The Attrition of the 'Institutional' Lease

As my firm celebrates its 50th year in business, and I enter my 56th year of schooling to be the 'CompleatSurveyor', I set out my experiences of how the so-called 'Institutional' Lease has been so atrophied over the past half century.

When I joined the profession as a Trainee, fresh from school in 1964, a typical business lease was on full repairing and insuring terms, for a period of twenty-one years, with septennial upward only rent reviews and full privity of contract provisions. A strong covenant might then secure a lease with a rent review after fourteen years, or very rarely without rent review for the term of the Lease.

As inflation quickened, in the latter part of the 1960's decade, Leases moved to a twenty five or sometimes a thirty five year term, with quinquennial upward only rent reviews. This model remained the standard through the 1970's and 1980's, albeit with a short-lived attempt to impose triennial rent reviews in the late 1980's, which died at the onset of the 1990 -1992 recession. Furthermore, throughout all this period it was customary for the Landlord's legal costs, incurred in the preparation of the Lease, to be borne by the Tenant.

In the mid 1990's, the government enacted the Landlord & Tenant (Covenants) Act, 1995, which removed full privity of contract provisions in all new commercial Leases with effect from 1st January 1996. Thereafter, a prior Lessee would no longer have liabilities for the Lease obligations in the event of a subsequent Tenant failure, beyond the first assignment of the Lease. On all Leases that predate 1996, previous Lessees had, and still have,full privity of contract liability for the entire term of the Lease.

As the first concerns over emerging on-line retail sales were seen in the mid-1990's, several major retailers, concerned that their High Street businesses would be decimated, refused to renew expiring twenty five year Leases, for more than a five year term.

These fearsproved groundless, or at least far too premature, as the UK's economy began its "golden run" in 1993, with 63 quarters of consecutive growth, the longest unbroken period of economic growth, since records began.

Alas, this was followed by the Great Recession of 2008/9, with a steeper decline in gross domestic product than seen in the Great Depression of the 1920's.

In the early 2000's, government signalled its intentions to influence the market towards shorter Leases, by confirming it would not sign up for Lease terms longer than fifteen years.

At the same time a vigorous campaign by occupiers to abolish the upward only rent review, (more accurately described as the non-downward rent review), was eventually seen off by a strong Landlord campaign.

Rents peaked in mid-2007, with Business Rateable Values duly revalued in April 2008 for implementation in April 2010, by which time both the property market and the UK's economy were in a very different place.

Rents retreatedsharply due to a combination of on-line retail penetration, a flat-lining of the UK economy, excessive business rates, and the collapse of several leading national multiple retailers.

Almost twelve years on from the Great Stumble, we are still seeing continual attrition to the 'Institutional' Lease, the retail industry collapse this decade, having effectively destroyed it. With numerous multiple retailers, once of strong covenant status, seeking the shelter of a Compulsory Voluntary Arrangement (CVA), Lease covenantsare being set aside in respect of repairing liabilities, terms of payment, and passing rents.

Faced with a grossly unfair 100% liability for excessive Business Rates, few Landlords are confident enough to rejecta CVA process and chance takingtheir premises back to relet in the current moribund market conditions.

In the 2010's, we saw Leases shorten to Ten year terms, frequently with Tenant break options at the end of the Fifth Year. Whilst these Lease breaks were rarely implemented, they had a negative effect on a rent review uplift. The hard won success retaining upward only rent reviews has been negated by the Lease term shortening.

Today, we see Tenants offering Lease renewals for a Five Year term, often with a Three Year break option, rents payable monthly, rather than the traditional quarterly in advance payments, and at half the previous passing rent.

In the latest attrition of the commercial property Lease,some Tenants are even demanding an internal repairing liability, as opposed to the long established full repairing covenant.

So over the past 50 years the "Institutional" Lease has gone from a 25 year unbroken full repairing and insuring term, with full privity of contract provisions, upward only five yearly rent reviews, rents payable quarterly in advance, and the ingoing Tenant paying the Landlord's legal costs in the preparation of the Lease, to a FiveYear Lease, possibly with an internal repairing liability, an option to determine at the end of the Third Year, rents payable monthly in advance andfrequently softened below market value to off-set excessive business rates liabilities.

Yet, despite the typical business Lease of today being a shadow of its original form fifty years ago, investment yields have remained surprisingly unchanged.In 1996, many Investment Surveyors thought a two-tier market would develop, with pre-1996 Leases, having much more robust provisions, being more keenly sought after, and higher prices paid. Such a distinction never materialised and today yields remain surprisingly similar, despite aTenant's much reduced liabilities.

What is certain is that once retail supply and demand are back in balance and retail development revives, Five Year Lease patterns will not be fundable. Retailers wanting new premises will then have to accept Lease lengths with sufficient certainty of term to satisfy a Lender's criterion of security.

I hope to still be around to see that swing of the pendulum.

Anthony H Ratcliffe
Ratcliffes
February 2020