lease of the property than do the Standard Conditions of Sale (Condition 8.3). In particular, under the Standard Conditions of Sale, the buyer is only obliged to provide information and references, whereas under the Standard Commercial Property Conditions, the buyer may be required to provide covenants and guarantees.

The Standard Commercial Property Conditions are split into Part 1 and Part 2. Part 1 is similar to the Standard Conditions of Sale, although it contains 12 Conditions compared with 10 in the Standard Conditions of Sale. Part 2 contains specific provisions in relation to VAT (in particular, provisions for transfer of a going concern), Capital Allowances and tenants’ rights of first refusal under the Landlord and Tenant Act 1987. Although it is not surprising that the Standard Conditions of Sale do not deal with the first two topics, which are relevant to commercial properties only, it is somewhat surprising that the Standard Conditions of Sale do not provide for the 1987 Act, which relates to the rights of tenants of residential, rather than commercial, properties.

Amending the Conditions

Most solicitors, whether they incorporate within their contracts the Standard Conditions of Sale, the Standard Commercial Property Conditions, or an old set of Conditions of Sale, will amend those Conditions further by express provisions in the contract itself. Provisions such as the prohibition on sub-sales and the list of incumbrances subject to which the buyer will take the property are commonly amended in a commercial sale. Generally, the sale contract will state that the relevant Conditions apply save where a Condition is inconsistent with an express provision of the contract, or where otherwise required; best practice is to set out expressly the changes and deletions required to the Conditions, so that there can be no doubt as to whether or not a particular Condition applies or has been altered.
Covenants for Title

It is normal practice for the seller to provide covenants for title, in standard form, by selling with “full” or “limited” title guarantee, in accordance with the Law of Property (Miscellaneous Provisions) Act 1994. The effect of this wording is that, following completion, the buyer can sue the seller for breach of the title guarantee. The seller will normally sell the property with full title guarantee, unless the seller is a trustee, personal representative or mortgagee, in which case he will normally sell the property with limited title guarantee. A liquidator selling a property, or a seller who cannot prove good title to his property, may sell with no title guarantee at all, in which case no covenants for title are given, and there is nothing in respect of which the buyer can sue. Both the Standard Commercial Property Conditions (Condition 6.6.2) and the Standard Conditions of Sale (Condition 4.6.2) provide for the seller to transfer the property with full title guarantee unless otherwise provided in the contract.

Full title guarantee - the implied covenants

Where a seller transfers the property with full title guarantee, the following covenants for title are implied:

• That the seller has the right to dispose of the property in the manner purported;
• That the seller will at his own cost do all that he reasonably can to give the transferee the title he purports to give;

PRACTICE POINT

Note that the implied covenants apply to any “property” (including any thing in action and any interest in real or personal property), any “disposition” of property, whether for valuable consideration or not (including a mortgage created for a term of years and the grant of a lease or underlease but not a contract) and any instrument effecting or purporting to effect a disposition of property (including an instrument which is not a deed). So chattels at a property can be covered by the implied covenants, in addition to the property itself.
That the seller is disposing of his whole interest in the property, where that interest is registered, and of the whole lease, where the interest is leasehold (clearly this implied covenant may need to be amended on a sale or lease of part);

That the seller is disposing of a freehold, where it is unclear whether the interest is freehold or leasehold (a highly unlikely situation where the property is registered at the Land Registry, but the seller should in any event state in the contract that the property is leasehold if it is not a freehold property, in view of this implied covenant);

In the case of a subsisting lease, the seller covenants that the lease is still subsisting and that there is no subsisting breach which might result in forfeiture (Condition 3.2.2 of both the Standard Conditions of Sale and the Standard Commercial Property Conditions expressly exclude from this covenant any wants of repair which may entitle the landlord to forfeit the lease on the grounds of a breach of the repairing covenant. Where, however, there is any other breach of covenant, even if the buyer is fully aware of this, the contract must expressly exclude that breach from the implied covenant for title);

1. It is not unusual in a commercial transaction for the seller to amend the warranty that he will at his own cost do all he reasonably can to give his transferee the title he purports to give, so as to provide for any cost incurred to be paid by the buyer. Unless there are exceptional circumstances, this amendment is unreasonable and should be resisted by the buyer - the seller surely should provide the title that he has contracted to give and, if there is any problem with this, the seller should sort it out at his expense. In practice, where the seller is registered at the Land Registry as proprietor of the property with title absolute, it is highly unlikely that there will be any problem in giving the transferee good title to the property.

• That the seller is disposing of his whole interest in the property, where that interest is registered, and of the whole lease, where the interest is leasehold (clearly this implied covenant may need to be amended on a sale or lease of part);

• That the seller is disposing of a freehold, where it is unclear whether the interest is freehold or leasehold (a highly unlikely situation where the property is registered at the Land Registry, but the seller should in any event state in the contract that the property is leasehold if it is not a freehold property, in view of this implied covenant);

• In the case of a subsisting lease, the seller covenants that the lease is still subsisting and that there is no subsisting breach which might result in forfeiture (Condition 3.2.2 of both the Standard Conditions of Sale and the Standard Commercial Property Conditions expressly exclude from this covenant any wants of repair which may entitle the landlord to forfeit the lease on the grounds of a breach of the repairing covenant. Where, however, there is any other breach of covenant, even if the buyer is fully aware of this, the contract must expressly exclude that breach from the implied covenant for title);
Covenants for Title

• In the case of a mortgage of a property which is subject to a rentcharge or lease, the seller covenants that the mortgagor will observe and perform the obligations under the rentcharge or lease;

• That the transferor is disposing of the property free from all charges and encumbrances and from all other third party rights, not being rights that the transferor does not and could not reasonably be expected to know about (Condition 3.1.2 of both the Standard Conditions of Sale and the Standard Commercial Property Conditions state those incumbrances subject to which the property is sold, but the contract will often go on to list additional incumbrances).

PRACTICE POINT

Note that there are differences between the Conditions, in that the Standard Commercial Property Conditions refer to matters “which would have been disclosed by the searches and enquiries which a prudent buyer would have made before entering into the contract” whereas the Standard Conditions of Sale merely refer to “entries made before the date of the contract in any public register except those maintained by the Land Registry or its Land Charges Department or by Companies House”. In a large complex commercial transaction, the prudent buyer may make all kinds of esoteric searches and raise enquiries with many different persons, and all of these searches and enquiries will be excluded from the covenant for title unless the buyer is able to negotiate a specific list of those searches and enquiries which he is actually making, and exclude any others. However, the seller is unlikely to agree to such a provision since it is for the buyer to make his own investigations in relation to the property.
Limited title guarantee - the implied covenants

Where the transfer is made with limited title guarantee, all the above implied covenants are given, only the final implied covenant set out above is changed. The seller covenants that the transferor has not encumbered the property nor granted third party rights, and is not aware that anyone else has done so since the last disposal for value, but there is no covenant relating to the transferor’s predecessors in title, unlike in the case of a transfer made with full title guarantee.

Exclusion in relation to buyer’s knowledge

The seller is not liable under the first and last of the implied covenants listed above (namely that the seller has the right to dispose of the property in the manner purported and that the transferor is disposing of the property free from all charges and encumbrances and from all other third party rights, not being rights that the transferor does not and could not reasonably be expected to know about) for anything which, at the time of the disposition, is within the transferee’s actual knowledge, or which is a necessary consequence of facts which are then within the transferee’s actual knowledge. Deemed notice by virtue of registration alone is not sufficient to bring the matter within the transferee's knowledge for this purpose. It is not uncommon for documents to state expressly matters within the actual knowledge of the buyer/transferee, so that the transferor may be certain that he has no liability for such matters.

Enforcing implied covenants for title

The benefit of the implied covenants runs with the land (i.e. they can be enforced by every person in whom the estate or interest, whether in whole or in part, is vested). Therefore, if the owner discovers a defect in title, he can (subject to any express term in an instrument to the contrary) take action against the person who covenanted in his favour and, in a case where a full title guarantee has been given, does not have to determine which previous owner was responsible for the defect. Each previous owner can then enforce the guarantee given by its immediate predecessor in title.
Except in exceptional circumstances, a contract for the sale of land will always contain a provision requiring the buyer to pay to the seller a deposit, i.e. a percentage of the purchase price, on exchange of contracts. Both the Standard Conditions of Sale and the Standard Commercial Property Conditions provide (Condition 2.2) for a **10% deposit**, to be held by the seller’s conveyancer as stakeholder (although on a sale at auction, they provide (Condition 2.3.6) for the deposit to be held by the auctioneer as agent for the seller) and to be paid to the seller on completion together with accrued interest. The payment of a 10% deposit, the holding of that deposit as stakeholder, except in the case of auction sales, and the paying of the interest on the deposit to the seller is all standard practice, but there are some exceptions to this, namely:

- in the case of residential transactions, particularly where the buyer is borrowing the whole, or 95%, of the purchase price, the seller may sometimes accept a 5% deposit only;

- in the case of very large commercial transactions, where the purchase price is many millions of pounds, the parties will sometimes negotiate a reduced deposit, perhaps 5%;

- very substantial institutional buyers, such as pension funds, generally refuse to pay a deposit, and this will normally be agreed by the seller;

- it is not the practice of the Crown or the Crown Estate to pay a deposit;

- it is not unheard of on a substantial commercial transaction for the buyer to seek to share in the interest earned on the deposit, and for this to be agreed by the seller;

- where the contract is conditional on the satisfaction of one or more conditions, and there is to be a substantial delay between exchange and completion, it is not uncommon for there to be a reduced deposit and/or for the parties to share the interest paid on that deposit. Sometimes no deposit is payable on exchange but a deposit is payable on satisfactions of the condition(s) if there is then to be a substantial delay before completion takes place.
Stakeholder or agent for the seller

Where the deposit is held as stakeholder, the stakeholder will hold the deposit on behalf of both parties and cannot pass it to either party without the consent of the other (at least pending completion or default by either party). Where the deposit is held as agent for the seller, however, the agent may pass the money to the seller at any time, and as a result, the buyer may have difficulty in recovering the deposit if the seller defaults on the sale.

Payment of the deposit in case of default

The main reason why a deposit is normally payable is because, if the buyer defaults on his purchase, the seller can forfeit the deposit and thus recover his costs, together with some compensation for inconvenience caused, without the need to resort to litigation. This is why a reduced deposit may be payable on a multi-million pound commercial transaction, since the amount of money involved may be out of all proportion to the loss which may be suffered by the seller if the buyer defaults. Indeed, if the buyer defaults and the seller is able immediately to find an alternative buyer, the deposit may be in the nature of a windfall for the seller, effectively increasing the value of his property to 110% of that value (less costs incurred in connection with the abortive sale).

Both the Standard Commercial Property Conditions (Conditions 9.5 and 9.6) and the Standard Conditions of Sale (Conditions 7.5 and 7.6) provide that if either party fails to comply with a notice to complete,
the other may rescind the contract, in which case, if the buyer is at fault, the seller may forfeit and keep the deposit and any accrued interest, whereas if the seller is at fault, the buyer may recover his deposit together with any accrued interest. In each case, the wronged party retains his other rights and remedies.

**Insurance (property)**

Where risk passes to the buyer on exchange of contracts, he would be well advised to insure the property from exchange, since otherwise he will have to fund any accidental damage to the property out of his own pocket, subject to:

- Section 47 of the Law of Property Act 1925, which states that where, after exchange, money becomes payable under any policy of insurance maintained by the seller in respect of damage to the property which he has contracted to sell, that money shall be paid to the buyer at completion (or on receipt of the same by the seller, if later) - note that both the Standard Conditions of Sale (Condition 5.1.4) and the **Standard Commercial Property Conditions** (Condition 7.1.5) exclude Section 47, and that it is subject to any consent of the insurers which may be required and also subject to payment by the buyer of the proportionate part of the insurance premium from exchange;

- the seller’s duty to take reasonable care of the property between exchange and completion (see Practice Point).

However, the seller would also be well advised to maintain his insurance of the property between exchange and completion, in case the buyer defaults on his purchase, and the seller is left with a damaged property and no buyer. Accordingly, it is not unusual for both parties to insure the property between exchange and completion, which may give rise to difficulties if the property is damaged or destroyed by an insured risk between exchange and completion, since each insurer will only pay out to each party half the amount insured.
Insurance (property)

The Standard Conditions of Sale

The Standard Conditions of Sale provide for the seller to retain the risk until completion, imposing an obligation on the seller to transfer the property in the same physical state as it was in at exchange of contracts. If at any time before completion, however, the physical state of the property makes it unusable for its purpose at the date of the contract, the buyer has the right to rescind the contract. The seller may also rescind the contract where the damage is caused by a risk against which he was reasonably unable to insure or where he is not legally able to make good the damage. The seller is not, however, obliged to insure the property (although clearly he will be in considerable difficulties if he fails to insure, the property is damaged and the buyer does not choose to exercise his right of rescission).

The Standard Commercial Property Conditions

The Standard Commercial Property Conditions provide for two alternatives (Condition 7):

- the first alternative (Conditions 7.1.1, 7.1.2 and 7.1.3) deals with the situation where the seller is under an obligation (under a lease of the property or pursuant to the contract) to insure the property. In that case, the seller must do everything required to maintain the

PRACTICE POINT

The seller holds the property as trustee for the buyer between exchange of contracts and completion. However, the nature of that trusteeship is clearly very odd, since the seller retains the right to protect his interest against the buyer until completion, whilst also having duties to perform for the benefit of the buyer. One of the duties of the seller in this situation is to use reasonable care to keep the property in a reasonable state of preservation and, so far as possible, in the same state that it was in at exchange - however, clearly destruction by fire or flood, except where this is due to the seller's negligence, cannot be prevented, hence the importance of insurance.
insurance, increasing the cover at the buyer’s cost if the buyer so requests (and the insurers agree), permitting the buyer to inspect the policy, noting the buyer’s interest on the policy if so requested and repaying to the buyer any part of an additional premium which the buyer paid and is returned by the insurers. If the property is damaged between exchange and completion, the seller must pay to the buyer on completion any insurance proceeds not already used to reinstate the property (or assign the right to claim under the policy, if the proceeds have not yet been received). On completion, the seller must cancel the insurance policy and pay any refund to the buyer where that refund relates to a part of the premium paid by the buyer or a tenant or third party (in which case the buyer will hold that money subject to the rights of that tenant or third party). The buyer must pay a proportionate part of the premium for the period between exchange and completion, except where the seller can recover this from a tenant. Although the first alternative seeks to avoid the problems of double insurance, the buyer may still have difficulties if the seller is in breach of his obligation to insure, or if the insurance is avoided due to non-disclosure or for some other reason. Also, there is no mention of loss of rent insurance, which will obviously be crucial to the buyer if the property burns down between exchange and completion and the tenant’s rent payments are suspended pending reinstatement of the demise. There is also no mention of damage by uninsured risks.

• the second alternative (Condition 7.1.4) is where there is no such obligation, in which case the seller is not obliged to insure the property but where the buyer’s insurance proceeds are reduced because the seller has in fact insured the property, the price is also reduced to the same extent. The presumption, in the case of the second alternative, is that the buyer will himself have insured the property. It is also presumed that the property is either empty, or occupied only by the buyer, and is unmortgaged, since the landlord will normally be obliged to insure the property where that property is tenanted, and a mortgage will normally require the mortgagor to insure the property.

There is no buyer’s (nor seller’s) right to rescind under the Standard Commercial Property Conditions if the property burns down
between exchange and completion – in other words, risk passes to the buyer on exchange, as used to be standard practice under the old National Conditions of Sale.

**PRACTICE POINT**

The ideal solution must be for insurance to be effected, in respect of both the property and loss of rent, in the joint names of the seller and the buyer from exchange of contracts until completion. This will deal with all the difficulties which may lead to both parties insuring the property and hence to double insurance. In practice, however, this arrangement will almost never be put into force, in particular because of the difficulty that would arise where the seller has a block insurance policy that includes other properties in addition to the property being sold. Also, even this solution will not assist in the case of an uninsured risk causing damage to the property.

**Damage before exchange**

Where damage occurs before exchange, the buyer cannot insure against this because he will have no insurable interest in the property at that stage. Clearly there will be no difficulty if the period before exchange takes place is sufficiently long to allow the seller to claim on his insurance and reinstate the damage. If, however, contracts are exchanged at the pre-damage price, the seller will suffer no loss and accordingly will be unable to claim on his insurance policy. Either the seller must reduce the purchase price to take into account the cost of reinstatement (together with any rent suspension), so as to be able to claim against the insurers for diminution in value, or the parties must enter into a contract in which the seller agrees to reinstate and the buyer only completes the purchase, at the full price, when this has been done.

The seller should involve his insurers before agreeing to either alternative, as the policy may contain a condition that no such agreement is entered into.
Conditional Contracts

Condition Precedent or Subsequent

There are two types of conditional contract:

- a contract subject to a condition precedent: this means that the contract does not come into effect until the terms of the condition have been met; and
- a contract subject to a condition subsequent: this means that the contract comes into effect immediately on exchange, but can later be terminated if the terms of the condition are not satisfied.

There may be significant tax consequences depending upon whether or not a contract is subject to a condition precedent or a condition subsequent. This is because exchange of contracts where the condition is a condition precedent will not lead to a transfer of the beneficial interest in the property to the buyer until such time as the condition is fulfilled. Where, however, the condition is a condition subsequent, the beneficial interest in the property will transfer to the buyer immediately on exchange, as in the case of an unconditional contract, although the beneficial interest will then transfer back to the seller if the contract is subsequently terminated following non-satisfaction of the condition.

Main conditional contract issues

The main issues that arise in relation to a conditional contract are:

- whether the contract should be subject to a condition precedent or a condition subsequent (normally, the decision will be made in the light of the tax consequences of each alternative);
- what the condition(s) should be. Conditional contracts are normally entered into where planning permission is required (particularly where the property is being sold at a price which reflects a use which does not currently have planning permission) or, in the case of the sale of a leasehold property, where landlord's consent is required for the transfer or assignment of the lease. Other conditions may include the
obtaining of a liquor or other licence or the obtaining of a third party consent (e.g. a mortgagee or the Charity Commission). In residential transactions, the buyer may wish to exchange contracts subject to obtaining satisfactory replies to his searches, or a satisfactory survey result, although this is not normally to be recommended, given the difficulty of specifying the meaning of “satisfactory” in a residential context. In large commercial development transactions, there may be a long list of conditions, including not only the requirement to obtain planning permission but also road closure orders, acquisition of third party land required for the development, satisfactory arrangements to be made with third parties having rights of light, etc;

• the precise requirements for each condition to be satisfied. If a condition requires the grant of planning permission, should that be outline or detailed permission? What conditions may or may not be acceptable to the parties? Must both parties approve the planning permission, or only one of them? What form should the application for planning permission take?

Where the parties enter into a contract subject to a pre-condition requiring planning permission to be granted in relation to the property, note that the Planning Authority may be unwilling to grant such permission unless a planning agreement is entered into under Section 106 of the Town and Country Planning Act 1990. Such an agreement can only be entered into by the party owning the land at the date of the agreement, so the buyer will need to ensure that he can require the seller to enter into a planning agreement, otherwise he will be unable to satisfy the condition for planning permission to be granted.

Should the condition not be deemed to be satisfied until after the expiry of a period of time (such as three months) following the grant of permission to allow for a third party challenge to the permission?

• whether the contract should terminate automatically if the condition(s) is/are not satisfied by a specified date, or whether the contract should continue, notwithstanding that the
condition(s) has/have not been satisfied until one of the parties terminates the contract;

- how long a period should elapse before the contract terminates (or is capable of termination), and whether that period should be extended in certain circumstances (for example, where the condition relates to the grant of planning permission, the parties may wish to extend the period if an appeal is lodged, or if a third party challenges the planning permission);

- which party is responsible for satisfying each of the conditions and what obligations that party has in relation to each condition;

- whether the party who is not responsible for satisfying a particular condition should be required to assist the other party in relate to satisfying the condition, and if so, at whose expense;

- whether one or more of the conditions should be capable of being waived, and if so, which of the parties should be entitled to waive each such condition (although a party for whose sole benefit a condition has been included can waive it unilaterally, it may be difficult, in a complex contract with several conditions, to determine, in relation to each condition, whether it is for the benefit of one or both parties, so a specific right to waive is desirable);

- if the condition(s) is/are not satisfied and/or a party terminates the contract, what consequences should arise? In every case, the buyer should be required to remove any entries made by him at the Land Registry in relation to the property, but additional obligations may be required in a particular case.

Note that an option (either a put option, where the seller can require the buyer to purchase the property, or a call option, where the buyer can require the seller to sell the property, or a put and call option) may be an appropriate alternative to a conditional contract in certain cases.
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In this role she is responsible for keeping a large property team up to date and trained in property matters including related online services.

She has contributed to various Legalease publications including the Property Law Journal.
Effect of exchange of contracts

Formal exchange of contracts means that a binding contract will come into existence, withdrawal from which will mean liability for breach (see Remedies). Until such formal exchange has taken place either buyer or seller is free to withdraw from negotiations. The buyer's solicitor needs therefore to check that all the Pre-Contract matters have been dealt with to his satisfaction before exchange, that is matters relating to:

- Searches
- Enquiries – SPIF and CPSEs
- Title – Registered/Unregistered rules
- Insurance
- Leasehold sales
- Occupiers – vacant possession
- Special Circumstances including capacity

In addition, it is necessary to check that the terms of the Contract are satisfactory and properly reflect the full agreement of the parties. In particular, the following should be checked:

- Conditions of sale
- Covenants for title
- Deposits
- Conditionality (ie Conditional contracts)

Reporting on title to the buyer

Once the buyer has completed the steps referred to above, he should prepare a report on title explaining to his client, in terms that his client will understand, what investigations he has carried out and the results of those investigations. He should summarise his conclusions and advice to his client.
Exchange of Contracts

Authority to exchange contracts

The client’s authority to exchange must be obtained before exchange. [NB Risk Management issue]

A solicitor who exchanges contracts without his client’s express or implied authority will be liable to his client in negligence.

Exchange of contracts

Physical exchange of two identical parts of the contract is the usual method adopted by the seller and the buyer of bringing the contract into existence.

The contract will usually be prepared in 2 identical parts, one for signature by the seller and one by the buyer. The contracts must be identical in every way (save for the signatures by the parties) including filling in the date of the contract and the date agreed for completion. The 2 parts are physically exchanged, with the buyer receiving the part signed by the seller and the seller receiving the part signed by the buyer.

The terms of a contract can, however, be contained in a single document signed by all the parties.

The time when the contract comes into existence depends upon the method of exchange used.

Exchange of contracts by telephone

This is now the most common method of exchanging contracts.

Both parties’ solicitors must agree before exchange that exchange of contracts by the telephone is to be governed by one of the Law Society’s formulae: A, B or C.

The use of these formulae allow the solicitors to agree by telephone that contracts are exchanged and therefore are legally binding at that point in time rather than when a physical exchange of contracts takes place.
Exchange of Contracts

Each of the formulae incorporates firm's undertakings and therefore solicitors need to consider who within their firms is to be authorised to exchange contracts using this method. For guidance on solicitors’ undertakings see Chapter 18 of The Guide to the Professional Conduct of Solicitors 1999 or at www.lawsociety.org.uk [NB: Risk management issue]

Whilst the formulae may be used where a party is represented by a solicitor or licensed conveyancer, they must not be used where a party is represented by an unqualified person since their undertaking would not be enforceable in the same way as that of a solicitor or licensed conveyancer.

The text for these formulae, A, B & C and explanatory notes can be found in The Guide to the Professional Conduct of Solicitors 1999 as Annex 25D or at www.lawsociety.org.uk [select Annex 25D – Guidance – Law Society’s formulae for exchanging contracts by telephone, fax or telex].

Formula A is for use where one solicitor holds both signed parts of the contract.
The solicitors agree on the telephone that contracts are exchanged in accordance with Formula A. The contract becomes binding at this point. The solicitor holding both parts of the contract dates them and sends the part signed by his client to the solicitor on the other side.

Formula B is for use where each solicitor holds his own clients signed part of the contract
The solicitors agree on the telephone that contracts are exchanged in accordance with Formula B. The contract becomes binding at this point. Each solicitor dates his clients signed part of the contract and sends it to the other solicitor.

Formula C is for use where each solicitor holds his own clients signed part of the contract (and is particularly for use in chain transactions).
The solicitors agree on the telephone to release the contracts for exchange for a specified period. Note: Under Formula C the ultimate recipient of the deposit in the chain must hold it as stakeholder. Where Formula C is to be used, it is a requirement of that formula that express authority to use this method be obtained.
Exchange of Contracts

The Law Society’s explanatory notes on the use of the formulae include a suggested form of authority to exchange contracts on a Formula C basis. It should be adapted to cover any special circumstances - [www.lawsociety.org.uk](http://www.lawsociety.org.uk) [select Annex 25D - Guidance - Law Society’s formulae for exchanging contracts by telephone, fax or telex] [See Note 8]

A contemporaneous memorandum should be made of details of the exchange, together with any variations to the formulae agreed between solicitors. Any such agreed variations should be confirmed in correspondence between solicitors.

Where an undertaking is given to send a deposit cheque/transfer funds electronically to the solicitor acting on the other side, compliance must take place on the day of exchange. If, for example, it is too late in the day to send a deposit cheque or transfer funds electronically, then compliance must take place as soon as possible on the following day.

Exchange of contracts personally

This method is less common because of the time and inconvenience involved.

Here, the solicitors physically meet and a contract exists from the moment of physical exchange. The benefit of this method is that the parties can check before exchange that both parts of the contract are identical and that the contracts have been signed, instead of having to rely on the solicitor’s confirmation to this effect.

Exchange of contracts by post

Here, the buyer’s solicitor will send his client's signed contract and deposit cheque to the seller’s solicitor. Once the seller’s solicitor receives them he will post his client's signed contract to the buyer’s solicitor. The contract becomes binding when the seller’s solicitor posts his part of the contract to the buyer’s solicitor.

A contract will be binding even if the seller’s part is lost in the post and is never received by the buyer’s solicitor.
Exchange of Contracts

Exchange by document exchange

The document exchange can be used to exchange contracts in a similar way to the postal service. When exchange is effected, however, differs from normal postal service; the contract will come into existence when the seller’s part of the contract is received by the buyer’s solicitor.

No exchange by fax

It was held in the case of Milton Keynes Development Corporation v Cooper (Great Britain) Limited [1993] EGCS 142 that an exchange of faxes was not an exchange of contracts because the legal requirements for the creation of a land contract under s2 of the Law of Property (Miscellaneous Provisions) Act 1989 had not been satisfied.

Fax can, however, be used to transmit the messages which activate the Law Society’s Formulae ie fax is used as a substitute for the telephone.

PRACTICE POINT

It is not sufficient for the envelope containing the seller’s part of the contract to be handed to a third party with instructions to post it. [Re London and Northern Bank ex p Jones [1900] Ch 220]
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Before that, she was an assistant solicitor at Simmons & Simmons, where she specialised in landlord and tenant matters.
Negotiating the commercial lease – what is important?

Negotiating a commercial lease is sometimes referred to as a “ritual dance”, during which the landlord’s solicitor will submit a draconian first draft, which the tenant’s solicitor then amends beyond all recognition. During a lengthy period of negotiation, the parties finally reach a compromise. Landlord and tenant clients frequently find this frustrating. There is room for negotiation (and relevant case law) in relation to almost all clauses of a lease; but from a commercial point of view, some matter more than others. What follows does not attempt to identify every point that could be made during a lease negotiation. Instead, it focuses on those areas that are the most hotly debated by landlords and tenants as well as their solicitors – the issues that have a significant impact on the respective commercial interests of the landlord and tenant.

The code of practice for commercial leases in England and Wales (the “Code”)

The Code sets out recommended “best practice” for landlords and tenants negotiating commercial leases (but is not mandatory). It was produced by the Commercial Leases Working Group, which includes the British Property Federation, the British Retail Consortium and the Royal Institution of Chartered Surveyors. The second edition of the Code was published in 2002, in response to concerns expressed by the government that some leases appeared to be biased in favour of landlords and that some tenants did not appear to fully understand the impact of specific clauses. Some of the recommendations in the Code reflect common market practice. Others are more favourable to tenants than was common when the Code was published and have encouraged a change in market practice.

PRACTICE POINT

If you are negotiating a commercial lease, make sure you are familiar with the contents of the Code, which can be downloaded from the British Property Federation website.
Leases - The basic terms

The demise

The part of the lease known as the demise is short but crucial - it is where the leasehold interest is created. In this clause, the landlord agrees to let the Property to the tenant for the agreed term, reserves the rent and sets out the rights granted to the tenant and those reserved by the landlord. The items included in the rent are usually set out in full in this clause. The Property, the term and the rights may also be set out in the demise but are usually defined elsewhere in the lease and simply referred to here, because this makes the drafting neater.

The property

Defining the property

It is vital that the lease identifies clearly the extent of the property that the tenant is entitled to occupy (and obliged to repair), together with any other areas that the tenant will have a right to use. The property let to the tenant may be referred to as the “Demised Premises”; more modern drafting will simply refer to the “Property”.

If the lease relates to the whole of a freestanding building, the definition of the Property will be straightforward. If title to the Property is registered, the definition should include the title number (for example “the property known as Unit 4, The Retail Park, Anytown, registered with title number XY 12345”).

If only part of a building is being let, the definition must set out clearly which parts (if any) of the structure (such as load-bearing walls and joists) are included. Office premises are usually let by floor, on “internal only” leases. Typically, the tenant will get

• the space enclosed by the walls, floor and ceiling;

• the inner half of any non-loading bearing walls dividing the Property from the rest of the building;

• the floor; and

• the ceiling and the space above it, up to the slab of the floor above.
Unless there is a statement to the contrary, a lease includes the ground below the Property and the airspace above it, to the height necessary for the ordinary use and enjoyment of the land and any structure on it (Bernstein of Leigh (Baron) v Skyviews & General Ltd [1978] Q.B. 479). This prevents the landlord letting valuable roof space to telecoms operators. It may also affect the landlord’s ability to place air conditioning units on any adjacent property it owns, even if they are several metres above ground level (Laiqat v Majid [2005] PLSCS 114).

### Plans

The verbal description of the Property should be supplemented by a plan. A lease for more than seven years will have to be registered and so must include a plan that satisfies the Land Registry's requirements.

The verbal description will usually be more detailed than the plan, so it has been common practice to refer to a plan being “for identification only”. This means that the description of the Property will prevail. However, current Land Registry practice is to reject plans expressed to be for identification only. In practice, if these words are included in the description of the Property and not marked on the plan, the Land Registry may not object, although it is unwise to rely...
on this. A compromise may be to refer to the plan as showing only “general boundaries” and to make sure that the plan and the verbal description do not contradict each other.

Rights granted to the tenant

The tenant will usually need rights to use other areas not included in the lease, to get to and from the Property. These must be expressly set out in the lease. If there is no right granted, the tenant will be trespassing. The exact rights needed will depend on the position of the Property and what it will be used for but a typical lease would grant rights in relation to

- access roads
- utilities
- common areas, such as entrance lobbies, stairs and lifts
- car parking
- servicing/delivery areas

PRACTICE POINT

Tenant – make sure rights granted are adequate for the tenant’s intended use of the property. Look out for restrictions on the hours during which rights may be exercised.

The tenant may also need rights to do specific things on the Property, such as putting up signs or fixing air conditioning or telecoms equipment to the outside of the building. Section 134(2) Communications Act 2003 means a landlord cannot unreasonably refuse consent where a tenant wants to do something relating to an “electronic communications matter”. This is a wide definition but it does not apply to areas outside the let property, so the tenant will still need express rights.
Leases – The basic terms

PRACTICE POINT

Tenant - if the tenant needs to enter areas outside the Property to inspect or repair, include express rights (particularly if the airspace is excluded).

Rights reserved to the landlord

The landlord must anticipate the rights it will need over the Property during the term of the lease and reserve them expressly. These should include not just rights to enter the Property but also rights to do things on any adjoining land that may have an adverse effect on the tenant’s enjoyment of the Property.

Rights to enter

The landlord should always have the right to enter the Property, to inspect and, where the tenant is in breach, to carry out repairs or remove unauthorised alterations. This is known as a Jervis v Harris clause (Jervis v Harris 1996 1 All ER 303). It enables the landlord to enter the Property, carry out repairs and recover its costs from the tenant as a debt, rather than damages (see Practice Point). This technical distinction has two important practical consequences:

• The landlord does not need to get a court order, which would otherwise be required if the lease was granted for seven years or more and had at least three years left to run (Leasehold Property (Repairs) Act 1938).

• Section 18 Landlord and Tenant Act 1927 (LTA 1927) restricts the amount a landlord can recover in damages for disrepair but this does not apply to costs incurred under a Jervis v Harris clause.

Right to use services

Utilities serving the rest of the building may run through the Property, so the landlord should reserve an express right.
Leases – The basic terms

Rights to alter common areas
A lease of part of a building or estate will grant the tenant rights over common areas. The landlord will not be entitled to alter those areas without an express right to do so.

Rights to develop adjoining land
If the landlord owns or may acquire land adjacent to the Property, it must reserve clear rights to carry out works, including redevelopment of the adjacent land. If there are no express rights, the tenant might be able to argue that the works interfere with its enjoyment of the Property and that the landlord is undermining what it agreed to grant the tenant (“derogating from grant”). The reservation should allow the landlord to carry out works on adjacent land, whether or not the landlord actually owns it. Without this wording, if the adjacent land is owned by a joint venture in which the landlord is participating, there is an argument that the landlord cannot rely on the reservation (Paragon Finance v City of London Real Property)

Term
Commercial leases are almost always granted for a fixed term, which should be clearly stated. The term commencement date is important. Rent reviews and the exercise of break rights usually happen on anniversaries of this date. Landlords often require lease terms to commence on the quarter day immediately before the date the lease is actually granted (so a lease granted on 1 September would have a term commencement date of 24 June). This means significant events such as rent reviews and break rights take effect on quarter days,

PRACTICE POINT

Tenant - make sure the landlord is obliged to make good any physical damage caused when exercising a right of entry.

Landlord - rights of entry should be exercisable not just by the landlord but also by those authorised by the landlord. This avoids any argument about whether agents and contractors are allowed onto the Property.
helping the landlord to keep track of them. This does not mean that the obligations in the lease will bind the parties before the lease is actually completed, unless the parties expressly agree that they will.

**PRACTICE POINTS**

If the term is expressed to be “from” 24 June, it is presumed to start at midnight between 24 and 25 June, unless there is evidence that the parties intended something different. Avoid uncertainty by stating that the lease is for a term “beginning on [date] and ending on [date]”.

Landlords - if the lease is protected under the Landlord and Tenant Act 1954, state that the term includes any statutory continuation of the lease, to make sure that any authorised guarantee agreement covers that period (City of London Corporation v Fell (1993) 4 All ER 968)

**Rent**

*When and how is rent paid?*
As well as stating that rent is payable, the demise should set out how and when the rent is to be paid. The most common arrangement is for rent to be paid quarterly, in advance. Most leases require rent to be paid on “the usual quarter days” (25 March, 24 June, 29 September and 25 December), although some landlords specify other quarterly payment dates. Most landlords also require rent to be paid by direct debit.

*What does the rent include?*
The demise will normally list a number of items that will be treated as rent:

- The principal rent - the yearly rent agreed for the Property. If the lease has rent review provisions, the definition of principal rent should include the rent as reviewed from time to time. The lease should also state expressly that the principal rent is exclusive of VAT (see VAT on rent).
Leases – The basic terms

- Insurance rent – the amount the landlord is entitled to recover from the tenant in insuring the Property as required by the lease (see Insurance).
- Service charge – this will be calculated by reference to the relevant part of the lease (see Service charge).
- Interest on any payments the tenant makes late (see Interest)
- VAT on the rent (see VAT on rent)

PRACTICE POINTS

If payments are reserved as rent, the landlord can use (or threaten) the remedy of distress to recover them.

Landlord – consider reserving all payments due under the lease as rent.

Tenant – try to restrict items reserved as rent to those listed above. In particular, make sure that only quarterly advance payments of service charge are reserved as rent, leaving the balancing payments to be demanded in accordance with the service charge provisions.

VAT on rent

The landlord may charge VAT on rent if it has elected to waive the exemption from VAT in relation to the Property. [Will there be a general note that detailed consideration of tax is outside the scope of this section?] The landlord will want to charge VAT in addition to the principal rent agreed.

PRACTICE POINT

The principal rent must be expressed to be exclusive of VAT. If it is not, the landlord will have to account for VAT out of the rent it actually receives, so will be out of pocket.

The lease should also include a tenant’s covenant to pay rent, VAT and interest.
Leases – The basic terms

Tenant’s covenants

Rent, VAT and interest

Rent
The tenant should give an express covenant to pay the principal rent on the specified dates. If there is a rent free period, the lease should specify a rent commencement date and state that the tenant’s obligation to pay starts on that date.

VAT
The tenant should give an express covenant to pay any VAT which is payable in addition to the rent.

Interest
The lease should set out the interest rate that will apply to any late payments. This will usually be between 2 and 4% above the base rate of a specified bank. The tenant should covenant to pay interest on any payment not made on its due date.

Landlord – state expressly that the tenant must pay the rent without deduction or set-off, otherwise the tenant may be able to withhold certain sums from the rent. Simply referring to deductions is not enough to exclude the right to set-off (Connaught Restaurants Ltd v Indoor Leisure Ltd (1994) 4 All ER 834).

Landlord – if the lease is protected under the Landlord and Tenant Act 1954, include an obligation to pay any interim rent, to make sure that such sums are covered by any authorised guarantee agreement (Herbert Duncan v Cluttons (1992) All ER 449)
Leases – The basic terms

PRACTICE POINT

Landlord - make sure the interest clause states that interest is payable both before and after any court judgment.

Tenant - consider negotiating a grace period (for example 14 days) after the date on which a payment is due, before interest becomes payable.

Repair

Landlord's objective:

• to make sure that the Property is maintained to an acceptable standard, at the tenant's expense, so it can be re-let without significant work or expenditure by the landlord.

Tenant's objective:

• to limit liability to repair to what is reasonable given the age and condition of the Property and the length of the lease; and

• to avoid liability for carrying out work that arises because of a defect in the Property or which is covered by the landlord’s insurance.

Basic repairing covenant
The normal position in a commercial lease is for the tenant to be responsible for repairing the parts of the property let to it, except where damage is caused by an insured risk (see Insurance for more detail on this and the position in relation to uninsured loss). The definition of the Property will govern exactly what the tenant is obliged to repair, so it is vital that this is clear, especially where the lease relates to part of a larger building. The landlord’s repairing obligation should cover the parts not let to the tenant. If the lease is badly drafted and there are parts of the building that neither party is obliged to repair, the court will be reluctant to fill the gap by implying
Leases – The basic terms

the missing obligations (Jacey Property Co Ltd v de Sousa [2003] EWCA Civ 510)

PRACTICE POINT

Make sure there are no gaps in the repairing obligations. It is often unclear who is responsible for replacing glass in the windows of the property, so set this out expressly.

Repair generally means restoring the Property by renewing or replacing subsidiary parts of it (Lurcott v Wakely [1911] 1 K.B. 905). Work that would involve renewing the whole of the Property or giving back to the landlord something wholly different from the Property originally let will generally not fall within a repairing obligation, although this can be a question of degree (see Inherent defects).

PRACTICE POINT

Tenant – Look out for references to renewing and rebuilding in a repairing covenant. They may extend the obligation beyond straightforward repair.

A typical repairing covenant will read: “To keep the Property in good and substantial repair”. Words like “good and substantial” or “good and tenantable” do not add anything to the basic obligation to repair (Proudfoot v Hart (1890) 25 Q.B.D. 42). The tenant must keep the Property in the state of repair that a reasonably minded tenant likely to take a lease of the Property would expect. The required standard of repair will be judged by reference to the age, character and nature of the Property at the date of the lease.
Leases – The basic terms

Good condition
It is increasingly common to see a covenant that reads: “To keep the Property in good and substantial repair and condition”. The reference to condition adds to the basic repairing obligation and may mean the tenant has to carry out works that go beyond mere repair. For example, a property suffering from damp and condensation because of poor ventilation would not comply with a covenant to keep it in “good condition and repair” and the tenant might be obliged to improve the ventilation. This would not be the case without the reference to “condition” (Welsh v Greenwich London Borough Council [2000] 3 EGLR 41).

Inherent defects
The Property may suffer from defects caused by faulty design or construction (often referred to as inherent defects). If the lease does not set out expressly who is liable to remedy inherent defects, the general rule is that the tenant will not be obliged to deal with them unless they have caused disrepair. In practice, this means that the Property must be in a worse condition than it previously was (Quick v Taff-Ely Borough Council [1985] 3 All ER 321). If the Property is defective (for example, the basement floods regularly) but has not suffered any actual deterioration, the repairing obligation will not bite (Post Office v Aquarius [1987] 1 All ER 1055).
If a defect has caused disrepair, the tenant’s repairing obligation may extend to remedying the defect as well, depending on the extent of the work that would be required (Ravenseft Properties Ltd v Davstone (Holdings) Ltd [1979] 1 All ER 929; Stent v Monmouth D.C. [1987] 1 EGLR 59).

PRACTICE POINT

Tenant - An obligation to keep the property in repair implies an obligation to put it in that state if it is not at the date of the lease (Proudfoot v Hart). If this will be too onerous, consider using a schedule of condition.
Schedules of condition
If the tenant's repairing obligation is to be limited to keeping the Property in no worse a state than it is at the date of the lease, it is vital to include a comprehensive schedule of condition in the lease. This should be prepared by a surveyor and agreed by the parties. It must describe in detail the precise condition of the Property at the date of the lease and should include photographs.

Use of the Property

Landlord's objective:

• to maintain the investment value of the Property by controlling the type of business carried on there;
• where the Property is part of a larger development, such as shopping centre or retail park, to make sure that the mix of uses is attractive to customers and other potential tenants; but
• to avoid being so restrictive that the tenant gets a discount when the rent is reviewed.

Tenant's objective:

• to be able to use the Property for its current business;
• to have flexibility to change the use if the tenant wants to
assign the lease or sub-let to another occupier; but
• to avoid paying higher rent for a use that is unnecessarily wide.

Permitted use
The lease should set out clearly what business the tenant is allowed carry on at the Property. This is usually expressed as a negative covenant, for example “Not to use the Property other than as ....”. A clause like this gives the landlord absolute control over the use of the Property, as there is no statutory obligation to act reasonably if the tenant requests a change of use. This degree of control usually comes at a price, because a very restrictive use will often mean the tenant gets a discount when the rent review is being settled. At the other extreme, a wide permitted use may enable the landlord to argue for an increased rent on review. A common compromise is for the user clause to refer to a specific class of uses in the current Town and Country Planning (Use Classes) Order, with an obligation on the landlord not unreasonably to withhold consent to a change of use within the specified class.

PRACTICE POINT

Note that the Town and Country Planning (Use Classes) Order 1987 was amended from 21 April 2005 by the Town and Country Planning (Use Classes) (Amendment) (England) Order 2005. Use classes change relatively frequently, so any reference to them in a lease should state clearly whether it is intended to include only the Order current at the date of the lease or to take in subsequent amendments.

Tenant mix policies
Landlords of retail developments are increasingly keen to manage the mix of shops and services offered to customers. If a landlord can show that it has a genuine and reasonable tenant mix policy, it is likely to be reasonable for the landlord to refuse to consent to a change of use that does not fit that policy (Moss Bros Group plc v CSC Properties Ltd [1999] EGCS 47).
Leases – The basic terms

Competing uses
The tenant may want to make sure that nearby premises are not let to businesses that compete with its own. The most reliable way to achieve this is for the landlord to covenant

• not to use or permit adjoining premises to be used for the specified use;
• not to sell or let those premises without imposing an appropriate restriction; and
• to enforce the restriction when required to do so.

PRACTICE POINTS

Agree and state clearly which premises are to be subject to the restriction and consider agreeing a time limit.

The landlord should be careful about imposing restrictions on uses that compete with its own business, in case they breach the Competition Act 1998 (outside the scope of this work).

PRACTICE POINT

Landlord – Consider qualifying the obligation not unreasonably to withhold consent by reference to a tenant mix policy. Any such policy should be in writing and be consistently applied.

Tenant – the landlord will only be obliged to be reasonable in relation to a request to change use if the lease expressly provides for this. Unlike in relation to assignment there is no implied duty to act reasonably.
Leases – The basic terms

Alterations

Landlord’s objective:

• to maintain the investment value of the Property by preventing adverse alterations to the structure, layout and external appearance; and

• to ensure that the Property can be re-let with the minimum of delay and expense at the end of the term.

Tenant’s objective:

• to have flexibility to alter the Property as the tenant’s own business needs change and to meet the requirements of potential assignees/sub-tenants.

What is permitted?
It is rare to find a commercial lease that absolutely prohibits all alterations. As with permitted use, a very restrictive alterations clause could lead to a lower rent being agreed on review. In any case, even where there is an absolute bar on alterations, Part I of LTA 1927 permits a business tenant to make improvements. Whether or not a particular alteration is an improvement is assessed from the tenant’s point of view. If the tenant correctly follows the procedure set out in LTA 1927, it can make improvements and claim compensation for them at the end of the term, unless the landlord opts to do the work itself, in which case it can charge additional rent for it. Either way, the tenant gets round the apparent ban on alterations.

The definition of the Property will itself limit the alterations the tenant is entitled to make. If the lease only relates to the internal parts of a floor of an office block, the tenant will never be entitled to carry out works affecting the structure or exterior without express permission from the landlord.
If the lease prohibits alterations being made “without consent”, there is an implied proviso that consent will not be unreasonably withheld in relation to works that are improvements (s19(2) LTA 1927). In fact, most leases refer expressly to consent not being unreasonably withheld.

In practice, the best way to deal with alterations is to divide them into three categories:

- those which are absolutely prohibited (such as alterations to the structure or the addition of any new structures);
- those which will be permitted with consent not to be unreasonably withheld (such as internal, non-structural alterations); and
- minor works which are permitted without the need for consent (such as erecting or removing internal demountable partitioning).

**PRACTICE POINT**

If control of the external appearance of the Property is important, refer to this specifically. Retail tenants will want as much freedom as possible in relation to signs and external “branding” of Property, especially where they operate from more than one property. Landlords will want to maintain some uniformity. A good compromise is to designate specific areas on the exterior of the Property where the tenant can erect signs without consent, as long as they do not exceed the agreed size and genuinely reflect the tenant’s brand and style.

**Reinstatement**

The landlord and tenant must agree whether or not the tenant will have to remove any alterations or improvements at the end of the term. Landlords usually want to reserve the right to make the tenant remove all alterations, in an attempt to avoid having to pay compensation under LTA 1927. In fact, there is no guarantee that this will work, because s9 LTA 1927 prevents contracting out. Tenants will not want to be obliged to
Leases – The basic terms

spend time and money removing alterations where, for example, the landlord intends to carry out a major refurbishment. In practice, most leases provide for alterations to be removed if required by the landlord. The Code recommends that the tenant should be required to remove permitted alterations only where it is reasonable – whether or not landlords agree this will depend on the bargaining position of the parties.

**PRACTICE POINTS**

Whatever is agreed, make sure it is clearly expressed. See Fairgate International v Citibank International plc [2005] 27 EG 222 for an example of how ambiguous drafting led to litigation to settle whether a number of reinstatement obligations cancelled each other out.

Landlord – deal specifically with tenant’s fixtures. The tenant is entitled to remove them but will not be obliged to do so unless there is an express provision in the lease.

**Alienation**

Alienation is the general term given to the various ways in which the tenant might dispose of the Property: assignment, underletting, charging, parting with or sharing occupation or possession and holding it on trust for someone else.

**Landlord’s objective:**

- to control the identity of the tenant from time to time, to make sure that the rent will be paid and the investment value of the Property is maintained; but
- to avoid being so restrictive that it is impossible for the tenant to dispose of the Property.

**Tenant’s objective:**

- to maintain the maximum possible flexibility to dispose of the whole or part of the Property, if the tenant’s business requirements change.
Leases – The basic terms

General prohibition
In the absence of any express restrictions, the tenant will be free to deal with the Property as it chooses. The best way to make sure all methods of alienation are clearly dealt with is to include a general prohibition on all forms of dealing, except those expressly permitted by the lease. This is followed by a series of specific provisions setting out the circumstances in which various ways of dealing with the Property are allowed.

PRACTICE POINT
Do not rely on general words – refer expressly to each type of dealing.

It is possible for the landlord to impose absolute restrictions on the various ways of disposing of the Property, without statute implying any duty to act reasonably. In practice, landlords should approach this with care, because too much control can make the lease so difficult to dispose of that the tenant can argue for a discount on rent review.

PRACTICE POINT
Absolute prohibitions should normally relate only to dealings with part of the Property, which can genuinely make managing the Property more difficult for the landlord. Depending on the nature of the Property, underlettings of part may be acceptable.

Assignment
Almost all commercial leases allow assignment of the whole with the landlord’s consent, which is not to be unreasonably withheld or delayed. If this is not allowed, the tenant has a good argument for a discount on rent review. The Landlord and Tenant (Covenants) Act 1995 (LTCA 1995) made significant changes to the way assignment clauses are operated and drafted. The tenant is released from its covenants on a lawful assignment but may be required to enter into an authorised guarantee agreement (AGA), to guarantee the
performance of those covenants by the assignee. In addition, landlords now have the right to specify in the lease circumstances in which it will be reasonable to withhold consent and conditions that the landlord may reasonably impose when giving consent. Where such conditions and circumstances are to be determined by the landlord (for example whether or not the investment value of the Property will be adversely affected by the proposed assignment) they must either require the landlord to exercise its judgement reasonably or provide for determination by a third party.

When LTCA 1995 first came into force, leases were drafted with long lists of conditions and circumstances, including complex financial tests to be applied to proposed assignees. In general, practice has now moved towards shorter lists.

A typical set of circumstances in which consent may be refused would include:

- substantial outstanding breaches of covenant by the assigning tenant;
- the proposed assignee not, in the landlord’s reasonable opinion, being capable of complying with the tenant’s covenants;
- the proposed assignee being subject to diplomatic immunity;
- the proposed assignee being incorporated or resident in a country outside the UK with which the UK has no treaty for mutual enforcement of judgments; and
- (sometimes) the proposed assignee being a group company of the current tenant.

Of these, the group company exclusion is the most controversial. Landlords want it because they fear that it would otherwise be quite easy for a tenant with good covenant strength to assign a lease to a weaker group company, giving an AGA. If the lease was assigned again within the group, the original tenant would be released from its AGA and the landlord would be left with weaker group companies to rely on. Tenants will resist it, because it fetters their ability to move property around as part of group re-organisations. In practice, it is down to the bargaining strength of the parties, although there is a fairly strong tenant argument that a landlord should be able to resist
an assignment to an unacceptable group company by applying the other tests, without imposing a blanket restriction on group company assignments.

A typical set of conditions that could be imposed on an assignment would include:

- the assigning tenant entering into an AGA and, if the tenant has a guarantor, the guarantor guaranteeing the AGA (see Guarantee provisions for further discussion of this); and
- if reasonably required by the landlord, the assignee providing an acceptable guarantor.

The Code recommends that a AGA should be required only if reasonable, although during the first 10 years' operation of LCTA 1995, most leases have provided for an automatic AGA on all assignments. So far, the court has looked at this issue only in relation to the renewal of a pre-LTCA 1995 lease under LTA 1954, when it held that the new lease should provide for an AGA only where reasonable (Wallis Fashion Group Ltd v CGU Assurance Ltd [2000] 27 EG 145). A number of tenants have started to argue for this on new leases, so market practice may change.

### PRACTICE POINT

Specifying conditions that may be imposed and circumstances in which consent may be withheld should not limit the landlord’s right to refuse consent on any other reasonable ground or to impose other reasonable conditions, although this has not been tested in court since LTCA 1995 came into force. To avoid any doubt, include an express statement to this effect.

**Underletting**

The usual position is for underletting of whole to be permitted with the landlord's consent, which must not be unreasonably withheld or delayed. Landlords are more reluctant to allow underlettings of part, because of the perceived difficulties involved in managing a building with multiple occupiers. However, where the Property is easy to divide (particularly if it consists of more than one floor of a building),
underlettings of defined “Permitted Parts” are often allowed.

Landlords need to keep some control over the terms of any underletting, for several reasons.

- Any rent agreed in relation to an underlease may be used as a comparable in a review of the head lease rent.
- If the underlease is not contracted out of the security of tenure provisions of LTA 1954, the underlease will continue if the undertenant remains in occupation. If the head tenant is not back in occupation at the end of head lease, that lease will come to an end and the undertenant will have a right to apply for a new tenancy. The court will take the terms of the underlease into account in settling the terms of any new lease.
- If the head lease is forfeited, the undertenant may apply for relief. While one would expect the undertenant to have to comply with the terms of the head lease, relief is granted at the court’s discretion and there is no guarantee that the court would not look at the terms of the underlease if they were very different.

Ideally, the landlord will want to make sure that the rent payable under the underlease is at least equal to the current market rent for the underlet property and that the terms of the underlease otherwise mirror those of the head lease. The tenant should also be required to make sure that the underlease is contracted out of the security of tenure provisions of LTA 1954.

Until recently, it was common for leases to state that the tenant would only be permitted to underlet at the higher of market rent and the rent actually payable under the head lease at the time of the underletting (often referred to as the passing rent). This protected the landlord against having a lower rent agreed for an underletting used as evidence on review of the head lease rent. However, it also deprived the tenant of its only likely method of disposing of the Property where market rent had fallen below the rent payable under the head lease. To get round such restrictions, tenants frequently did deals with undertenants, typically granting the underlease at the same rent as the head lease but entering into a side letter stating that the undertenant would only be required to pay a lesser rent, or
that part of the rent would be repaid by the head tenant. There were numerous variations on this scheme, often extending to relaxing repairing obligations in the head lease.

Arrangements like this are no longer effective. In Allied Dunbar Assurance plc v Homebase Ltd [2002] 27 EG 144, the Court of Appeal held that an underlease and any side arrangement must be read together. If the combined effect is an underletting that does not comply with the requirements set out in the head lease, the tenant will be in breach.

**PRACTICE POINT**

If the head lease does not prohibit the tenant paying a reverse premium to the undertenant (to induce it to enter into an underlease at more than market rent), this may be a way round the problem (NCR LTD v Riverland Portfolio (No 1) Ltd [2004] 16 EG 110), although it is difficult to see exactly why this is acceptable where a straight forward rent rebate is not and the decision may be challenged.

The problem of tenants not permitted to underlet at less than passing rent has given rise to pressure from the government and a number of landlords have agreed publicly not to impose this requirement in any new leases (see BPF subletting declaration at www.bpf.org.uk/publications/declaration/) Landlords who do impose this restriction in any case risk the tenant arguing for a discount on rent review (see next Practice Point).

**Giving consent**

Before formal consent is given to a proposed assignment or underletting, there is usually a period of negotiation, during which the landlord may request further information about the proposed assignee/undertenant and the terms of the deal. It is important that all parties understand when formal consent has been given. It is common to mark correspondence “subject to licence” but that does not guarantee that a court will not find that the landlord has given consent, even where there are outstanding conditions to be satisfied.
Leases – The basic terms

Charging
It is normal for the lease to prohibit charging of part of the Property but most tenants will want to retain the right to charge the whole. In practice, it is more likely that a rack-rented lease will be charged as part of a floating charge over the whole of the tenant company’s assets than as fixed security in its own right. Tenants will want the ability to enter into floating charges without needing landlord’s consent.

Sharing occupation
Commercial leases often allow the tenant to enter into informal sharing arrangements with group companies. Retail tenants may also want the right to grant informal concessions to other traders.

PRACTICE POINT
If the lease is drafted so that the tenant will be allowed to grant underleases only if they comply with certain pre-conditions (for example that the underlease rent is reviewed at the same time as the head lease rent or that the underlease is otherwise on the same terms as the head lease), the landlord’s obligation to act reasonably does not arise unless those pre-conditions are met (Bocardo SA v S&M Hotels Ltd [1979] 2 EGLR 48). Drafting in this way can give the landlord greater control over the terms of any underletting.

(Aubergine Enterprises Ltd v Lakewood International Ltd [2002] EWCA Civ 177).

PRACTICE POINT
Provide in the lease that any consent required from the landlord must be given in writing and by deed. This should ensure that no letter can be construed as giving consent before a formal licence has been competed.
Landlord’s covenants

The landlord usually gives fewer covenants than the tenant, typically dealing with the following areas:

- quiet enjoyment of the Property by the tenant;
- insurance of the Property;
- reinstatement of the Property following damage or destruction; and
- provision of services (including repair and maintenance of the parts of the Property not let to the tenant).

The covenant for quiet enjoyment is usually in standard form and is rarely the subject of negotiation. Covenants in relation to the other areas are more keenly debated and are dealt with here in separate sections.

Insurance

Landlord’s objective:

- To make sure that if the Property is damaged or destroyed, there will be sufficient money to rebuild it (or redevelop the site), while maintaining a constant income stream.
Leases – The basic terms

Tenant's objective:

• To make sure that if the Property is damaged or destroyed, it will be rebuilt promptly, so the tenant can carry on with its business; and
• to avoid paying rent while the Property cannot be used.

The general position
The usual arrangement in relation to insurance is as follows:

• The landlord covenants to insure the Property against an agreed list of risks, for the full reinstatement cost, together with three (or more) years' loss of rent.
• The tenant covenants to pay the whole (or an appropriate proportion) of the cost of insuring (the insurance rent).
• If the Property is damaged by one of the insured risks, the tenant’s repairing obligation does not apply and the landlord is obliged to reinstate.
• The tenant's obligation to pay rent is suspended for the period during which loss of rent insurance is payable.
• If the Property has not been reinstated (or reinstatement at least begun) by the end of an agreed period (usually the loss of rent period), one or both parties will be entitled to bring the lease to an end.

Insured risks
Most draft leases set out a fairly standard list of risks against which the landlord is to insure, although the landlord should discuss the list with its insurers, to make sure that everything on it is actually covered. There should always be a general clause, referring to “any other risks against which the landlord reasonably decides to insure”, to make sure the landlord can recover the costs of insuring any additional risks not included in the initial list.
Leases – The basic terms

Full reinstatement cost
Both parties will want to be sure that any insurance monies will be enough to cover the complete costs of reinstatement, including preliminary site clearance and it is usually the responsibility of the landlord to make an appropriate estimate.

PRACTICE POINT
The list of insured risks should always be qualified, so that the landlord is obliged to insure against them only where insurance is actually available at reasonable rates. Terrorism and flooding are just two examples of risks against which it may not always be possible to get insurance. See below for discussion of how to deal with damage by an uninsured risk.

Tenant – try to impose an obligation on the landlord to make up any shortfall in insurance monies out of its own money. If the landlord is responsible for estimating the reinstatement value, it is fair for the landlord to bear the risk of the estimate being wrong.

PRACTICE POINT

What is to be reinstated?
As the tenant has been paying insurance rent throughout the term of the lease, it will usually be keen for the Property to be reinstated as soon as possible, so the tenant can resume its business. The landlord may not always want to reinstate – it may have other plans for the site. The extent of the landlord's obligation to reinstate will depend in part on the nature of the Property. If it is a free-standing building, there should be little argument. However, where the Property is part of a larger development, the landlord may want to keep some flexibility about how much it is obliged to reinstate and may try to limit its obligation to the Property itself.
Rent cesser
The purpose of paying for loss of rent insurance is so that the tenant is can be given a break from paying rent (a rent cesser) if it is not able to use the Property following damage by an insured risk. The loss of rent cover ensures that the landlord still gets a regular income. Loss of rent insurance should cover a period equivalent to the length of time it is likely to take for the Property to be reinstated (or for it to become clear that reinstatement is not possible). Three or four years is the norm, although a longer period may be appropriate for a very complex building. The rent cesser will usually start on the date of the damage and end at the end of the loss of rent period or, if earlier, the date on which the Property is once more capable of being used by the tenant (see Practice Point 1).

Right to break if Property not reinstated
If it proves impossible to reinstate the Property (for example because planning permission cannot be obtained) neither party will want to be tied to a lease that no longer serves any useful purpose. The tenant will be particularly keen to walk away once the rent cesser period comes to an end, to avoid paying rent for unusable premises. The lease should include a right for either or both parties to bring it to an end by serving notice on the other party if the Property has not been reinstated by the end of an agreed period. The landlord may also want the right to break without attempting to reinstate if damage occurs during the last few years of the term (see Practice Point 2).
Uninsured loss

Not all risks can be covered by insurance. Changes in circumstances may mean that insurance that was once easy to obtain is no longer automatically available (for example, cover against terrorist damage or flooding). The tenant’s repairing obligation is usually qualified so that it does not apply where there is damage by an insured risk. The tenant’s rent cesser and the landlord’s obligation to reinstate and right to break are generally triggered by damage by an insured risk. Until recently, few leases addressed specifically what would happen where the damage was the result of an uninsured risk, so the parties were left in a stalemate position, with neither party obliged to reinstate but with the tenant still paying rent and neither party able to walk away.

1 Do not rely on the lease being frustrated even by significant damage. It is possible for frustration to apply to a lease but only in rare circumstances (National Carriers Ltd v Panalpina (Northern) Ltd [1981] 1 All ER 161). Always provide expressly for rent cesser and a right to bring the lease to an end if reinstatement is impossible.

Tenant - make sure the trigger for the end of the rent cesser period includes the reinstatement of any essential access ways, not just the Property itself.

2 Landlord - try to restrict the tenant’s right to break if the Property has not been fully reinstated by the end of the loss of rent period but the landlord has already made substantial progress.

Tenant - try to include a statement that where the lease is determined without the Property being reinstated, the insurance monies will be shared between landlord and tenant in proportion to their respective interests in the Property. If the tenant has paid for improvements that have become part of the Property, it will want a fair proportion of the insurance monies, to reflect its expenditure.
Leases – The basic terms

PRACTICE POINT

Provisions dealing with uninsured loss should cover

• the period of any rent cesser;
• the landlord’s obligation to decide whether or not to reinstate; and
• the right of either party to bring the lease to an end.

Publicity surrounding terrorism and flooding mean that tenants are increasingly insisting on some explicit sharing of risk in relation to uninsured loss. The Code recommends that the tenant should have the right to break following damage by an uninsured risk, unless the landlord agrees to reinstate at its own expense. In practice, the provisions being negotiated are more complicated than this and depend very much on the bargaining position of the parties. Typically, the parties will agree a period during which the landlord must decide whether or not to reinstate at its own expense. If it decides not to, either party may bring the lease to an end by notice. If the landlord decides to reinstate, the tenant will be required to carry on paying rent for at least part of the period. Whether or not the tenant carries on paying rent while the landlord makes up its mind is a matter of negotiation.

Rent review

Landlord’s objective:

• to maintain a minimum income stream: and
• to adjust the rent at regular intervals, to achieve the best return available from letting the Property from time to time.

Tenant’s objective:

• to avoid paying more rent than it would pay if it took a new
Leases – The basic terms

lease of similar premises; and

• to make sure that rent reviews are conducted on a basis that reflects as closely as possible the actual Property the tenant occupies and the terms of the actual lease by which the tenant is bound.

Whole books have been written on the immensely complex subject of rent review. This section concentrates on the main points the landlord and tenant should bear in mind when negotiating the most frequently encountered form of rent review clause.

The basic mechanism
The most common form of rent review provision is still what is referred to as an upwards-only review to open market rent. This means that on each designated review date, the rent will be reviewed by comparing the rent actually payable under the lease on that date (the passing rent) with the rent that would be obtained if the Property had been marketed and was being re-let on similar terms on that date (the hypothetical letting). If that rent is higher than the passing rent, the passing rent will be increased. If it is the same or lower, the passing rent will stay the same until the next review date. Reviews like this are called “upwards-only” because even if the market rent at the review date is lower than the passing rent, there is no reduction.

Upwards-only reviews are perceived to be unfair to tenants during periods where market rents are falling, especially if tenants are tied in to long lease terms. The Code recommends that tenants should be offered priced alternatives to upwards-only reviews and the government has put considerable pressure on landlords to implement this recommendation. It was widely expected that the government would legislate to ban upwards-only rent reviews following a consultation in 2004 but so far, it has not done so. In practice, the market has changed and tenants are taking shorter leases, with more opportunities to terminate, so the impact of upwards-only reviews is less significant.

The rent review provisions should set out

• the dates on which the rent is to be reviewed;
Leases – The basic terms

• what premises are assumed to be being let and what state they are assumed to be in;
• the exact terms of the hypothetical letting, including the length of the hypothetical term;
• how the revised rent is to be settled; and
• when tenant is to start paying the revised rent.

It used to be common for rent reviews to be triggered by a landlord’s notice, to which the tenant had to respond with a counter-notice. Provisions like this frequently gave rise to litigation and are best avoided. Most leases now simply state that the rent is to reviewed on the specified review dates and provide a mechanism for the revised rent to be settled by a third party if the parties cannot agree it.

What is being reviewed?
The revised rent will ultimately be determined by valuation. The lawyer’s role, when negotiating the lease, is to set out as clearly as possible what the valuer is to value.

The basis of the hypothetical letting is usually set out in three separate parts of the rent review provisions, which need to be read together:

• the definition of reviewed or revised rent;
• the assumptions; and
• the disregards.
Definition of revised rent

Typically, the definition of revised rent would refer to the “best rent” available on a new letting of the Property on the open market. This is the landlord’s preferred position, as it arguably allows the valuer to take into account any unusually high bids that might be made by a tenant that really wanted the Property and would be prepared to pay higher than average rent to get it. The tenant will prefer to refer simply to the rent payable in the open market.

The definition of revised rent should also deal with rent free periods and concessionary rents. The landlord wants to make sure that the tenant cannot argue for a discount to reflect the fact that on a new open market letting, the incoming tenant would be allowed a rent free period to fit out the Property. This is sometimes dealt with by an assumption that the Property is fitted out but this can lead to uncertainty over the exact nature of the assumed fitting out. It is better to provide that the revised rent will be the rent payable “after the expiry of any rent free period…..given in connection with the fitting out of the Property”.

PRACTICE POINT

The reference to the rent free period (or any concessionary rent period) having been given in connection with fitting out is important, because it distinguishes this sort of inducement from more significant payments or rent concessions. Without the reference to fitting out, the landlord might be able to argue that the revised rent should be the higher rent a tenant would pay after receiving a more significant inducement.

Assumptions

Most of the terms of the hypothetical letting are set out in the list of assumptions that the valuer is to make.
Leases – The basic terms

A typical lease would include the following assumptions:

• Basis of letting

The Property is available to be let by a willing landlord to a willing tenant, with vacant possession. This ensures the hypothetical letting reflects a genuine new open market letting.

• Terms of the hypothetical lease

The usual starting point is that the hypothetical lease will be on the same terms as the actual lease, with the exception of the amount of rent stated. It is, however, very important to make it clear that the hypothetical lease contains rent review provisions, otherwise it may be treated as a fixed rent lease, for which the tenant might be expected to pay more. To put this beyond doubt, most leases state expressly that rent review provisions are included.

PRACTICE POINT

When called to interpret rent review provisions, the court will generally adopt a “presumption of reality” (St Martin's Property Ltd v (1) CIB Properties Ltd (2) Citibank International PLC [1998] EGCS 161). This means that the rent review provisions will be construed to reflect the actual situation rather than an imagined one, unless there are very clear words (Beegas Nominees Ltd v Decco Ltd [2003] 3 EGLR 25). Any assumptions that depart from reality must be very carefully worded, so that there can be no doubt about what was intended.

Tenant – make sure the assumption also states that neither willing landlord nor willing tenant is to pay a premium, as this might affect what would otherwise be the market rent.
Landlords may want to exclude any particularly onerous terms in the actual lease from the hypothetical lease, to prevent the tenant arguing for a discount. Tenants should resist this, on the basis that it is unfair for the rent to be fixed by reference to lease terms that are better than those the tenant actually enjoys (see Practice Point).

**PRACTICE POINT**

Deal specifically with any terms of the actual lease that are personal to the actual tenant, such as break clauses. If they are to be taken into account in the hypothetical lease, say so expressly (St Martin’s Property Ltd v (1) CIB Properties Ltd (2) Citibank International PLC [1998] EGCS 161).

• **Length of the hypothetical lease**

The length of the hypothetical lease will affect the level of rent, although the actual effect can change over time. Earlier cases on this issue involved landlords arguing for longer hypothetical terms, because these would attract a higher rent (St Martin’s Property Ltd v (1) CIB Properties Ltd (2) Citibank International PLC [1998] EGCS 161). By 2003, the opposite was true and in Canary Wharf Investments (Three) Ltd v Telegraph Group Ltd [2003] 3 EGLR 31 the landlord successfully argued that a shorter term was intended.

**PRACTICE POINT**

State clearly how long the hypothetical lease is intended to be and whether it is to begin on the relevant review date or the date on which the actual lease term began (for example “a term equal to the residue of the Term on the relevant Review Date or 10 years commencing on the relevant Review Date, whichever is the longer”). Do not simply refer to a term equal in length to the term originally granted.
Leases – The basic terms

• Compliance with covenants

It is usual to assume that at least the tenant’s covenants have been complied with. This is to make sure a tenant that is in breach of its repairing obligation cannot argue for a discount on the basis that it is occupying dilapidated premises. Tenants may resist an assumption that the landlord’s covenants have been complied with, so that the landlord cannot argue against a discount to reflect any actual reduction in the value of the Property as a result of a breach on the part of the landlord.

• Property fully restored

The landlord will want to assume that if the Property (or any part of it) has been damaged or destroyed, it has been fully restored, so that if a review falls at a time when the Property has been damaged, this does not affect the rent for the next five years. This is fair in relation to damage by insured risks but may be very unfair in the case of uninsured loss.

• No work carried out that decreases rental value

It is normal to assume that no work has been carried out on the Property by the tenant, any undertenant or their respective predecessors in title that has decreased the rental value.

PRACTICE POINT

Tenant – try to exclude any work done to comply with statute.

Disregards

The main purpose of the disregards is to make sure that the specific circumstances of the actual letting do not affect the valuation of the hypothetical letting. A typical lease would include the following disregards:

• Effect of occupation

The effect on rent of the fact that the tenant, any undertenant and their respective predecessors in title have been in occupation.
Leases – The basic terms

Without this, the landlord might argue that a tenant already in occupation would pay more rent to maintain continuity.

• Goodwill

Any goodwill attached to the Property by the carrying on by the tenant, any undertenant and their respective predecessors in title of their respective businesses there.

• Improvements

The tenant will want to make sure that it does not pay extra rent because of improvements to the Property that it has paid for, so rent review provisions usually disregard improvements.

PRACTICE POINTS

Tenant – make sure the disregard includes

• works carried out before the Term began (such as initial fitting out);
• works carried out by anyone else (including the landlord) on behalf of and paid for by the tenant; and
• works carried out by any undertenant or any predecessor in title of the tenant or any undertenant.

Landlord – try to exclude any works carried out pursuant to an obligation to the landlord. This would usually include works carried out to comply with statute.

Services and service charge

Landlord’s objective:

• to limit the services it is obliged to provide to those essential to the maintenance and running of the Property, while reserving the right to charge for additional services; and
• to ensure that all money spent on providing services can be
Tenant’s objective:

• to make sure the Property is properly maintained; and
• to ensure that the cost of services is reasonable and reflects value for money and that the tenant is not paying for improvements to the Property or unnecessary services.

Services and service charge are really only significant in relation to multi-let properties, such as office blocks or retail parks. Both landlord and tenant will want to make sure that the parts of the development not let to occupational tenants are kept clean and in good repair and properly insured. Depending on the nature of the development, a variety of other services may be necessary or desirable – for example, provision of lighting and air-conditioning, collection of rubbish, provision of security staff.

PRACTICE POINTS

Take precise instructions on the exact services to be provided. The landlord will not be entitled to charge for anything that is not mentioned, unless it falls within a general “sweeper” clause.

Tenant –

• Make sure the landlord has an absolute obligation to perform those services the tenant considers essential. It may be acceptable to divide services into two categories, essential and optional. The landlord should be obliged to perform the essential services and entitled to recover the reasonable cost of such of the optional services as it carries out.
• Reasonableness will not be implied in relation to expenditure on services so if the tenant wants to make sure that the landlord can recover only costs that are reasonably incurred, say so expressly.
Leases – The basic terms

Basic structure
Service charge provisions usually work as follows:

• There is an agreed set of services, the cost of which the landlord is entitled to recover. There is usually also a list of costs that may not be recovered.

• The landlord will make an estimate of the expected expenditure for each year and the tenant will pay its proportion of the estimate in four quarterly instalments. These quarterly payments are usually reserved as rent.

• At the end of the year, the landlord will prepare a service charge account, which will be certified by the landlord’s accountants.

• If the actual expenditure exceeds the estimate, the tenant will be required to make up the difference by making a balancing payment. If the tenant’s quarterly payments exceed what has actually been spent, the excess will either be credited to the service charge account for the following year or repaid to the tenant, depending on the bargaining position of the two parties when the lease is negotiated.

Guide to good practice on service charges in commercial properties (the “Guide”)

The Code recommends that the parties to a lease should observe the suggestions set out in the Guide to good practice on service charges in commercial properties, the second edition of which appeared in August 2000. Like the Code, the Guide is published jointly by various property industry bodies. Part of the purpose of the Guide is to encourage landlords and tenants to interpret and operate existing service charge provisions more fairly. It is also a very useful checklist for use when negotiating a new lease, both in relation to the categories of expenditure which should be excluded and the mechanism by which the landlord is to account to tenants for what has been spent. The Guide is available at www.servicechargeguide.co.uk

The issues that give rise to most discussion when negotiating service charge provisions are set out below. They are all also dealt with in the Guide.
Leases – The basic terms

Tenant's proportion
The total expenditure on services must be divided between the individual tenants. Landlords often want simply to refer to a “reasonable and proper” or “fair” proportion. This can work perfectly well and has the advantage of being very flexible if circumstances change. Alternatives are to agree a fixed proportion at the outset or a proportion based on the ratio of the net internal area of each unit to the total net internal area of all the units intended to be let to tenants.

Costs to be excluded

• Initial development
The tenant will want to make sure that none of the costs associated with the initial development (or future redevelopment) of the Property are recoverable through the service charge.

• Improvements
The tenant does not want to feel that its landlord is improving its property asset at the tenant’s expense. It can be difficult to decide where necessary work ceases to be repair and becomes an improvement, for example where major work is required to the roof of a property and the landlord wants to replace it rather than patch it up. Where the work done is what a reasonably minded landlord would do and it does not leave the landlord with something wholly different from what it had at the beginning, the cost is likely to be recoverable as a repair (Postel Properties Ltd v Boots the Chemist [1996] 2 EGLR 60). The courts have recently begun to recognise that it may not be reasonable for tenants with only a few years left of their leases to pay as much towards major repairs as tenants who are likely to be in occupation for longer. There is no clear rule but the indication is that it is reasonable for a landlord to recover only the cost of complying with its covenants until the end of the lease in question. A tenant with two years left to run could not, on that basis, reasonably be required to pay the same as its neighbour with 15 years still to go (Scottish Mutual Assurance plc v Jardine Public Relations Ltd [1999] EGCS 43).
Leases – The basic terms

• Dealings with other tenants

None of the costs associated with enforcing covenants against other tenants or dealing with consents to assign etc should be recoverable through the service charge.

• Share of costs attributable to empty units

The tenant will ideally want the landlord to contribute a sum equivalent to the proportion of the service charge costs attributable to any empty (or “void”) units, to make sure there is no shortfall. As a compromise, it should at least be clear that these costs may not be recovered from the existing tenants.

Promotional costs

These can be controversial, particularly on retail developments. Retailers spend huge sums on advertising and are often sceptical about the benefit of the landlord spending extra money on their behalf in promoting a particular shopping centre or retail park. The Guide recommends that the landlord should consult the tenants when planning promotional activities and it may be sensible to deal with this expressly in the lease.

Income received from use of common areas

The landlord may receive income from certain uses of the common areas of a development: examples include charges for car parking, licence fees for barrows and kiosks and income from public telephone/internet facilities. The tenants will argue that if those areas are being maintained at their expense, through the service charge, then any income received should be credited to the service charge.

If the cost of remedying inherent defects is to be excluded, say so expressly. A compromise position may be to oblige the landlord to pursue any remedies it has against the design and construction team before attempting to recover the cost through the service charge.

PRACTICE POINT
charge account. The Guide supports this approach but, again, it is better to deal with it expressly.

**Sinking funds/reserve funds and shortfalls**

It might seem sensible for a proportion of what the tenant pays each year to go into a fund to be used to cover the cost of major works. This would arguably spread the cost of such works and avoid the tenant being asked to make disproportionately large contributions in particular years. It could also address any unfairness where some tenants have shorter leases than others (although the courts have begun to do this anyway – see Improvements). In practice, such funds are rare, partly because of the complicated way in which they are treated for tax purposes and partly because of fears about funds being lost if the landlord becomes insolvent.

Without a fund available to cover unexpected expenditure, the landlord will have to rely on a provision allowing it to request additional contributions from the tenant part way through a year. The tenant should make sure that such requests can only be made where it is reasonable and may want to try to restrict the number of times such a request can be made in any year.

**PRACTICE POINTS**

Do not set up or agree to contribute to a sinking fund or reserve fund without taking specialist advise on the tax implications.