

Reality bites for post Covid lease renewals

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By Claire Munn

When a lease is renewed under the 1954 Act, the starting point is that it will be on the same terms as the old lease. In practice, that may no longer reflect the market but if the landlord or tenant want changes, they must justify them. We are starting to see the impact of the pandemic on renewal terms and the case of HPUT Trustee No.1 Limited and HPUT Trustee No.2 Limited v Boots UK Limited is the latest example of a judge being willing to allow different terms, to better reflect the current market.

The case concerned an unopposed 1954 Act renewal of retail premises, where the parties could not agree on the length of the renewal term, the rent and interim rent, or whether the tenant should have a break right. The existing lease had a stepped annual rent increase of 1.5% and gave the tenant an annual right to break. On renewal, the landlord wanted a 10-year term with no break, on the same stepped rent basis. Boots, the tenant, wanted only a 5-year term, with a break at year 3 and no stepped rent or other rent review.

Duration

The judge held that the overriding criterion was the tenant's need for flexibility in an uncertain market. On that basis, the term should be 5 years, to balance a reasonable period of security for the tenant with the landlord's need for a period of certainty. The judge recognised that shorter leases are now more common, and that the market was uncertain. The landlord had not given any evidence to counter this, of how it would be adversely affected by a shorter term.

Tenant break clause

In relation to the tenant's break right, the judge again noted the uncertainty in the market. The onus was on the landlord to justify removing all break rights and it had not done so. The judge awarded Boots a break right at year 3, commenting that if the post Covid market was as optimistic as the landlord believed, it would suffer no injustice if the premises were handed back after 3 years.

Rent increases during the term

The judge held that there should be no fixed stepped increases and no rent review over the 5-year term. The provision was in the existing lease because it was included as part of the terms of the sale and leaseback transaction, but that was no longer relevant. He noted that it would be unusual to find a stepped rent provision in the market and it could be unfavourable to the tenant if the rent increased above the market rent.

Rent and interim rent

The landlord was successful on rent (and the parties had already agreed that the rent and interim rent should be the same). Boots argued that it should have the benefit of a rent free, to reflect the position in the open market, which would equate to a discount over the term of the tenancy. The judge disagreed for the following reasons:

- The 1954 Act assumes that the tenant will pay the market rent from day one.
- The value of the hypothetical letting may take the real world situation into account.
- In the market, whether the tenant needs an inducement depends on all the circumstances in a commercial negotiation and in reality, Boots was unlikely to need a rent-free period to enable it to fit out the premises.

Key points to take away

This was an important case for the parties, as it was a test case for a portfolio of 123 properties. As a county court decision it is not binding but has some useful take-aways:

- The purpose of the 1954 Act is to give a tenant security of tenure. The court will give high regard to a tenant's needs, granting flexibility of terms if needed.
- The court's decision on the treatment of rent-free periods was contrary to some recent decisions on this point (but see our commentary on a recent decision where the judge said rent free periods in comparables should be ignored).
- The court said that it would have granted an upwards only rent review had it been necessary to reflect market practice (historically the courts have ordered upwards/downwards reviews).
- Where landlords believe a proposed term will have an adverse effect, they should provide evidence if they can.