Global Corporate Real Estate Guide - England and Wales

Leases

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# What are the usual forms of leases?

Leases of land in England and Wales are infinitely variable and can contain such terms as the parties may agree. However, in general terms, there are two main forms of lease:

Long lease granted for a premium with a nominal or ground rent.

For commercial property such leases are usually in excess of 50 years and, possibly, may extend to 999 years. Usually, a substantial capital premium is paid by the tenant on the grant of the lease and the annual rent thereafter is a nominal amount. Very often, such long leases are granted to developers who also assume building obligations such as city center re-developments.

In those circumstances, once the relevant buildings have been constructed, they will then be let on standard commercial lease terms and it is possible that the nominal ground rent paid during the course of the building works will increase to represent a percentage of the rental income achieved by the developer from such commercial leases.

Such long leases or “virtual freeholds” are regularly bought and sold. Shopping centers are a prime example of this.

Leases of residential flats or houses are also usually granted by way of a long lease (99 years plus) and a premium is paid to the developer by the original tenant. An additional ground rent of between GBP 100 and GBP 250, (increasing regularly throughout the term of the lease, usually at 25- or 33-year intervals) may also be payable in respect of leases granted before 30 June 2022.

There is considerable legislation relating to residential leases, particularly the sale of the underlying freehold and the administration of service charges. In recent years, and in an attempt to maximize income from residential leases, many developers adopted the practice of imposing higher levels of initial ground rent combined with rent review mechanisms which result in significant increases on review (generally every 10, 15 or 25 years). On review, the ground rent is usually doubled or increased in line with the retail prices index.

This practice has the effect of increasing the value of the freehold reversion in the hands of the developer and, as a result, an active market in the sale of freehold reversions as a separate investment class has developed.

However, in some cases, the review mechanisms have been thought to be so onerous that the residential properties concerned are potentially unsaleable. As a result, new residential leases granted since 30 June 2022 are no longer permitted to contain a ground rent.

Rack rented leases

Commercial premises in the UK are usually let on commercial leases for a term of between five to 20 years at an open market rent. However, It is increasingly common in the case of retail, and some hospitality, leases for rent to be charged based upon a percentage of the tenant's turnover, or a combination of a fixed initial rent and a turnover rent.

Rent is generally reviewed at regular intervals (usually five yearly) on an upward-only basis.

In recent years, there has been a move toward geared or fixed rent reviews where the parties agree at the outset that the rent will increase at a rate equivalent to the rise in the Retail Prices or, more recently, the Consumer Prices Index at a relevant review date. Currently in England and Wales, it would be highly unusual to have a rent review mechanism that allows the rent to go down as well as up.

If a new lease is being negotiated, the parties will agree the commercial terms and there will usually be an agreement for lease, which is then followed at a later date by the formal grant of the lease. Often, the intervening period is used by the landlord to complete certain fit-out works on behalf of the tenant or to obtain any necessary consents to the grant of the lease.

In addition, existing commercial leases are regularly assigned from one tenant to another where the incoming party accepts the existing terms of the lease in question. It is rare for a premium to be paid by an incoming tenant to an outgoing tenant. In fact, it is not unusual to see a “reverse premium” paid where the outgoing tenant makes a capital contribution to the incoming tenant to facilitate the assignment. Such reverse premiums can often be substantial in circumstances where the existing lease is viewed as “over-rented” compared to the open market rent then payable on new premises.

Generally, commercial leases are granted on a full repairing and insuring (FRI) basis, which means that, in addition to the rent payable to the landlord, the tenant is also responsible (whether directly or by way of service charge) for the cost of repair and insurance of the premises. In addition, the tenant, as occupier, will be liable to pay business rates (a tax to local government).

In some retail leases, rents are based on the turnover generated by the business being carried on at the premises or, possibly, a combination of a base rent and a turnover rent.

Increasingly, there is a move to include “Green Lease” provisions in new leases, and many of the UK’s leading commercial property owners have worked with the UK Better Buildings Partnership to develop an industry standard set of green lease provisions for new leases and a “toolkit” for affecting changes into existing lease structures, to retroactively “green-up” existing leases via a more informal memorandum of understanding.

Legally binding “green” lease clauses in new leases are likely to address issues such as data sharing on water and energy usage, participation in a building management committee and restrictions on alterations and reinstatement, whilst some may go further to mandate more proactive collaboration, for example, the supply and use of renewable energy.

# Are lease provisions regulated or freely negotiable?

Generally speaking, lease provisions are unregulated and are freely negotiable between the parties, although it is fair to say that there is a recognized format for commercial leases.

There are also a number of industry codes or guidelines that recommend certain standard provisions. Such codes of practice (for example, the Commercial Lease Code 2020 recommended by the Royal Institution of Chartered Surveyors ("RICS Lease Code")) are gaining increasing recognition.

# Is there a maximum term for leases? Can these be extended?

In reality, there is no maximum term for a lease although lease terms must not be indefinite.

Commercial lease terms can be extended by negotiation although this could give rise to an additional charge to SDLT.

# What are the usual lease terms?

Most commercial leases have between five and 15-year terms (although the current market trend is for shorter-term leases). In some industry sectors, such as the leisure sector, longer leases of 20-30 years are often the norm.

# Are there instances where tenants may demand an extension of the lease?

Many commercial or business leases enjoy the protection afforded by the provisions of the Landlord and Tenant Act 1954 (the “1954 Act”) which, broadly speaking, grant to a tenant the right to call for a new lease at the end of the original term of years unless the landlord objects to such renewal and demonstrates to the court’s satisfaction that the renewal should not be granted.

There are a limited number of grounds on which a landlord may object to a renewal and the landlord must prove such ground(s) to the satisfaction of the court. One such ground is that the landlord wishes to redevelop the property at the end of the term. Another is that the landlord wishes to occupy the premises for its own business at the end of the term.

Usually, the parties are able to negotiate the basis of a renewal lease without the need for a court to impose terms. However, if the parties are unable to agree the terms of such renewal lease, then the court will direct that the renewal lease be granted on similar terms to the existing lease but at an open market rent for a maximum term of 15 years.

However, increasingly, parties agree at the beginning of the lease that the tenant will not enjoy the security of tenure protection offered by the 1954 Act. The effect of this is that the lease automatically expires at the end of the original term with no right for the tenant to renew.

The parties must follow a simple statutory procedure to exclude the lease from the provisions of the 1954 Act.

The provisions of the 1954 Act are currently undergoing a review by the Law Commission.

In relation to residential leases, legislation exists that entitles a long residential tenant to demand, at a cost, an extension or renewal of the lease. In certain circumstances, long residential tenants may also exercise a legal right (known as collective enfranchisement) to join together and buy the freehold of their building.

# On what grounds may a lease be terminated?

It is not unusual for the parties at the outset of a lease transaction to negotiate formal break or termination rights in a lease which can be either mutual rights or operated by one party only.

In the absence of any contractual right to terminate the lease, then the tenant will have no ability to bring the lease to an end prior to its contractual term. However, a landlord may terminate or forfeit a lease in the event of a breach of covenant by the tenant or upon the tenant’s insolvency.

There is a formal procedure to be followed in relation to such termination and it is open to the tenant or any other interested party (such as a subtenant or a mortgagee) to apply to the court for relief from forfeiture. On such an application, the court will consider the relative merits and commercial interest of the parties in deciding whether or not to grant such relief.

# Must rents be paid in local currency?

The parties are free to set the rent in currencies other than sterling but such arrangements are very unusual.

# Is rent paid on a monthly basis? Is it required to be paid in advance?

Traditionally, rent is paid quarterly in advance on the usual English quarter days of 24 March, 24 June, 29 September and 25 December.

However, it is open to the parties to negotiate different timings for the payments of rent.

# How is rent reviewed? Are there limits to the increase in rent?

In a typical commercial lease, the rent is reviewed at regular five-yearly intervals on an upward-only basis, which means that the rent passing can never be less than the rent agreed at the outset of the term.

Traditionally, such rent reviews are carried out on an open market basis with certain agreed assumptions and disregards. However, rent reviews may also be based upon fixed rental increases or, possibly, the higher of a fixed rental increase (usually linked to the increase in the Retail or Consumer Prices Indices) or the open market rent at the time of review.

Currently, there are no limits to the increase in rent of commercial leases.

# What are the basic obligations of landlords and tenants?

The following is usually required of landlords:

Repair and maintain the structure of the property

Insure the property

Manage the property in a multi-tenanted building

The following is usually required of tenants:

Pay rent

Pay service charges

Keep the interior of the premises in good repair and condition

Comply with the express terms of the lease as to user and signage

Allow the landlord access for inspections and work

# What provisions or restrictions typically apply to the transfer of the lease by the tenant? May a tenant sublet the leased premises?

There are usually very detailed provisions as to the ability of a tenant to assign or sublet a lease but it is rare that there is a total prohibition against such assignment and subletting, other than in very short term lettings.

The landlord is required to act reasonably when considering the tenant’s request for an assignment or subletting and must not unreasonably withhold or delay such consent. There are statutory provisions that entitle the tenant to apply to court if it believes that the landlord has either acted unreasonably in refusing consent or has unreasonably delayed the grant of its consent.

# What happens in the event of destruction of the leased premises?

This is a matter for negotiation between the parties but generally speaking, if the premises are substantially damaged or destroyed by an “insured risk,” then the lease will provide that the tenant is relieved from its obligations to pay the rent for a period of up to three years, during which time the landlord takes on an obligation to rebuild or reinstate the premises to allow the tenant to resume its occupation. Accordingly, the landlord will usually take out loss of rent insurance, the premium for which is met by the tenant as part of the service charge.

In circumstances where a landlord is unable to rebuild the premises after the agreed period, then it is usual for either party to have an ability to determine the lease upon notice.

In cases where the damage has been caused by an “uninsured risk,” leases have historically been silent, leaving it for the parties to negotiate an exit route. The RICS Lease Code recommends that uninsured risk issues are addressed by the parties at the outset. The Code further recommends that the lease should terminate in the event of damage by an uninsured risk unless the landlord notifies the tenant that it intends to rebuild or reinstate the premises within a specified period of three years. If the landlord makes such an election, then the lease continues but the tenant is not obligated to pay any rent. New leases now increasingly set out the "uninsured risk" position.

# Who is usually responsible for insuring the leased premises?

The landlord is usually responsible for insuring the leased premises and recovers the cost from the tenant as part of the service charge.

# Will the lease survive if the owner sells the leased premises?

All leases survive a sale of the immediately superior interest and remain binding upon both the new owner/landlord and the existing tenants.

# Will the lease survive if the leased premises are foreclosed?

Generally, existing leases will survive any foreclosure.

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