

Code of conduct

Two years on, Linda Hayllar reviews the Code for Leasing Business Premises



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It may seem but a dim and distant memory, but not so long ago the economy was thriving, business occupancy was strong, rents marched inexorably upwards and there was a perception that landlords were presenting an attitude of 'take it or leave it' to tenants. It was against this backdrop that the government conceived an objective of achieving a better 'balance of fairness' between the interests of landlords and tenants, and in particular to improve the position of tenants in negotiations. The government expressed a desire for the property industry to level the playing field itself, with the threat of legislation if self regulation were not sufficient. The Code for Leasing Business Premises in England and Wales 2007 was subsequently developed and adopted by the industry in an attempt to stave off the government's threat of intervention.

There were two earlier versions of the Code, but these had a minimal effect on the property industry. Two years on, the impact of the Code is currently the subject of a study by the University of Reading and the results are expected later this year. Anecdotal evidence would suggest, however, that the Code is being far more widely implemented than its predecessors. The commercial property market is of course now in a very different position to what it was when the Code was introduced, and arguably the market has done far more to improve tenants' negotiating stance than any voluntary code could ever hope to achieve. Indeed, while the aim of the Code was to avoid the imbalances that can arise as a result of market conditions there are some landlords who would claim that it is they that now need protection

from tenants holding all the negotiating cards!

So what are the main points of the 2007 Code and the issues arising from it?

Heads of terms

The Code contains model heads of terms which it is suggested are adopted at the outset of a transaction. The model heads of terms are extremely detailed, with the intention that any potential issues with the letting are brought to the fore at the outset of the transaction. However, their detail (and perhaps length) means that they are not user-friendly, and anecdotal evidence suggests that these model terms are not widely used, even by landlords who purport to have embraced the Code.

Flexibility

The Code envisages landlords offering a menu of lease terms to tenants, with rents priced accordingly. Such a pricing mechanism is, however, perhaps rather more sophisticated than required by either landlord or tenant in the marketplace. The chief determining factors for a tenant when choosing premises tend to remain location, whether the premises are physically appropriate, and the level of rent.

Break clauses

If a lease contains a tenant's break right, the Code states that the only pre-conditions to a tenant exercising that right should be that the basic rent is paid up to date, the tenant gives up occupation of the premises, and that there are no continuing sub-leases. This simplification of the tenant's ability to exercise its break right is intended to avoid tenants being caught out on a

minor technicality and being held to have not validly exercised their break right. The intention is that disputes about the state of the premises, or what is being removed or left behind, should be settled after the break right has been exercised. A breach of covenant by the tenant should not prevent the break clause being exercised, as either party may still claim damages from the other for any antecedent breach.

Assignments

The Code's provisions for authorised guarantee agreements (AGAs) are potentially an issue for landlords in times like these when tenant failure is becoming commonplace. The Code recommends that an AGA should not be required as a condition of an assignment unless the assignee is of 'lower financial standing' than the assignor or the assignee is resident or registered overseas. 'Lower financial standing' is not defined. As a result of the Code, and also the High Court's decision in *Wallis Fashion Group v CGU Life Assurance Ltd* (in the context of lease renewals), it has become a standard tenant amendment that a landlord should only be able to require an AGA 'where reasonable'. The absence of an AGA potentially reduces a landlord's options in the event of tenant failure.

Sub-letting

If sub-letting is permitted, the Code states that sub-lease rent should be the market rent at the time of the sub-letting. This simply reflects what has become market practice in any event, following the 2005 British Property Federation declaration of intention to end the practice of requiring a sub-lease's rent to be the higher of the passing rent and the current market rent. The Code goes on to state that sub-leases which are excluded from the security of tenure provisions of the Landlord and Tenant Act 1954 should not have to be on the same terms as the tenant's lease. While at first glance this seems uncontroversial, it potentially creates a problem for a landlord where its head tenant becomes insolvent and it inherits the sub-lessee.

Repairs

The Code states that a tenant's repairing obligation should be appropriate

to the length of the term and the condition of the premises at the start of the lease. The intention is to negate a presumption of the tenant accepting a full repairing covenant. The Code encourages the use of photographic schedules of condition.

Alterations

The Code recommends a landlord's control over alterations, and changes of use should not be any more restrictive than is necessary to protect the value of the landlord's reversion and any neighbouring property. The Code indicates that landlord's consent should not be required for internal non-structural alterations, unless these alterations could affect services or systems in the building. Instead the tenant should simply

notify the landlord of any internal non-structural alterations carried out. Furthermore, reinstatement of any alterations at the end of the term should only be required 'where reasonable'. The Code requires the landlord to notify the tenant of its requirements for reinstatement at least six months before the end of the term. Even more prescriptive is the proposal that the landlord is required to give consent to alterations within a 'reasonable time period' – 21 days is suggested as reasonable in this context.

Insurance

If premises are damaged by an uninsured risk, the Code provides that the rent suspension should apply unless the damage was caused by a deliberate act of the tenant. If the premises are damaged so as to prevent occupation, the Code envisages that the tenant should be able to terminate the lease unless the landlord agrees to rebuild at its own cost, and a rent suspension

applies. The landlord is therefore effectively required to operate the rent suspension and bear the loss of rent and the cost of rebuilding itself.

The intention of the Code is that it should be adopted by landlords in its entirety, ie landlords who have subscribed to the Code should issue 'Code Compliant Leases'.

It will be interesting to see, when the results of the Reading University study are published, how many landlords have, in fact, adopted the Code in full. In practice, we are seeing that more and more landlords are willing to adopt at least some of the Code's principles. Initially this may have been due to concerns that the government would resort to legislation if landlords were not seen to be levelling the playing

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field voluntarily. Latterly compliance has been born of necessity, as tenants have become increasingly bullish as occupancy levels have fallen. In the current market, especially given the new burden of empty rates liability, ensuring that premises are let is a landlord's number-one priority. Having empty space is arguably more harmful to investment value than whether or not the terms of a lease are Code-compliant.

The government's goal of achieving fairness in negotiations between landlord and tenant appears to be being achieved, although arguably market conditions share the credit for this. However, if the Code leads to more productive negotiations and swifter conclusions of transactions this should be embraced as a benefit to both landlord and tenant alike. ■

*Wallis Fashion Group v
CGU Life Assurance Ltd
[2000] 2 EGLR 49*