

When breaking up is not an option – leasing from local authorities

Voluntary sector organisations provide valuable and often innovative services to their local community. A local or public authority will often be prepared to grant the long lease of a building or open space to such an organisation, potentially enabling a strategic approach to the property, and in particular, the possibility for capital investment.

The local authority's concerns

Generally speaking, local authorities need to seek full value when disposing of property that they own under section 123 of the Local Government Act 1972. The General Disposal Consent (England) 2003 provides that a local authority can, however, dispose of land at an undervalue not exceeding two million pounds if the authority believes that it will help to secure the promotion or improvement of the economic, social or environmental well-being of its area.

There is therefore a legitimate concern on the part of local authorities that, where there is a disposal of what may be valuable land in public ownership, mechanisms should be in place to ensure that this aim is achieved.

Burdensome provisions

In every case it is important to consider whether the burden on the community organisation will be manageable and proportionate to the safeguards that the authority is seeking.

The requirement for the tenant to provide regular updates as to the 'impact' of activities, the reservation of unusual rights over the property in favour of the landlord, and restrictions on use and occupation are often sought by the landlord authority.

This type of provision may at first sight seem credible at the commencement of the lease negotiation, in the context of a property for which the community organisation is to pay relatively little, or nothing at all. In many cases, however, such restrictions can inhibit the performance of the community organisation in using the property in a creative, constructive, and most importantly, sustainable manner.

The most dangerous type of provision that local authorities propose in this type of negotiation is the landlord's break right.

The nature of landlord's break rights

Landlord's break rights (as opposed to tenant's break rights) are relatively unusual in the commercial world except in the case of some very short-term occupation arrangements in what are sometimes termed 'serviced' premises.

A landlord's break right permits the landlord to terminate the lease, which can be conditional on certain prior events occurring, or can be unconditional.

This is the 'nuclear' option from the tenant's point of view as there would be no scope for appeal or redress. It could potentially lead to the insolvency of the organisation itself.

For community organisations these break rights can turn what is intended to be a long legal interest into what is potentially a very short one, impacting on strategy (because of the risk that the organisation's base of operations may be lost) and deterring funders (because of the threat to the organisation and the unsuitability of such a potential short-term interest as security for a loan or the default repayment provisions in a grant).

A right of forfeiture the better option

Default by tenants under leases is usually dealt with by way of a forfeiture clause. This mechanism provides a more realistic protection for the tenant's legitimate interests.

A forfeiture clause is a clause stating that a landlord may 're-enter' the property if you fail to comply with a number of requirements (e.g. your obligation to pay rent or other obligations under the lease).

Under the law of forfeiture it is necessary for a landlord (except in the case of non-payment of rent) first to serve notice on the tenant, giving a reasonable time for the tenant to put things right. That of itself can be extremely beneficial, allowing the tenant to put its house in order or explain why it is believed that the allegations in the notice are inappropriate or unfounded.

The landlord's right to forfeit is also subject to the tenant's right to apply to court for what is known as 'relief from forfeiture'. This can also be very valuable.

On receipt of an application for relief from forfeiture, the court will have regard to the facts, and if the tenant has acted quickly to remedy any breaches (and agrees to pay the landlord's legal fees), relief will usually be granted. This is based on the long-standing equitable principle that the right for the landlord to re-enter the property is 'merely security' to the breach being put right. The tenant should be given an opportunity to know what their fault is and to remedy it, and to be able to prevent the loss of their property in so doing.

There are yet further protections against forfeiture in longer leases with respect to alleged breaches of obligations relating to the state of repair or condition of the property.

A break right (which by its nature does not have these safeguards) can therefore be seen as a way to bypass the protection that the legislature and the courts have considered appropriate.

A break right may be a forfeiture clause anyway

Landlords should be reminded in the course of negotiations that the courts have in fact stamped down on attempts to end leases for a breach via a break clause rather than forfeiture (as essentially circumnavigating the statutory provisions referred to above requiring the tenant to be given an opportunity to remedy the breach).

In *Richard Clarke & Co Ltd v Widnall*, a clause giving a landlord the right to serve 3 months' notice to end a lease for breach of covenant (i.e., a clause framed as a 'break clause') was held to be akin to a forfeiture clause from which the tenant could claim relief from forfeiture.

The risk in relying on a conditional break right being regarded as a forfeiture clause is that the position will never be certain and if the local authority relies on the effectiveness of the clause, the organisation might be locked out of their premises and left to complex, expensive and risky court procedures if they wish to make the argument and reinstate their use of the property.

The risk in bringing this issue into focus in the course of negotiations is that the landlord might seek unconditional break rights in the landlord's favour.

Impact on negotiations

The strategy of the community organisation should be to persuade the local authority that landlord's break rights in this context are no more in the interest of the landlord than they are in the interest of the prospective tenant.

The community organisation should argue that since the purpose of the lease is so that the community organisation can develop a strategy to use the property for the benefit of the community on a sustainable basis, it is unwise for a local authority to insist on inclusion of a provision that would impact on the organisation's strategy and sustainability.

Reliance instead on a right of forfeiture is the right course for all parties.

For further information, please contact:

James McCallum

Partner

+44 (0)20 8394 6481

James.Mccallum@russell-cooke.co.uk

Clare Garbett

Associate

+44 (0)20 8394 6487

Clare.Garbett@russell-cooke.co.uk

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