

# JOELSON WILSON

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## CONCESSIONS TO COMMERCIAL TENANTS



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## **CONCESSIONS TO COMMERCIAL TENANTS**

The present climate in the world of commercial property could hardly be better for business tenants negotiating terms for new leases. Landlords are prepared to make concessions unheard of in more affluent times.

The Code of Practice on Commercial Leases, issued by the Royal Institution of Chartered Surveyors, has been with us for several years, but in 2007 the British Property Federation (BPF), comprising the biggest companies in the property industry - property developers and owners, institutions, fund managers, investment banks and professional organisations working and advising in the commercial property sector - launched the third edition of its Commercial Lease Code. This urges its members to play fair in their negotiations with tenants and, although voluntary, the code began to change the mindset of those who control the majority of commercial premises in the UK.

An early battle raged in 2008 over monthly rental payments. Retailers of all types had traditionally preferred, for cash-flow reasons, to pay rent monthly rather than be met with large quarterly bills. The British Retail Consortium (BRC), with Sir Philip Green in the van, led a fight for quarterly rents to be relaxed, but were initially resisted by the BPF and landlords generally. Large property companies did not want the additional administrative burden of collecting rents every month instead of every three. Gradually however more and more tenants individually negotiated this concession, which landlords usually agreed only on a temporary basis, by side letters personal to the current tenant.

Once the country began to struggle through a period of recession, letting negotiations became ever more favourable to the business tenant, as landlords realised that their tenants could demonstrate that they could no longer afford high rents and had a wider choice of alternative premises. Concessions introduced included:-

- Break clauses – on lease renewals and new lettings, even where the term agreed was as short as 5 years, tenants could ask for break options at various intervals, even rolling breaks, without incurring penalties.

- Rent-free periods – these were traditionally meant as compensation to tenants for the cost of fitting out premises, only occasionally as inducements. They have now become commonplace, even on lease renewals which do not involve the tenant in fitting-out works, and also are conceded in situations where a tenant does not exercise a break option.
- Allowances – landlords are offering inducements, such as allowances for carpets or other initial installations.
- Service charge caps – landlords are agreeing to limit service charges to a certain rate per square foot, albeit that rate is often indexed annually. This is happening despite the fact that existing tenants in a building may not have the same benefit; the landlord picks up the tab for the difference.
- Dilapidations caps – at the end of a term tenants are usually presented with substantial claims for dilapidations for which they may not have budgeted, for one reason or another. To overcome this problem, tenants are asking for dilapidations claims to be capped.

Mention of indexation tends to imply a steady increase, but the Retail Prices Index can of course go down, as it did between September 2008 (218.4) and March 2009 (211.3).

The most recent form of concession being offered is on rent reviews. Large property companies are prepared to bind themselves to having the review figures indexed, so that there is effectively a cap on rental increases. This must have a significant effect on future investment values, but the rationale may be that the comfort of having a tenant on board for more than five years is worth the pain of capping future increases at review.

One is tempted to think that a factor in agreeing this is avoiding the cost of rent review negotiations or arbitrations, but the actual market rent will still have to be assessed, even if it is limited by the cap. Across the industry however, such caps, if widely used, must have a built-in effect of moderating market values generally.

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On the other hand, where normal market rental value reviews occur, there could be the opposite effect because of the tenant-friendly concessions currently being built into leases – if such leases are long enough to be subject to rent reviews.

**Need to know more?**

**Ask us. For information/advice on property issues, please contact:**

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