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The Lease Code – what landlords need to know

Real Estate briefing
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The Code for Leasing Business Premises in England and Wales 2007 (the "Code"), published in March by a property industry working group, sets out ten recommendations intended to promote fairness and flexibility in relation to the terms of commercial leases, the negotiation of them, and ongoing lease management matters. This is the 3rd edition of the Code. Compliance is not compulsory but the Government, in its desire to achieve a better bargaining position for tenants (in particular small businesses), has indicated that it would be willing to legislate should landlords fail to make sufficient changes to their practices. To encourage self-regulation, the British Property Federation has recently launched a Commercial Landlords' Accreditation Scheme with the aim of directing businesses towards those landlords who offer Code compliant leases and who conduct negotiations and carry out their lease management in the spirit of the Code.

Nabarro has signed up to the Code and in doing so has pledged to promote the Code to clients, encouraging clients to adopt the Code wherever possible.

The Code also includes an Occupiers' Guide containing tips for tenants in negotiating a lease and a detailed set of model heads of terms. A full copy of the Code can be found on the BPF website (www.bpf.org.uk). This note sets out a number of aspects of the Code which require careful consideration by landlords.

REPAIRS

The Code states that "unless expressly stated in the heads of terms, tenants should only be obliged to give the premises back in the same condition as they were in at its grant". Landlords and their managing agents should therefore beware of leaving heads of terms silent in respect of the tenant's repairing obligations. Tenants' lawyers faced with a draft lease with a full repairing covenant when the heads of terms were silent on the matter will no doubt cry foul play if the landlord has held itself out to be "Code compliant". As landlords will be aware, where a tenant's repairing covenant is limited by reference to the state of the premises at the start of a lease, it is preferable for a schedule of condition to be attached to the lease. It is likely that the Code's recommendations will lead to an increase in the number of schedules of condition being drawn up and landlords will need to adopt a stance as to which party should bear the cost of doing so (the Code does not make any stipulation on this point).

REINSTATEMENT AND DILAPIDATIONS

The Code states that tenants should not be required to reinstate any alterations unless it is reasonable to do so and landlords should notify tenants of reinstatement requirements and serve schedules of dilapidations at least 6 months before the end of the term. Landlords who generally require reinstatement automatically and deal with dilapidations on or after expiry of the



lease must, therefore, ensure that their management systems now trigger consideration of these issues at a much earlier stage. This may be feasible where the tenant does not have security of tenure, but is less practical where a landlord does not know whether its protected tenant will remain in occupation after contractual expiry of the lease term, or where a tenant has a break option on 6 months' notice or less. It is also questionable whether tenants will be happy to pay for schedules of dilapidations, drawn up by their landlords as early as possible just to be Code compliant, only to find they also have to pay for supplemental schedules nearer the end of the term, or where they have no intention of vacating upon expiry of the term.

BREAK CLAUSES

Landlords commonly seek to impose conditions on the exercise of tenants' break options, in particular requiring rents to be paid up to date and vacant possession to be given, as well as sometimes requiring repairing obligations to have been complied with. The Code however states that the only preconditions should be that the main rent is paid up to date and that the tenant gives up occupation and leaves behind no subsisting subleases. This is not the same as vacant possession. Where the tenant has not, for example, removed items of its furniture, or squatters have moved in after it has vacated, or where an undertenant that does not have security of tenure has remained in occupation after the expiry of its underlease, the landlord would have to pursue the tenant for damages for breach of contract but could not prevent the valid exercise of the break option.

ASSIGNMENT - AUTHORISED GUARANTEE AGREEMENTS (AGA)

Under the Code, an AGA from the outgoing tenant may only be required by a landlord where the assignee is of lower financial standing than the outgoing tenant or is registered or resident overseas. This will be a departure for many landlords who are used to insisting on an AGA being provided in all cases, and even for those who are willing to concede that an AGA will only be required "where reasonable". Landlords should note that a "lower financial standing" test is not the same as the right for a landlord to require an AGA "where reasonable" and the latter may in some circumstances be more favourable to a landlord. The Code also suggests that where the tenant is a small business, a rent deposit from the incoming tenant should be acceptable to a landlord in place of an AGA.

INSURANCE

The Code requires landlords to disclose to tenants any commission received for taking out the required insurance. The Code does not suggest that commission should be for the benefit of or shared with the tenants but, inevitably, disclosure may lead to tenants asking for this. Allowing the benefit of commission to each and every tenant on a large portfolio of properties will, no doubt, be an administrative burden for many landlords. The Code also provides for damage by an uninsured risk to be borne by the landlord with the tenant having a right to terminate unless the landlord agrees to reinstate. This may, in fact, reflect the current market trend although no doubt many landlords would hope for at least a mutual break option in such circumstances.

A number of landlords will already be well aware of the recommendations set out in the Code and many have made changes to their standard forms of leases, keen to be seen to be implementing the Code and to keep at bay the Government's threat of legislation. Landlords should, however, be wary of holding themselves as being fully "Code compliant" (for example by making this statement in their heads of terms or on their websites) if, in fact, they intend to diverge from one or more of the recommendations in the Code or, for example, where they are



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constrained from complying with the Code by the terms of their own headleases or funding arrangements. Dissemination of the Code will mean that tenants are now better informed and better prepared and there is even a risk that a statement by a landlord that it has signed up to the Code could be held to be a misrepresentation giving rise to a damages claim where aspects of its lease or the landlord's ongoing management practices depart from the Code. It would seem, however, that a landlord and its lease can still be "Code compliant" if the landlord is clear from heads of terms stage which aspects of the Code the landlord will adhere to, and if it is willing to explain its rationale in respect of any departures from the Code. Landlords should therefore assess realistically whether they can or want to comply with each of the Code's recommendations and must be willing to be transparent as to their position.

If you wish to discuss how best to implement the Code in relation to your leases or require any other advice in relation to the Code, please contact your usual Nabarro contact or Marie Scott.

CONTACT

Marie Scott, Associate **T +44 (0)20 7524 6783** m.scott@nabarro.com

London

Lacon House, 84 Theobald's Road,
London WC1X 8RW
T +44 (0)20 7524 6000
F +44 (0)20 7524 6524

Sheffield

1 South Quay, Victoria Quays,
Sheffield S2 5SY
T +44 (0)114 279 4000
F +44 (0)114 278 6123

Brussels

209A Avenue Louise,
1050 Brussels, Belgium
T +32 2 626 0740
F +32 2 626 0749

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