



FACT SHEET NO. 5

BUSINESS PROPERTY LEASES

One of the fundamental factors in planning to establish a business is that of the premises from which the business will operate.

The business will then need to decide operating within one of three modes. These are:

- buying the freehold of the commercial premises;
- trading from home;
- entering in to a lease on a commercial premise.

The manner in which the business operates will very much depend on factors such as cash flow, capital appreciation, flexibility required in running the business efficiently and effectively assessing the benefits of acquiring a property asset for the business.

INFORMATION

In this supplement we will be concentrating primarily on business property leases and in particular what a business tenant needs to look out for before and after entering into a lease agreement.

BUSINESS LEASES - NEGOTIATION TIPS

Because a business lease can commit you for a substantial period of time, it is very important that you get the right premises on the right terms. Consider the following:

- firstly, write down all the key features you need in a new premises;

- inspect every property you visit and check it against your key features list;
- weigh up the advantages and disadvantages of each property;
- start with the deal that you want and not the one presented to you by the landlord. Make sure you know how long you would like the lease (short or long) for. A short lease can be less than 5 years.

WARNING

As a business tenant your legal rights come under the Landlord and Tenant Act 1954. Before signing a lease, your landlord may ask you to 'contract out'. This means you would lose your rights under this act. Consult a legal professional before considering this.

- If agents or business landlords think that you are most likely going to take up the lease then rarely will they vary the fixed terms on offer. However, if you were to state that you are also considering other suitable premises then perhaps there could be room for flexibility on those 'fixed terms' originally offered. Ultimately, business landlords would want you to enter in to a lease with them rather than with their competitors.
- Consider the economics of the business rental market. If the market is poor and the terms on offer are favourable to you make sure you include in the terms a ceiling on rent to be paid in the event the market starts to pick up in the future.

- Business property leases tend to be reviewed every three to five years and these rent reviews usually take the form of increases in accordance with the state of the business rental market and what, like for like, business landlords are charging. Make sure you do your calculations here so to avoid any nasty surprises and include these costs in your cash flow forecasts.
- Quite often business landlords will entice you to enter into a pre-contract agreement by setting out only half the terms which favour you. **Do not sign any agreement before reading all the terms and conditions!** If you do then you are legally bound by those terms and conditions under contract law.
- If you have entered into a lease for part of a building you will normally be legally responsible to share the costs of maintaining that building with other business tenants trading from the same building. Therefore it is important that you understand in advance what these costs are going to be before signing the lease agreement.
- Always use an experienced commercial valuer to help you with rent valuation, negotiating terms on your behalf and advising you as to what is and is not possible.



WARNING

Always read the small print before signing.

BUSINESS LEASES - CODE OF PRACTICE

Renting premises

Both landlords and tenants should negotiate the terms of a lease openly, constructively and considering each other's views.

Obtaining professional advice

Parties intending to enter in to leases should seek early advice from property professionals or lawyers.

Financial matters

Landlords should provide estimates of any service charges and other outgoings in addition to the rent. Parties should be open about their financial standing to each other, on the understanding that information provided will be kept confidential unless already publicly available or there is proper need for disclosure. The terms on which any cash deposit is to be held should be agreed and documented.

Duration of a lease

Landlords should consider offering tenants a choice of length of term including break clauses where appropriate and with, or without, the protection of the Landlord and Tenant Act 1954.

Rent and VAT

Where alternative lease terms are offered, different rents should be appropriately priced for each set of terms. The landlord should disclose the VAT status of the property and the tenant should take professional advice as to whether



WARNING

Always request break clauses to be included in your lease agreement. This is important given that there are no guarantees your business will last the length of the lease agreement. If your business does fail and there is a remaining lease term you are responsible under the law of contract for the remaining rent up to the date the lease expires. As a guidance if you enter into a lease agreement for five years then your break clause should allow you the right to give notice of termination after the first two or three years.

any VAT charged on rent and other charges is recoverable.

Rent review

The basis of rent review should generally be based upon the market values. If you are unhappy with the rent review proposed you should ask the landlord for alternatives. The Code of Practice for Commercial Leases in England and Wales urges landlords to consider alternatives where possible. Beware of upward only rent reviews as this means your rent could increase if similar properties in the area do but never reduce.

Alternatives could include:

- **up/down rent reviews:** where rent will increase and fall in line with similar properties in the market;
- **indexed rent:** where rent charges increase in line with some form of measurement, e.g. the Retail Price Index;
- **turnover rents:** where the rent charged will be linked to the trade/turnover of the business;
- **fixed increases:** where the rent will increase periodically: stated in the lease.

Repairs and services

The tenants repairing obligations and any repair costs included in service charges should be appropriate to the length of the term, the condition and age of the property at the start of the lease. Where appropriate the landlord should consider appropriately priced alternatives to full repairing terms.

Insurance

Where the landlord is responsible for insuring the property, the policy terms should be competitive. The tenant of an entire building

should in appropriate cases be given the opportunity to influence the choice of insurer. If the premises are so damaged by an uninsured risk as to prevent occupation the tenant should be allowed to terminate the lease unless the landlord agrees to rebuild at his own cost.

Assignment and sub-letting

The only restriction on assignment of the whole premises should be obtaining the landlords consent which is not to be unreasonably withheld. Landlords are urged to consider requiring authorised guarantee agreements only where the assignee is of lower financial standing than the assignor at the date of the assignment.

Alterations and changes of use

Landlords control over alterations and change of use should not be more restrictive than is necessary to protect the values of the premises and adjoining or neighbouring premises of the landlord. At the end of the lease the tenant should not be required to remove and make good permitted alternations unless this is reasonably required.

BUSINESS LEASES -CODE OF CONDUCT DURING A LEASE

Ongoing relationships

Landlords and tenants should deal with each other constructively, courteously, open and honestly throughout the term of the lease and carry out their obligations fully and on time. If either party faces difficulty in carrying out any obligations under the lease, the other should be told without undue delay so that the possibility of agreement on how to deal with the problem may be explored. When either party proposes to take any action which is likely to have significant consequences for the other party, the party proposing the action should notify the

other without any undue delay, when it is appropriate to do so.

Requests for consent

When seeking consent from the landlord, the tenant should supply full information about his/her proposal. The landlord should respond without undue delay and should, where practicable, give the tenant an estimate of the costs that the tenant will have to pay. The landlord, or mortgagee, whose agreement is needed, should give details to the tenant so that any problems can be resolved efficiently.

Rent review negotiation

Landlords and tenants should make sure that they fully understand the basis upon which rent may be reviewed and the procedure to be followed, including the existence of any strict time limits which could create pitfalls. They should seek professional advice on these matters well before the review date and also immediately upon receiving (and before responding to) any notice or correspondence on the matter from the other party or his or her agent.

Varying the lease effect on guarantors'

Landlords and tenants should seek the agreement of any guarantors to proposed material changes to the terms of the lease or even minor changes which could increase the guarantor's liability.

Holding former tenants and their guarantor's liable

When previous tenants or their guarantor's are liable to a landlord for default by the current tenant, landlords should notify them before the current tenant accumulates excessive liability. All defaults should be handled with speed and landlords should seek to assist the tenant and guarantor in minimising the losses. An Assignor

who wishes to remain informed of the outcome of rent reviews should keep in touch with the landlord and the landlord should provide the information. Assignors should take professional advice on what methods are open to them to minimise losses caused by defaults by the current occupier.

Release of landlord on sale of property

Landlords who sell their interest in premises should take legal advice about ending their ongoing liability under the relevant clauses.

Repairs

Tenants should take the advice of a property professional about their repairing obligations near the end of the term of the lease and also immediately upon receiving a notice to repair or a schedule of dilapidations.

Business rates

Tenants should consider if their business rates assessment is correct or whether they need to make an appeal. They should refer to the DTLR Business Rates a Guide or obtain advice from a rating specialist.

Dispute resolution

When disputes arise the parties should make prompt and reasonable efforts to settle them by agreement. Where disputes cannot be settled by agreement, both sides should always consider speed and cost when deciding how to resolve the dispute. Mediation may be appropriate before starting legal action.

Repossession by the landlord

Tenants threatened with repossession or whose property has been repossessed will need professional advice if they wish to try to keep or regain possession. Similarly landlords should be clear about their rights before attempting to

operate a forfeiture clause and may need professional advice.

Renewals under the Landlord and Tenant Act 1954

The parties should take professional advice at least six months before the end of the term of the lease and also immediately upon receiving any notice under the above Act from the other party or their agent.

BUSINESS LANDLORDS – POWERS OF ENFORCEMENT

If you are in arrears with your business rent your landlord may take the following courses of action against you.

County court proceedings

Generally the debtor would receive a 'claim form' from the court through the post setting out what the creditor says is owed by the debtor. The claim form will include details of the debt known as the 'particulars of claim'.



ADVICE

Although the creditors have legal rights to recover the debt, the debtor too has rights to respond to the claim as set out in the Civil Procedure Rules. In other words, if the debtor agrees that he/she owes the money they must then complete the 'admissions form' that comes with the claim form within sixteen days from the date of the postmark and return it to the claimant with an offer of payment.

If the debtor does not send the 'admissions form' back the court will give judgment against the debtor and order him/her to pay the whole debt in one lump sum. This debt will then be registered with credit reference agencies for six years, which in effect will restrict the debtor's ability to obtain credit in the future.

Upon receipt of the debtor's offer of repayment the creditor can either accept or reject it in which case the court will then determine what the debtor should pay each month. In the event a debtor cannot afford the court's set rate or repayment the debtor has the right to apply for a 'redetermination'. This must be done within fourteen days of getting the order. A court hearing will then be set.

In the event that a debtor challenges the debt a 'defence form' must be completed and sent back to the court within sixteen days. If more time is needed to put a defence together the debtor should fill in and send back the 'acknowledgment of service' which then gives a further fourteen days to complete and return the defence.

Bailiff action

As a general rule if bailiffs have not previously gained peaceful entry to a debtor's premises to collect the debt they have no right to come in and therefore a debtor could refuse them entry and if necessary use reasonable force.



WARNING

Under no circumstances should a debtor leave windows open or doors unlocked as bailiffs can gain peaceful entry through these means. Please note however, that bailiffs cannot get the police to help them break in as this would be unlawful entry.

Some bailiffs may leave a telephone number and arrange to come round to 'have a chat'. If bailiffs use this tactic the debtor can still exercise his/her right to refuse them entry.

If bailiffs leave papers for the debtor to sign and return having been unsuccessful in gaining entry to the debtor's premises he or she should not sign them. Usually bailiffs have a tendency to send these papers through the post.

In the event that bailiffs have already gained entry then they can enforce the debt through carrying

out a 'levy' on the debtor's goods. The current law on bailiffs however does exempt certain goods from seizure. These include:

- such clothing, bedding, furniture, household equipment and provisions as are necessary for satisfying basic domestic needs of the person and his/her family;
- essential tools of the trade without which the debtor's present business or job could not continue. This may include vehicles in exceptional circumstances.

Personal bankruptcy

In accordance with current insolvency laws, any creditor can make a debtor personally bankrupt so long as the debt is at least £750. If you are the director of a limited company the landlord would not be able to make you personally bankrupt unless you have given a personal guarantee.

The procedure for instigating bankruptcy proceedings against a debtor is that a creditor must serve a 'statutory demand'. This is a formal notice warning the debtor that he/she could be made bankrupt unless they pay the debt or make an arrangement acceptable to them. However a debtor can ask the court to stop or 'set aside' the statutory demand within eighteen days but only on very specific grounds.

The impact of bankruptcy is that the debtor's assets (such as the home) will most certainly be at risk. The consequence of bankruptcy on the debtor's home would be such that their beneficial interest gets 'vested' in the Official Receivers or Trustees. This gives them an interest in the home which enables them to:

- apply for an order for sale;
- apply for an order for possession;

- apply for a 'charging order' against the property. The consequence of this would be that interest will still accrue on the debt at the statutory rate of 8% per annum until such time that it is cleared in full. If there's no equity in the debtor's home a creditor will strategically use this power of enforcement and wait until the value of the home rises to such a level that the equity will be enough to cover the debt plus any accruing interest. This equity however would have to be released within three years from the date of bankruptcy following the Enterprise Act 2002 which came in effect on 1 April 2004.

INFORMATION

In practice the Official Receiver or Trustee in bankruptcy will not only be looking to cover the original debt but also the legal fees, administration charges and interest in bringing the petition against the debtor and this could mean the equity being completely wiped out.

Company insolvency

Essentially the appointed liquidator will take control of the debtor's company affairs and almost all the powers of a director will cease. The liquidator disposes of all the company's assets, if any, and after paying the costs and expenses of the liquidation, distribute any remaining money to creditor.

As soon as the affairs of the company are fully wound up the liquidator will hold a financial meeting of the company and its creditors and

during this time the debtor/company director will be responsible for:

- providing information about the company's affairs to the liquidator and attend interviews with the liquidator as and when reasonably required;

- look after, and hand over, the company's assets, if any, to the liquidator, together with all its books, records, bank statements, insurance policies and other papers relating to its assets and liabilities.

The liquidation ends when the company is dissolved after the final meeting held by the liquidator. How long the liquidation takes will depend on the circumstances of the individual case but once the process has been completed the company will be dissolved and cease to exist.

Forfeiture of lease

In the event that a debtor has arrears on his/her business rent the landlord may take court action to get the premises back. This is known as forfeiture. In some cases the landlord may be able to take back the premises without a court order. If this happens you should ask a solicitor what your rights are.

Negotiating with your landlord

Because of the considerable powers of the business landlord, you should contact them as soon as possible if you fall in to arrears to make an arrangement that will be acceptable to both parties. This would usually involve paying an amount towards the arrears on top of your normal rent payment.

Use our self-help pack 'Dealing with your business debts' to help you work out a budget and prioritise your debts.

USEFUL ADDRESSES

Issues around business leases can be very complicated, if you are unsure about any of the terms of your lease or are considering taking out a business lease, consult a qualified solicitor, accountant or chartered surveyor.

You can also obtain further information from the following:

Office of the Deputy Prime Minister

Responsible for policy and legislation on business leases: www.odpm.gov.uk

Code of Practice for Commercial Leases in England and Wales.

To download a copy, see the website: www.commercialleasescodeew.co.uk

Alternative phone us on 0800 197 6026

Remember: You can always contact us for advice about any difficulty you have in dealing with your debts.

Freephone 0800 197 6026 Website www.bdl.org.uk

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