

RENT AND DURATION OF LEASE

Rent

Rent is always a key commercial term. In the case of an investment property, the landlord will expect that rent is paid in addition to contributions for service charge and insurance. Rent will usually be payable quarterly in advance, although it is possible to make any commercial agreement as may be required in the lease. Generally interest will be due on late rent payments at a rate such as about 4% above a base rate.

It is usual and desirable that the tenant is obliged to pay any VAT that arises on the rent. Under the general rules of VAT, the landlord will himself have to account for VAT out of the rent unless the lease specifies that the tenant has to pay VAT on the rent.

Rent Deposits and Guarantees

Rent deposits are often required as an alternative or in addition to a guarantee. There is no equivalent to the protections covering residential tenants in relation to rent deposits. Rent deposit arrangements would generally be more formal than in Ireland. It would be more usual to have a detailed deposit deed involving the deposit of the deposit monies with a financial institution.

It is possible to have rent deposits and guarantees limited in time or limited in amount. Frequently if a tenant is commencing business it may be able to negotiate a clause which provides that once it achieves certain financial targets (e.g. turnover, profits or free cash or distributable cash in excess of a certain number of times the rent) it is entitled to have its guarantor released.

Rent Review

The rent review clause will be critical in longer leases. The standard form of rent review found in Ireland is very similar to that often found in England and Wales. Reviews are

commonly programmed to occur at five year intervals. In the modern fifteen year institutional lease, five year rent reviews are standard.

The standard rent review clause involves resetting the rent based on market value at the review date. However, other forms of increase, which are occasionally found in Ireland are more common in the UK. A turnover rent may be found, which is geared to the extent of turnover in a business. Another more unusual rent review clause is one that links rent increase to the increase in a specified indexes. There are several published indexes in United Kingdom relative to particular types of property market, which are commonly used. The Retail Price Index is equivalent to the Irish Consumer Price Index but it is unlikely to be a very good measure of the rental market

The most common position is that there are “open market rent” reviews. As in Ireland, the process is that the parties endeavour to negotiate and if they cannot agree the rent, it is referred to an independent valuer or surveyor who will decide the matter either as an expert or an arbitrator. As in Ireland, the premises are valued on an open market rent basis on the assumption of a hypothetical new lease between a willing landlord and tenant with no premium. The wording of the rent review clause is critical. In the case of older leases, it may be that the wording has hidden traps for landlord and tenant on rent reviews.

The purpose of the rent review clause is to ascertain the open market rent on the basis of a hypothetical lease of the property on the review date. The hypothetical circumstances and assumptions that the valuers make in setting the new rent are set out in the lease. The valuation is usually undertaken on the basis of the terms of the lease. The effect of this is that the more onerous the lease terms and conditions are, the less attractive they are in the context of a rent review. This is an issue of which a landlord or investor should be aware. A restrictive lease is not necessarily in the landlord’s favour.

There are usually a number of assumptions made and a number of matters disregarded in rent reviews which are very similar to those commonly found in Ireland. Usually it is assumed that the property is fully fitted out and ready for immediate occupation and that the tenant has performed its obligations (so that tenant's failures of repair etc are

disregarded). Tenant's improvements (would be deemed to be capital type works over and above those which the tenant is obliged to do under the lease) are commonly disregarded. It is possible for there to be further more detailed different assumptions for valuations which would be very relevant to the value of the lease as an investment.

It is essential to look at the terms of the lease to ensure that rent review procedures are undertaken in time and are properly conducted. Generally, the time limits for starting rent reviews are not strict. In some other leases, the time limits are strict, so that the right to conduct a rent review could be lost in these cases if it is not commenced in time. Invariably the rent review will not start off automatically. There would have to be some form of trigger from the landlord or tenants side.

Almost invariably the rent review will be upwards only. There has been some pressure from government and industry sources for upward and downward rent reviews. This would be adverse from the landlord's perspective. The alternative is shorter term lettings.

Term or Duration

The term or duration of a lease is a matter for negotiation between the landlord and tenant and their agent. Because of the ease at which landlord and tenant rights can now be excluded, the term or duration of the lease is commercially significant. The term will be relevant to both landlord and tenant, in that the tenant will be obliged to quit the premises unless he negotiates a longer term and the tenant's obligations to pay rent will terminate at the end of the lease term unless an extended term is agreed by both landlord and tenant.

Break options are a matter of agreement. They can allow for either the landlord or tenant to terminate the lease on particular dates. They usually specify dates such as 5, 10 years etc. Some are expressed to be personal and can only be exercised by the original tenant. Some will be free options or some may require an additional payment. Generally they can only be exercised if the tenant is substantially and compliant with its obligations.

A variation on a break is an option to renew. They are not often found in leases because there may already be a statutory right of renewal. A landlord would prefer to negotiate terms of a new lease at the time rather than in advance.

In England and Wales, it is relatively easy for a tenant to sign away or “contract out” of its general rights of renewal of the lease at the end of the term. Before 2003, this could only be done with court approval.

Unlike the case in Ireland, where stamp duty is simply 1% of the annual rent in the case of leases under 35 years, the term of the lease is more relevant to Stamp Duty Land Tax liability in England. A 20 year lease at £250,000 per annum will result in a £50,000 stamp duty charge. Over the last few years terms have fallen from the classic 25 year terms of the past to 10 or 15 years or even less. Even then, tenants are insisting on break clauses being included. Therefore short flexible lease terms are becoming more common.

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.