On Wednesday 10th June, Kings Chambers hosted an interactive webinar with The Property Litigation Association. Geraint Wheatley and Matthew Hall provided a practical guide to the basis upon which the Court sets the terms of new business leases upon renewal under the 1954 Act to over 400 delegates.

If you are interested in viewing the webinar, a recording is available via the Kings Chambers website: [https://lnkd.in/gVvuGB4](https://lnkd.in/gVvuGB4)
Valuation in Lease Renewal
Matthew Hall
PLA 10.06.20

Scrutinising the Analysis of the Valuation Surveyors
LTA 1954 s 34 Rent

“... that at which, having regard to the terms of the tenancy (other than those relating to rent), the holding might reasonably be expected to be let in the open market by a willing lessor”

i.e. a matter of valuation rather than discretion

Valuation
The Parties to the Lease

• There is a willing lessee as well as a willing lessor (obvious but decided in Dennis & Robinson Ltd v Kiossos Establishment [1987] 1 EGLR 133)

• They are hypothetical – the actual characteristic of the landlord and tenant are irrelevant (FR Evans (Leeds) v English Electric (1977) 36 P & CR 185

• Both are deemed to be “willing” (ibid)
Restrictions on User

*Aldwych Club v Copthall Property Co* (1962) 185 EG 219 – the tenant cannot insist on a restriction to existing use being introduced to keep the rent down.

*Conversely*

*Charles Clements (London) Ltd v Rank City Wall* [1978] 1 EGLR 47 - landlord cannot insist on relaxation in new tenancy of user clause to gain higher rent.

No market (coronavirus?) Could the rent be nominal?

Although s34(1) posits an “open market” “... there is no assumption required as to how lively that market is”

*Dennis & Robinson Ltd v Kiossos Establishment* [1987] 1 EGLR 133 (a rent review case). The court could in theory order a nominal rent.
Who Should the Expert Be?

- The client’s own agent – possible – but may be seen as a “hired gun”
- Local Advantage - Generally speaking a surveyor from a local valuation firm will have an advantage simply because he or she will know the area in question.
- Familiarity with
  - The relevant RICS materials
  - The duties and role of an expert when giving evidence
- Common sense!

Lewison J in
*Marklands v Virgin Retail [2014] 2 EGLR 43*

The Valuer
- Looks for the closest real life transactions: “comparables”
- To adjust for size
  - “Devalues” the comparable to find a £ rate per square foot (often using “ITZA”)
  - Applies to the subject property
- Adjusts to take into account particular features
- May adjust for size (e.g. direct application of ITZA may overvalue large or wide pty)
"As you value, so you must devalue"

ITZA calculation

We know the rent was £45,000 p.a.

The area devalues at

<table>
<thead>
<tr>
<th>Zone</th>
<th>Area (sq ft)</th>
<th>Calculation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Zone A 350</td>
<td>350</td>
<td>£45,000 / 643.75 = £69.90 per sq ft</td>
</tr>
<tr>
<td>Zone B 350 /2</td>
<td>175</td>
<td></td>
</tr>
<tr>
<td>Zone C 350 / 4</td>
<td>87.5</td>
<td></td>
</tr>
<tr>
<td>Zone D 250/ 8</td>
<td>31.25</td>
<td></td>
</tr>
</tbody>
</table>

643.75 sq ft ITZA
“The ideal comparable property hardly ever exists”
(per HHJ Hamilton in *Barrett (W) & Co v Harrison* [1956] EGD 178)

Special Features 1
Special Features 2

Special Features 3
Special Features 4

Special Features 5
## The List of Comparables

<table>
<thead>
<tr>
<th>Property</th>
<th>Transaction Type</th>
<th>Date</th>
<th>Area (sq ft)</th>
<th>Term</th>
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## The “Hierarchy” of Transactions

- Open Market Lettings
- Agreed Lease Renewal
- Agreed Rent Reviews
- Independent Expert Determination or Arbitrators’ Award
- Court Decisions
Charles E Goad

The Goad Plan

Matthew Hall's Webinar Presentation
The Rental Market
RICS UK Commercial Property Survey

Q1 2020: UK Commercial Property Market Survey
Commercial market outlook hit by coronavirus outbreak

- Near term rental and capital value expectations turn negative
- Sentiment deteriorates across all sectors, albeit industrials more resilient than retail and offices
- Headline twelve-month projections also negative, although medium term expectations less downbeat away from retail

Supply and Demand

Commercial property - Sector Breakdown
Coronavirus Considerations

• Trial may be substantially delayed — arbitration?
• S 64 — valuation date is + 3 months anyway
• Evidence of recent rent renegotiations?
• s 34(2) rent review after short period?
• Turnover rent?

Conclusions

• Most Important - Think Judge!! (if you don’t understand it, then neither will he or she!)

• Experts need to show objectivity sometimes by modifying their opinion.

• Don’t be surprised if, after all the detailed analysis, the judge “splits the difference”
Introduction

- When a business lease has come to an end, either the tenant or the landlord can apply to the court for a new tenancy to be granted: Landlord and Tenant Act 1954 section 24(1) (“the Act”).

- The court must fix any terms of the new lease which cannot be agreed by the landlord and the tenant, including the term, break clauses and the rent.

- It is important to understand how the judge goes about fixing the rent, not just because you might have to represent a landlord or a tenant in litigation, but because all negotiations for rents under new leases of business properties take place against the backdrop of the Act, where it applies.

- Typically, the negotiations will be undertaken by surveyors. Where the parties cannot agree terms and it is becoming an issue, a competent property lawyer will need to be able to evaluate the analysis on each side, in order to advise which approach is most likely to find favour with the judge.

The Basic Legal Framework

The following are the headline points

- Whereas the duration of the new tenancy is that which is “... reasonable in all the circumstances...” (s 33)
and the other terms are those which the court determines having regard

“... to the terms of the current tenancy and to all relevant circumstances...” (s 35)

the Act fixes the way the rent must assessed.

• The rent is determined under s 34 of the Act by reference to

“... that at which, having regard to the terms of the tenancy (other than those relating
to rent), the holding might reasonably be expected to be let in the open market by a
willing lessor”

As the House of Lords remarked in O’May v City of London [1982] 2 WLR 407 it is a
matter of valuation rather than discretion.

• There being disregarded, the effect on rent of the tenant’s occupation, tenant’s
goodwill and improvements

• Since regard must be had to the other terms of the tenancy, the rent will always be
set last.

• The landlord and the tenant are hypothetical and do not have the personal
characteristics of the actual landlord and the actual tenant.

Example: A national retailer of cosmetic products asserts that the rent for its new lease
of town centre premises should be reduced. A marketing director does a witness
statement referring to all the trading problems it faces; the fact that demand for
cosmetics has fallen, that purchasers now shop online. The estates director does a
witness statement saying that in many other renewals, it has negotiated shorter terms
and lower rents. None of this is relevant unless it can be shown to have a bearing on
general demand for the type of property in question in the town in question, which is,
of course, a matter of expert evidence.

Restrictive Covenants and their Effect on Rent

In determining the rent, the Court has regard to use to which the premises can be put under
the new lease. Therefore, if there is an unqualified covenant to use only for a given
permitted use, this will obviously affect the valuation.

• Two useful cases exemplify this, one from the tenant’s perspective and one from the
perspective of the landlord.

  o In Aldwych Club v Copthall Property Co (1962) 185 EG 219 there was a covenant
to use the premises only as a club, unless the landlord consent to any other
use and such consent was not to be unreasonably withheld. Planning
permission had been obtained to use the premises as offices. There could be
no reason to refuse consent for a change. If the new lease restricted user to that of a club the rent would be £2500 pa, but if the property could be used as offices and a club it would be £5,200 pa. Pennycuick J rejected a suggestion by the tenant that the user should be restricted to that of a club “... with the consequence and indeed, the sole purpose, of bringing about a diminution of the rent to be determined under section 34”

- **In Charles Clements (London) Ltd v Rank City Wall** [1978] 1 EGLR 47 the tenant was cutlery company. It was renewing its lease of the shop at 125 Regent Street. The lease restricted user to that of retailing cutlery, without the landlord’s previous consent in writing. The landlord proposed that, under the terms of the proposed lease, the restriction should be relaxed so that it was “... without the landlord’s previous consent in writing, such consent not to be unreasonably withheld”. This was so that the rent under the new lease would be higher. The tenant did not want any relaxation. It was content to carry on its cutlery business at the lower rent. The landlord argued that the court ought to impose a relaxation, since otherwise it would effectively be sterilising the property in the hands of the landlord. Goulding J disagreed. It was the purpose of the Act to protect the tenancy in the continuation of its business. The landlord could not seek to impose a relaxation to gain a higher rent.

- **Aldwych** and **Charles Clements** effectively remove the possibility of the landlord or the tenant trying to impose restrictions or relaxations on one another with a view to decreasing or increasing the rent.

- Restrictions on user may have a dramatic effect on rent in the pandemic. The rent will be much lower. For example, the covenant restricts user to that of a restaurant selling food on the premises, the rent could be very low.

**What About Where There is No Market?**

What if a market is dead? Could the judge order a new tenancy on terms that only a nominal rent is payable.

- Although the Act refers only to a “willing lessor”, the reference to an “open market” presupposes that there is also a “willing lessee”. Authority for that, if it is needed, is **Dennis & Robinson v Kiossos Establishment** [1987] 1 EGLR 133, a rent review case in which the lease referred to the open market and this was held to imply both a willing lessor and a willing lessee.

- **Kiossos** also establishes that, whilst there is a requirement to assume an “open market”, the valuer might consider in the circumstances that the tenant might not be willing to pay any more than a nominal rent, i.e. that the market is dead.

“It is essentially a matter for the valuer to inquire into and determine the strength of the market. He is, for example, entitled, if such is his expert opinion on the facts, to
say that, having regard to the state of the market and the condition of the property, a tenant, though a willing tenant, could not be expected to take the stipulated lease save at a low or nominal rent and that the full yearly market rent must be determined accordingly”

- The rent was found to be £1 per annum in *Flanders Community Centre v Newham LBC* [2016] EWHC 1089 (Ch) (community centre where covenants in the new lease allowed the local authority landlord to control how the premises were run. Tenant’s expert reports that no commercial tenant would pay a rent on those terms).

**Who Should Your Client’s Expert Valuer Be?**

Given that the trial on the issue of rent is essentially the trial of an issue of valuation, the most important decision you take in the case may be who to appoint as the expert.

- There is no bar to an employee of the client being chosen: *Field v Leeds City Council* [1999] EWCA Civ 3013. The *RICS Guidance Note on Surveyors Acting as Expert Witnesses* at para 2.4 provides that

  “You are entitled to accept instructions from your employer and to give expert evidence on behalf of that employer. Prior to accepting such instructions, you must satisfy yourself that your employer understands that your primary duty in giving evidence is to the tribunal and that this may mean that your evidence may conflict with your employer’s view of the matter or the way in which your employer would prefer to see matters put”

- In my view it is not ideal for the expert valuer to be either an employee or a valuer who has accepted a large number of prior instructions from the client. 2 points arise here

  o Whilst it may not be permissible for the opposing advocate to assert that the witness is making up his or her evidence to suit the employer’s interest, the judge may nevertheless view the expert as having a natural inclination one way.

  o In many cases the employee / agent will have been conducting the negotiations and may have been advancing points “… for negotiation purposes” which would not withstand the scrutiny of the court.

- Ideally, your valuer should

  o Be locally based – so that he or she has knowledge of the area

  o Demonstrate full knowledge of the relevant RICS materials. In particular, *RICS Valuation Global Standards* (the “Red Book”) and *RICS Guidance and Practice Note on Surveyors Acting as Expert Witnesses (4th ed)*
o Be able, most importantly, to “see the wood for the trees” and who can articulate his or her rationale in a comprehensible way.

The Valuation Exercise Itself

An authoritative introduction to the process is in the judgment of Lewison J in Marklands v Virgin Retail [2014] 2 EGLR 43, set out here for reference

“Valuation essentially proceeds by analogy. The valuer looks for an analogue that is as close as possible to that which he has to value, and which has been the subject matter of a real transaction. ... In the case of a property valuation, the analogues are usually called “comparables”. In a property valuation, typical adjustments will reflect differences between the comparables in location, terms of letting and so on. One obvious difference between different properties is that they will be of different sizes. As a first step towards eliminating the differences in size between a comparable and the subject matter of the valuation, the valuer will not take the rent of the comparable and apply it to the subject property. Rather, he will divide the rent of the comparable by the area of the comparable to produce a rate per square foot. The area can be calculated in a variety of different ways, depending on the nature of the property. The RICS publishes a Code of Measuring Practice to guide practitioners .... This process of division is called “devaluation”. Having devalued the comparable, the valuer can then apply the rate per square foot to the subject property (if necessary, making adjustments for the factors I have mentioned). He will then multiply the rate per square foot by the area of the subject property, and thus arrive at a rental value. Sometimes, however, the valuer will think it appropriate to make a further adjustment for size, over and above the process of devaluation. This is because the subject property may be considerably larger than the comparable (in which case, an end allowance or discount for size may be appropriate), or because a particular comparable may be so small as to produce an extremely high rent if looked at as a rate per square foot (often known as “kiosk rents”). This is essentially the “overall” method of valuation.

In the case of retail property, valuers have developed a more sophisticated technique, called the “zoning” method. This method notionally divides a shop into parallel zones (usually of 20ft), starting at the street frontage and working backwards to the rear of the shop. The zone nearest the street is called “zone A”, the one immediately behind it is called “zone B”, and so on. At some point, however, usually at around zone C, the valuer stops zoning and classifies the rest of the shop as “remainder”. Zone B is taken to be half the value of zone A, zone C as half the value of zone B, and so on. This process is known as “halving back”. An alternative way of looking at this method of valuation is for the valuer to divide the area of zone B (as opposed to its value) by two, the area of zone C by four and so on. The resulting area is expressed “in terms of zone A” or “ITZA”

(i) ITZA

- The ITZA produces a lower rent per square foot for narrower, deeper shops
- The assumption is that the frontage of the shop has far more value – it is what attracts the customers in and where they spend the very limited amount of time which, on average, they spend in a hop. However, this may not be a valid assumption in a given case.
- ITZA cannot be applied mechanically. There have to be adjustments to take into account a number of factors which make premises more or less desirable.

(ii) Making Adjustments When Applying the ITZA From One Type of Premises to Another

- Premises differ from one another in all sorts of ways other than size and location. A valuer may make an “end allowance” to reflect a number of features.
o Frontage to depth ratio

Although lots of frontage may be an advantage, does the application of ITZA properly equate to the ability of the tenant to make money? If premises are 7 units wide and one room’s width deep, ITZA may distort the rent.

o Internal Configuration

Shoppers may be less likely to walk upstairs and so mezzanine or upper floors may be valued far less. This all has to be looked at in context, though. Whilst a customer might not be willing to walk upstairs to shop for clothes, he or she would be less bothered about doing so to visit a hair salon, or a dentist.

Similarly, certain areas, even if in Zone A may be “masked”. This can be taken into account in applying ITZA (e.g. an area behind a pillar in Zone C might be taken at A/6 rather than A/4) or by adjustment when comparing.

o Listed Status?

This will mean that there is less flexibility in the way that the premises can be fitted out. On the other hand, if the premises are listed because they are extremely attractive, this may make them more desirable to certain types of business e.g. luxury stores on New Bond Street.

o Return Frontage

This can increase the prominence and therefore profitability of a store. On the other hand, if the frontage is excessively glazed, it can reduce the options inside and increase insurance. Further, where is the return frontage to?

o Hard Frontage

Many retailers will want plenty of visibility into the premises to display goods, rather than “Fort Knox”. For some this will be less important.

o Accessibility

An adjustment may be made if the shop is at the top of a steep hill. The issue of location generally is deal with below.

(iii) The Comparables

- Once the experts’ reports are obtained, the comparables need to be set out in a list as follows, in reverse order, or possible in 2 lists in the order of importance according to each expert.
Such a list is indispensable for the judge and the parties’ representatives during a trial.

<table>
<thead>
<tr>
<th>Property Type</th>
<th>Transaction Type</th>
<th>Date</th>
<th>Area (ZA)</th>
<th>Term</th>
<th>Rent</th>
</tr>
</thead>
<tbody>
<tr>
<td>15 Market Street</td>
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<td>03.01.14</td>
<td>653</td>
<td>15</td>
<td>3 months rent free £18,000 for first 2 years £25,000 thereafter</td>
</tr>
</tbody>
</table>

- Obviously the more recent the transaction, the more probative it is.
- There is an accepted “hierarchy” of comparable transactions
  - Open Market Lettings
  - Agreed Lease Renewal
  - Agreed Rent Reviews
  - Independent Expert Determination or Arbitrators’ Award
  - Court Decisions

(iv) Locating the Comparables

- A “Goad Plan” is essential when dealing with valuations in town centres or shopping malls. Such plans are detailed plans showing the occupation of individual buildings and were pioneered by the noted cartographer and civil engineer Charles E Goad (1848 – 1910) for insurance purposes.

- In towns and cities, rental values vary dramatically even over the space of a hundred yards. The Apple Store on Covent Garden on the sample Goad Plan is in a different rental market entirely to the Indian restaurant at the side of the office building.

- At the risk of stating the obvious, shop premises will generally earn more and therefore be worth more, the more people who walk past. This is not universally true, though. In secondary locations, many types of business will not be reliant on passing trade, e.g. “counter stores” such as “Plumb Center”.

- A good valuer will assess where pedestrians are going from and to. Where do they park their cars, or get off the bus? Is there any “destination” such as a shopping centre?

- For a trial, all of the comparables should ideally be located on one plan if possible.
(v) **Economic Conditions**

- By definition, comparables are historic. Accordingly, it is always necessary to have in mind how the market may have changed.

- Here, an invaluable resource in my experience is the quarterly reports produced by the RICS “UK Commercial Property Market Survey”.

- The expert’s attention should be drawn to the above. If it is not, then it may well be used in cross examination.

**Coronavirus Considerations**

- The date of valuation is the termination of the current tenancy under LTA 1954 s 64, so the court is looking 3 months ahead anyway.

- A trial itself may well be delayed well into next year. There is a very large backlog of trials which has built up. In Manchester, for example, according to the note of HHJ Bird on 04.06.20 by the 15.05.05 the backlog stood at around: 511 small claims trials, 200 fast track trials, 25 Multi Track trials. This looks set to rise.

- Uncertainty in rental valuation would not in my view be a good reason to adjourn a trial which would otherwise be heard. County Court judges are expected to do the best they can with the evidence that is available to them: see Arden LJ in *Latimer v Carney* [2006] EWCA Civ 1417 at [44].

- A good valuer would not simply throw his or her hands in the air and claim that it was impossible to arrive at a value.

- How will valuation be approached?

  - In addition to comparables from the “hierarchy”, a valuer might consider the sort of terms which are being reached in rent re-negotiations currently underway. For instance, a retail operator at a comparable property may have negotiated a 12 month rent free period, in return for an extra year on the lease.

  - If, by the time of the trial, there is still uncertainty, the judge may consider that, on the open market, the parties would agree an initial very low rent, but with a rent review provision to take effect not in 5 years but perhaps in a year or 18 months. The Court has express power to insert a rent review clause.

  - There are a number of reports of retailers seeking to negotiate turnover rents. If this becomes widespread then it will no doubt be argued that this is a “rent payable... at which... the holding might reasonably be expected to be let in the open market”. There is an issue about whether the court has jurisdiction to order a new tenancy on turnover rent terms. Fixing the rent in this way means that the rent is
being determined having regard to the goodwill and the tenant’s occupation, which must be disregarded. See on this *Reynolds & Clark Renewal of Business Tenancies 5th ed* at 8-100.

**Conclusions on Valuation**

In my experience the most potent reports are those which are focussed sound like common sense and do not “blind with science”.

Comparables and adjustments must be used judiciously to reinforce what common sense dictates: i.e. that premises are worth what someone is willing to pay.

Ultimately, valuers need to ask: who is going to rent this property? how much money can be earned from it?

MATTHEW HALL

10th June 2020
Profile

Having specialised in land law since starting at the Bar over 20 years ago, the focus of Matthew’s work is now mainly on issues surrounding commercial property and in particular rights of way and restrictive covenants (e.g. recently advising a national developer on ransom strips), torts affecting land (e.g. a 6 day TCC nuisance trial concerning leaking fuel) and rectification (recently acted for brewery in mistaken inclusion of a house in a transfer of a pub).

Matthew also regularly advises local authorities and other public bodies on the exercise of their land-holding functions, particularly concerning city centre redevelopment and the charitable status of public facilities and spaces.


As the testimonials referred to below show, Matthew couples a direct and focused approach with great attention to client care.

Qualifications

Oxford University BA (First Class) in Law with Law Studies in Europe (French)

City University Diploma in Law 1999

Recommendations

Chambers UK 2020

"He is very available and willing to help as well as practical and incredibly down to earth." "He is astute and aware of the tactical considerations in a case."

Chambers UK 2019

"Approachable and friendly." "He provides good advice on complex real estate issues."

Chambers UK 2018

"Very forthright and very personable. Clients like him." "Very approachable and user-friendly."

Chambers UK 2017

"Excellent junior with a keen eye for detail." "Very good, assertive and user-friendly."

Chambers UK 2016

"Very client-friendly and diligent."

"Very good to work with and very pragmatic."
The 1954 Act: Principles & themes relating to duration, breaks and other terms

Geraint Wheatley
for the Property Litigation Association, 10 June 2020

Issues for consideration

• ‘Other terms’: O’May
• Guarantors
• Duration
• Redevelopment break clauses
Other Terms: *O’May*

**Section 35**

“The terms of the new tenancy ... in default of agreement, may be determined by the court; and in determining those terms the court shall have regard to the terms of the current tenancy and to all relevant circumstances”

---

**O’May**

**Well-known principles**

Starting point: the new lease will be on the same terms as the current;
the party seeking change bears the burden of justifying it with good reasons

Any new terms have to be fair and reasonable
Consider the facts...

- Proposal that T would pay a variable SC based on the actual repair costs
- T to be compensated by a fixed deduction from the rent – market rate bearing in mind the variable SC
- Change would increase value of reversion by £1-2M
- Change would increase the marketability of the reversion
- Leases of this kind were prevalent in the market
- 5 year original tenancy; new term to be 3 years

... then the application of the principles

- LL’s position reasonable – not a good enough reason
- Prevalence of leases of this nature in the market – not a good enough reason
Fundamental change in balance

T held under a relatively short lease. The SC covered long-term capital expenditure. The changes reversed the risks inappropriately.

Tools for assessing future cases?

Consider:
1: the fundamental nature of the parties’ interests in the premises
2: whether the changes alter the fundamental balance between the parties as set out in the original lease

- Measure fairness and reasonableness against these
- Ensure lay/expert evidence addresses them
Guarantors

*Cairnplace v CBL* [1984] 1 WLR 696

- Current lease: alienation clause requiring guarantors
- Assignment to Ltd Co: directors provided as guarantors
- Ltd Co applies for new tenancy
- LL wants directors to continue as guarantors

Guarantors

*Cairnplace v CBL*

The court has jurisdiction to require guarantors

Discretion:
- Particular facts: same directors caused Ltd Co to take the assignment, gave themselves as guarantors, and shortly thereafter caused Ltd Co to apply for a new tenancy
Guarantors

_Cairnplace v CBL_

Discretion, apart from the particular facts:

- T argued requiring guarantors for a 10 year term goes well beyond requiring them for the short period post-assignment
- Rejected: T’s argument transfers risk of default from Ltd Co to the LL

Duration

S.33 cap of 15 years

Some relevant factors:

- Duration of old lease
- Length of time T has held over
- Commercial considerations for both parties
- LL’s own occupation
- Comparative hardship
Duration

Discretionary: broad guidance only

- In practice many judges will take current term as starting point
- Purpose of the Act is to protect Ts in the pursuit of their business

---

Duration

*CBS UK v London Scottish Properties [1985] 2 EGLR 125*

- 10 year underlease
- LL held under 150 year headlease – rent payable
- T moving out – due to have moved out in 1 yr
- T sought term of just over 1 yr
- LL sought 14 year term
Duration

*CBS UK v London Scottish Properties*

LL argues:
- V significant diminution in value of reversion if short term
- Risk of void period, paying rent under headlease
- Market conditions: (i) 15 year terms the norm (ii) no LL would offer 1 yr
- 14 year term akin to current 10 years
- T can assign residue of the 14 years after it leaves

Duration

*CBS UK v London Scottish Properties*

Tenant argues:
- Just wants orderly departure
- Possible difficulty in assigning residue of term
- Risk of void period low
- No real diminution of value of reversion
- Purpose of Act = protection of T
Duration

*CBS UK v London Scottish Properties*

T wins

- Market forces argument of little weight
- LL would probably have enough time to find new T, and would suffer no tangible loss in terms of the reversion
- T’s business interests ought to be protected

Redevelopment

*Break Clauses*

*Adams v Green [1978] 2 EGLR 46*

Redevelopment is part of the policy of the Act: Ground F

Jurisdictional element – redevelopment break clause permissible where works are a ‘real possibility’ or ‘on the cards’
Redev Break Clauses

*Adams v Green*

Discretion – the need to balance redevelopment with protection of T’s business

Redev Break Clauses

*Adams v Green*

LL sought 14yr term with rolling 2yr redev break

T didn’t want to leave and pointed to market uncertainty and absence of financial evidence re build costs, rent returns

Trial judge ordered 7 year term, with no break
Redev Break Clauses

*Adams v Green*

Uncertainty not determinative. T would have 2 yrs’ notice

No need to prove intention in similar way to Ground F opposition

- Break may never be exercised
- Protection for T inherent in Act:
  - Break > App for new tenancy > LL has to rely on and prove
  - Ground F in opposition

End
INTRODUCTION

The aim of this brief seminar is to provide a high-level overview of some of the fundamental principles and themes encountered in ’54 Act disputes relating to the duration of the new term (including redevelopment break clauses), and the residual category of ‘other terms’ (including guarantors). It does not – nor could it, in the time available - attempt to be a comprehensive summary of the law in relation to these areas.

OTHER TERMS OF THE NEW TENANCY: O’MAY

35 Other terms of new tenancy

(1) The terms of a tenancy granted by order of the court under this Part of this Act (other than terms as to the duration thereof and as to the rent payable thereunder), including, where different persons own interests which fulfil the conditions specified in section 44(1) of this Act in different parts of it, terms as to the apportionment of the rent, shall be such as may be agreed between the landlord and the tenant or as, in default of such agreement, may be determined by the court; and in determining those terms the court shall have regard to the terms of the current tenancy and to all relevant circumstances.
In subsection (1) of this section the reference to all relevant circumstances includes (without prejudice to the generality of that reference) a reference to the operation of the provisions of the Landlord and Tenant (Covenants) Act 1995.

The leading case is of course O’May v City of London Real Property Co. Most are familiar with the fundamental principle arising out of O’May; namely, the starting point is that the new lease will be ordered on the same terms as the current, and that the onus is on the party seeking a change to justify it with good reasons. Equally, it is well-known that the House of Lords referred to s.35’s requirement to ‘have regard’ to the current terms as an ‘elastic’ concept, somewhere between an obligation to reproduce the existing terms and an unfettered right to substitute new ones, and held that any new terms have to be ‘fair and reasonable’.

However, it can be tricky to advise on the likely outcome of a given case, notwithstanding these familiar legal propositions. I believe that rather than focussing exclusively on O’May’s central ratio/propositions, it is also useful to look again at its actual facts and outcome as a guide for future cases.

In O’May, the LL wanted to change the terms of the lease. The details of the changes are relatively involved, but for our purposes what matters is that they involved, in essence, the potential imposition on the tenants of a service charge requiring them to contribute a share of the actual costs of structural repairs and lift maintenance/repair, as well as to a new sinking fund for the renewal of plant and equipment. As this related to actual costs, the amount payable would be variable, and given the nature of the works covered, the cost could be significant. In an attempt to compensate for this, the LL proposed a reduction in the rent. That reduction would be fixed (ie the rent would always be payable at the same lower level). The experts agreed that if the service charge change were to take place, the proposed reduced rent would reflect it (ie the rent was set at a level the market would regard as acceptable bearing in mind the variable SC). The LL’s evidence was that it would benefit hugely by the change – the value of the reversion would increase by £1-2M, and the marketability of the reversion would substantially improve too. The House of Lords accepted that this was a perfectly reasonable and legitimate position for a LL to take. They also accepted the evidence that ‘clear’ leases of this kind were prevalent in the market for premises such as this. But neither reason was sufficient.

“a short-term tenant such as the plaintiff tenants, is not adequately compensated by a small reduction in rent for the assumption of the financial risks implicit in the maintenance of the structure of an office block. Those risks are proper to be borne by the owner of the inheritance or of a long term of years but are not appropriate to be borne by one who is in possession for three years and has no further interest save a limited statutory security of tenure. Such risks are indeterminate in amount and could prove to be wholly out of proportion to the very limited interest held by a short-term tenant.”

In my view what can be taken from O’May is more that the main principles to which I referred previously. The case also demonstrates a need to step back from the detail and to consider (i) the fundamental nature of the parties’ interests in the premises (eg freeholder vs short term tenant) and

1 [1983] 2 AC 726
2 Not a direct guide, because every case will turn on its own facts, but as a way of understanding the processes and reasoning involved in evaluating proposed changes
3 Taken from the Court of Appeal’s decision – it was endorsed by the House of Lords
(ii) the fundamental balance between the parties as struck by the terms of the original lease. Through the interplay of their rights and obligations, all leases strike a balance of some kind between the parties – that balance may be more or less in favour of LL or T, or it may be broadly equal. For 1954 Act purposes, it matters not whether the balance is pro-LL or pro-T, what matters is the need to identify it, and to recognise that the Court will be reluctant to alter that balance in a significant way, whether through ‘modernisation’ or otherwise, if might impact negatively on the T’s business.

Accordingly, it is crucial to remember that the parties are not negotiating afresh – the Court is not trying to decide what the parties would agree were they to be negotiating now. Although the House of Lords stated that the changes have to be fair and reasonable, these are not concepts to be considered in a vacuum. They have a context, and that context is the starting balance between the parties as enshrined in the existing lease. All changes have to be measured against that – the greater the change in the fundamental balance, the harder it will be to persuade the Court to order it. In particular, a change that alters the balance to the significant detriment of the tenant’s business will be next to impossible to get through. It is important for lay / expert evidence to consider this question of balance when assessing the impact of a proposed change.

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4 See for example, *Gold v Brighton* [1956] 1 WLR 1291, in which the Court refused to order a restriction in a user clause preventing the sale of second hand goods. The LL’s desire to do so was reasonable, but part of the T’s business involved such sales.
GUARANTORS

It is within the scope of s.35 for a Court to impose a requirement for guarantors where none existed before: *Cairnplace v CBL*[^5^]. In *Cairnplace*, the alienation provisions already contained a requirement for guarantors in the event of an assignment to a limited company. Such assignment had taken place, and guarantors had been provided. Shortly thereafter, the limited company sought a new tenancy, and the LL wanted those guarantors to continue as guarantors.

The T sought to argue that the Court had no jurisdiction to require guarantors, since it was not within the T’s sole control to find people willing to do it. As there could be no certainty that guarantors would ever be found, to require them as a condition of granting the tenancy would be to deprive the T of its security of tenure.

The Court of Appeal rejected that. Many terms require the input of 3rd parties (such as insurance clauses). Moreover, the clause was not a condition precedent – the lease was to be granted come-what-may. The clause was simply for a guarantor to be provided within 6 months of execution of the new lease. Failure to comply could be enforced by forfeiture.

Having decided the question of jurisdiction, the Court considered the exercise of its discretion. It considered it plainly fair and reasonable for the LL to want the guarantor requirement, bearing in mind the facts of the case (the existing guarantors were directors of the limited company, and they had caused the limited company to take the assignment fully anticipating applying for a new tenancy thereafter). The T tried to argue that there was a difference between the provision of guarantors for a limited period post-assignment in the original lease, and the provision of guarantors for the new 10-year term, but the Court disagreed:

> “The term of 10 years is a term proposed by the tenants. The practical effect of the argument is that if there are greater risks of tenants’ default over a 10 year term than over the year for which the assignment was contractually effective, the landlords, not the directors of the company, should bear the risk.”

That was considered to be an unattractive argument. We can see the notion of balance lying behind the Court’s conclusion. The lease permitted an assignment to a limited company but, in recognition of the fact that companies with limited liability can pose risks for landlords, there was agreed provision for guarantors in the event of an assignment. Any limited company tenant was always going to need a guarantor. That was the original balance struck in the lease. The renewal lease effectively preserved that balance.

Although the facts of *Cairnplace* were fairly particular, unusually the Court of Appeal went out of its way to try to avoid it being distinguished.

> “In the foregoing, we have deliberately confined our reasoning to the facts of the instant case. But the judge’s decision upon the exercise of discretion is only an illustration of what is fair and reasonable having regard to the existing lease and to all the circumstances. Thus the principle which we have affirmed is wider than the application of the principle to the facts of this case. We only add this observation in case our judgment is interpreted more narrowly than is the

[^5^]: [1984] 1 WLR 696
case. Each case, as the section makes clear, must be decided on its own facts; there may be many other circumstances differing widely from those in the instant case, in which it would be fair and reasonable for the court to determine that there should be guarantors of the tenant's obligations in the new lease.”

Oddly, Cairnplace does not seem to have been mentioned in any subsequent reported decisions6. This renders it difficult to say when the Court will order guarantors to be provided in other factual situations. Woodfall tentatively suggests such an order may ‘perhaps’ be made where the T has a poor record of payment or performance of other covenants. Reynolds & Clark suggests that “the requirement to obtain guarantors is likely to be imposed where the tenant company has recently been incorporated, the tenant having taken an assignment shortly prior to the expiration of the term”, but that is little more than a summary of the facts of Cairnplace. No guidance is offered in Hill & Redman, Emmet & Farrand, Ross on Commercial Leases, or Halsbury’s. For my part, it seems to me that the Court’s reference to risk is important. The alienation provisions are an indication that the original parties recognised that for a limited company to be the tenant, guarantors would be required, as the LL did not want to bear the risk of default from such a tenant. The new clause reflects that balance of risk. Moreover, the hint set out above from the Court of Appeal will in practice be hard for some County Court judges to resist.

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6 Other than one dealing with a different issue
DURATION

The statutory maximum term which the Court can order (in default of consent) is 15 years: s.33.

Subject to that cap, the question, which is a matter of discretion, is as to what term is reasonable in all the circumstances. Typical relevant factors include:

- The duration of the old lease
- The length of time during which the T has held over under the old rent
- Commercial considerations for both LL and T
- The LL’s intentions as regards his own occupation
- Comparative hardship for the parties

As a result of the breadth of these factors, it is not possible to identify much by way of clear guidance which will be applicable for any given case. The duration of the current tenancy is likely to be seen by many judges as a starting point\(^7\), but commercial factors will often point towards an upwards or downwards revision, so it cannot be assumed that the status quo will prevail. It is a question of balance – the factors relied on by both parties being weighed against the standard of reasonableness, but always bearing in mind that the Act’s raison d’etre is the protection of Ts in the pursuit of their business.

The best way to advise as to the likely outcome of any given case is to consider some of the authorities to get a feel for how the Courts have approached the balance. I will take the High Court case of *CBS UK v London Scottish Properties*\(^8\) as an example.

**Facts**

- Current Lease = 10 years from March 1974
- LL was T under 150 year headlease, with a significant passing rental obligation of its own
- LL sought a 14-year term
- T was already in the process of moving out of the demised premises to set up elsewhere. Due to have completed the move by July 1986.
- T sought a very short term, expiring only just over a year from trial to coincide with its move
- Trial: June 1985

**LL’s Arguments**

- Capital value of its interest in the premises would be substantially diminished by a short term (£90,000 - £200,000 loss according to its expert evidence)
- On the open market, a LL would typically demand a 15-20 year term for premises of this nature, and would be likely to achieve a term of 15 years.
- No LL would offer these premises on the open market for as little as 1 year
- The 14 years it was seeking was closer to the 10 year current term than the T’s very short term proposal
- It would not be difficult for the T to have to assign the residue of a 14 year term

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\(^7\) Even though, unlike s.35, s.33 does not expressly require the Court to have regard to the current term

\(^8\) [1985] 2 EGLR 125
• There was a risk of a void period at the end of the short term sought, during which the LL would need to keep paying rent under the headlease.

**T’s Arguments**

• The term sought was just sufficient to allow it to complete an orderly departure.
• The risk of a void period was relatively low – the LL would have around 11 months to prepare
• As Ts in the market tended to seek terms of around 15 years, it could not be assumed that, in the event the Court ordered the LL’s proposed term of 14 years, the residue (likely to be 13 years) would be easy to assign once T moved out.
• The purpose of the Act is to protect the tenant
• Any diminution in value of the LL’s interest is a paper matter only – as soon as a new T is found, the value of the LL’s interest would return to normal. LL was not looking to sell.

**Decision**

The T won. The Court attached little weight to the ‘market forces’ argument, accepted that there was in reality no tangible loss to the LL in terms of market value, and ultimately considered that reasonableness required the T to be given the protection it needed for its business. The case is indicative of the fact that the protection of the T’s business interests is a powerful factor, and that if the LL wants a term which suits itself, it needs to adduce very persuasive evidence. Market conditions are very unlikely to be sufficient.
REDEVELOPMENT BREAK CLAUSES

One factor which may play into the award of a shorter term is the prospect of redevelopment, but it can be easier for a LL to justify a redevelopment break clause if redevelopment is in the offing. Bear in mind that the context for this is that the policy of the Act is to recognise the importance of a LL being able to redevelop, as evidenced by its presence as a mandatory ground for possession. Redevelopment break clauses come in useful in the event that redevelopment is less certain, or further into the future, than is required for Ground (f).

The initial jurisdictional test for whether a redevelopment break clause can be added to the new lease is usually taken to be whether the work is a “real possibility” or “on the cards” – i.e., something less than probability. Aside from that, however, there is still the need for the Court to consider, as a matter of discretion, whether such a clause ought to be added to the new lease. As with other areas under the Act, it is a question of balance. Here, there is a need to balance the legitimate desire of the LL to redevelop with trying to ensure that the T has a reasonable degree of security of tenure. Often the balance will result in the incorporation of a break clause (“it is no part of the policy of the 1954 Act to give security of tenure to a business tenant at the expense of preventing redevelopment”), but not always. In the event that problems will be caused for a T by the incorporation of such a clause, if those problems are to lead to any difference in outcome, it is more likely to be through a delay to the operation of the break, rather than an outright refusal of a break clause at all.

Again, a case study is useful as an example. In Adams v Green the LL sought an order for a 14 year term, with a rolling 2 year redevelopment break clause. The trial judge reduced the term to 7 years, on the basis that it would be harsh on the LL to saddle it with a 14 year term if redevelopment was ever to become a reality, but he refused to include a break clause as he was not convinced as to the likelihood of the redevelopment. There was no evidence as to financial viability (eg build costs, likely rental returns), and the market conditions in the future could not be known. The Court of Appeal ordered the LL’s desired 14 year term with a rolling 2 year redevelopment break. Stamp LJ was not too concerned by the uncertainties inherent in a case like this. There will always be market uncertainty, and there was no need for this LL to provide the kind of financial modelling which the trial judge had thought was important. If, as the T had contended, the redevelopment was uncertain / unlikely to go ahead, then the effect of that would simply be that the break would not be exercised, an eventuality that is beneficial for the T. Moreover, and importantly, the Court of Appeal noted that there is a clear distinction between an attempt to include a redevelopment break clause in a new lease, and the use of redevelopment under Ground F to object to the grant of a new tenancy. In the event that the LL were to exercise the break to terminate the tenancy, the T could apply for a new one under the Act. At that stage, if the LL were to object on the basis of Ground F, it would have to prove

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9 Ground (f)
10 Adams v Green [1978] 2 EGLR46
11 Adams v Green
12 As to this, Reynolds & Clark cites the unreported Central London County Court case of Horserace Betting v Grosvenor Properties (2001) (which appears to have dealt with duration of term rather than break clauses) in which the LL apparently sought a 1 year term to develop, the T sought a 2 year term to allow it to wind down its business in an orderly fashion. Moving out during the process would have been extremely disruptive, whereas the LL did not stand to lose a significant sum if its plans were delayed. A 2 year term was apparently granted.
its intention in accordance with the strict standards required by that provision. The T is thus protected from a frivolous use of the break. Although the incorporation of a break clause is likely to reduce the value of the T’s leasehold interest, the Act aims to protect the security of the T’s business, not the value of its lease as a “saleable asset”.

‘54 ACT: PRINCIPLES AND THEMES RELATING TO DURATION, BREAKS AND OTHER TERMS | Geraint Wheatley
Profile

Geraint Wheatley is recognised as a leading real estate junior in Chambers UK 2020, and has been ranked as such for a number of years.

His submissions were recently praised by the Court of Appeal as "excellent" in the important case of Thorpe v Frank [2019] EWCA Civ 150, in which he successfully appealed a decision of the Upper Tribunal concerning the proper limits of the law of adverse possession.

Geraint is an experienced property specialist, combining an outstanding academic background with tactical awareness and an eye for detail. His practice covers the full range of property litigation, as well as non-contentious advisory work relating to property transactions.

At this time of uncertainty, with cases being adjourned and trials being postponed indefinitely, Geraint is aware of lay clients' concerns over certainty and cashflow. He is keen to assist in the resolution of disputes via ADR. He has the expertise to offer Early Neutral Evaluation, and has experience of providing independent Opinions on disputes (or specific issues within disputes) to help the parties to reach settlement. Opinions/Determinations can be provided on a binding basis (where the parties agree between themselves to adhere to the Determination, for example, on a particular legal issue or point of construction) or an advisory basis, where Geraint’s view can be taken away by both parties to assist with their own consideration of the merits and guide their settlement efforts.

Geraint regularly acts in both the High and County Courts for institutional clients such as developers, banks, receivers and national limited companies. He has appeared a number of times before the Court of Appeal and the First Tier Tribunal: Property Chamber (formerly the Adjudicator to HM Land Registry).

Qualifications

Oxford University (St Edmund Hall)
1st Class Law Degree

Bar Vocational Course, Manchester
Grade: Very Competent (ranked 1st in year)

Awarded the Edmund-Davies Award by Gray's Inn

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