

Commercial Property Solutions

Practical And Professional Commercial Property Comment
From The Culshaw Partnership

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Tenants Guarantor Liability After Assignment



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A long awaited decision has clarified the effect of arrangements that provide for a tenant's guarantor to retain responsibility after an assignment.

Late July saw the handing down of one of the most significant landlord and tenant cases of recent times. The long awaited decision in *K/S Victoria Street v House of Fraser (Stores Management) Ltd [2011]* has clarified the legal position of tenants' guarantors after the assignment of the lease.

An old problem

The problem addressed by the Court of Appeal was recognised by property professionals when the Landlord and Tenant (Covenants) Act 1995 was passed. This Act radically altered the law on the effect of assignments for post 1996 leases. A standard assignment of such leases now automatically releases the outgoing tenant from all tenant covenants. However, the Act permits the effect of this relief from ongoing tenant liability to be mitigated by the use of an authorised guarantee agreement (AGA). These have become standard and an outgoing tenant usually guarantees that the assignee will perform the tenant covenants in the lease. (Importantly, an AGA

cannot impose any liability on the outgoing tenant that will last beyond the assignee's release following a further assignment.) Although the AGA has given landlords significant protection, sometimes, it is of little value. This occurs where a lease has been granted to a tenant of low covenant strength but where that of the tenant's guarantor persuaded the landlord that the deal was worth doing. Here, the backing of the tenant's AGA for any subsequent assignee of the lease is of no use to the landlord; what the latter wants is for the original guarantee to continue.

The question of whether the liability of a tenant's guarantor can survive an assignment has been debated since 1996. The difficulty is that section 24(2) of the 1995 Act provides that, once a tenant is released following a lawful assignment, its guarantor is released "to the same extent". Furthermore, section 16 stipulates that only the tenant can enter into an AGA. When this is coupled with the widely drafted anti-avoidance provisions contained in section 25, it is clear that continuing the liability of a guarantor is fraught with difficulty. Professional opinion has been divided on whether a solution could be found.

Landlords were faced with a choice. Either they could decline to enter into leases where the proposed tenant (and thus any future AGA) was inadequate or they could take their chance by including provisions requiring guarantors to underpin any future assignee, knowing that these might not work. Many landlords took the latter option.

The most common method of attempting to preserve the liability of the tenant's guarantor is to specify that the guarantee covers the tenant's liability under the lease covenants or any AGA (sometimes referred to as a "subguarantee").

Some commentators felt that because it was arguable that such subguarantees were not guarantees of the performance of tenant covenants but rather of the AGA (which is not a tenant covenant), this device would work. Alternatively, some landlords impose, as a condition of consent to any assignment, a requirement that the tenant's guarantor enters into a direct guarantee. The issue eventually came before the courts in *Good Harvest Partnership LLP v Centaur Services Ltd [2010]* and then, again in *K/S Victoria*. Both cases involved a lease provision that required the tenant's guarantor to provide a direct

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More Bank Stock Coming To The Market ?

Commercial auctioneers say there are early signs of a sea-change in levels of commercial debt disposal, bringing a fragile but palpable sense of optimism to a sector becalmed since the credit crunch hit in August 2007.

Auctions act as a weather vane for wider market sentiment. Leading auctioneers nationally are witnessing a rise in the number of valuation requests and a small, yet perceptible, swell in volumes of bank-held commercial assets in their sales rooms. But no one is anticipating a deluge any time soon. Latest figures from market analyst the Essential Information Group, produced exclusively for *Estates Gazette*, show that the number of distressed commercial lots on offer at auctions between August 2010 and July 2011 rose as institutions shifted away from their "extend and pretend"

strategy, which enabled borrowers to service the debt while the asset value plunged beneath the Plimsoll line. LSH chief executive Ezra Nahome expects to see more bank-driven sales over the coming months. "The banks have focused considerable resources on their loan book and, given that, they have their arms around the problem," he says. LSH auctioneer Simon Riggall agrees, saying: "We are starting to see more receivership stock, though this has been slow in coming. In many respects, local authorities, for whom we often act, are way ahead of the trend because they work on a strict financial year."

According to Richard Auterac of London firm Acuitus, relationship building with lenders is key to successful sale by auction. "In this recession, auctions are being seen as a more effective marketplace for

secondary investment-grade commercial property stock disposal for lots of less than £5m," he says. "The best results we have had come from being brought in at an early stage in the formulation of the strategy. We have to build up the banks' understanding of the pricing and auction process and of their needs. Simply 'sticking the property in an auction' may lead to disappointment, although this is not to underplay the effectiveness and speed of this method of sale, where binding contracts can be achieved in less than three weeks."

Estates Gazette - 1 October 2011

C.P. Comment:

There is more stock coming to the market although to our mind not that much of it looks very tempting.

Green Leases

According to commercial property investors, green leases are inevitable. Until now, the subject has been skirted around, but the sector is embracing the idea, with almost two-thirds of commercial property owners regarding their leases as being inadequate to meet their sustainable needs.

The call for their adoption is gathering momentum. However, a Tuffin Ferraby Taylor survey shows a clear difference of opinion between commercial landlords and their tenants.

Property consultants are always interested in ways of making commercial buildings more sustainable. Identifying the issues that must be addressed to improve the sustainability credentials of the property is important. Of those surveyed, 81% of investors and landlords thought that the co-operation of their tenants will be required before implementing a green lease, with every tenant agreeing that they would need to work with their landlord. In a similar vein, more

than half of both parties believe that the costs of implementing sustainability measures should be shared between the owners and the occupiers of the building. Respondents have expressed a fear that a tenant's green requirements will result in increased costs to the landlord under repair and refurbishment contracts. Green leases come in three gradients: dark, light and a memorandum of understanding. All three establish practices for parties in taking measures to improve a building's effect on the environments. Dark and light green leases are legally binding documents that replace the standard lease. A dark green lease includes specific obligations and targets, whereas a light green lease includes more general obligations without setting specific targets. The third option is the inclusion in a standard lease of a supplementary non-legally binding memorandum of understanding. The two moderate versions have most backing, with 43% of land-

lords saying that they would consider signing a light green lease and 37% finding a memorandum of understanding appealing.

Estates Gazette - 1 October 2011

C.P. Comment :

You have to wonder who the commercial property owners were, 2/3's of whom considered their leases inadequate to meet their sustained needs. I have yet to meet a landlord who gives a tinkers damn about the sustainability or not of their leases, and certainly more who would consider incurring costs to achieve this laudable aim. I suspect the article relies upon quite a select group of the largest commercial landlords, landlords with an eye to branding, much as their tenants, the multi-nationals and household names are careful to tick all the sustainable boxes in terms of their presentation to the wider world. For most landlords I suspect the emphasis will remain on maximising rent and minimising costs.

Auctions Struggle



Allsop

The success rate at Allsop's commercial sale this week fell to its lowest level in three years. Of the 167 lots on offer at the 10th October event at Park Lane Hotel on Piccadilly, W1, 112 sold, reflecting a 68% success rate. Sales, which totalled £61m, were hit as private investors opted for "known quality" as economic uncertainty spilled over to the auction room.

Auctioneer Duncan Moir said: "Vendors who are looking to take advantage of market momentum by changing prices at the last minute may find they are over-anticipating buyer enthusiasm and then the market makes its preference very clear". Initial yields on grade A retail stock

improved since the summer, closing at 6.3%, up from 6.6%. Yields on grade B investments continued to soften, moving out from 7.4% to 8% over the period. The overall retail yield result eased out from 6.9% to 7.5%, "reflecting well known concerns in the high street since summer", said Moir.

Jones Lang LaSalle

Investors left almost half the catalogue untouched at Jones Lang LaSalle's 6th October auction - its second sale since its takeover of King Sturge.

The event, held at Le Meriden Hotel on Piccadilly, W1, closed with a 52% success rate after 13 of 25 lots sold, raising £8m.

At JLL's first sale in July, some 84% of the 54-lot catalogue sold, raising £30m.

Auctioneer Felix Rigg said that wider economic volatility was to blame for the decline in investor sentiment and activity between the

summer and autumn sales.

He said "Investor confidence at this stage in the cycle is at an all time low". There was demand for safe investments, however. A shop in Faversham Kent, let for 16 years to Alldays Stores for a rent of £31,679 pa and guided at £500,000, sold for £555,000- a net initial yield of 5.4%.

A shop in Hayes Middlesex, let to Tesco Express until 2024 without breaks and producing £45,000 pa with RPI rent reviews, was guided and sold for £725,000.

Estates Gazette - 15 October 2011

C. P. Comment :

The old adage "Cash is King" can rarely have been more true. Getting decent lending terms are ni-on impossible, but if you are in a position to buy there are some good deals to be done.

How We Can Help You

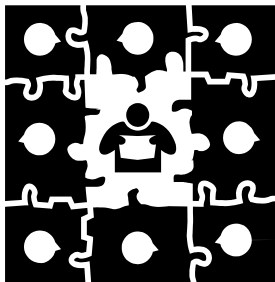
Dear Clients/Prospective Clients

Merry Christmas!!

Yes its that time of year again, well almost. Time to think about festivity, food and of course family. Time to book that early season skiing holiday to get away from the whirl.

Time also to spare a thought for any empty property you may have - is the water turned off? Are the pipes adequately lagged? does your insurer know its unoccupied? You really don't want to return from that skiing holiday all glowing and content, to find a

flooded property waiting for you and if last year is anything to go by!!!



The Culshaw Partnership
one company for all your
property needs

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Rent Reviews/Lease Renewals

Investments ~ Sales & Lettings

Dilapidations ~ Rating

Planning ~ Survey & Valuation

Landlord & Tenant Disputes

The services we offer are listed here please contact us to see if we can be of assistance with any property issues you may have. See page 4 for all our contact details .

Tenants Guarantor Liability After Assignment - cont

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guarantee - always the more suspect device. In *Good Harvest*, Newey J held that a direct guarantee was void under the 1995 Act and expressed the tentative view that a subguarantee would also be ineffective. The judge in *K/S Victoria* did not depart from this view. The property world reacted with dismay.

A sigh of relief

The Court of Appeal tried to make a definitive ruling that will lay this matter to rest. Despite sympathising with the landlord (which had, at the request of the House of Fraser group, granted the lease to a worthless subsidiary in order for the latter to achieve a tax advantage), the court concluded that the use of a direct guarantee falls foul of the 1995 Act. The judgement makes it clear that in no circumstances can a tenant's existing guarantor directly guarantee the immediate incoming assignee. Thus, a requirement to that effect whether contained in the lease, a separate guarantee, the subsequent assignment, or a

licence to assign, is of no effect. Furthermore, after more consideration, it was also held that even a completely voluntary direct guarantee is outlawed. Mindful of how unattractive this conclusion was, Lord Neuberger MR gave a firm view on a matter that was not before the court - namely the legal effectiveness of the alternative device whereby the tenant's guarantor is required to guarantee the outgoing tenant's AGA. To the relief of the property world, this is that such subguarantees are valid; they comply with the Act's requirement that a guarantor must be released to the "same extent" as the outgoing tenant. Although this is in opinion and not a legally binding decision, it will be regarded as definitive. Leases should be checked; those with provisions for direct guarantees will be defective (and any direct guarantees will be unenforceable). Lease precedents will need to be changed so that future leases use subguarantees.

Estates Gazette - 17 September 2011

C.P. Comment :

To be frank I wasn't aware this issue was still live. It is now 15 years since the law of privity of contract was changed, quite specifically to release the original tenant of a lease from the prospect of being held to account after years and many assignments later down the line. Heresy to say so but this provision was one of the more blatant inequalities in landlord and tenant relations. Since 1996 AGA's have been available to provide for the outgoing tenant to guarantee their proposed assignee which does offer landlords a significant degree of protection, and of course leases are vastly shorter now than they were so multiple assignments are pretty unlikely. I can understand that there will still be a kernel of leasehold transactions at the stratospheric end of the market which involve very large sums, very complicated leases and very long terms, for which Lord Neuberger's obiter dicta will cause rejoicing - sadly I don't think it will impinge on my own work to any degree!!

John Tookey

Market Indicators

Prices at present are continuing to move out and at present it is hard to see anything changing fast.

The ECB have cut the Euro Zone interest rates by a ¼ point, the first change since a ¼ point rise in July. The UK doesn't really have anywhere to go on interest rates but all signs suggest that the availability of bank finance is likely to get harder rather than easier in the short term.

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