

Heads of Terms

for Commercial Leasehold Premises

Once a tenant has found commercial premises to rent the landlord and tenant must agree the Heads of Terms. Whilst this is not a legally binding document it will set out the main terms to be included in the Lease and it is therefore important that the tenant understands what they are agreeing to as any attempt to vary these at a later stage is likely to be strongly resisted.

The Heads of Terms set out the principal terms to be included in the Lease and will generally include the following:-

1. Property

It is important to ensure that the extent of the property being leased is clearly established, particularly as the tenant's repair liability will relate to the area "demised". Ideally, a plan should be attached to the Heads of Terms showing the area in question, particularly if the property forms part of a larger building.

A tenant should be clear whether it is taking responsibility for the whole of the premises i.e. both the interior and the external structure and roof or whether it is only taking an internal demise with the landlord retaining responsibility for the external structure.

If the tenant is to be granted rights over any external areas of the landlord's estate such as a right to use certain car parking spaces, this should also be included in the Heads of Terms.

2. Term

The Term of the Lease is the length of time for which the tenant will have a right to occupy the property. It has to be for a fixed period but it is possible to include a right to end the Term early (see the information below).

The security of tenure provisions of the Landlord & Tenant Act 1954 will also have an impact on the length of term of the lease. These provide a statutory right for a commercial tenant of business premises to remain in the property at the end of the fixed term. This is discussed in more detail below.

3. Rent

Most commercial leases will require the tenant to pay an annual rent. This is normally paid in advance and can be payable either quarterly or on a monthly basis. It is usual for a tenant to seek a "rent free period" at the commencement of the Term whilst it is fitting out the property and not therefore generating income. The length of the rent-free period is a matter for commercial negotiation between the parties and a landlord may agree a longer period than is necessary to carry out the fitting out works in order to entice a higher quality of tenant.

Some leases of retail premises may calculate the rent by reference to turnover. This is seen as a fairer way of determining the rent payable for the property and means that both parties have an interest in the success of the business. Although the landlord will benefit from any profit the business makes it will also share in any losses.

4. Rent Review

Dependent upon the length of the Term, the Lease may contain rent review provisions. This is a mechanism by which the rent payable at the beginning of the Lease is altered during the Term. The rent may be increased on fixed dates to fixed sums agreed before completion of the Lease or may be reviewed to reflect the market rent payable for comparable properties at the relevant review date. It is usual for any such review to be on an upwards only basis, i.e. the reviewed rent will be the higher of the existing rent and the open market rent at the review date.

It is worth pointing out that the Annual Rent is only one of the payments usually due under a lease. The tenant will usually be required to reimburse the landlord for the cost of insurance for the property and (where the tenant takes an internal demise) a service charge (which relates to the costs incurred by the landlord in maintaining any external parts and other common areas of the building/estate on which the property is located). These sums are often referred to together as "Rents" but are variable charges and therefore distinguishable from the Annual Rent which is a fixed figure (subject to review/turnover).

A tenant will also be liable for other outgoings relating to the property, such as utility charges and rates. A tenant should establish whether or not VAT is payable on top of the Annual Rent. This will depend upon whether the landlord is registered for VAT and has elected to charge VAT in respect of the property in question. If it has, it is entitled to charge VAT on the rent.

5. Security for the Landlord

Dependent upon the financial strength of the tenant, the landlord may require the tenant to pay a rent deposit on completion of the Lease. The amount is again a question of commercial negotiation but can be equivalent to 3-12 months annual rent plus an amount "equal to" any VAT payable on the rent. Alternatively, the landlord may request a guarantor for the tenant. In the case of a company, this may be a parent company or other group company and/or individual directors of the company.

6. Repair and Decoration

The tenant will be responsible for maintaining and repairing the property during the term of the Lease. Repair obligations can result in considerable financial expenditure for a tenant and therefore where possible, the extent of a tenant's repair liability should take account of the current condition of the property. A schedule of condition can be annexed to the Lease containing photographs and details of the condition of the property at the start of the Lease.

The tenant should also be clear about the extent of the property they are required to repair. If the Lease is an FRI lease, the tenant will either be required to repair both the interior and exterior and reimburse the landlord for the cost of its buildings insurance or the tenant will be required to repair the interior whilst the landlord remains responsible for the exterior and any communal areas, subject to recharging the costs of maintenance to the tenant under the service charge, together with the cost of its building insurance.

In some cases, the Lease will be an IRI Lease, in which case the tenant will only be responsible for maintenance of the interior of the property. Maintenance of the exterior will fall on the landlord but the landlord will not be entitled to recharge the costs of this to the tenant. The extent of the landlord's obligations in respect of maintenance of the exterior can range from an obligation to keep the property wind and watertight to a full maintenance obligation. Again, this is a question of negotiation between the parties and should be considered in light of the current condition of the property and whether the property is, for example, a listed building.

7. Alienation

This is the ability of a tenant to dispose of its lease where, for example, the property is surplus to requirements or the tenant is looking to expand into more space. This covers assignment of the lease to a new occupier, underletting the whole or part and sharing occupation. It is usual for a tenant to be allowed to assign the lease; grant a sub-lease of the whole (and in some circumstances part) of the property and share possession of the property with a group company but the landlord's consent will normally be required in respect of assignment or underletting. The size of the premises themselves may dictate whether or not underletting of part is possible but ideally some alienation should be permitted, even if the tenant has no current plans to move, as its business needs may change throughout the Term. For more information on Alienation, [view our guide to assigning or underletting your lease](#).

8. Permitted Use

The Heads of Terms should confirm the permitted use of the property, for example, use as offices or as an industrial warehouse. The use permitted under the terms of the Lease is not however the same as the authorised use under planning legislation and it will be for the tenant or its solicitor to investigate this and ensure that the property does have the necessary planning permission for the proposed use.

9. Alterations

It is likely that a tenant will wish to make alterations to the property at the beginning of the Term of the Lease, to fit it out in accordance with its business needs. As the business changes, further alterations may also be needed during the Term of the Lease. It is usual for a lease to allow for internal alterations but subject to obtaining the landlord's consent. The ability to carry out external alterations will only be relevant if the tenant is demised the whole of a building, including the exterior walls and structure but the ability to do such works is usually prohibited. If the tenant envisages the need to carry out such works this should be raised whilst Heads of Terms are being negotiated. It will be for the tenant to ensure that it has the necessary planning permission and or building regulations approval for such alterations.

10. Break Rights

As referred to above, the Lease will be granted for a fixed term. If the landlord insists on a longer length term than the tenant would like to take it may be possible to agree a break right giving the tenant the option to determine the Lease early. It is usual for there to be conditions attached to the exercise of such break right, including an obligation to serve prior written notice. The tenant will normally also be required to have paid all Annual Rent due under the Lease up to the break date and to give back the property free from any other third-party rights of occupation. Any suggestion that the break right should be conditional upon the tenant having complied in full with all Lease obligations, in particular the repair obligation, should be resisted as a minor item of disrepair could invalidate the exercise of the break.

11. Landlord & Tenant Act 1954

Tenants of commercial premises have statutory rights to remain in the property at the end of the fixed term. This right can however be excluded by agreement between the parties. This will not prevent a tenant from negotiating terms for a new lease following expiry of the existing lease however the landlord will be under no obligation to agree to this and may look to impose new terms and undoubtedly a higher rent. Where the tenant has a statutory right to remain in the property and request a new lease from its landlord the terms of that lease (other than rent) will need to be largely the same as the existing lease. Tenants should ensure that they understand the implications of giving up this right, albeit this is rarely a matter for commercial negotiation and most landlords will seek to exclude security of tenure.

It is always recommended that you seek the advice of a solicitor before agreeing terms for the grant of a lease.

Moorcrofts' commercial property team provides legal advice to owners and occupiers of commercial property. We specialise in tenant representation and have extensive experience advising corporate occupiers on all aspects of leasehold acquisitions and disposals. If you would like legal assistance with your commercial property needs, please contact our Partner and Head of Commercial Property – Julia Ferguson.



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