

## OVERVIEW OF COMMERCIAL LEASES

### General

A lease is an agreement between landlord and tenant setting out the terms and conditions under which a property is let. The landlord may be a freehold owner or may himself hold under a longer lease at a market rent or at a nominal or relatively low rent.

“Commercial” leases are effectively investments in non-residential property. It is possible for a landlord and tenant to agree any type of lease terms and conditions they wish, subject to some matters which are regulated. The parties to the original lease sign it and give effect to its terms and conditions which thereby become legally binding between them and their successors.

The lease sets out the rights and obligations of the landlord and tenant in detail. From the perspective of the commercial investor, it sets out the terms of his investment and the risks which are run in relation to issues such as repairs, damage and destruction, insolvency and so forth.

As in Ireland, there is no completely standard common form of lease of commercial property. Each lease of property needs to be investigated and considered in light of the circumstances concerned. Older leases or poorly drafted leases may not contain all the clauses typically found in more modern leases and may impair the value of the investment by exposing the landlord to hidden risks or by failing to give him the rights he would expect..

Longer leases are broadly similar in form to those found in Ireland. The form of commercial lease found over the last 25 years is almost invariably an upwards only market rent lease, with five yearly rent reviews. Lease terms are matters for negotiations. Fifteen year leases are very common. There is usually a full repairing and insuring



responsibility on the tenant so that repairing and insuring costs are paid or reimbursed by the tenant over and above the rent.

In order to bring some element of uniformity to commercial leases, a Code of Practice for Commercial Leases in England and Wales, was published in 2002 following a Government initiative. This Code is not a legal requirement but is influential in negotiation of commercial leases. The British Government has expressed concern about the inflexibility of commercial property leases, in particular, the upwards only rent review. Although Government reviews have been announced, it is likely that practices will change through industry practice rather than through mandatory legislation. It is likely that the principle of freedom of contract for a landlord and tenant to choose and negotiate the terms of a commercial lease will remain.

There are a number of significant differences between the England & Wales and Irish Landlord and Tenant legislation. Since 2004 it has been considerably easier for parties to “contract out” of Landlord and Tenant Act rights. Accordingly contracting out now happens in most cases. When the renewal right is contracted out, the tenant will not have the right to a new lease at the end of the lease term or period. For leases granted before 2002, the Landlord and Tenant Act rights could only be signed away by a County Court order, which could be obtained where appropriate but was burdensome.

### **Parties to the Lease**

The parties to a lease, who are the original signatories, will be a landlord and tenant and often a guarantor. The landlord is often described as the "lessor" and the “tenant” is often described as the "lessee". The guarantor is sometimes described as the "surety". The terms are interchangeable. The term lessor would normally be reserved for a case of a written longer lease while the expression “landlord” and “tenant” frequently used for a shorter lease or a short term verbal letting.

Unlike other contracts, a lease will go on and continue to affect the property, even after both the original landlord and the original tenant have sold their respective interests in the property. It can be renegotiated or surrendered by the landlord and tenant at any

time by mutual agreement. However, generally it would be in the interests of one party or the other to keep the lease in existence on its current terms so this would be relatively unusual. When a landlord or tenant transfer on their own interest in the building the new landlord or tenant, respectively, will step into their shoes.

### **Pre-1996 Leases**

In the case of leases granted before 1996 (which are still very common), the original tenant remains liable for all the lease obligations even after assignment i.e. transfer or sale to another party. This appears quite extraordinary from an Irish perspective as the relevant legislation in Ireland was changed in 1860. Generally, in Ireland once a tenant assigns, he walks away from future responsibilities of the lease covenants. However, in England this was considered a heresy because the view was that the original tenant who had entered a contract with the landlord should be liable on it during the entire term. It was not until 1996 that the possibility of the original tenant being released from the lease obligations upon assignment or sale of his leasehold interest, was allowed for.

The position under pre-1996 leases puts a heavy onus on the original tenant. Even if a successor tenant indemnifies the original tenant against future rent and performance of the lease obligations, this would be little comfort if the successor refused to perform, went bankrupt or disappeared. The original tenant is effectively a guarantor of his successors unless the landlord agrees to release him from the obligations (which he would not have any incentive to do).

### **Post 1996 Leases**

Under a lease granted after 1996, a tenant under lease is only liable for obligations while the lease is vested in him. Therefore on assignment (transferring his lease) with the landlord's consent, he is released from the tenant's covenants. Therefore he cannot be sued for any future breaches of obligations. This rule also applies to subsequent successor tenants as would previously be the case. They are bound by the lease covenants while they are tenants.

The tenant is of course only released when he transfers on his interest with the landlord's consent. Every commercial lease will or should contain a restriction on the tenant transferring, assigning or sub-letting the property without the landlord's consent. The landlord's consent cannot be unreasonably withheld so that the original landlord may lose the original tenant where a new tenant succeeds in showing that it is not reasonable for the landlord to refuse consent.

To counterbalance the loss of the landlords' rights under the old regime, the new post-1996 law allows for the landlord to require an outgoing tenant will be released from the lease on condition that it enters into an agreement by which the outgoing tenant guarantees the performance of the covenants of the incoming tenant. In practice this type of guarantee is very commonly inserted in post 1996 lease, unless the tenant has the commercial bargaining power to negotiate it away.

The original landlord under a pre-1996 lease was also liable under the terms of the lease for the entire term, although this was in practice less onerous than on the tenant. Under a lease granted after 1996, there is a procedure whereby the selling landlord can serve a notice on the tenant requesting release. If within four weeks the tenant objects by serving a written notice on the landlord, the landlord may apply to the County Court for a declaration that it is reasonable for the landlord to be released. If the tenant does not object within that time limit the original landlord is discharged. The landlord's future responsibility ceases.

It is possible and desirable for a landlord to state in a lease that he is only to be liable while he holds the reversion or covenants. The landlord would generally want to do this. The matter may be of practical relevance to a tenant if the landlord performing obligations under a head lease in respect of a larger building. In this case the tenant would not want to agree such a term or would not want to release a landlord from obligations in relation to the management of a larger structure if the successor is not of the same commercial substance.

A landlord's successor becomes bound by all the terms in the lease and likewise becomes entitled to the benefit of all the tenant's obligations. The benefit of the



guarantor's obligations will generally pass to the landlord. The successor landlord can apply to be released from his obligations when he himself sells on at a future date.

Guarantors are very commonly required by landlords in leases. This is because the original or incoming tenant may not have the financial strength by itself to perform the obligations in the lease. Frequently, a group company takes a lease but a “head” company, with more financial strength and depth will guarantee the performance of the tenant’s lease obligations. In the case of smaller companies it would be common that the directors or principal shareholders are required to guarantee the performance of the tenant’s lease obligations. In the case of pre 1996 leases it is critical for the investor to establish that the guarantee covers successors of the original landlord.

Post 1996, where a tenant is released, the guarantor will be released as well. This is because the guarantor is guaranteeing that specific tenant and not any other substituted tenant.

---

This Guide is intended as an overview and broad outline of the matters covered in it. Its purpose is to inform and raise awareness. We are happy to offer specific legal advice on particular circumstances.

This Guide should not be relied on as a substitute for comprehensive legal advice with reference to the particular circumstances.

While we have taken due care in the preparation of this publication, we do not accept legal liability as a result of any reliance placed on anything in this Guide. The reader should rely only on specific legal or taxation advice.