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Practical And Professional Commercial Property Comment
From The Culshaw Partnership

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Lease Re-gearing

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A side effect of the economic recovery is the increasing number of leases being "re-geared". Legally a re-gear means that the terms of an existing lease are restructured or varied by mutual agreement. The current commercial impetus for lease re-gearing is unsurprising: leases negotiated and put in place in less certain economic times may need to be adapted to better fit a healthier business or a change in occupational needs.

For example, a tenant may have no intention of exercising a break option that it negotiated when business was less robust. An astute tenant can capitalise on this by agreeing to relinquish its break option in return for some concession on the landlords part - typically a rent suspension. From a landlord's prospective, this may be an opportunity to secure its rental income and increase the capital value of its investment. The re-gear therefore represents a "win-win" outcome for both parties. Some variations - for example, to increase the duration of the lease or the extent of the demise will result in a deemed surrender and re-gear of the lease, which may not be an intended consequence of the variation.

Other variations - for example, removing a break option - will be less legally significant.

However, in all cases the reach of the taxman is long and it may result in unexpected consequences for unwary landlords and tenants.

SDLT

Most landlords and tenants will be aware of the SDLT implications that may arise from some common variations:

*****A variation to increase the rent in the first five years of the term is treated as if it were the grant of a new lease in consideration of the additional rent. SDLT is payable by reference to the increase in rent.

*****A variation that will result in a deemed surrender and re-grant of the lease (such as an extension to the length of the tenancy or an increase in the demised area) will also be treated for SDLT purposes as if it were the grant of a new lease. As with any other lease, SDLT will be payable in respect of the deemed new lease subject to the availability of "overlap" relief. This is one reason why tenants may want to take steps to mitigate the SDLT implications, for example, by taking a supplementary lease rather than increasing the demise, particularly if the original lease was subject to stamp duty. The landlord should not suffer SDLT in respect of the surrender itself, which is in effect disregarded for SDLT purposes on a surrender and re-grant provided that the parties remain the same (and that the landlord gives no consideration other than the re-grant).

*****Where the tenant gives money or money's worth for a variation (other than an increase in the rent or a variation to the term), the variation is treated as an acquisition of a chargeable interest by the tenant and SDLT must be paid on the consideration. Consideration given by the tenant for a reduction in rent is also chargeable to SDLT, although HMRC states that it ignores a party relinquishing a right under a lease (such as a tenant's break option) for these purposes.

VAT

The VAT consequences of a lease variation are also worth considering. If either party has opted to tax the property for VAT purposes then VAT will need to be charged on any supplies treated as made by that party. Often, however, the parties do not appreciate that there has in fact been a supply.

Direct Tax

The direct tax treatment of re-gears can vary dramati-

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Business Rates Appeal Reform

On the 30th October 2015 another consultation paper appeared from the government on reforming business rate appeals.
Paul Easton, National Head of Business Rates at Lambert Smith Hampton reviews the latest consultation.
" The Government has asked for views from stakeholders, including ratepayers, local councils and others by 4th January 2016, with a view to all the new changes being in force for the next business rates revaluation on 1st April 2017.
While the thrust of this latest paper is to simplify the procedure and to have a check, challenge and appeal system, the latest proposals appear substantially convoluted and loaded against the ratepayer.
One of the main issues ratepayers have is that they don't know how the Valuation Office Agency (VOA) arrives at its rateable values.
In most cases, you can see the valuation on the VOA website but this does not show what rental evidence the VOA has used to arrive at a rateable value. The VOA steadfastly refuses to show its workings, rental evidence and analysis at any early stage, hiding behind the Commissioner for Revenue and Customs Act 2005.
Uniquely, this is the only form of taxation in England where it is not made clear how the tax base (rateable value) has been calculated. As such, many of the appeals under the current system are made just to flush this information out from the VOA - a hugely wasteful and confusing process. The latest proposals will not improve things. The onus on the ratepayer to say why their rateable value is wrong will be set at a much higher level under the proposed system and is heavily biased towards the VOA. If the VOA provided the information on how it arrived at a rateable in the first place, then a ratepayer could decide whether to challenge it or not, thereby reducing the number of challenges and appeals that the VOA receives.
The proposals also include charging to make an appeal.
This is a first and is unlikely to receive support, especially from smaller and un-represented ratepayers, even if the appeal fee is refundable if successful. It is not an alternative to any professional fee incurred in the challenge.
While the Department of Communities and Local Government (DCLG) will likely receive a large number of responses to its consultation paper, the most important question is will it listen?
On business rates, there has been a history of reaching out to ratepayers and external parties, receiving feedback and then filing the responses with absolutely no resulting tangible action or change."

Commercial News Media - 13th November 2015

C.P. Comment:

Unfortunately one has to be sceptical as to whether the consultation will in the end be anything more than a box-ticking exercise, the results of which will be ignored.
If they do make a mandatory charge for making appeals, the number of appeals will plummet and as a result overtime the rating list will become increasingly inaccurate.
Justin Fowler

Lease Re-gearing (Cont)

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cally depending on the nature of the lease, the nature of the variation and the characteristics of the tax payer. The applicable tax treatment may be affected by a number of overlapping rules. Payments made for a lease variation can be subject to a wide range of tax outcomes. Non-monetary aspects of the transaction (such as a surrender and re-grant) may also give rise to taxable gains.
The deductibility of any payments and associated transaction costs such as professional fees and SDLT will similarly be affected by the specific facts of the transaction. Although the application of the rules will be straightforward in many situations, a wary eye will help to ensure that variations do not give rise to unexpected tax consequences.

Planning ahead
The concept of re-gearing is a very flexible one: lease variations can be negotiated at any time and many terms of the existing lease may be up for grabs. Re-gearing can therefore be a genuine opportunity for both landlords and tenants to better their position.
However, to evaluate fully the financial advantages of a re-gear, the tax consequences must be understood and factored into the economic equation.

Estates Gazette - 9th May 2015

C.P. Comment :

The tax issues add a layer of complication that many might not foresee, and clearly it is an issue where good advice from a team that includes experts not only in legal and surveying matters but also financial would be of benefit.
Justin Fowler

"Repair" - The Meaning of the Word Can Differ

In an article in the Estates Gazette on 24th Oct 2015, Guy Fetherstonhaugh QC quoted that he was surprised by the diversity of results and apparent inconsistency of principles. Is it possible nevertheless to devise a satisfactory approach to the interpretation of repairing covenants?

The leading contender for the most cited dilapidations decision of all time is that of the Court of Appeal in *Proudfoot v Hart (1890) 25 QBD 42*. The case is authority for the proposition that an ordinary repairing covenant does not require that premises be put into the same condition as when the tenant took them; rather; they need only be put into such a state of repair as renders them reasonably fit for the occupation of a reasonably-minded tenant of the class who would be likely to take them. We can all understand that. But their Lordships continued by explaining that the state of repair necessary for a house in Grosvenor Square would be wholly different from the state of repair necessary for a house in Spitalfields. The irony is of course, that houses in Spitalfields are now inhabited by new Georgians, who are likely to be more fastidious about the state of their wainscoting than the oligarchs of Grosvenor Square. But putting that to one side, what does this differentiation actually mean in practice? That chavs are supposed not to mind leaky gutters?

The real problems start to emerge when one takes authorities on similar facts, but with different outcomes, and seeks to derive a coherent principle to apply to the next case. Take, for example, the famous duo of *Lister v Lane [1893] 2 QB 212* and *Lurcott v Wakeley [1911] 1 KB 905*. Each case concerned the demise of (or included) a house, with a full tenant's repairing covenant; in each case, substantial work was needed at the end of the term to put right significant structural defects (principally a bulging wall), involving much demolition and rebuilding; in each case the landlord sued the tenant for the cost of the works. The landlord failed in *Lister* but succeeded in *Lurcott*.

The reason? In *Lister*, the house had been built on a wooden raft atop 17 ft of mud on the Lambeth Marshes, and the works were to involve the provision of a new piled foundation and then a rebuilt house, which was said to involve giving back the landlord "something entirely different"; whereas in *Lurcott* the rebuilding of the front of the house (1) was held not to have changed the character of the premises; and (2) concerned only a subsidiary portion of them. Is either of these distinctions persuasive? As to (1), it is now accepted that the substitution of a completely new type of structure, if that is a sensible modern way of doing the work, does not mean that the work is not repair. So, although the foundations would be "entirely different", it seems difficult to say that the character of the whole premises had changed. As to (2) although the house in *Lister* was indeed to be completely rebuilt, it was itself only part of a much larger demise, including a wharf, warehouse and the celebrated Lambeth Shot Tower - so the rebuilt house was a subsidiary portion of the premises, just as was the wall in *Lurcott*. What then is the guiding principle?

Ultimately, as with all contracts, to assess what a reasonable person with knowledge of the surrounding circumstances would understand the parties to mean by the words of the lease. So context is everything. The only safe guide to interpreting repairing covenants is not to use previous decisions as guidelines (because they all turn on their own facts), but to consider each piece of drafting on its own merits, having regard to (a) the language of the covenant set in the context of the lease as a whole; and (b) the factual background that was known to both parties.

And the moral of the story? Read the authorities for the principles that emerge from them but do not try to apply the actual results as analogies - for that way confusion and disorder lies.

Estates Gazette - 24th October 2015

C.P. Comment :

One is tempted to say to the courts "make your mind up" but the best advice is always negotiate/ compromise and do your best not to end up in court because usually there, the winner is not you.

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End of Lease—Dilapidation Issues

Although in theory the process of ending an office tenancy should be straightforward, the reality is that the issue of dilapidations often leads to disagreements. Whether these are resolved quickly or turn into disputes that eventually head towards court depends on the ability of both sides to be flexible. Industry professionals agree the introduction of a dilapidations protocol two years ago has helped to weed out overzealous claims from landlords, as their surveyor is now required to physically sign off the amount as being accurate. Nevertheless, many add that almost every case they see is inflated and they expect the amount claimed reduced by half. Even when disagreements turn into disputes, very few dilapidations claims make it to court, though a sudden hike in fees this year (see box) could see the number rise.

Estates Gazette - 16th May 2015

In March, the Ministry of Justice dramatically upped a wide range of court costs. This may be good news for the Treasury, but less so for landlords issuing proceedings for money owed in a dilapidation claim. A fixed charges scale has been replaced by 5% of the total claimed, capped at £10,000, So a claim brought in February for £190,000 would have cost £1,300. Now, it will cost 622% more. As the Property Litigation Association pointed out in its response to the brief government consultation: "Front-loading of fees hardly encourages parties to settle claims through alternative dispute resolution. A party may find it impossible to persuade the other side to negotiate without first issuing proceedings. Having paid a hefty up-front fee, a party may be more inclined to go through with those proceedings to get its money's worth.

C.P. Comment :

While any increase in fees payable by landlords seeking to persuade tenants to abide by their repair obligations is to be deplored, I don't see that this necessarily will lead to more cases being decided by the courts as pundits suggest. The majority of dilapidations claims will be counted in the tens of thousands rather than the hundreds of thousands and both parties inherently want to agree a settlement rather than prolong the process and incur further costs. It is only a very few cases that resist the natural inclination to compromise and in those cases the landlord will be very aware of the swingeing fee required to proceed to law, and the tenant will know that a landlord who makes that choice means to go the course. A helpful focus for both minds at that point I feel.
John Tookey

Merry Christmas and A Happy New Year From The Culshaw Partnership

Market Indicators

The Market is mixed with certain classes of commercial property still hard to let.

Some high streets are still blighted with vacant properties whereas others are fully let and people are tentatively talking about rental growth again.

The first wave of commercial auctions after the summer showed strong demand and hardening yields.

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