

- Part II of our review of the Code of Practice for Commercial Leases
- Understanding Underletting

Welcome to this Winter edition of our topical bulletin focusing on Commercial Property matters. Last year was a truly busy year for the Commercial Property department and we look forward to more of the same for 2006.

Congratulations go to Alison Lauder, who was promoted to partner in July. Alison is a lively member of the department who specialises in property work for the firm's major retail clients. I am also delighted to welcome back Jacqueline Simmonds from maternity leave.

Finally, one of our home-grown trainee solicitors qualified and joined the department in September. Simon Wade has a degree in politics from Reading University and has recently played cricket for his local club in Barbados. He is currently enjoying a wide range of property work including landlord and tenant matters.

The Partners and staff wish you all a prosperous year for 2006.

Angela Thomas

Head of Department

## Code of Practice for Commercial Leases (Part II)

Following my previous article, I conclude by summarising the University of Reading's final report on the operation of the Code in practice.

### Market Changes

There is certainly increased awareness of the Code amongst institutional landlords and professional advisors.

The average length of a lease term continues to fall and tenant break clauses are increasingly common. Tenants are negotiating diluted repair covenants, for example, by including a schedule of condition. Rent reviews are less frequent, mainly due to the shorter leases. However, is this actually attributable to the Code or changing market conditions?

It's not all good news. Rarely will a landlord offer a choice of lease terms. Restrictions governing assignments and sublettings remain subject to lengthy pre-conditions and there is concern that tenants, particularly small businesses, are unaware of the Code.

### Upwards Only Rent Reviews ("UORR")

UORR remain virtually universal. Landlords do not offer alternatives and tenants rarely request them. UORR are entrenched in the market and there is no evidence to suggest any change. The Code has had very little effect in creating fairer rent review terms and the government has decided against banning or restricting UORR for now.

### Help is at hand

The government is intent on improving the tenant's position and is to review market practices with the option to legislate if necessary. The government is particularly concerned that many small businesses fail to obtain appropriate advice when negotiating leases. Don't be one of them



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# Understanding Underletting

Restrictions on underletting in commercial leases are a very real source of dispute. Whilst landlords are keen to impose restrictions on a tenant's ability to underlet, tenants often require flexibility, enabling them to underlet with ease should the need arise.

Most modern leases impose various restrictions on a tenant's ability to underlet including circumstances in which underlettings may be prohibited, along with terms to be incorporated into the sublease itself. The government is concerned over this inflexibility and has hinted at legislation in the future.

Such legislation is likely to be based on The Code of Practice for Commercial Leases which recommends that the only restriction on underletting should be obtaining the prior consent of the landlord, which may not be unreasonably withheld.

## When can a Landlord withhold consent?

A recent case sheds fresh light on this issue. The Court held there is no objective standard of what is reasonable, rather it will depend upon individual circumstances.

Of particular note, landlords are entitled to withhold consent where there are concerns over a sub-

tenant's financial strength, but only if the concern is genuine. Confusingly though, the landlord does not need to show the concern to be factually accurate or justifiable. This may be detrimental to tenants.

## Head Lease Rent v Market Rent

Leases commonly prohibit underletting at a rent less than that in the headlease as landlords are fearful that this may prejudice future rent reviews. This makes it difficult to attract subtenants where the current market rent is lower than the headlease rent as prospective subtenants will not want to pay rent above the market rate.

Importantly, the Court in the same case also held that a tenant paying a reverse premium to a subtenant did not breach a restriction in the lease prohibiting underletting at less than the passing rent.

This may be of particular importance to retail tenants who often need to vacate premises in reaction to changing circumstances. The ability to attract subtenants is of huge significance as it enables them to mitigate losses incurred as a result of paying rent on vacant premises.

## Going forward?

The British Property Federation

recently issued a statement from twenty of the UK's most prominent landlords who pledged:-

- New leases will contain no restriction on subletting under the passing rent.
- They will waive such a restriction in existing leases.

Taken in conjunction with the decision in recent case this is a promising trend for tenants.

## Don't get caught out

Underletting has important implications both for landlords and tenants and is an issue to be considered carefully before entering into a Lease. Tenants should press for less onerous restrictions on subletting and in particular regarding any prohibitions on subletting below the passing rent. Equally, landlords should be aware of recent trends in order to deal with requests to sublet efficiently and reasonably.



*If you need any further information about subletting, please contact Simon Wade on 01582 731161 or email [simon.wade@taylorwalton.co.uk](mailto:simon.wade@taylorwalton.co.uk)*

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