
Real Estate Law in Practice

Week 11 – Leases in practice

Rent reviews, repairs & dilapidations

Agenda for today

- Rent reviews
- Repair and dilapidations
- Serving notices effectively (covered in Week 4)
- Open questions
- Rent review valuation

Rent reviews

- Purpose
- Basis of valuation
 - Set out in lease
 - RPI, CPI, fixed, turnover or market rental value
 - Advantages and disadvantages of each?
 - Date of valuation
- Process

Market rental value

- What do we mean by 'market rent'?

'The estimated amount for which an interest in real property should be leased on the valuation date between a willing lessor and a willing lessee on appropriate lease terms in an arm's length transaction, after proper marketing and where the parties had each acted knowledgeably, prudently and without compulsion'

RICS Valuation Global Standards (2017) p.10

- (8) The revised rent to be determined by the Arbitrator shall be such as he shall decide should be the rent at the relevant Review Date (following the expiration of any rent free period or concessionary rent period which may for whatever reason be available to a Tenant in the open market at the relevant time) for the Premises making the Assumptions but disregarding the Disregarded Matters and having regard to open market rental values current at the relevant Review Date

Unit 3 University Avenue example lease, Schedule 8

“The hypothetical lease”

- Creates an artificial world – why?
 1. The existing tenant has not kept the property in repair so the poor condition reduces the open market rental value
 2. I am a tenant and have spent a lot of money on the property and operate a very successful restaurant which attracts many customers. Why should the rent for my unit be higher than the rent recently agreed for a similar empty unit nearby?
- So what assumptions are made and what do we disregard/ignore?
 - Unit 3 University Avenue Schedule 8

Assumptions

- (a) that the Premises are fit for and fitted out and equipped for immediate occupation and use and that no work has been carried out on the Premises by the Tenant its sub-tenants or their predecessors in title during the Term which has diminished the rental value of the Premises and if the Premises have been destroyed or damaged they have been fully restored
- (b) that the Premises are available to let by a willing landlord to a willing tenant as a whole without a premium but with vacant possession and subject to the provisions of this Lease (other than the amount of the Rent but including the provisions for rent review) for a term equal to the Contractual Term and
- (c) that the covenants contained in this Lease on the part of the Landlord and the Tenant have been fully performed and observed

Disregards (1)

- (a) any effect on rent of the fact that the Tenant its sub-tenants or their respective predecessors in title have been **in occupation** of the Premises
- (b) **any goodwill** attached to the Premises by reason of the carrying on at the Premises of the business of the Tenant its sub-tenants or their predecessors in title in their respective businesses
- (c) any increase in rental value of the Premises attributable to the existence at the relevant Review Date of **any improvement** to the Premises and carried out [by the tenant] with consent where required otherwise than in pursuance of an obligation to the Landlord or its predecessors in title

Disregards (2)

- (e) any effect on rent of any alteration or other work carried out by the Tenant or any sub-tenant during the Term which has diminished the rental value or lettable floor area of the Premises
- (f) any damage to or destruction of the Premises (whether or not by any of the Insured Risks)
- (g) any actual or potential obligation on the Tenant or any sub-tenant to reinstate alterations or additions to the Premises
- (h) any temporary works of construction demolition alteration or repair being carried out at or near the Premises
- (i) all restrictions whatsoever relating to rent or to security of tenure contained in any Act of Parliament and any direction thereby given relating to any method of determining rent

'Presumption of reality'

- *"In the absence of clear contrary words or necessary implication, it is assumed that the hypothetical letting...is of the premises as they actually were, on the terms of the actual lease and in the circumstances as they actually existed".*

Co-operative Wholesale Society Ltd v National Westminster Bank plc [1995]

- If the lease unambiguously directs the valuers to depart from reality, then they must do so.

Beegas Nominees Ltd v Decca Ltd [2003] EG 62

- **Headline rents and rent-free (RF) periods**
 - Comparable let on 10 year lease with 2 year RF at **£40**psf.
 - $(8 \times £40)/10 = \mathbf{£32}$ psf net effective rent
 - Which figure should be used for the rent review?
- **Length of assumed term**
 - residue (remainder) of the lease term or from the original date?

Process

- Preparatory lease review and valuation
 - do we want to start the rent review process?
- Initiating the rent review
 - does the lease require a special notice to be served? *[NB nothing to do with s25/26/27 notices]*
 - is there a timetable for the review?
 - is 'time of the essence'?
 - expressly stated, interrelation with other clauses, surrounding circumstances
United Scientific Holdings v Burnley BC [1978]
- Negotiate and agree
- Refer to third party (independent expert or arbitrator)
- Complete rent review memorandum and collect back-dated rent

Dispute resolution

- Week 1 referred to methods of alternative dispute resolution. Suggested activity to read:
 - Appendix B, p20, of RICS (2018) *Surveyors and lawyers involved in tenancy renewals under PACT 2nd edn.*
- Contract/lease will set out details.
- Common for rent review disputes to be referred to between independent expert and arbitrator
 - What is the difference?
 - Which is better in what circumstances?
- For further detail, see Furber (2006)
 - Available at:
http://www.pla.org.uk/images/uploads/library_documents/Arbitrators_and_Experts_in_Rent_Reviews_-_John_Furber_QC.doc

Repair and dilapidations

Tenant's repairing covenant

- What is the physical subject matter?
 - lease, licence for alterations
- Is it damaged or deteriorated?
- Is it below the standard expected?
 - schedule of condition
- What work is required?
 - renewal & improvement
 - inherent defects
 - decoration

Tenant's repairing covenant

- Unit 3 University Avenue clause 5.4:
 - 'To repair and **keep** in repair and where necessary to rebuild the Premises (damage caused by an Insured Risk excepted other than where the insurance moneys are irrecoverable in consequence of any act or default of the Tenant or anyone at the Premises expressly or by implication with the Tenant's authority) and to **replace from time to time the Landlord's fixtures fittings** and appurtenances in the Premises which may be or become beyond repair at any time during or at the expiration of the Term'

Tenant's decorating covenant

- Unit 3 University Avenue clause 5.5(c):
 - 'As often as may in the reasonable opinion of the Surveyor be necessary in order to maintain a high standard of decorative finish and attractiveness and to preserve the Building and in the last year of the Term to redecorate the exterior and interior of the Building in a good and workmanlike manner and with appropriate materials of good quality to the reasonable satisfaction of the Surveyor the tints colours and patterns of such decoration to be approved by the Landlord provided that the covenant herein contained relating to the last year of the Term shall not apply where the Tenant shall have performed the obligation in question less than 18 months prior to the expiration of the Term'

Tenant's yielding up covenant

- Unit 3 University Avenue clause 5.7 (a):
 - 'At the expiration of the Term to yield up the Premises in repair and otherwise in accordance with the terms of this Lease to give up all keys of the Premises to the Landlord and to remove all lettering and signs erected by the Tenant in upon or near the Premises forthwith to make good any damage caused by such removal'

..if not in repair

- Unit 3 University Avenue clause 5.7 (b):
 - If at the expiration of the Term the Premises are not in the state of repair and decoration in which they should be having regard to the Tenant's covenants and conditions contained in this Lease the Tenant shall (if so required by the Landlord) pay to the Landlord on demand by way of liquidated damages

..liquidated damages

- Unit 3 University Avenue clause 5.7 (b):
 - such sum as shall be certified by the Surveyor to represent in his reasonable opinion
 - the cost of putting the Premises into the state of repair and decoration in which they should have been had the Tenant complied with the terms of this Lease and
 - the Rent at the rate prevailing at the expiration of the Term that would have been payable under this Lease if the Term had been extended for such period as is reasonably necessary to put the Premises into the state of repair and decoration in which they should have been and
 - the reasonable fees of the Surveyor for the preparation and service of a Schedule of Dilapidations and the preparation and issue of the said certificate

Schedule of dilapidations

- interim, terminal, final

Flow Chart following service of Dilapidations

Tenant's option can depend on when the schedule was served

L/L does not need to serve notice before lease expiry

The Landlord's Intention is an important factor throughout

Dilapidation tactics

- Does the landlord want the tenant to do the repair work or would s/he prefer a cash payment?
- Timing
- Future plans
- Impact of s18 L&T 1927 and 'diminution of value'

s18(1) Landlord & Tenant Act 1927

■ Limb 1

Damages for a breach of a covenant or agreement to keep or put premises in repair during the currency of a lease, or to leave or put premises in repair at the termination of a lease, whether such covenant or agreement is expressed or implied, and whether general or specific, shall in no case exceed the amount (if any) by which the value of the reversion (whether immediate or not) in the premises is diminished owing to the breach of such covenant or agreement as aforesaid;

■ Limb 2

and in particular no damage shall be recovered for a breach of any such covenant or agreement to leave or put premises in repair at the termination of a lease, if it is shown that the premises, in whatever state of repair they might be, would at or shortly after the termination of the tenancy have been or be pulled down, or such structural alterations made therein as would render valueless the repairs covered by the covenant or agreement

In Practice, what does this mean?

- Cost of works
£40,000
- Value in disrepair
£475,000
- Value in repair
£500,000
- Loss in value £25,000
- If landlord intends to demolish the property?
- If the landlord intends to refurbish the property?

Serving Notices Effectively

Notices

- When might a formal notice be needed?
 - To trigger completion of a sales contract
 - To enforce payment or other obligation in a lease
 - To initiate a rent review
 - To terminate a lease
 - To trigger a break notice
- Complying with requirements
 - format
 - content
 - method of service
 - timescales
 - conditions – pre-service/subsequent