

Code for leasing business premises (1st edition), RICS professional statement

Basis for conclusions

Purpose

The aim of this project is to fundamentally improve transparency and fairness in the negotiation of commercial leases. This will be achieved by moving the industry document into RICS ownership and making this a document that can be regulated and embedded into the leasing process, leading to widespread recognition of RICS work in this area.

The 2007 version of the *Code for leasing business premises* (the 2007 Code) was produced by a coalition of bodies from across the UK property industry. This coalition included RICS and a range of other public and representative organisations. The copyright for the document was held by the joint working group on commercial leases, and the document was primarily distributed via a website paid for by RICS.

The 2007 Code was intended to provide advice to landlords and tenants as to the terms that should be included within a standard business lease. While it was suitable for all landlords and occupiers, the intention was that the 2007 Code would primarily be of use to small business tenants who may otherwise not have access to reasoned advice when negotiating a lease.

Research by the University of Reading in 2009 showed that the initial awareness and usage of the 2007 Code was limited, and subsequent feedback suggested that there had been little improvement in this situation.

There was criticism of RICS as the regulatory body for not playing a more active role and it was thought that the 2007 Code lacked 'teeth'. This led to RICS reconsidering the status of the 2007 Code and looking at producing a new, and potentially more influential, version.

The new and revised *Code for leasing business premises* (the 2020 Code) is owned and published by RICS as a professional statement but is endorsed and badged by the other organisations. These organisations are listed within the acknowledgements section of the document.

The working group contains representatives from a number of organisations, including BPF, REVO, Law Society, Federation of Small Business, Association of Licenced Multiple Retailers and BCO.

The objective of the 2020 Code is to improve the quality and fairness of initial negotiations on lease terms and to promote the issue of comprehensive heads of terms that should make the legal drafting process more efficient.

Other highlights of the revised document are:

- It introduces mandatory requirements for RICS members and regulated firms to provide written heads of terms.
- It provides assurance and clarity for occupiers and is in keeping with our public service remit.
- It promotes a less adversarial relationship between occupiers and owners and their advisors.
- It encourages surveyors and lawyers to work more collaboratively.
- It encourages occupiers to take professional advice.

Public consultation

The public consultation of the 2020 Code opened on 25 March 2019 and closed on 5 May 2019. Below are some specific details:

- PDF downloads: 487
- participants: 32
- comments: 40
- questionnaire responses: 6.

In order to address the comments raised at consultation, we have:

- hosted the organisations supporting the 2020 Code on four separate occasions to run through the document and they have confirmed they are comfortable with the draft in its final form
- presented to major firms, JLL, CBRE, British Land, Hammerson and
- run a series of RICS roadshows on the subject around the UK.

This document focuses only on the more significant changes made, but a number of minor textual refinements put forward by commentators have also been adopted, which improve the overall clarity of the 2020 Code. RICS is very grateful to all those who responded.

It should be noted that responses were received from organisations that represented landlords and occupiers, and in some cases, their comments were asking for diametrically opposed amends to be made.

Structure

The structure of the document has been revised to add clarity and is now made up of the following sections:

- Introduction
- Mandatory requirements
- Lease negotiation best practice
- Appendix A – Template heads of terms and checklist
- Appendix B – Guide for landlords and tenants.

Introduction

Consultation responses underlined that members continue to look for absolute clarity as to what is mandatory and what is advisory, as well as what is expected by RICS. Opportunity has been taken in the final version to:

- be more consistent in the language used and
- add additional explanation on the status of the content.

The introduction was amended to clarify what was meant by 'business premises' and that agricultural tenancies and telecoms installations were not included.

Mandatory requirements

Individual bullet points were clarified and, in some instances, combined, and a section relating to reinstatement rights was added.

Lease negotiation best practice

2 Length of term, renewal rights and break rights

Issue:

'Unless the landlord has special reasons for imposing stricter conditions, a tenant's break should be conditional only on there being no rent arrears, the tenant paying the basic rent up to the end date, giving up occupation and leaving no subtenants or other occupiers. Leases should require landlords to repay any rent, service charge or insurance paid by the tenant for any period after a break takes effect.'

Response:

Clause 2.4 was amended following suggestions from occupier groups and landlords to remove the term 'special conditions':

'Unless the parties have agreed stricter conditions in the heads of terms, a tenant's break should be conditional only on the tenant paying all basic rent payable on any date before the break date, giving up occupation and leaving no subtenants or other occupiers. Disputes about the state of the premises, or what has been left behind or removed, should be settled later, as at normal lease expiry.'

4 Rent and rent review

Issue:

'Rent review clauses should be clearly expressed. Definitions of market rent should not result in a rent higher than the true market rent unless that has been expressly agreed by the parties, such as where that is agreed in return for a financial inducement. Provisions for indexed increases in rent should not contain obscure formulae designed to produce a greater increase than is proportionate to the increase in the index over the appropriate period or outside any agreed caps or collars.'

Response:

Clause 4.3 relating to upward only rent reviews was amended to be clearer as the above was felt to be of disadvantage to a tenant. The clause is now clearer:

'Rent review clauses should be clearly expressed. Definitions of market rent should not result in a "headline rent" unless that has been expressly agreed by the parties, such as where that is agreed in return for a financial inducement. Provisions for indexed rent reviews should not contain obscure formulae designed to produce a greater increase than is proportionate to the increase in the index over the appropriate period or outside any agreed caps or collars.'

5 Service charges, insurance costs and other outgoings

Issue:

'Landlords should be aware of the RICS professional statement *Service charges in commercial property*, (1st edition) and, so far as practicable in the circumstances, service charge provisions in leases should be drafted in conformity with the mandatory provisions of that professional statement.'

Response:

Amended to include reference to core principles:

'The parties should have regard to the current edition of *Service charges in commercial property*, RICS professional statement and, so far as practicable in the circumstances, service charge provisions in leases should be drafted in conformity with the core principles and mandatory provisions of that professional statement.'

6 Assigning, subletting, charging and sharing

Issue:

'Leases should allow tenants to assign the whole of the premises with the landlord's consent, which is not to be unreasonably withheld or delayed. However, landlords may set out reasonable circumstances in which consent can be refused, such as where there are arrears of rents, service charges or insurance premiums that are not the subject of a legitimate dispute.'

Response:

The word 'reasonable' was replaced and the sentence made clearer:

'Leases should allow tenants to assign the whole of the premises with the landlord's consent, which is not to be unreasonably withheld or delayed. Landlords may set out circumstances in which consent can be refused, such as where there are arrears of rents, service charges or insurance premiums that are not the subject of a legitimate dispute, or where the assignee has insufficient financial strength, but all such circumstances should be reasonable and appropriate.'

7 Repairs

Issue:

'Leases should impose tenant's repairing obligations appropriate to the length of the term, the condition of the premises and the financial terms. If the tenant's repairing obligations are to be limited to the initial condition of the premises, a schedule of condition will normally be required and the parties should agree which party is responsible for the cost of obtaining it.'

Response:

'Leases should contain tenant's repairing obligations appropriate to the length of the term, the condition of the premises and the financial terms.'

Issue:

'Where the premises are or will be newly built, a tenant taking on direct or indirect responsibility for repairs should be given rights for the enforcement of the defect liabilities of the main building contractor (and, so far as that contractor does not have design liability, those responsible for design), either directly through warranty deeds or statutory third party rights or by the developer being obliged to enforce its remedies.'

Response:

Section 7.3 was significantly simplified to reflect occupier concerns:

'Where the premises are or will be newly built, a tenant taking on direct or indirect responsibility for repairs should be given suitable protection against inherent construction defects for an appropriate period.'

The heads of terms template was amended.

8 Change of use, alterations and fit-out

Issue:

'Leases should give landlords control over alterations and changes of use that are no more restrictive than are necessary to protect the value of the premises and any adjoining or neighbouring premises of the landlord, and this may differ between different types of property.'

Response:

This clause was left unamended.

Issue:

‘Landlords should not normally prohibit, or require their consent to be obtained for, internal non-structural alterations that do not affect the character, value, stability, building services or energy efficiency performance of the building, but may require the tenant to carry out such works properly and without causing damage or nuisance and to give written details to the landlord.’

Response:

Opposite views were expressed from landlords and tenants, therefore the amend tries to strike a balance:

‘In a lease of an entire building, a landlord should not normally prohibit, or require its consent to be obtained for, internal non-structural alterations that do not adversely affect the character, value, structural stability, statutory compliance or energy efficiency performance of the building, but landlords will require the tenant to carry out such works properly and without causing damage or nuisance and to give written details to the landlord.’

Issue:

‘Except where, as a term of a consent for alterations, the parties have agreed that certain alterations are to be removed at the end of the lease, leases should allow the landlord, where it is reasonable to do so, to require the tenant to remove alterations at the end of the lease and make good. Leases should require the parties to identify the required works in sufficient time before the end date to enable the tenant to comply with any such obligation.’

Response:

Clause 8.5 was amended in response to occupier concerns to be simpler and less stringent on consent to alterations:

‘Except where the heads of terms state that there will be a reinstatement specification or an obligation on tenants to remove alterations, a lease should allow the tenant to leave alterations in place unless it is reasonable for the landlord to require their removal.’

The heads of terms template was amended.

9 Insurance and damage

Issue:

‘Landlords should pass on to tenants the benefit of discounted premiums and should disclose to tenants whether the landlord benefits from insurance commissions.’

Response:

This section was left unchanged, as it was felt to be adequate and good practice.

Supplemental guide

While this is simply a guide for occupiers and not part of the regulated document, amends were made to be consistent with the document and references were updated where required.