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## **The leaf turns again but has it now gained teeth - the new code for leasing business premises?**

The current Code for Leasing Business Premises in England and Wales was published in 2007.<sup>1</sup> Like its two predecessors its purpose is to guide landlords towards an approach of fairness and best practice as regards their negotiations with tenants on new commercial lease terms. Like its predecessors it safe to say that it has also been a failure. The difficulty which the Code, throughout its various editions, has faced is that it is entirely voluntary so it has not had much, if any, take up in the market. It is now to be replaced by a new Code for Leasing Business Premises which was published by the Royal Institute for Chartered Surveyors on 12th February 2020 and which is to take effect from 1st September 2020. The new Code can be viewed on the RICS website.<sup>2</sup>

The new Code will take effect as an RICS Professional Statement. So, whilst it is similar in content and form to the 2007 Code it is replacing, unlike that Code, compliance with the new Code will be mandatory for RICS members and RICS regulated firms. Could this now mean that the new Code will not be the failure that has been the hallmark of previous versions?

### **Background**

Before looking at the key provisions of the new Code, it is perhaps worth considering the history leading up to it.

The first edition of the Code, entitled the ‘Code of Practice for Commercial Leases in England and Wales’, was published in 1995 as a voluntary agreement between professional and industry bodies.<sup>3</sup> Its aim was to ensure that parties involved in commercial lease negotiations, particularly smaller tenants, were properly informed of the obligations being undertaken. The Code followed a call by the Government to negotiate a Code of Practice on business leases to deal with upward only rent reviews, confidentiality clauses in leases and dispute resolution procedures. The then Government had decided that it would not be appropriate to legislate on these matters and instead asked the industry to ensure that business tenants were better informed about their rights and obligations and to commit itself to openness in lease negotiations. The Code was supported by the Government as an initiative by the property industry to regulate itself and address concerns over a perceived inflexibility in commercial lease terms. The Government agreed to monitor the effect of the 1995 Code but threatened to introduce legislation if the 1995 Code did not have the desired effect.

After it became apparent that the 1995 Code did not have any marked impact, the Government once again threatened legislation.<sup>4</sup> Particular concerns were raised at the requirement in leases for upwards-only rent reviews. A working party of representatives from all sides of the property

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<sup>1</sup> The Code for Leasing Business Premises in England and Wales 2007 is available at <https://www.bpf.org.uk/sites/default/files/resources/The%20Code%20for%20Leasing%20Business%20Premises%20in%20England%20and%20Wales%202007%20%E2%80%93%20full%20suite%20of%20documents.pdf> [Accessed 29 February 2020].

<sup>2</sup> See <https://www.rics.org/uk/upholding-professional-standards/sector-standards/real-estate/code-for-leasing-business-premises-1st-edition> [Accessed 29 February 2020].

<sup>3</sup> See J.E. Adams, “A new leaf turns? The code of practice on commercial leases” [1996] Conv. 9-11 for a discussion of the 1995 Code.

<sup>4</sup> The failure of the 1995 Code was discussed by J.E. Adams, “Failure of Commercial Leases Code?” [2000] Conv. 372-375.

industry agreed in autumn 2001 on revisions to the 1995 Code that would address these concerns and the second edition of the Code was published in April 2002.<sup>5</sup>

The Government subsequently commissioned a review of the impact of the 2002 Code and in April 2004 Reading University published its interim report on the effect the 2002 Code was having.<sup>6</sup> At the same time, the Government announced that it would consult on options to make the commercial leases market fairer and more flexible. A consultation paper was published in 2004, which outlined options for legislating to ban upward only rent review provisions in leases.<sup>7</sup>

In March 2005, the Government published Reading University's final report.<sup>8</sup> This concluded that the 2002 Code had made a greater impact than its predecessor in that it had been more widely disseminated. However, even where it was known about, the 2002 Code was having little direct impact on individual lease negotiations. The Government announced that, whilst still concerned about flexible terms, and whilst not ruling out the possibility of future legislation, it had no immediate intention to legislate. Instead it said that it would review the law of assignment and subletting and would monitor the 2002 Code, renewing its efforts to disseminate the Code and provide an effective mechanism for dealing with complaints.

The Reading report eventually led to the publication of the third edition of the Code under the new name of the Code for Leasing Business Premises in England and Wales 2007. The 2007 Code comprises a primary document, the Landlord Code, and two supporting documents, the Occupiers' Guide and the Model Heads of Terms, which contain recommendations that come into play at different stages in the relationship between the landlord and tenant.

In January 2009, the government commissioned the first part of a two-part research project to assess the dissemination, awareness and use of the 2007 Code and in July 2009 the then Department for Communities and Local Government<sup>9</sup> published a report on the findings of the first stage of the research.<sup>10</sup> This concluded that awareness and advice on the 2007 Code was limited and that it played only a minor role, if it played any role at all, in lease negotiations. The second phase of the research, which was expected to look at more substantive issues, such as the impact of the 2007 Code on leasing patterns against the background of trends in the property market, appears to have never taken place.

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<sup>5</sup> See J.E. Adams, "Code of Practice for Commercial Leases revised – and revived?" [2002] Conv. 439-442 for a discussion of the 2002 Code.

<sup>6</sup> <http://www.reading.ac.uk/LM/LM/interimrept.pdf> [Accessed 29 February 2020].

<sup>7</sup> See *Commercial property leases: options for deterring or outlawing the use of upward only rent review clauses* Consultation paper issued by the Office of the Deputy Prime Minister and the Welsh Assembly Government. The report is available in archive form at <https://webarchive.nationalarchives.gov.uk/20120919173446/http://www.communities.gov.uk/documents/regeneration/pdf/131330.pdf> [Accessed 29 February 2020].

<sup>8</sup> See *Monitoring the 2002 Code of Practice for Commercial Leases*, Reading University Report, February 2005 (ODPM). The report is available in archive form at [http://web.archive.org/web/20070205131116/http://www.communities.gov.uk/pub/260/Monitoringthe2002codeofpracticeforcommercialleasesPDF1537Kb\\_id1128260.pdf](http://web.archive.org/web/20070205131116/http://www.communities.gov.uk/pub/260/Monitoringthe2002codeofpracticeforcommercialleasesPDF1537Kb_id1128260.pdf) [Accessed 29 February 2020].

<sup>9</sup> Now the Ministry of Housing, Communities and Local Government.

<sup>10</sup> See *Monitoring the 2007 Code for Leasing Business Premises*, Reading University Report, February 2005 (DCLG). The report is only available in archive form at <https://webarchive.nationalarchives.gov.uk/20120919221158/http://www.communities.gov.uk/documents/regeneration/pdf/1273120.pdf> [Accessed 29 February 2020].

Meanwhile more direct action was happening across the Irish Sea. A ban on upwards only rent reviews in commercial leases, one of the concerns the Code was supposed to deal with, was introduced in the Republic of Ireland on 28 February 2010.<sup>11</sup> The ban means that any rent review provision in a lease after that date will be deemed to provide that the rent payable following a rent review can be an amount lower than, higher than, or equal to, the rent payable immediately prior to the rent review date.

On 13 December 2011, the then Department for Business, Innovation and Skills<sup>12</sup> published a report setting out recommendations for improving the state of high streets and town centres following an independent review by Mary Portas.<sup>13</sup> The report urged landlords to sign up to the 2007 Code and for more to be done to raise awareness of it. The government subsequently published a response in which it confirmed that it had written to local authorities encouraging them to adopt the 2007 Code as well as to industry players encouraging them to promote the 2007 Code.<sup>14</sup>

The saga continued with the publication by RICS in 2018 of a consultation on a new professional statement to replace the 2007 Code<sup>15</sup> which led to the publication in February 2020 of the 2020 Code.

## **2020 Code**

The objectives of the 2020 Code are stated as improving the quality and fairness of negotiations on lease terms and promoting the use of comprehensive heads of terms to make the legal drafting process more efficient.

The Code will apply to the majority of business premises let for a period of more than six months with the exception of agricultural lettings, premises that will only be used for housing plant and equipment (such as electricity transformers or telecoms) or advertising media (such as hoardings), or premises that are intended to be wholly sublet by the tenant.

## **Mandatory requirements**

The Code sets out the following requirements for RICS members when entering into a lease of business premises:

- Lease negotiations must be approached in a constructive and collaborative manner.
- Any party not represented by an RICS member or other property professional must be advised by the other party or its agents of the existence of the Code and its supplemental guide and must be recommended to obtain professional advice.

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<sup>11</sup> Section 132, Land and Conveyancing Law Reform Act 2009.

<sup>12</sup> Now the Department for Business, Energy & Industrial Strategy.

<sup>13</sup> See *The Portas Review: an independent review into the future of our high streets*, Mary Portas, December 2011 which is available at <https://www.gov.uk/government/publications/the-portas-review-the-future-of-our-high-streets> [Accessed 29 February 2020].

<sup>14</sup> See *High streets at the heart of our communities: government response to the Mary Portas review* which is available at <https://www.gov.uk/government/publications/high-streets-at-the-heart-of-our-communities-government-response-to-the-mary-portas-review> [Accessed 29 February 2020].

<sup>15</sup> Available only to registered users at <https://consultations.rics.org> [Accessed 29 February 2020].

- The agreement as to the terms of the lease on a vacant possession letting must be recorded in writing, stating that it is ‘subject to contract’ and summarising, as a minimum, the position on each of the following aspects:
  - the identity and extent of the premises (and requiring the landlord to arrange the provision of a Land Registry-compliant plan if the lease is registerable);
  - any special rights to be granted, such as parking or telecom/data access;
  - the length of term and whether the Landlord and Tenant Act 1954 will apply or be excluded;
  - any options for renewal or break rights;
  - any requirements for a guarantor and/or rent deposit;
  - the amount of rent, frequency of payment and whether exclusive of business rates;
  - whether the landlord intends to charge VAT on the rent;
  - any rent-free period or other incentive;
  - any rent reviews including frequency and basis of review;
  - liability to pay service charge and/or insurance premiums;
  - rights to assign, sublet, charge or share the premises;
  - repairing obligations;
  - the initial permitted use and whether any changes of use will be allowed;
  - rights to make alterations and any particular reinstatement obligations;
  - any initial alterations or fit-out (if known); and
  - any conditions of the letting, such as subject to surveys, board approvals or planning permission.

The mandatory requirements will also apply to lease renewals and lease extensions except for any terms that are stated to follow the tenant’s existing lease subject to reasonable modernisation.

Negotiations should aim to produce letting terms that achieve a fair balance between the parties having regard to their respective commercial interests.

The landlord, or its letting agent where relevant, will be responsible for ensuring that heads of terms complying with the above provisions are in place before the initial draft lease is circulated.

An optional template heads of terms is set out as an appendix to the Code together with a checklist against which non template heads of terms may be checked.

The remaining provisions of the Code, set out in Part 3, are not mandatory but, instead, indicate best practice for lease negotiations and set out and include matters to consider when negotiating heads of terms and the lease itself.

### **Best Practice**

Some of the key points<sup>16</sup> of “best practice” set out in Part 3 of the Code are:

- The identity of the premises should be clearly defined, a lease plan should be provided and the tenant should be granted all necessary rights for the intended use of the premises (such as car parking and where necessary rights to run data cabling).

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<sup>16</sup> See Part 3 of the Code for full details of the best practice.

- The length of term, any break provisions and options for renewal should be clearly stated. Where relevant, the tenant should be notified at the outset to take professional advice as to the implications of excluding the Landlord and Tenant Act 1954. Unless the parties have agreed stricter terms in the heads of terms, any tenant's break should be conditional only on vacant possession and the payment of basic rent up to the break date and any advance payments of rent, service charge or insurance rent for the period after the break takes effect should be repaid to the tenant.
- Rent deposit provisions should state whether the deposit is security for the rent, or all of the tenant's obligations under the lease and should set out the circumstances in which the deposit will be returned to the tenant with any interest accrued. Rent deposit agreements should provide that landlords will hold rent deposit funds in bank accounts designated for holding only rent deposits and that any bank interest will accrue for the tenant. Landlords and managing agents should refer to the current edition of the RICS professional statement on client money protection for further information on the steps that should be taken when handling deposit funds.<sup>17</sup>
- The initial rent, the frequency of payment and whether the landlord intends to charge VAT on the rent should all be clearly stated, together with details of any rent-free period or other incentive. Leases should allow either party to start the rent review process. Tenants should be made aware of the method or formula for review where appropriate to allow time to take professional advice and the review should not result in a “headline rent”. If a review is index linked the formula for review should not be designed to give a disproportionate increase outside of any agreed cap or collars.
- Landlords should indicate the range of main services, if any, and provide proper estimates of service charges and insurance payments. They should disclose known irregular events that may have a significant impact on the amount of future service charge. The parties should have regard to the provisions of the RICS professional statement *Service Charges in Commercial Property*.<sup>18</sup>
- Leases should allow tenants to assign the whole of the premises with the landlord’s consent, which is not to be unreasonably withheld or delayed. Landlords may set out circumstances in which consent can be refused, such as where there are arrears of rents, service charges or insurance premiums that are not the subject of a legitimate dispute, or where the assignee has insufficient financial strength, but all such circumstances should be reasonable and appropriate. Leases should also provide that, if in each case the landlord reasonably requires, the assignor is to provide an authorised guarantee agreement, any existing guarantor is to guarantee that the assignor complies with the AGA, and/or the assignee is to procure a new guarantor and/or rent deposit.
- Leases should allow tenants to sublet the whole of the premises and may allow subleases of parts, if appropriate without security of tenure, and in each case with the landlord’s consent, which is not to be unreasonably withheld or delayed and at rents not less than market rent. Subleases should be required to be on terms consistent with the tenant’s own lease, except that subleases which are to be excluded from statutory renewal rights and subleases of only part of the premises may be granted on different terms where appropriate.
- Leases should allow tenants to grant a bank or other reputable lending institution a charge over the lease, without the landlord’s consent needing to be obtained unless the lease is to

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<sup>17</sup> The current edition is available at <https://www.rics.org/uk/upholding-professional-standards/standards-of-conduct/client-money/client-money-handling-1st-edition> [Accessed 29 February 2020].

<sup>18</sup> The current edition is available at <https://www.rics.org/uk/upholding-professional-standards/sector-standards/real-estate/service-charges-in-commercial-property-1st-edition> [Accessed 29 February 2020].

contain step-in rights for lenders if the landlord intends to take action where the tenant defaults.

- Repairing obligations should be appropriate to the length of the lease and the condition of the premises. If the tenant's repairing obligations are to be limited to the initial condition of the premises, a schedule of condition will usually be required and the parties should agree which party is responsible for its cost. Where the premises are or will be newly built, a tenant taking on direct or indirect responsibility for repairs should be given suitable protection against inherent construction defects for an appropriate period.
- Controls on alterations and change of use should be no more restrictive than are necessary to protect the value of the premises and any adjoining or neighbouring premises of the landlord. Where reinstatement of alterations is required this should be stated in the heads of terms.
- In a lease of whole, a landlord should not normally prohibit, or require its consent to be obtained for, internal non-structural alterations that do not adversely affect the character, value, structural stability, statutory compliance or energy efficiency performance of the building, but landlords will require the tenant to carry out such works properly and without causing damage or nuisance and to give written details to the landlord.
- In a lease of a unit in a multi-let building, a landlord may require that its consent for internal non-structural alterations is to be obtained and that such consent is not to be unreasonably withheld or delayed, and may prohibit any alterations that adversely affect the character, value, structural stability, statutory compliance or energy efficiency performance of the building or its building services.
- Where the landlord insures, the lease should provide that the policy will be on normal market terms, full terrorism cover should be provided where it is available on reasonable terms and the lease should make adequate provision for damage caused by both insured and uninsured risks.
- Provision should be made in leases of part of multi-let buildings to encourage co-operation between the parties to a lease to improve operational efficiencies and share available data. This may include "green" provisions such as those set out in the Building Better Partnership Green Lease Toolkit.<sup>19</sup>
- Leases should state which party is responsible for obtaining any EPC that may be needed during the lease term and the landlord should be required to act reasonably if it reserves the right to choose the EPC assessor that the tenant is to use.
- Where the landlord's title is subject to enforceable covenants that prevent the landlord from complying with the Code, the landlord should comply with the terms of those covenants but, if challenged, should explain the position to the tenant.

## **Informatives**

Part 4 of the Code includes Appendix A comprising the template heads of terms and checklist mentioned above and Appendix B which is a non-mandatory supplemental guide for landlords and tenants including a checklist of occupancy costs intended to assist occupiers particularly those that may not be familiar with standard lease terms and terminology.

## **The future**

Whilst it is recognised that there may be exceptional circumstances in which it is appropriate to depart from the Code, RICS members that do so may be required to justify their decisions

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<sup>19</sup> See <http://www.betterbuildingspartnership.co.uk/green-lease-toolkit> [Accessed 29 February 2020].

and actions. Could it therefore be that, in time, tenants will look to the provisions of Part 3 as standard terms for commercial lettings? Or like the previous versions of the Code will it be another failure and in the words of a previous Precedents Editor “pass into decline in a year or so”?<sup>20</sup> Only time will tell.

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<sup>20</sup> J.E. Adams, “Failure of Commercial Leases Code?” [2000] Conv. 372-375.