




Rent Reviews in Commercial Property









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The law as stated in this seminar is correct as at 7 November 2017





Speaker Profile 

▶ **Michael Large, Prettys Solicitors LLP**

- ▶ Michael qualified as a solicitor in 2002 and is an expert in property litigation including landlord and tenant disputes, possession claims, squatter evictions, lease renewals, rent arrears, service charges, dilapidations, forfeiture of leases and breach of covenant, nuisance, boundary disputes, rent reviews, and adverse possession. He is particularly experienced in dealing with disputes involving unregistered land. In addition he deals with insolvency/bankruptcy matters, breach of contract claims, and commercial disputes. Michael acted for the UK's biggest landlord for over ten years and has also acted for major commercial landlords and commercial tenants, banks, insurance companies, and property developers
- ▶ Michael recently presented webinars for LexisNexis on the subjects of Residential Leases in 2017 (with Sarah Walker) and Commercial Leases in 2017 (with Gary Blaker QC)

Purpose of this Seminar



- ▶ A guide to managing the commercial property rent review process
- ▶ Attend this seminar to gain a step-by-step guide to the procedural and practical actions you must undertake when conducting a rent review. Key to the process is appraising the terms of the lease, collating and analysing evidence, and handling negotiations.
- ▶ This seminar will cover:
 - ▶ The various types of rent review provisions in a commercial lease e.g. open market, upwards only, turnover etc
 - ▶ Triggering the review, time of the essence, extreme delay
 - ▶ Turnover leases
 - ▶ Dispute resolution
- ▶ (NB: This seminar does NOT cover stamp duty land tax (SDLT) implications of rent reviews.)

Common Terms



- | | |
|-------------------|--------------------------------------|
| ▶ Assumption | ▶ Rent review memorandum |
| ▶ Comparable | ▶ Rent-free period |
| ▶ Disregard | ▶ Review date |
| ▶ Ground rent | ▶ RPI rent |
| ▶ Headline rent | ▶ Side by side or geared rent |
| ▶ Indexed rent | ▶ Turnover rent |
| ▶ Market rent | ▶ Valuation date |
| ▶ Peppercorn rent | ▶ Without Prejudice Save As To Costs |
| ▶ Rack rent | |

Types of rent review provisions



- ▶ Rent review provisions allow rent to be updated in line with market conditions. Examples of common types of rent review provisions include:
 - ▶ Open market: reflects value of premises on the "open market"
 - ▶ Indexed or RPI rent: increases in line with an index such as Retail Prices Index
 - ▶ Stepped increases: fixed increases, not really a 'review'
 - ▶ Side-by-side or geared rent: sometimes used in a joint venture where head landlord lets land to a developer which underlets and the head landlord receives a basic ground rent and a share of the income from the underleases - rarely used due to SDLT and other issues
 - ▶ Turnover rent: normally based on tenant's turnover at the premises (usually a percentage of that turnover) or may be based on profit or even production at the premises
 - ▶ Upwards only: if market rents fall the rent will remain the same and not be reduced, the reviewed rent will be the higher of the market rent at the date of the review or the rent being paid at the review date
 - ▶ Barreillage: pub leases / beer ties
 - ▶ Interim rent: Section 34 Landlord & Tenant Act 1954 (LTA1954) (not strictly a rent review)

Assumptions and Disregards (1)



Many – but by no means all – commercial leases use either an identical or a very similar set of Assumptions / Disregards for rent reviews as are found under Section 34 LTA 1954, namely:

- ▶ the rent payable shall be what the holding might reasonably be expected to be let in the open market by a willing lessor, there being disregarded—
- ▶ any effect on rent of the fact of the tenant (or predecessors) occupation of the premises
- ▶ tenant goodwill
- ▶ improvements carried out by a person who at the time was the tenant, but only if it was carried out otherwise than in pursuance of an obligation to the immediate landlord and either was carried out during the current tenancy or not more than twenty-one years ago
- ▶ any addition to its value attributable to the licence for licenced premises
- ▶ any effect on rent of the operation of the provisions of the Landlord & Tenant Covenants Act 1995 (Section 34(4) LTA 1954)
- ▶ Adjudicator/Court will generally assume **vacant possession**, (although this is not an express requirement of Section 34), and also assume that the new lease will be granted subject to any existing sub-tenancy

Assumptions and Disregards (2)



Improvements generally:

- ▶ Adjudicator/Court will value the property in its **existing state of repair**, but will disregard any disrepair resulting from the tenant's breach of its repairing obligations (*Family Management v Gray* [1979] 253 EG 369)
- ▶ On the other hand, where the tenant has carried out improvements or alterations without landlords consent and in breach of covenant, it appears likely these should be rentalised and not be disregarded: *Hamish Cathie Travel England Ltd v Insight International Tours Ltd* [1986] 1 EGLR 244)
- ▶ LTA 1954 does not define "improvement", but improvements do not include tenant's fixtures (*New Zealand Government Property Corp v HM&S Ltd (The New York Star)* [1982] QB 1145)

Assumptions and Disregards (3)



Rent Free Periods (Section 34 LTA 1954):

- ▶ Conflicting decisions under the LTA 1954 regarding rent discount on the grounds that comparable lettings offer a rent free period for fitting out:
- ▶ In *Max Mara Ltd v Pearl Assurance Plc* (unreported), 16 May 1996, (Central London County Court) the rent free period was regarded as a bargain between a landlord and a tenant based on the tenant's requirements in specific circumstances. The tenant's occupation is not central to the bargain, and this factual situation does not exist on renewal. Therefore, no discount for a rent free period was allowed
- ▶ More recent decisions on the issue have been in favour of a discount on the rent to reflect the costs and to a fit out where the comparable lettings had a similar discount (*Britel Fund Trustees Limited v B&Q PLC* (unreported), 11 March 2016, (Central London County Court))

Triggering the review



- ▶ Rent reviews are commonly due every five or ten years and are naturally loathed by tenants
- ▶ Triggering the review is usually done by written notice
- ▶ The tenant may be required to serve a counter-notice to preserve their right to contest the review
- ▶ The notice (and any counter-notice) may have specific requirements for content, form, and timing, and service: see for example *Arundel Corp v Khoker* [2003] EWCA Civ 1784 or *Lancecrest Ltd v Asiwaju* [2005] EWCA Civ 117
- ▶ **NEVER** serve a rent review notice (or counter-notice) that is expressed to be "without prejudice" or "without prejudice save as to costs", or "subject to contract" as that is likely to invalidate it: *Maurice Investments Ltd v Lincoln Services Ltd* [2006] All ER (D) 402
- ▶ By all means make settlement offers at the same time by separate (without prejudice save as to costs) letter if appropriate
- ▶ If there is no agreement on rent, then the lease will usually provide for a third party (adjudicator) to decide the matter: a further notice will need to be served to commence this procedure

Time of the Essence



- ▶ There may be express lease clauses providing that time is of the essence
- ▶ It may also be implied either by the terms of the agreement or the actions of the parties.
- ▶ "Deeming" provisions in the lease may require steps to be taken by a certain time ie potentially making time of the essence
- ▶ If time is of the essence, and a rent review provision states that a notice must be served on or by a certain date to trigger a rent review, then the chance to review the rent may be lost
- ▶ Time limits also commonly apply to tenant counter-notices: if not served in time, the tenant may lose the opportunity to contest landlords' proposed increase: *Starmark Enterprises Ltd v CPL Distribution Ltd* [2001] EWCA Civ 1252
- ▶ No general rule that time is of the essence in rent reviews unless there are contrary indications ie specific wording in lease: *United Scientific Holdings v Burnley BC* [1978] AC 904
- ▶ Parties may seek to make time of the essence by serving a notice requiring performance of an obligation by a reasonable time

Extreme Delay



- ▶ The lease usually provides that tenant will pay the old rent until review
- ▶ The lease must specify that rent is to be backdated and interest payable on it – the Adjudicator/Court will not imply any such terms
- ▶ Extreme delay is not necessarily a bar to a rent review:
 - ▶ in *Million Pigs Ltd v Parry* [1983] 288 EG 809 the landlord referred a review for expert determination three and a half years after the review date, but without any time limit having been expressly required
 - ▶ in *McDonald's Property Co Ltd v HSBC Bank PLC* [2001] 36 EG 181, the landlord was eighteen months later than the required date in serving the trigger notice
 - ▶ in *Idealview Ltd v Bello* [2009] EWHC 2808, the High Court decided that time was not of the essence when the landlord triggered a rent review a mere 13 (thirteen) years after the rent review date: mere delay, in and of itself, did not disentitle the landlord from instigating the rent review

Extreme Delay – what should tenants do?

- ▶ If the tenant wants to bring the rent review to a head, but has no right to use any of the steps in the rent review process, then *Deaivew v Bell* is authority for advice that the tenant should serve a notice on the landlord making time of the essence and requiring it to start the rent review within a reasonable time
- ▶ An assignee of a lease should always ask for evidence of the outcome of rent reviews that should have been completed before the date of the assignment
- ▶ Where a review is outstanding (no matter how long ago) the assignee should ensure that the contract makes appropriate provision for the assignor to contribute to the top up payment, if and when it is eventually agreed or determined. The assignor, if it agrees to this, may want to expand that clause to give it involvement in the rent review process, or the right to agree the amount, before it is finally settled (so that the bill it faces is not unnecessarily inflated)
- ▶ Standard Commercial Property Condition 5 deals with this if the rent review has started, but not been completed. However, where the rent review has not yet started, a special condition will be needed

Turnover Leases

- ▶ Turnover rent is normally based on tenant's turnover at the premises (usually a percentage of that turnover)
- ▶ May be based on profit or even production at the premises
- ▶ Common in retail sector
- ▶ Usually have a basic rent payable in addition to turnover element
- ▶ May be calculated as percentage of tenants annual turnover
- ▶ Likely to be calculated annually
- ▶ Basic rent commonly below market rent
- ▶ Relatively high SDLT compliance burdens
- ▶ Tenant must demonstrate turnover to landlord which is likely to require special accounts and which may be difficult where tenant has more than one property
- ▶ Specific problems created by digital age: online sales, collection of goods, multichannelling, etc

Dispute Resolution

- Disputes on rent reviews are resolved by the following methods:
- ▶ Adjudication (Arbitration / Expert Determination)
 - ▶ Unopposed Lease Renewal Proceedings under Landlord & Tenant Act 1954
 - ▶ Professional Arbitration on Court Terms (PACT)
 - ▶ Without Prejudice negotiations and offers

Dispute Resolution: Arbitration



- ▶ Lease usually provides for rent review to be referred to President of the Royal Institution of Chartered Surveyors (RICS) who will appoint an Arbitrator
- ▶ One or both parties will serve notice to commence the Arbitration
- ▶ Arbitrator should be properly qualified and determine a rent in accordance with RICS Red Book Valuation
- ▶ Parties choose the procedure of the Arbitration
- ▶ Confidential and flexible
- ▶ Arbitrators powers arise from English Arbitration Act 1996
- ▶ Award is binding and can be enforced through Courts
- ▶ No 'Appeal' as such; opportunities to challenge the award are very limited, namely: the award is incomplete or has not addressed an issue; it contains a clerical error or ambiguity; the arbitrator lacked jurisdiction; there was a serious irregularity; or a mistake of law
- ▶ Strict 28 day time limit to challenge award

Dispute Resolution: Expert Determination



- ▶ Expert Determination
- ▶ Less common than Arbitration
- ▶ Terms of reference will set out the matters in dispute and the experts powers and duties
- ▶ Limited grounds to challenge decision:
 - ▶ fraud/collusion
 - ▶ partiality
 - ▶ material departure from instructions
 - ▶ failure to state reasons
 - ▶ certificate not certain
 - ▶ manifest error

Dispute Resolution: Lease Renewal



- ▶ Unopposed Lease Renewal Proceedings under Landlord & Tenant Act 1954
- ▶ Usually in County Court
- ▶ Interim rent liability arises from earliest date that could have been specified in statutory notice
- ▶ Determination on the basis of Section 34 LTA 1954 (see above)
- ▶ Determination of some or all new lease terms by judge (rather than by surveyor)
- ▶ Appeal from decision of County Court Judge (usually to High Court)

- ▶ Some or all matters in dispute (including rent) can be sent to Professional Arbitration on Court Terms (PACT) provided both parties agree:
 - ▶ PACT is essentially referring off some or all matters in the Lease Renewal to either an Arbitrator or Expert (the parties must agree which one, and the parties must agree terms by way of consent order/agreed directions).
 - ▶ PACT is NOT compulsory.

Dispute Resolution: With Prejudice



- ▶ With Prejudice: the Without Prejudice Save as To Costs Rules
- ▶ Without prejudice communications are a genuine attempt to settle a dispute and are legally privileged
- ▶ Can be letters, emails, telephone discussions, meetings, mediations
- ▶ Without prejudice offers if accepted can be legally binding
- ▶ Without prejudice communications should be clearly labelled as such but labels are not definitive
- ▶ Must be marked 'Without prejudice save as to costs' if you want to refer to them on question of costs after judge/arbitrator makes their decision
- ▶ Labelling a rent review notice or counter notice "without prejudice" or "without prejudice save as to costs" or even "Subject to Contract" will probably invalidate the notice: Maurice Investments Ltd v Lincoln services Ltd [2006] All Er (D) 402

Dispute Resolution: Offers to Settle



- ▶ Offers to Settle: tactical device to put on pressure
- ▶ Will normally be without prejudice save as to costs
- ▶ Open offers:
 - ▶ Very unusual in rent review context
 - ▶ but Courts in non-rent review cases are increasingly taking these into account
- ▶ Calderbank Offers: Calderbank v Calderbank [1976] Fam 93
 - ▶ Any genuine settlement offer
 - ▶ Very flexible and can contain whatever you want
 - ▶ Judge/arbitrator has wide discretion as to what weight to give it on costs
- ▶ Part 36 Offers:
 - ▶ Self-contained costs code (see next slide)
- ▶ 'Sealed' offers:
 - ▶ rarely used now, in practice replaced by Part 36 Offers

Dispute Resolution: Part 36 Offers



- ▶ Part 36 Offers: Self-contained and very rigid costs code in Part 36 CPR
 - ▶ Offer must be in writing and expressed to be a Part 36 Offer; can be open or WP
 - ▶ Must specify the relevant period (not less than 21 days) within which Defendant will be liable for Claimants' costs
 - ▶ If offer is accepted, unless it is made less than 21 days before start of Trial, Court's permission is not required
 - ▶ Where offer includes offer to pay or accept money that must be paid within 14 days
 - ▶ Attempts to modify costs provisions likely to stop it being Part 36 Offer
 - ▶ Offer remains 'live' until withdrawn in writing.
- ▶ Arbitration: CPR 36 not apply
 - ▶ Best practice is to follow Part CPR 36 by analogy, but no obligation to do so
 - ▶ Arbitration Act 1966 Sections 61 to 63 give wide authority to set costs, usual rule is costs follow the event

Dispute Resolution: Part 36 Offers contd



- ▶ If Claimant obtains judgment at least as advantageous as its own offer:
 - ▶ Defendant must pay Claimants costs on indemnity basis from relevant period onwards
 - ▶ Interest on costs up to 10% above base rate
 - ▶ Interest on whole or part of sum awarded up to 10% above base rate
 - ▶ Additional amount on money claims / mixed claims of up to 10% of first £500,000 and 5% thereafter
 - ▶ Additional amount on non-money claims of up to 10% of first £500,000 of legal costs and 5% thereafter
 - ▶ Additional amount capped at £75,000
- ▶ Applicability to Rent Review Arbitration?

Dispute Resolution Case Update



- ▶ Market rent evidence:
 - ▶ Flanders Community Centre Ltd v Newham LBC [2016] EWHC 1089 (Ch)
- ▶ Sham transactions:
 - ▶ Clear Call Ltd v Central London Investments Ltd [2016] EWCA Civ 123
- ▶ Admissibility:
 - ▶ Mondial Assistance (UK) Ltd v Bridgewater Properties Ltd [2016] EWHC 3494 (Ch)

Dispute Resolution



- Flanders Community Centre Ltd v Newham LBC [2016] EWHC 1089 (Ch)**
- ▶ Tenancy of business centre granted at £1 per year (plus insurance) on condition extensive works were carried out. New tenancy granted at £1 per year (plus insurance) not the £16,000 the landlord sought. Judges decision upheld on landlords' appeal because:
 - ▶ Trial not a "dress rehearsal for some second round" (i.e. get it right on the day!);
 - ▶ Judge entitled to find comparable evidence unreliable as terms of allegedly comparable leases not available;
 - ▶ Evidence as to what rent the tenant could afford was irrelevant;
 - ▶ Passing rent accepted as a relevant factor;
 - ▶ Neither expert satisfactory. Judge could have carried out their own analysis but not obliged to;
 - ▶ Landlords expert made a mistake relating to the lease terms, but no one drew it the judges attention so no error in law in failing to address it in the judgment. Judge entitled to decide on the evidence put forward by both sides; and
 - ▶ Local authority argued that the works had actually never been done so under the terms of the original lease a higher passing rent applied (£1,200). This was not raised at trial but only on appeal. Rejected as it was too late, and tenant was still required to do the works if it had not.

Dispute Resolution



Clear Call Ltd v Central London Investments Ltd [2016] EWCA Civ 123

- Judge and Court of Appeal rejected tenants argument that a comparable rent transaction was a sham.
- Two comparable transactions put forward, one alleged to be a sham because the premises lay empty for 16 months after the transaction.
- Tenant tried to rely on new evidence that
 - (i) the property remained unoccupied and
 - (ii) its tenant was a non-trading company
- Fresh evidence failed the Ladd v Marshall [1954] 1WLR 1489 tests for admission because
 - (i) the fact that the comparable property continued to be empty beyond the 16 months added nothing if the judge accepted at trial that the comparable transaction was genuine and
 - (ii) the evidence about non-trading could have been used at trial, but was not.

Dispute Resolution



Mondial Assistance (UK) Ltd v Bridgewater Properties Ltd [2016] EWHC 3494 (Ch)

- ▶ Tenant applying unopposed for a new lease and had an experts report on the condition of lifts, lighting, and curtain walls. Attached to the report as appendices were further reports from a lift consultant, a curtain walling consultant and a mechanical & engineering expert. Some were 'historic' and some prepared for the proceedings.
- ▶ Landlord sought to exclude on the basis on non-compliance with CPR 35. Judge agreed on the basis expert evidence should not be allowed in "by the back door". Appeal allowed because:
- ▶ Combined effect of Civil Evidence Acts 1972 and 1995 was that the opinion of a properly qualified expert was prima facie admissible. That was only affected by CPR 35 where the expert was instructed "for the purpose of proceedings".
- ▶ Opinion evidence not within CPR 35 was prima facie admissible subject to the Court's discretion to exclude it: if it was objected to, the issue was how much weight to give it.

Any Questions?



- ▶ We hope you enjoyed this seminar and found it useful.
- ▶ If you have any questions about this subject, or any other legal issues involving property, please do not hesitate to contact the speaker, Michael Large, of Prettys Solicitors LLP, on 07387 411402 or email mlarge@prettys.co.uk
- ▶ Prettys Solicitors LLP, Elm House, 25 Elm Street, Ipswich, Suffolk IP1 2AD
- ▶ Telephone 07387 411402
- ▶ Fax 01245 295299
- ▶ www.prettys.co.uk
