

Avoiding common pitfalls when extending the term of a lease – Renew in haste, repent at leisure

In these uncertain times it is tempting to grab any offer by a tenant to remain in occupation of otherwise vacant space with both hands. However, a little thought as to the structure of the transaction at the outset can prevent future pain in trying to unravel an unintended consequence at a later date.

COVID-19 has created havoc with retail, office and leisure portfolios across the country. Lockdown reduced the requirement for these spaces and vacancy rates are rising. Tenants are falling behind in rent or becoming insolvent. A tenant calls you and offers to vary their current lease, extending the term by 12 months in return for a rent concession. They can't commit to more, but do want the security of a slightly longer term. This sounds too good to be true, so you instruct your solicitors to document the deal as quickly as possible. What could go wrong?

Surrender and re-grant

If your solicitors follow your instructions to the letter, the variation of the lease to increase the term will amount to a surrender of the tenant's existing lease and the grant of a new one on similar terms, save for its length. This may well have undesired consequences:

Security

Although the tenant's existing lease may have been granted outside of the security of tenure provisions of the Landlord and Tenant Act 1954, the process will not have been repeated for the new lease. The new tenancy will therefore gain security, which may not fit with your plans for the property.

Release of guarantor

If there is a guarantor in place for the current lease, they will have been released by the surrender and re-grant. Unless that guarantor enters into the deed of variation to guarantee the new lease, you will have lost this additional security.

Dilapidations

As you had not intended the surrender, you will not have intended to release the tenant from any liability for accrued dilapidations. However, the deed of variation will have "restarted the clock" on these. Depending on the length of the existing lease, this could be costly.

Key issues

- Vacancy rates in retail, office and leisure are rising and tenants are falling behind in rent or becoming insolvent.
- A variation of a lease to extend the term, amounting to a surrender of a tenant's existing lease and grant of a new one on similar terms, may have undesired consequences.
- A reversionary lease could achieve an extension of the status quo without wasting time on negotiating a whole new lease.
- Landlords should not allow their eagerness for income to prejudice their long-term plans for a property.

Rent review

Without express provision what will be the starting rent? Is there an outstanding review? This will be on the same terms as the first lease, with no uplift in the additional 12 months. Any uplift or review should be dealt with expressly in the document.

Reversionary lease by reference

If you decide that the offer of a variation would not be ideal, you may consider the most pragmatic way of documenting the deal is to have a new “reversionary lease” by reference to the existing one. The term of the reversionary lease will start at the end of the first lease. However, you should bear in mind that if the term starts more than 21 years after the date of the reversionary lease, this will usually be void for breaching statutory requirements. A reversionary lease could achieve an extension of the status quo without wasting time on negotiating a whole new lease. However, do consider the following points:

Age of lease

Bear in mind how long ago the existing lease was drafted. There may have been legislative changes which are not covered in the document, and these will be pulled through into the new lease. Examples include leases granted before 1996, which have a distinct assignment and sub-letting regime; no reference to the commercial rent arrears regime; incorrect or historic references to planning use classes; changes to the insolvency regime which serves as a trigger for forfeiture or re-entry; and possibly even no reference to VAT.

Differences in the demise or deal

Will the document be “fit for purpose”? There may be new terms which need to be incorporated into the lease? These may be so wordy as to make the use of a lease by reference pointless in terms of saving drafting and negotiating time. Any differences may be simple to incorporate, or may create ambiguity in the future. For example, what will the starting rent be and how will this be set if the figure isn’t available now? Will a rent review be required at the start of the term of the new lease? It might be clearer and simpler to set out all the mechanics in one document which doesn’t need to be read in conjunction with the existing lease.



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Rent deposits

Remember that any current rent deposit arrangement will not automatically continue under the reversionary lease. This needs to be catered for by varying the existing rent deposit deed or creating a new one relating to the reversionary lease.

Underleases

Will any existing underleases subsist? If undertenants would continue to have rights under the Landlord and Tenant Act 1954, how will this sit with any reversionary lease?

“Stapling” existing and reversionary lease together

Depending on the length of the remaining term of the existing lease, it may be sensible to bind the alienation provisions of the two together, so that one cannot be assigned (or even underlet) without the other. Whilst this requirement can be incorporated into the reversionary lease, to vary the existing lease would require a deed of variation.

Continuing occupation

Both of the scenarios above concern extensions of leases where there is time left to run on the existing lease. It may be that the tenant hasn’t been so forward-thinking, and the lease has already ended, but the tenant remains in occupation.

Whenever this is the case (and the first lease was not a protected lease under the Landlord and Tenant Act 1954) it is important to regularise the position as quickly as possible to prevent a tenant claiming any rights or security. The safest way to do so would be to issue a tenancy at will letter in order to formalise the basis of their occupation during the negotiation of the new lease.

Whilst this is being documented it is advisable to put a rent stop on the account, to avoid losing the right to forfeit. Whilst this would not be a landlord’s goal, it is a useful tool in promoting discussion.

Conclusion

The message is a simple one: landlords should not allow their eagerness for income to prejudice their long-term plans for a property.



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