

Exhilarating Roller Coaster Ride in U.K.

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I could hardly write the terms fast enough – Freeholder, License to Underlet, Practical Completion, Upward Only Rent Review, Solicitors, Dilapidations, Superior Lease, VAT – before I added yet another one that I didn't understand to the list.

This was the kick-off call for my first international real estate assignment. It followed the request from our corporate client's real estate portfolio manager to resolve an issue in London that had become a big problem for him. He explained that others who had strong ties at the very top of his corporation had attempted to resolve this real estate issue and failed. Moreover, he indicated that if we solved this problem it would probably open the door to future assignments with this multi-national organization.

The conference call with our client included Martin Levy, Managing Director of our London office, and lasted 30 minutes. I took a deep breath after the call, redialed Martin in London, and asked him to explain the terms on my extensive list. After 24 years in corporate real estate, I felt like a beginner again. It was both an eye-opener and a great lesson to learn: I didn't know what I didn't know, at least about corporate real estate transactions in the U.K.

Over the course of working on this project, I continued to ask many questions of my London associate



and learned what various terms meant. It proved essential for me to have a trusted member of our team who was native to the London market and could comprehensively review every nuance of the transaction.

Consequently, we successfully resolved this real estate problem which resulted in a cost savings of \$1.2 million or £734,160 to our client.

For me, a vital component to understanding the difference between how the corporate real estate market operates in the U.K. versus in America is the terminology used in transactions. I, therefore, want to share the terms and definitions below and point out that Reinstatement and Rent Review are hidden costs that cannot be quantified prior to signing a lease:

- **Alienation** – Rights to assign or sublease (underlet) granted or excluded from a corporate lease.
- **Break Option** – This term is used synonymously with what is referred to in the U.S. as a termination or surrender option, meaning an option to end the lease prior to its scheduled expiration date.

- **Business Rates** – A local tax that is paid by the tenants (occupiers) of all non-domestic/business property in England and Wales.
- **Heads of Terms** – Typically referred to in the U.S. as a Letter Of Intent, this outlines the most important business points and serves as the term sheet for a lease.
- **Freeholder** – One who has absolute ownership (fee simple) rights to real estate. We typically refer to this as a Landlord in the U.S.
- **Licence to Underlet** – A licence from the landlord to the tenant giving consent to lease (underlet) the whole or part of the property.
- **Licence to Alter** – A licence which is required to be granted by the Landlord prior to commencement of the tenant's improvements. Similarly, a permit in the U.S. is required for tenant improvements prior to construction.
- **Outgoings** – Charges levied on the leased space or demised premises.
- **Practical Completion** – Typically referred to in the U.S. as substantial completion.
- **Reinstatement** – A hidden real estate expense that can be very costly to a tenant. This means the space must be restored to an agreed condition at the end of the lease term. Typically, the landlord identifies a list of repairs needed (dilapidations) and provides it to the tenant prior to the termination

date. We advise our clients to scrutinize this cost carefully. (On this issue, our advisory services saved the above described client more than \$700,000 or £428,120.)

- **Rent Deposit Deed** – Similar to a security deposit in the U.S., a Rent Deposit Deed is held by the Landlord at the commencement of a lease as security for payment of rent. Subject to the terms of the deed, it is intended to be returned to the tenant in full with all accrued interest upon the expiration or earlier lease termination (break). Note that in commercial leases in the U.S., interest accrued is typically not provided to the tenant.
- **Rent Review** – An expense that can't be quantified until after the lease is signed. This is a review of the rent by the Landlord, typically every five years, to determine if it should be adjusted. Modern leases still contain a clause providing for an increase only to the rent and never a decrease (Upward Only Rent Review) that, at best, will result in a minor increase but during a tightening market can be significant. We advise our clients to fully understand the market before agreeing to any rent increase resulting from a Rent Review. (On this issue, our advisory services saved the above described client approximately \$250,000 or £152,925.)
- **Service Charge** – This term is used synonymously with what is referred to in the U.S. as operating and tax expenses.
- **Solicitors** – Lawyers

- **Superior Lease** – This term is used synonymously with what the U.S. refers to as a master lease, meaning the controlling lease on which a sublease, which is known in the U.K. as an under lease, is based.
- **Superior Landlord** – Owner of the building in which the demised premises is located.
- **VAT** – Value Added Tax, which currently stands at 20 percent and is based on the aggregate base and service charge, but is not assessed on the Business Rates cost.
- **Works** – This is commonly referred to in the U.S. as tenant improvements or tenant fit-out.

While I'm still not our expert on corporate leases in the U.K., Martin Levy, managing director of our London affiliate, *is*, and together we delivered favorable results when others could not. Today, we are working on our thirteenth and fourteenth assignments in London and soon the total cost reduction or recovery to our client is expected to surpass \$41 million or £25,083,800.

So, instead of paying too much because you don't know what you don't know, contact an ITRA Global affiliate to help you resolve your corporate real estate issues. It could mean the difference between your company spending or saving the equivalent of millions of dollars.

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