

IT'S THE LAW: Commercial Property

When landowners are looking to document the short term occupation of their commercial properties they have three options to choose from. Firstly, a lease (also sometimes referred to as a tenancy), secondly a licence and thirdly a tenancy at will (a special type of lease/tenancy).

Different types, different rights

The three different types of occupation come with different rights for the occupier. So it's critical that landowners consider which type they want to create and then are careful to make sure they don't accidentally allow one of the others to arise.

A commercial lease may grant an occupier a valuable right known as security of tenure. Licences and tenancies at will do not.

What is security of tenure?

Security of tenure is the brainchild of the Landlord & Tenant Act 1954 and protects the commercial lease in two ways.

Firstly, the tenancy created by the lease will not automatically come to an end on the expiry of the fixed term of the lease. Instead, the tenancy created by the lease will continue and the tenant will be allowed to remain in occupation of the property until the tenancy is ended by one of the ways specified in the 1954 Act.

Secondly, the tenant will have a statutory right to apply for a new lease. The renewed lease will be on similar terms to the original one. The landlord will only be able to resist renewing the tenant's lease on certain limited statutory grounds – set out in the 1954 Act. Any lease that is renewed in this manner will also enjoy security of tenure. In short – once there is a protected tenant in occupation of a property, it is tricky to get them out.

Insecurity

There are four ways to avoid your occupier securing security of tenure:-

- You can grant them a lease – but 'contract it out'. It is possible for a landlord and tenant to agree to exclude the security of tenure provisions from a lease by following a set procedure before the lease is granted or an agreement for lease is entered into. This used to involve going to Court – but nowadays it's a matter of putting the right words into the documents, serving a notice and making a statutory declaration. This is called 'contracting out'. If done properly the tenant will not benefit from security of tenure
- You can grant them a lease for 6 months or less
- You can grant them a licence (the 1954 Act doesn't apply to licences)
- You can grant them a tenancy at will (likewise, the 1954 Act doesn't apply)

Careful now

Landowners often think that the last two options are the easiest. A common @#*~ up, however, is for landlords to think they are granting a licence or a tenancy at will – but because they don't get it quite right, they accidentally grant a lease. They won't have gone through the contracting out procedure – because they didn't think it was needed. Hey presto: six months later



Neil Toner
Partner, Head of Real Estate
020 7065 1823
neil.toner@devonshires.co.uk



Aruna Sarwar
Partner
020 7065 1846
aruna.sarwar@devonshires.co.uk



Dan Moan
Partner
020 7880 4336
dan.moan@devonshires.co.uk

they end up with a tenant with security of tenure.

Substance over style

Simply labelling a document a licence will not necessarily mean that that is what it actually is. That would be too easy. Instead, a Court will look at the substance of the document itself and the rights and obligations it contains and decide whether it thinks that the arrangement has the characteristics of a lease or a licence.

What is a lease?

A lease confers an interest in land on the tenant. As a general rule (and subject to certain exceptions) a lease will exist where the following three key components exist:

Exclusive possession of land: A tenant will have exclusive possession of land if they can exercise the rights of a landowner and exclude both the owner of the land and third parties from it (save to the extent that the actual owner has reserved rights of entry within the lease). There is no need for the tenant to actually be in occupation of the land in order for them to have exclusive possession. It's a question of control. A key element is literally who has the keys.

A determinable period of time: In general, a lease must have a certain beginning and a certain end. So a term from now until next January 1st passes the test. A term from now until the weather gets warmer does not. Having said that, you can have a fixed term with a break right – even though you don't know when the break right will be exercised.

A rent: This can be very small. Tiny in fact. A common rent is 'a peppercorn per year' which effectively means nothing – but manages to pass the legal test. A more poetic rent sometimes used is 'a single white rose per annum'. That sounds nice, but can be troublesome when you are filling in your Stamp Duty Land Tax return.

The benefit of granting a lease is that the landowner will know where they stand and be able to expressly exclude security of tenure. If the parties want some flexibility in the length of the lease, this can be safely introduced by using a mutual rolling break clause. The disadvantage of a lease is that even one for a short term will be a more complex document than a licence as it is creating an interest in land. As such, it will take longer to negotiate. There may also be SDLT implications for the tenant.

What is a licence?

A licence grants the licensee a personal right or permission to do something on the licensor's property. No interest in land is created.

A licence is often used where office space is to be made available for a short time or for the period between exchange and completion of a sale contract or agreement for lease.

Whether what you want to be a licence is, in reality, a lease will often turn on the question of exclusive possession. For example,

if the owner of a car park grants a driver the right to park their car in a specific parking space within the car park, this is indicative of a lease as the driver can enjoy exclusive possession of a particular parking space. However, if the owner grants the driver a general right to park their car in any free parking space within the car park, this cannot be a lease as there is no exclusive possession of a particular bit of land.

What is a tenancy at will?

In practice, a tenancy at will is often granted where the parties want the tenant to enter into occupation quickly and there isn't time to sort out the formalities of a lease. It is common to see tenancies at will granted where the parties are negotiating a lease, but the tenant needs to go into occupation before the lease is completed. A tenancy at will allows the tenant into the property quickly but also enables the landlord to take the property back easily.

The critical thing about a tenancy at will is that it must contain a right to terminate the tenancy at any time – without any notice. It's not unheard of for tenants and landowners to sign up paperwork that includes an immediate break right – but by a nudge and a wink agree that they won't exercise that right without giving, say, a month's notice. Big mistake. Huge mistake. A Court will look at the substance of the transaction and hold that that arrangement is not a tenancy at will – because the parties don't intend for there, in reality, to be an immediate break right.

Consecutive tenancies?

The starting point is that leases for a term of six months or less don't benefit from security of tenure. However, this doesn't mean that a landlord can get around security of tenure by simply granting a whole series of six month tenancies one after the other. A landlord can get away with granting a fixed term tenancy for six months followed by another fixed term tenancy of just under six months but the grant of a third tenancy could potentially fall foul of section 43(3) of the 1954 Act. Section 43(3) provides that even a short term tenancy of less than 6 months will be protected if the same tenant has occupied the property for more than 12 months by the time it comes to an end. This 12 month period includes occupation by a predecessor tenant in the same business as the tenant.

The tiny print

This is one of a series of leaflets published by Devonshires' Real Estate & Projects Department aimed at our developer clients. No action should be taken on the matters covered by this leaflet without taking specific legal advice.

Find out more

Neil Toner
Partner, Head of Real Estate
020 7065 1823
neil.toner@devonshires.co.uk