

The purpose of this guide is to give a broad outline of the structure of retail leases in the UK, including brief details of the provisions which are usually contained in a retail lease and the reasons for those provisions.

BACKGROUND

A retail lease is a contract and, like any other contract, it sets out the terms which have been agreed between the parties. The subject matter of the contract is the premises being leased and virtually every lease will contain the same basic provisions – some leases will of course be longer than others.

There will also be variations, depending upon the type of property and the location of property. For example, a lease of a retail unit in a shopping centre will contain some different provisions to a lease of a unit on a high street or in an out of town retail park. This guide assumes that the lease we are dealing with is a lease of a typical unit in a high street.

THE MAIN PROVISIONS

Every retail lease will contain the following main provisions:

- premises – a description of what is included in the lease.
- term of the lease – how long does the lease run for?
- rent and rent review provisions.
- tenant covenants – the tenant's obligations under the lease.
- landlord covenants – the landlord's obligations under the lease.
- service charge/insurance provisions

We will consider each of these provisions in turn:

1. Premises

The lease will contain a detailed description of the premises. Why is this important?

The reason is that the lease will contain an obligation on the tenant to repair the premises. It is therefore of vital importance that the full extent of the premises is adequately described in the lease.

If only part of the building is included in the lease (for example, the retailer is taking a lease of the ground floor, and there are offices above which are not included) then the lease will invariably be a "non-structural demise". This

means that the area being demised will be described by reference to a plan (e.g. showing the extent of the shop unit edged red) but also the lease will describe what else is included as part of the premises – for example:

- the shop front; and
- the surface of the floor (including the screed) down to but excluding the structural support; and
- the ceiling and ceiling void and everything above the ceiling void (including any plant and machinery) up to but excluding the structural support for the floor above.

This detail is important because the tenant will be under an obligation to repair the premises and therefore the premises needs to be adequately described so that the tenant knows what it needs to do to comply with the lease terms.

If the whole of the building is included in the lease then the premises description will be much simpler and shorter – it will refer to the whole building and the tenant will then be liable to repair, maintain and insure the whole building.

2. Term

The term of the lease is simply the period of time that the tenant is committed to the lease. The term can vary – e.g. 5/10/15 years. Historically much longer terms were granted (e.g. 25 years) but the modern trend is for shorter terms.

The lease can either be "inside" or "outside" the provisions of the Landlord and Tenant Act 1954. If the lease is "inside" the 1954 Act, this means that the tenant will have an automatic right to a new lease at the end of the term. The landlord can oppose this right, but only on certain specific and quite narrow grounds – for example if the tenant has been in default under the lease or if the landlord wants the premises back in order to re-develop.

If the lease is "outside" the 1954 Act then the tenant has no right to a new lease at the end of the lease term and must vacate the premises if the landlord does not agree to a new lease. Most modern shopping centres have leases which are "outside" the 1954 Act because this gives the landlord maximum flexibility in terms of being able to manage the tenant mix/tenant profile within the centre.

Sometimes the lease will contain a break option, which will allow either the landlord or the tenant the right to break the lease at certain points during the term (e.g. on a 10 year Lease, a break option after year 5). The tenant's lawyer must be especially careful when negotiating the break option and should ensure that apart from the tenant paying the main rent up to date, there are no other conditions attached to the exercise of the break option. In this market, a landlord will invariably challenge a break notice and look for ways to defeat it.

3. Rent and review provisions

There are a number of different variations on the rent to be paid under the lease. The main ones are:

- open market rent
- turnover rent

In an open market rent lease, the rent agreed at the start of the lease will be the open market rent and that rent will then be reviewed every 5 years under the lease. Alternatively, the rent may be reviewed each year to reflect increases in the RPI (ie inflation) in the preceding year or after 5 years to reflect RPI increases for that 5 year period.

In a turnover rent lease, the tenant pays a basic rent (which is normally less than open market) but also pays a top up rent, called a "Turnover Rent" which is linked to the turnover derived by the tenant from the unit. The Turnover Rent is normally calculated by reference to a percentage of turnover, and can change depending upon turnover – e.g. Turnover Rent = 10% on turnover up to £1,000,000 and 12% on turnover over £1,000,000, less base rent.

4. Tenant covenants

Why are these needed?

The reason why the lease will contain a number of tenant covenants is to enable the landlord to exert control over what the tenant does in the premises, how the tenant conducts its business in the premises, and to whom the tenant may assign the lease. The following are the main tenant covenants:

(a) Payment of rent:

Rent is invariably payable quarterly in advance on the standard "quarter days", which are 25 December, 25 March, 24 June and 29 September in each year.

In addition, if the lease is only of part of the building, the tenant will be required to pay a contribution towards the cost incurred by the landlord in insuring and repairing the building (see below).

(b) Repair:

The tenant will be obliged to keep the premises in good repair and condition. It is of vital importance that the tenant arranges a full survey of the unit, so that any existing defects can be identified and excluded from the repair liability.

(c) Re-instatement:

The tenant will normally be obliged to remove all fixtures, fittings and alterations at the end of the term and return the premises to the landlord in a "shell" specification. This could be an onerous obligation and the tenant should therefore consider whether to water this down.

(d) Assignment:

The tenant will normally be allowed to assign, but only with the consent of the landlord. Sometimes there will be a bar on assignment for the first 2 or 3 years.

The lease will normally contain a number of tests which the incoming tenant must satisfy – e.g. the incoming tenant must

be of sufficient financial strength to be able to pay the lease rents and must have sufficient experience to operate the proposed user

The lease may contain offer back provisions, under which the tenant must offer the premises back to the landlord at the same premium as that which the incoming tenant has agreed to pay.

The tenant's lawyer must ensure that as far as possible these tests are watered down, so as to make it as easy as possible for the tenant to assign.

(e) User:

The main retail uses in the UK are set out in what is known as the Use Classes Order, and can be summarised as follows:

- Class A1 shops
- Class A2 financial/professional services (e.g. a bank)
- Class A3 restaurants and cafes (consumption on premises)
- Class A4 pubs and wine bars
- Class A5 take aways

In some high street locations (e.g. London's Regent Street/Carnaby Street/Marylebone High Street) where the landlord is a large property owner, the landlord will wish to exert a substantial degree of control over the use. This is especially important in a turnover rent scheme, where the landlord will wish to ensure that the various uses are complimentary, but not competing.

Therefore, those leases will normally contain a detailed description of the use permitted, but will normally allow the tenant to change the use to a use within Class A1/A2 or A3 (as the case may be), but only with the consent of the landlord and subject to various tests in the lease.

As in the case of assignment, the tenant's lawyer must ensure that as far as possible these tests are watered down, so as to make it as easy as possible for the tenant to change the use if it needs to – for example on any assignment.

(f) Alterations:

The Tenant will normally be permitted to carry out internal non-structural alterations, subject to obtaining the consent of the Landlord. Structural alterations will normally be prohibited.

5. Landlord covenants

These will not be as extensive as the tenant covenants. Where the tenant is only taking a lease of part of the building the main obligations which the landlord will undertake are:

- to insure the building and
- to repair and maintain the building and any common areas

6. Service charge/Insurance provisions

The lease will normally contain a list of services which the landlord agrees to provide – including repair, maintenance and decoration of the building etc. In a shopping centre lease the list of services is more detailed, and will include items such as security, provision of heating/air-conditioning, cleaning, landscaping etc.

In return, the tenant must pay the service charge. Normally this is collected quarterly in advance (with payment being made on the same quarter days as the rent), with a “top up” payment being made by the tenant at the end of the year, once the landlord produces a detailed account of exactly what it has spent.

The landlord will also insure the building against specified insured risks. In return, the tenant will pay a contribution towards the insurance premium, normally calculated by reference to the area of the premises.

Insurance is very important area for the tenant’s lawyer to focus on – in particular the issue of “uninsured risks”. Uninsured risks are risks which should normally be specified as insured risks, but where the risk has become so great that insurance is not available on reasonable terms in the UK insurance market. Terrorism is the obvious example. Unless the appropriate protections are built in to the lease by the tenant’s lawyer, the tenant could find itself severely exposed, which could have a material financial impact on the tenant and/or make the lease very difficult to assign to a third party.

7. The lease negotiation

Whilst the basic provisions in any retail lease, as outlined above, may be pretty much the same, leases will vary greatly in relation to the level of detail and how onerous those provisions may be for a tenant.

It is vitally important that a tenant is properly advised on those provisions, and that the lease is fully negotiated, so as to water down or delete any onerous provisions, so that the lease is as fair as possible to the tenant:

- To ensure that there is nothing in the lease which might result in the tenant having to pay an increased cost
- To ensure that there is nothing in the lease which might have a practical impact on the way the tenant runs its business
- To ensure that there is nothing in the lease which might affect the value of the lease if the Tenant wished to assign it

SUMMARY

We hope you find the above a useful and practical summary of the basic retail lease structure. If you require any further information please contact:

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