

Commercial Leases and the Credit Crunch: Part One

In the first of two articles, Gerard Small, Commercial Property Partner at John McKee & Son Solicitors, considers some of the practical and legal implications of the current economic downturn for landlords and tenants of commercial property.



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These are tough times for both landlords and tenants of business premises. Difficult trading conditions mean that many tenants are unable to meet rental payments as they fall due. Some tenants have become insolvent. Demand for commercial property has declined and the supply of financially strong tenants in the market has been greatly reduced.

All of this has impacted upon various pressure points in the commercial lease cycle - negotiations for the grant of a new lease, rent reviews, break options, renewal leases and applications to the Lands Tribunal for the grant of a new lease. Commercial landlords are struggling to get and retain good tenants and this has been reflected in the payment of 'reverse premiums' to entice tenants into new leases and the agreement of reduced passing rents.

There has been a shift from quarterly rents to monthly rents and whilst this is a welcome development for many business tenants, it can put pressure on the cash flow and business plans of their landlords. Delays in payment or non-payment of rent can affect landlords' ability to service bank debt and often lead to breach of financial covenants in loan agreements in respect of rent cover or loan to value.

Commercial tenants are in a stronger position now than they have been at any time in the last decade to negotiate hard not just on commercial terms such as rent and service charge but on all aspects of the lease where previously they have been forced to accept very pro-landlord terms.

So much for the tenant embarking on a new lease on much better terms than could have been negotiated in recent years. What about landlords faced with tenants simply walking away from premises in the middle of

a lease term or in serious breach of their rental and other obligations? A number of recent cases before the courts arising from circumstances such as these are worthy of consideration by commercial landlords who may find themselves in similar situations.

Unintentional surrender?

Sometimes tenants find themselves no longer able to pay the rent and simply vacate the premises and seemingly disappear. The lease, though, remains valid and subsisting in these circumstances as do the landlord's remedies against both the tenant and any guarantor.

In other cases, the tenant will seek to surrender the lease and the landlord may be agreeable because the tenant has ceased trading and vacated the premises and has no prospect of paying the rent in the future.

There are restrictions on agreements to surrender a business tenancy in Northern Ireland at a time when the tenant is in possession of the premises. If the tenant has vacated though, a surrender by operation of law will arise where the parties agree to bring the tenancy to an end and the landlord does some act which is inconsistent with the continuance of the lease and the validity of which he is later prevented from disputing. This could happen for example where the tenant hands back the keys and the landlord accepts them.

The effect of a surrender by operation of law is to bring the lease to an end from the date of the surrender. The tenant will have no liability for payment of further rent and any guarantor will be released from any future obligation.

A recent decision of the English Court of Appeal reveals how a tenant may seek to contrive a surrender by operation of law

in order to escape future liability under a lease. In *Artworld Financial Corporation v Safarian & Others*, the tenant vacated the premises and returned the keys to the landlord when there was still 15 months of the term to run. The landlord issued proceedings claiming payment of the rent for the remaining 15 months. The tenant argued that there had been a surrender by operation of law because the landlord had taken the keys back, carried out works of redecoration and had occupied the property for a period. The Court of Appeal rejected the landlord's claim on the basis that the acceptance of the keys and occupation of the premises for a while was inconsistent with a continuance of the tenancy.

Landlords, therefore, should be careful not to do anything which may give rise to an unintentional surrender of the lease and so prevent them from recovering the rent which would otherwise be due for the remainder of the term from the tenant and/or any guarantor.

Waiver of the right to forfeit the Lease

In some cases, regardless of the tenant's intention, the landlord may want to bring the lease to an end because of the tenant's non-payment of rent or breach of other obligations in the lease. Another English Court of Appeal case, *Osibanjo and Another v Seahive Investments Limited*, illustrates how a landlord may inadvertently give up (waive) its rights to bring a lease to an end (forfeit the lease).

In this case, the landlord brought bankruptcy proceedings against the tenant for arrears of rent. The tenant forwarded a cheque to the landlord's solicitors which was stated to be partly in discharge of the bankruptcy debt and partly in payment of subsequent arrears of rent. The solicitors lodged the

cheque but later wrote to the tenant stating that the landlord had retained the amount required to discharge the bankruptcy debt and enclosing a cheque refunding the balance. The solicitors' letter asserted that the clearance of the cheque through their account should not be regarded as a waiver by the landlord of its right to forfeit the lease.

After this, the landlord issued proceedings for forfeiture of the lease for non-payment of rent and breach of other covenants. The tenant argued against this on the basis that the landlord had waived its right to forfeit the lease by applying the cheque sent to the solicitors towards arrears of rent.

The Court of Appeal rejected the tenant's assertion, finding that the landlord's solicitors had clearly and promptly indicated the basis upon which the payment had been accepted in part. The landlord could not be said to have accepted the balance money as rent.

This case is instructive for landlords as to the dangers of taking payments of rent in circumstances where a right to forfeit the lease exists. Such a right may be deemed to have been waived by acceptance of the payment. It may be more prudent for the landlord simply to reject the payment or to confirm the basis upon which it is made before accepting it.

Next month we consider the position of the landlord where the tenant has become insolvent.

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