

SEMINAR JAN 19th 2015

❖ UNDERSTANDING RENT REVIEW CLAUSES

*SEMINAR BY DOUG STEVENS TO 1st & 2nd YEAR GRADUATES
DELIVERED AS A POWERPOINT PRESENTATION*

- ❖ Work on the basis that every single rent review clause you read will be different from the last one even within shopping centres or office buildings where a landlord has tried to impose standard provisions.
- ❖ Attempts at achieving a standardisation of the wording of rent review clauses have been made over the years by the RICS, Law Society and other bodies but have largely failed. It is important therefore you do carefully read each rent review clause in each lease you deal with.
- ❖ You also need to be aware that there may be other documents besides the subject lease you were dealing with which might impact on the rent review provisions. This might be an Agreement for Lease, a Deed of Variation or Licences. The original basis for revision of a rent was derived from the Landlord & Tenant Act 1954 in Section 34 which is summarised below:

▶ **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,
- ▶ (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 sets out a limited number of assumptions and a limited number of disregards.

❖ There is no requirement when granting a lease to follow Section 34 - hence there is such a multitude of different rent review clauses often containing more and more assumptions and more and more disregards.

❖ A rent review is a:

❖ MIXTURE OF ACTUAL & HYPOTHETICAL - FACT & FANTASY - UNDEFINED MIX

❖ THE BASIC PREMISE IS THAT THE PROPERTY IS VACANT AND TO LET ON 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 TENANT IN OCCUPATION

❖ THE LEASE TERMS TO BE ASSUMED AT THE DEMISE TO BE VALUED MAY BE TOTALLY DIFFERENT FROM THE ACTUAL LEASE TERMS AND THE ACTUAL DEMISE

❖ e.g. USC Oxford Street (a small ground floor unit with a 25,000 sq ft basement but which is assumed for rent review purposes to comprise a unit arranged on ground floor only with a specified ITZA to which the appropriate Zone A rate is applied and then a specified multiplier is applied

❖ 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.

❖ HYPOTHETICAL SCENARIO ACHIEVED BY SERIES OF ASSUMPTIONS & DISREGARDS

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

- ▶ 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
- ▶ RENT REVIEW PERIOD - In modern leases this is likely to be five years but may be more or less than five years and this will impact on rental value
- ▶ 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.
- ▶ ASSUMED LEASE TERM - Within the rent review clause it will state whether the lease term you are to assume is the unexpired term or it might state a minimum term or it might state that it is for 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 lease term assumption has 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.
- ▶ Whole term assumption 25 years
- ▶ Implications of assumed lease term longer than norm or shorter than norm
- ▶ 5yrs might be OK for a single shop unit - but 15/20/25 may be too long and may result in a possible discount.
- ▶ However, 5yrs/10yrs would be regarded as too short for a large store (department store or foodstore) and a discount would apply.
- ▶ BASIS TO VALUE - The basic premise of the rent review is to achieve an open market rent at the relevant review date. The wording provides for a number of assumptions and disregards.

ASSUMPTIONS

- ▶ VACANT POSSESSION
- ▶ WILLING LANDLORD + WILLING TENANT (not in S.34 L & T Act 1954)
- ▶ **F. R. Evans (Leeds) v. English Electric** (1978) hypothetical L/L & T - Read this case carefully. It defines the characteristic of the willing landlord and the willing tenant
- ▶ **Dennis & Robinson Ltd v Kiossos 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.
- ▶ 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
- ▶ 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] - that 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.
- ▶ USE - Are you to assume the actual use (see User Clause in lease) or an assumed use stated in the rent review provisions?

DISREGARDS

- ▶ Historically disregards were limited to tenants occupation, goodwill and improvements
- ▶ **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 3rd 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 ?
- ▶ APPLICATION TO RICS ? - WHO CAN APPLY - L/L OR T?
- ▶ ARBITRATOR (Umpire) or INDEPENDENT EXPERT - option to choose?
- ▶ ARBITRATOR - GOVERNED BY ARBITRATION ACT 1996 Reasons - Award on costs
- ▶ IF EXPERT ARE REASONS REQUIRED? COSTS SHARED 50/50 OR DETERMINED
- ▶ TIME FRAMES FOR APPLICATIONS - TIME FRAMES FOR DECISIONS
- ▶ OTHER MATTERS
- ▶ INTEREST ON ARREARS?
- ▶ MEMORANDUMS TO RECORD SETTLEMENT?