

## **LEASE BREAKS – Occupier Perspective**

### **Introduction**

In the last 10 to 15 years lease breaks (also known as Options to Determine) have become much more common, particularly as occupiers seek more flexibility and landlords have bowed to market forces.

However, having a tenant breaks may still not be that straightforward and needs careful pre-planning to determine if a break should be exercised and what is required to make it effective.

There are many pitfalls for tenants, which can lead to being tied to an unwanted lease for longer than anticipated, incur unexpected costs or even lead to “double overheads” if a new commitment is made as the old commitment is not extinguished.

The following information has been provided by a firm of Independent Chartered Surveyors with considerable experience in this field.

### **Plan Ahead – To Move or not to Move**

Any lease breaks, as with any significant lease event, should be diarised well in advance – be sure to know what notice period is required – 6 months is the norm but longer and even shorter periods are not uncommon.

Depending upon the complexities of the situation, you need to decide if you intend to exercise the break well in advance of the final notice date. Any decision to break needs take into account whether relocation is essential, preferable or even unwanted; comparing the benefits and disadvantages (not just financial) of staying or going.

Amongst many factors which may determine a move, the following are commonly to be considered:-

**Location** – is there a need to move simply because you are no longer in a suitable location; your market may have moved elsewhere or the locality has deteriorated. Bear in mind too that many break dates are also rent review dates and if you stay there may be a substantial increase in rent due, depending on market conditions. You may consider relocation to avoid an unacceptable rent increase. Other reasons to re-locate may be to attract/recruiting skilled staff, changes in transportation etc. which make the location less attractive than before.

**Growth or shrinkage** – Your business may have expanded such that you need larger premises or conversely a down-turn has led to a need for less accommodation. However you should consider whether this can be accommodated in your existing premises by re-configuring space or conversely negotiating a surrender of an unwanted part back to the landlord.

**Quality of Space** – Are better amenities required – air conditioning, raised floors, natural light etc. Does the layout and nature of the existing space prohibit a better working practice – from cellular to open plan layout, multi-floor to single floor, etc. Is image a concern or the growing need to be “Greener”

**Financial** – There may be cost savings as a result of the effects of the above or more simply changes in market conditions have meant that cheaper alternatives are available or, as stated, there is a clear need to relocate to avoid a rent increase. Bear in mind that a break may also be an opportunity to re-negotiate terms with your landlord – he may not want to lose you, particularly if his prospects for re-letting the space are poor.

There may also be substantial incentives on offer to relocate – at least offsetting relocation costs. Your landlord may offer similar to keep you.

## Make an Informed Decision

In making a decision on relocation it is vital to canvass opinion and take advice both internally but also from external professional consultants on all aspects of the relocation process. The sooner such advice is taken the more accurate and informed a decision can be taken with a greater chance of minimising errors and not being caught out by unforeseen circumstances!

A number of factors need to be considered as an ongoing process before the decision is taken, when the decision is taken and managing the decision to a successful conclusion thereafter.

In particular, advice should be sought from the following:-

**Lawyers** – They should be able to advise on the existing lease; especially the mechanism for operating the break clause and what is required to comply with any conditions attached (see “Do’s and Don’ts”).

**Property Consultants/Surveyors** – An experienced agent will advise upon your existing premises – rental levels/other costs, even insight into your landlord’s situation, etc. They can also offer invaluable information on prevailing market conditions and report on alternative options with full costs and incentives available. They will negotiate new terms on your behalf including incentives, carry out due diligence – check measurements, etc and provide comment on best practice in terms of modern lease structure and conditions, including future rent reviews and breaks. Alternatively they can negotiate with your landlord to re-gear the existing lease.

**Building Surveyors** can also advise on the costs that may be involved in vacating premises in terms of repairing and dilapidations liability which, depending upon a tenant’s extent of fit-out and repairing liabilities of the lease, could be very extensive. This is also vitally important where complying with dilapidations liability may be a condition of operating the break clause itself.

**Professional fit-out/design consultant** can offer space planning advice from a very early stage; they can audit your current and future space requirements and advise on the usability and efficiency of the existing space as well as compare potential alternatives once identified. They will also provide invaluable advice on the viability of staying in existing premises – re-organisation/refurbishment/cost/efficiency versus the benefits/costs of alternatives. They can include input on other relocation costs including removals, telecoms and IT infrastructure, furniture etc.

## Do’s and Don’ts - Some traps to avoid

Do ensure that the notice is served in good time, on the right party and in the manner required by the lease. Examples exist where a company simply posted their break notice to the landlord (who was only based two streets away), then waited until after the break date had passed before asking if the landlord had received it. Not surprisingly, the landlord denied all knowledge and without proof that tenant was committed to a further 10 years of that particular lease!

If the lease allows, always have your lawyer serve the requisite notice on your behalf. Check what is legally acceptable as the form of service of notice – email, fax etc. may not be for overseas delivery etc. ALWAYS GET A RECEIPT and, if possible, acknowledgment from the landlord that it is in a valid format.

Before serving the notice, ensure that you have or will be able to meet any conditions of the break.

Most modern forms of break clause (drafted within the last five years or so) if properly negotiated, will only require the tenant not to be in arrears of rent and other outgoings on the notice date and/or the subsequent expiry date. Still be sure that you have met all payments – if rent is demanded quarterly in advance you may have to pay a full and final quarter’s rent even if the lease expires between quarter days.

However many older forms of break clause (and even some relatively new ones) may impose other conditions – most commonly a requirement that the premises to be left in good condition. It may not then be sufficient to argue dilapidations or make a payment after the event as failure to comply itself will invalidate the notice to break. There is considerable case-law on this issue alone, particularly often coming down to precise wording of the lease and interpretation thereof.

Instances have occurred where the premises had to be in good condition not only at the expiry of the notice period (termination date) but also at the date the notice itself. Thus the tenant had to redecorate whilst still in occupation to make the service of the notice effective and then again when they vacated six months later. There was even then concern that they might have to vacate before serving the break notice so that the repairing obligation could be met.

Careful consultation with your lawyers and building surveyors is essential to know what is required.

Most important of all, if you are moving, make sure you have moved out and can offer up full vacant possession (which has a strict legal definition) when the lease expires.

It is also important to understand that once a lease is determined, the expiry is non-reversible, provided the terms of the notice are complied with. If you intend to stay, a new lease may need to be put in place or at the very least a legal Deed of Variation be agreed to revoke the notice.

Be sure that you know all of the costs that you may incur or benefits foregone in serving the break. Some breaks come with a financial penalty that must be paid to the landlord as consideration for exercising the break. On the other hand some leases offer additional incentives (often in the form of rent free period) to a tenant not to exercise the break.

Also be aware that if you serve a break as a tactic to renegotiate terms - lower rent and/or fresh incentives – the landlord may just accept your notice if he wants you out. Always try to anticipate your landlord's reaction. Instances exist of tenants who have operated a break clause, unaware that the landlord wanted to redevelop the building; had the tenants stayed they would have been in line for a substantial payment from the landlord to persuade them to go.

If staying put is a realistic option balance the need to keep your intentions secret from the landlord with the benefits of opening a dialogue with them at an early stage. This may get them to reveal whether they would “encourage you to stay”. Even if you intend to go, working with the landlord could assist you by agreeing what is required to go well in advance particularly where there may be a potential dispute over dilapidations.

If you ask them what they require to satisfy their requirements to quit they may even weaken their position in a later dispute if they have been seen to be obstructive.

Maintaining good relations may also help – for example if you need an extension to the period to vacate following notice. A landlord may oblige if it maintains his income stream that bit longer. But, as seen above, it has to be documented in good time!

Be aware that a break may be mutual or there may be a break in the landlord's favour only. You need to know of or plan for this eventuality. If the landlord only had to give six months notice would you have time to relocate if you were not forearmed?

Bear in mind that relocating is a very time consuming business, even a small office move will take up a lot of time and distract you from your core business. Be ready to delegate internally and through your consultants, who are used to dealing with these issues day in, day out.

Have a clear plan of what you wish to achieve and also an accurate timescale. Ensure you have sufficient time for the process of searching for alternatives, negotiating a new deal, legal formalities and necessary consents and organising the move. Then there is the period of fitting out new premises. You may also need to leave sufficient time to move and then carry out dilapidations on old premises in order to comply with the break conditions.

The nightmare scenario is to relocate at considerable cost and commitment to new premises to find you unable to end the old lease incurring a double overhead liability. Always have a contingency plan if things go wrong at any stage during the process.

### **Lease Expiry – a break by any other name**

A contractual lease expiry also needs advance planning and you should never assume that you can renew your lease. A lease expiry is effectively a MUTUAL break so it is essential to know your landlord's intentions in advance. Lease expiries are further complicated by commercial leases either having the protection of the Landlord & Tenants Act, regulating security of tenure or not, depending on whether you are contracted in or out – but this is for another article if not an entire library on the legal process.

### **Summary**

Without the right approach there are many traps waiting to catch the unwary and mistakes can be costly and potentially impossible to reverse. Thus, while a lease break may be a daunting task to take on board, if properly handled, it can be a considerable opportunity for a business and can change its fortunes entirely.

However you will only have one chance to get it right and it is important to plan in advance and to be fully informed of the pros and cons. Only with a clear vision of your business plan and the right advice can you the right decision be invaluable and of long term benefit.