

# SEMINAR JANUARY 23<sup>RD</sup> 2017

- ▶ 08:00 @ CBRE 'C BAR'
- ▶ SEMINAR BY DOUG STEVENS TO 1<sup>ST</sup> & 2<sup>ND</sup> YEAR GRADUATES
- ▶ DELIVERED AS A POWERPOINT PRESENTATION
- ▶ 50 MINUTES + QUESTIONS

# UNDERSTANDING RENT REVIEW PROVISIONS

We will look at the major elements (wording) in rent review clauses

- From the perspective of a valuer
- From the perspective of the Landlord (L/L) and Tenant (T)

The valuer should take a balanced view of any onerous or favourable provisions in the rent review clause and reflect these in the rental valuation

The L/L and the T look to emphasise in their negotiations the rent review provisions which give them the most favourable result

i.e. What helps me to achieve a higher rent (L/L)

OR

What helps me to achieve a lower rent (T)

- ▶ **THE BASIC WORDING OF RENT REVIEW CLAUSES COMES FROM S.34 OF THE LANDLORD & TENANT ACT 1954**
- ▶ **S.34 Rent under new tenancy**
- ▶ The **rent** ..... shall be the rent ... at which, **having regard to the terms of the tenancy** (other than those relating to rent), the holding might reasonably be expected to be let in the **OPEN MARKET** by a **WILLING LESSOR**,
- ▶ there being disregarded—
- ▶ (a) any effect on rent of the fact that the tenant has or his predecessors in title have been in occupation of the holding, **(i.e. VACANT POSSESSION )**
- ▶ (b) any **goodwill** attached to the holding by reason of the carrying on thereat of the business of the tenant (whether by him or by a predecessor of his in that business),
- ▶ (c) any effect on rent of any **improvement** carried out by the tenant or a predecessor in title of his otherwise than in pursuance of an obligation to his immediate landlord
- ❖ You will note that Section 34 is very short and simple. It sets out a limited number of assumptions and a limited number of disregards.
- ❖ There is no requirement when drafting a rent review clause to follow Section 34 - hence there is such a multitude of different rent review clauses many pages long often containing more and more assumptions and more and more disregards.

# ASSUMPTIONS

- ▶ BASIS TO VALUE - The basic premise of the rent review is to achieve an open market rent at the relevant review date.
- ▶ BUT the valuation basis may be not be OPEN MARKET. It might be fixed uplifts - or RPI (capped and collared) or base rent + turnover
- ▶ VACANT POSSESSION
- ▶ WILLING LANDLORD + WILLING TENANT (not in S.34 L & T Act 1954)
- ▶ ON SAME TERMS AS THIS LEASE or HYPOTHETICAL LEASE? Are you required to assume the same terms as this lease or an hypothetical lease.
- ▶ COMPARE LEASE TERMS TO THE RENT REVIEW ASSUMPTIONS
- ▶ LET AS A WHOLE - Are you required to assume that the property is let as a whole or parts (actual or assumed) and adopt a rent which is the greater of the whole/sum of parts
- ▶ ALIENATION Are you to value as a whole or in parts (if so does the lease permit sub-letting in part or parts ?)
- ▶ USE - Are you to assume the actual use (see User Clause in lease) or an assumed use stated in the rent review provisions?
- ▶ SPECIFICATION - Are you to value as shell - or part fitted - or fully fitted ?

# DISREGARDS

- ▶ TENANTS OCCUPATION - assume the property is vacant and to let
- ▶ TENANTS GOODWILL - ignore tenants goodwill, ie, their established business - you cannot take account of their trading performance/ trading accounts even if you have this information
- ▶ Q Why not?
- ▶ A This would conflict with vacant possession assumption  
The trading figures would not be in the public domain  
**Cornwall Coast Country Club v Cardgrange Ltd [1987] 1 EGLR 146**
- ▶ TENANTS IMPROVEMENTS - if T has carried out alterations / improvements at his own expense under a Licence for Alterations (ie, with L/L's consent ) then no account is taken of the effect on rent of those alterations
- ▶ RENT FREE PERIOD FOR FITTING OUT - 'DAY ONE RENT ASSUMPTION'  
No discount is made for a rent free period because this lease provision assumes that the ingoing T has already had the benefit of a rent free period for the purposes of fitting out - so pays rent from 'day one'

# IMPORTANT CLAUSES

- ▶ **RENT REVIEW DATE(S)** - This might be the anniversary of the date of the lease or the stated commencement date of the lease term or the review dates may be listed in the rent review clause or elsewhere in the lease
- ▶ **RENT REVIEW PERIOD** - In modern leases this is likely to be 5 years but may be more or less than five years and this will impact on rental value
- ▶ **Q** - If less than 5 years, ie, 3 years - WHAT DISCOUNT?
- ▶ **A** - discount of 1% per year may apply,
- ▶ **Q** - If more than 5 years, ie, 7 or 14 years - WHAT ADDITION?
- ▶ **A** - discount of 0.5% per year (perhaps 1% per annum) may apply
- ▶ **UPWARDS ONLY ?** Most modern leases will state that at rent review the revised rent shall not be less than the current rent passing but in some leases by design or default the rent may be subject to downwards provision.
- ▶ NB Where there are base rents with turnover provisions the unfortunate effect may be that the rent is set by reference to a turnover rent which is less than the passing rent
- ❖ **THE LEASE TERMS TO BE ASSUMED AND THE DEMISE TO BE VALUED MAY BE TOTALLY DIFFERENT FROM THE ACTUAL LEASE TERMS AND THE ACTUAL DEMISE**
- ❖ e.g. Nike Town which is valued by reference to a unit shop within the BHS block on Oxford Street rather than by reference to the actual Nike Town demise.

# VACANT POSSESSION

- ▶ THE BASIC PREMISE IS THAT THE PROPERTY IS VACANT AND TO LET ON A NEW LEASE
- ▶ IN REALITY THE PROPERTY IS OCCUPIED AND AN ACTUAL LEASE IS IN PLACE
- ▶ BUT AT RENT REVIEW IT IS ASSUMED THERE IS NO LEASE IN PLACE OR T IN OCCUPATION
- ▶ THE RENT REVIEW SCENARIO IS ARGUABLY HARSH ON BOTH L/L & T
- ▶ L/L HAS A T AND AN EXISTING LEASE IN PLACE BUT IS REQUIRED AT EACH REVIEW TO DEMONSTRATE THAT HE COULD RE-LET THE PROPERTY ON A NEW LEASE  
ie, DEMONSTRATE DEMAND IN THE OPEN MARKET
- ▶ T HAS AN EXISTING LEASE BUT IF THE L/L CAN DEMONSTRATE THAT ANOTHER T WOULD PAY A HIGHER RENT THAN THE EXISTING CAN AFFORD THEN IT IS THE HIGHER RENT WHICH WILL APPLY

# ▶ ASSUMED LEASE TERM

▶ WITHIN THE RENT REVIEW CLAUSE IT WILL STATE WHETHER THE LEASE TERM YOU ARE TO ASSUME IS THE

▶ UNEXPIRED TERM (YOU CAN SIMPLY CALCULATE THAT) OR

▶ A MINIMUM TERM (SAY 10 YEARS) OR

▶ THE WHOLE TERM OF THE ORIGINAL LEASE.

▶ SEE CASE LAW **CANARY WHARF INVESTMENTS (THREE) V TELEGRAPH GROUP LTD 2003** WHERE THE DECISION WAS THAT THE WHOLE TERM OF 25 YEARS WAS TO BE ASSUMED.

▶ THE ASSUMED LEASE TERM HAS SIGNIFICANT VALUATION IMPLICATIONS WHERE THE ASSUMED LEASE TERM IS LONGER THAN THE NORM FOR THAT MARKET SECTOR OR SHORTER THAN THE NORM FOR THAT MARKET SECTOR.

▶ **LOOK AT THE ASSUMED LEASE TERM – IS IT THE NORM FOR YOUR PROPERTY ?**

▶ WHOLE TERM ASSUMPTION 25 YEARS WOULD NOW BE REGARDED AS ONEROUS (EXCEPT FOR A LARGE STORE)

▶ 5 YEARS MIGHT BE OK FOR A SINGLE SHOP UNIT - BUT 15/20/25 YEARS MAY BE TOO LONG AND MAY RESULT IN A POSSIBLE DISCOUNT (PERHAPS 5% OR 10% AND HIGHER FOR TERMS OVER 25 YEARS).

▶ HOWEVER, 5 YEARS / 10 YEARS WOULD BE REGARDED AS TOO SHORT FOR A LARGE STORE (DEPARTMENT STORE OR FOODSTORE) AND A DISCOUNT WOULD APPLY.



# OPEN MARKET

- ▶ IT IS ASSUMED THAT THE PROPERTY HAS BEEN OPENLY MARKETED -
- ▶ Q - BUT FOR HOW LONG? A - AN ADEQUATE BUT UNDEFINED PERIOD
- ▶ IN REALITY IT HASN'T BEEN MARKETED - (EXCEPT IN THE FOLLOWING TWO EXAMPLES)
  1. TENANT IS TRYING TO ASSIGN THE LEASE
  2. T WISHES TO SURRENDER AND HAS AGREED TO ALLOW L/L TO MARKET

## IN SCENARIO (1)

Q. IS THE FAILURE OF T TO ASSIGN THEIR LEASE EVIDENCE OF A POOR LETTING MARKET?

A. POSSIBLY - BUT THE BASIS ON WHICH THE LEASE IS BEING OFFERED MAY NOT REPLICATE THE TERMS BE ASSUMED AT RENT REVIEW IN THE LEASE

I.E. THE RENT TO BE PAYABLE FROM REVIEW DATE IS UNKNOWN

THE UNEXPIRED TERM MAY BE LESS THAN THE ASSUMED TERM

T MAY BE SEEKING A PREMIUM (NB - RENT REVIEW PROVISIONS WILL EXCLUDE PREMIUMS)

## IN SCENARIO (2)

IF THE TERMS ON WHICH THE L/L IS OFFERING THE PROPERTY ARE SIMILAR TO THE RENT REVIEW TERMS THEN OFFERS RECEIVED WILL BE INDICATIVE OF DEMAND (AND VALUE)

THE NEW LEASE IS ASSUMED TO BE SIGNED ON THE RENT REVIEW DATE (unless otherwise specified)

# CLOSED MARKET

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THERE IS A GROWING TENDENCY FOR L/L'S TO LINE UP A PROSPECTIVE T ON AN AGREEMENT FOR LEASE (SUBJECT ONLY TO SURRENDER OF THE EXISTING T'S LEASE)

ie, if L/L can get v/p a binding agreement is in place for another tenant to take a new lease

Q. IS THIS GOOD EVIDENCE OF RENTAL VALUE?

A. YES - BUT ONLY IF (1) THE TERMS OF THE AGREEMENT FOR LEASE WITH THE NEW T FAITHFULLY REPLICATE THE TERMS OF THE LEASE TO BE ASSUMED AT RENT REVIEW

ie,	<u>EXISTING LEASE</u>	<u>AGREEMENT FOR LEASE</u>
TERM:	10 YEARS	10 YEARS
REVIEW:	TO OPEN MARKET RENT	TO OPEN MARKET RENT

**NB: IF THE TERMS ARE MARKEDLY DIFFERENT** I.E. 5 YEAR LEASE OR 10 YEARS WITH A T ONLY BREAK - OR - REVIEW IS TO RPI

**THEN THEY ARE NOT SIMILAR LEASES - THE 'EVIDENCE' IS TAINTED.**

A. YES - BUT ONLY IF (2) THE OPPORTUNITY HAS BEEN MARKETED TO MORE THAN ONE PARTY AND MORE THAN ONE PARTY WAS WILLING TO AGREE THOSE SAME /SIMILAR TERMS - Q WHY ?

B. because the Agreement for Lease has been negotiated in a CLOSED MARKET, ie, a market of one - so we do not know what would have happened in the open market

# WILLING LANDLORD (lessor) - WILLING TENANT (lessee)

- ▶ THE LANDLORD IS AN ABSTRACTION NOT THE ACTUAL LANDLORD
- ▶ HE IS NOT IMPORTUNATE OR AFFLICTED BY A CASH-FLOW CRISIS ie, NOT DESPERATE
- ▶ HE IS NOT INDIFFERENT AS TO WHETHER HE LETS THE PROPERTY. HE CAN`T WAIT FOR THE MARKET TO IMPROVE.
- ▶ HE IS A **WILLING LESSOR**. HE WANTS TO LET THE PREMISES AT A RENT WHICH IS APPROPRIATE TO ALL THE FACTORS WHICH AFFECT THE MARKETABILITY OF THESE PREMISES INCLUDING THE MARKET RENT OF COMPARABLE PREMISES, THAT IS TO SAY, PREMISES WHICH ARE DIRECTLY COMPARABLE OR, IF NOT DIRECTLY COMPARABLE, WOULD BE OK
- ▶ THE **WILLING LESSEE** IS ALSO AN ABSTRACTION
- ▶ A HYPOTHETICAL PERSON ACTIVELY SEEKING PREMISES WHICH THESE PREMISES WOULD SUIT
- ▶ HE WILL TAKE ACCOUNT OF SIMILAR FACTORS, BUT HE TOO WILL BE UNAFFECTED BY LIQUIDITY PROBLEMS, OR OTHER PRESSURES. HIS PROFILE MAY FIT THAT OF THE ACTUAL T BUT HE IS NOT THAT T
- ▶ EVEN IF THE ONLY POTENTIAL T IS THE EXISTING T WITH NO COMPETITORS AND EVEN IF THEY ARGUE THAT THEY ARE UNWILLING THEY ARE ASSUMED TO BE WILLING LESSEE AND MUST PAY A MARKET RENT
- ▶ EVEN IF THE SUBJECT PROPERTY IS THE ONLY ONE AVAILABLE ON THE MARKET THE WILLING LESSEE CANNOT RELY TOO MUCH UPON THE FACT THAT HE HAS NO COMPETITORS. HE IS A WILLING LESSEE AND MUST PAY A MARKET RENT
- ▶ THE WILLING LESSOR CANNOT PRESS HIS DEMAND FOR RENT BEYOND THE POINT AT WHICH THE LESSEE BECOMES UNWILLING

## ▶ **F. R. Evans (Leeds) v. English Electric (1978)**

- ▶ **Dennis & Robinson Ltd v Kioskos Establishment [1987]** assume willing L/L & T – In order to give full effect to establishing an open market rent the Court held that it must be assumed that there is a willing landlord and a willing tenant.

## WHAT IS THE ASSUMED SPECIFICATION OF THE PROPERTY

- ▶ SPECIFICATION - Does the lease require you to assume that the specification is shell or fitted or part fitted? Are there any schedules of fixtures and fittings attached? The leading case on the assumptions which are to be made regarding the specification of a unit is
- ▶ **London and Leeds Estates Ltd v Paribas Ltd [1995]**
- ▶ “ *the demised premises are fit for immediate occupation and use and that all fitting out and other tenant’s works required by such willing tenant have already been completed* “
- ▶ This is an important judgement. It determined where such wording occurs it is valuation neutral, i.e. it does not mean that the landlord can value fixtures and fittings or that the tenant can argue for a rent free period for fitting out.
- ▶ However variations on this wording may mean that fixtures and fittings are to be valued.

# ‘DAY ONE RENT’

- ▶ RENT FREE/CONCESSION/CAPITAL CONTRIBUTION ON LETTING - It is now commonplace for modern leases to contain wording to the effect that a rent free period and/or a rent concession and/or any capital contribution by a landlord to a tenant on letting are to be disregarded. This is normally effected by use of wording similar to the following:
- ▶ “There shall be no discount, reduction or allowance to reflect (or compensate any incoming tenant for the absence of) any rent free or concessionary rent period which reflects the time it would take for the incoming tenant to fit out the demised premises so as to be ready for immediate use or any capital payment or other consideration in lieu thereof and which will be granted to the willing lessee in the open market at the relevant review date so that such open market rent shall be that which will be payable after the expiry of any such rent free or concessionary rent period for fitting out purposes which the willing lessee shall hereby be assumed to have enjoyed.
- ▶ DISREGARD ONLY IN RELATION TO FITTING OUT PERIOD - The wording above seeks to achieve what is referred to as a **DAY ONE rent** i.e. at rent review a tenant cannot argue that they require a rent free period to fit out the unit because they are already assumed to have had the benefit of such rent free period.
- ▶ This wording has evolved following the case of **Broadgate Square-v-Lehman Brothers** where the following wording was adopted:
- ▶ “ .. the best yearly rent which would reasonably be expected to become payable after the expiry of a rent-free period of such length as would be negotiated in the market upon a letting of the Premises as a whole.....”
- ▶ **This wording** does not limit the incentives to rent free or capital which will be the equivalent of the period for fitting out a unit - it requires the disregard of all incentives and therefore **confers a headline rent**.

# TIME TRAPS - IS TIME OF THE ESSENCE?

- ▶ The lease may contain timetables for the service of landlord's rent review notice or tenant's counter-notice or may set a timetable for the appointment of an Arbitrator.
- ▶ You need to carefully record any such mechanisms because time may be of the essence and failure to adopt the correct timescales may result in the loss of the ability to exercise the review or the acceptance of a tenant's rental offer or the inability to have an Arbitrator appointed.
- ▶ See Case Law below:
- ▶ *United Scientific Holdings Ltd v Burnley Borough Council* ([1978] - Time is not of the essence unless it is stated to be.
- ▶ DEEMING PROVISIONS – Words that make Time of The Essence – In relation to service of notices or reference to 3<sup>rd</sup> party, ie “*but not at any at other time*”
- ▶ *Mecca Leisure Ltd v Renown Investments (Holdings) Ltd.*
- ▶ *Starmark Enterprises Limited -v- CPL Distribution Limited*
- ▶ *Secretary of State for Communities and Local Government v Standard Securities Ltd*

# DISPUTE PROCEDURE

- ▶ HOW IS RENT REVIEW DECIDED IF PARTIES CAN'T NEGOTIATE A SETTLEMENT?
- ▶ LEASE NORMALLY PROVIDES FOR PARTIES TO APPLY TO RICS TO APPOINT AN ARBITRATOR OR EXPERT ? -
  - WHO CAN APPLY ? - L/L OR T or either?
- ▶ Q. IF L/L ONLY CAN APPLY AND REFUSES TO DO SO WHAT CAN THE T DO?
- ▶ A. MAKE TIME OF THE ESSENCE
- ▶ In ***Barclays Bank plc v Savile Estates Limited [2002] EWCA Civ 589***, the Court of Appeal implied a time limit on the grounds of business efficacy. The rent review clause allowed the landlord (but not the tenant) to apply to the RICS for the appointment of an independent surveyor to determine the revised rent if the landlord and the tenant failed to agree the new rent by the review date. There was no time limit for the landlord making that application. The Court of Appeal held that the landlord had to make the application to the RICS within a reasonable time after the review date and the tenant was entitled to serve a notice making time of the essence in relation to that implied time limit.
- ▶ 3<sup>RD</sup> PARTY CAPACITY - ARBITRATOR (Umpire) or INDEPENDENT EXPERT - some lease give L/L option to choose?
- ▶ ARE THERE SET TIME FRAMES IN THE LEASE FOR MAKING APPLICATIONS -
- ▶ ARE THERE SET TIME FRAMES IN THE LEASE FOR THE EXPERT TO MAKE DETERMINATION

# SUMMARISE THE RENT REVIEW PROVISIONS

USE A TEMPLATE - TO IDENTIFY EVERY RELEVANT CLAUSE (PRESENT & MISSING)

WHY IS THIS NECESSARY?

BECAUSE EACH CLAUSE (PRESENT OR MISSING) MIGHT AFFECT VALUE

BECAUSE THERE MAY BE TIME TRAPS - POTENTIAL NEGLIGENCE CLAIM