GRANT OF A PHARMACY LEASE

Nick Austen and Gemma Brown of specialist pharmacy lawyers Vertex Law LLP make sense of the common legal jargon relating to pharmacy premises and leases.

1. What is a Lease?

A lease is right granted to a tenant for the exclusive possession of pharmacy premises for a certain period of time. A tenant has exclusive possession if it can exercise the rights of the landowner and exclude both the landlord and third parties from the premises (except to the extent that the landlord has reserved rights in the lease).

There are many types of leases including headleases and underleases. Full definitions of these kinds of lease can be found in our legal expressions glossary.

2. Rent

There are many different kinds of rent that can be payable under a lease, including:

- **Ground Rent**: this is a rent which reflects only the value of the ground and not of any building on it. This is likely to be payable where a long lease is granted at a premium.

- **Rack Rent**: this is the full open market rent of the property; it is the most that can be obtained in the market for the property. Most pharmacy leases are granted at rack rents.

- **Turnover rent**: this is where the rent is calculated as a percentage of the tenant's turnover at the premises. This enables a certain amount of risk-sharing between the landlord and tenant.

- **RPI rent**: this is rent which increases in line with the Retail Prices Index; this is a less common form of rent.

3. Process for Grant of a New Lease

- **Heads of Terms**: these may be agreed between the parties at the outset of the transaction and they will set out the key terms of the lease, i.e. the premises to be leased, rent, term, any break clauses, whether the lease is to be contracted out of the security of tenure provisions contained in the Landlord and Tenant Act 1954 (“LTA 1954”) and any other key provisions. The heads of terms will normally be prepared by the parties and will often be in the form of a letter.

- **Title Investigation and Searches**: your lawyers will investigate title to the property and carry out any relevant searches and enquiries including local authority, drainage and environmental searches. This is the stage at which you will be responsible for arranging any inspections and surveys of the property.

- **Documentation**: the terms of the lease and other ancillary documents will be negotiated between your lawyers and the landlord’s lawyers. There may be an agreement for lease exchanged if, e.g. the premises are not yet built. If the lease is
to be contracted-out of the LTA 1954 then this is the time at which the statutory notice procedure must be completed before the agreement is exchanged. Stamp Duty Land Tax liability may be incurred at this point and you are able to protect the agreement by registration.

- **Post-completion**: various matters will then be dealt with including the payment of Stamp Duty Land Tax by you, registration of the lease at the Land Registry and notification of the grant of the lease to superior landlords and any mortgagees.

4. **Documentation**

- **Schedule of Condition**: this is a record, prepared by the surveyors, of the physical state and condition of a property at a particular date. This will be used if you have negotiated a limited repairing covenant, which means that you have covenanted only to keep the property in no worse a state and condition than it is in at the date of the lease as evidenced by the Schedule of Condition.

- **Confidentiality Agreement**: in some instances a landlord may wish to keep details of the lease confidential in the fear that other prospective tenants will be encouraged to demand similar benefits should they become aware of what the landlord has conceded. Confidentiality is therefore usually prompted by the landlord and you may be required to enter into a confidentiality agreement.

- **Exclusivity Agreement**: you may agree with the landlord that you will have a short period during which you have exclusive negotiating rights. If this is the case then you may enter into an exclusivity agreement to record this.

- **Ancillary Documents**: In addition to the lease itself and the documents above, there are a number of ancillary documents that are often seen in connection with the grant of a lease. These may include, for example:
  - LTA contracting-out notices;
  - agreement for lease;
  - collateral warranties;
  - consents and licences; and
  - rent deposits and guarantees.

- **Agreement for Lease**: it is not necessary to have an agreement for lease and many leases are entered into without one. These tend to be used where there is a time gap between the terms of the lease being agreed and the lease being granted and where one or both of the parties needs the certainty of a contract. For example, this could be used to cover the time period involved for the application to the pharmaceutical list to be granted by the PCT.

- **Licences for Alterations/Fitting-out Works**: many leases will restrict your ability to make alterations to the property. The landlord's concern is that at the end of the lease term, the property will be in a readily re-lettable state.

  A common restriction is that alterations to the exterior and/or structure of the property are prohibited but non-structural alterations to the interior are allowed, with the landlord's consent and that consent should not to be unreasonably withheld. The position should be specified in heads of terms.

  It will be an important business issue for a pharmacy owner to be able to have the property configured to its needs. You will have certain statutory rights to carry out works (the legislation refers to them as "improvements", but most tenants' works are
covered) and although these only apply once the lease is granted, they form the backdrop to any negotiations between you and the landlord before the grant.

Consents for alterations may be included in the agreement for lease (particularly if the works are to be carried out before the lease is granted) or in a separate licence for alterations. A consent for alterations would not normally be in the lease itself. Where works are carried out, it is important to agree and specifically document their impact on future rent reviews.

- **Other Security**: if the landlord is of the view that you have insufficient covenant strength (this is where the landlord is uncertain that you will be able to pay the rent and comply with the covenants) the landlord may require additional security. This typically happens if, for example, you are going to run the pharmacy through a newly incorporated company, the lease will be the only asset held by you, your financial accounts do not show a sufficient level of profit in the landlord’s view. Additional security may take various forms including a Rent Deposit and/or Guarantee.

- **Rent Deposit**: a rent deposit is an arrangement whereby you deposit a sum of money (usually equal to approximately six months’ rent) with the landlord (or into a designated bank account) on which the landlord can draw if you fail to pay the rent. Often a rent deposit will allow the landlord to draw on the money if the landlord considers the tenant to be in default under the lease covenants and without the landlord having first to obtain a court order establishing the tenant’s liability. Rent deposits are often expressed to be repayable on assignment or if the tenant meets specified financial tests in the future (where the landlord perceives the tenant to have acquired sufficient covenant strength).

- **Guarantee**: lease guarantees could be given by your company's holding company or, where there is none, by its shareholders/directors who then have personal liability. Any guarantee will be set out in the lease itself, usually as a schedule.

5. **Grant of an Underlease**

If the lease to be granted will be an underlease, there are a number of particular issues that will arise:

- consents will usually be required from the superior landlord for the grant of the underlease, and for any charge over the underlease, any alterations or improvements, and any change of use;
- consents may be required from any mortgagee (e.g. lending bank) of the landlord's interest;
- the underlease may be contracted out of the security of tenure provisions contained in the LTA 1954; and
- on completion of the underlease, the superior landlords should be given notice of the underlease.

- **Superior Landlords’ Consent**: generally, consents from superior landlords will be required for the grant of any underlease and any alterations or improvements (fitting-out works) and any change of use required by the undertenant. Generally a lease will require you to pay the costs of any required consent but you will pass the costs down to the undertenant, either in an agreement for lease or through an undertaking for costs from the undertenant's solicitor.

- **Consent to the Grant of the Underlease**: most leases of commercial property have a covenant that you may not underlet without the consent of the landlord, such consent not to be unreasonably withheld.
• **Mortgagees’ (banks) consents for the grant of an Underlease:** a mortgage will often require the mortgagor to get the mortgagee’s consent before granting an underlease. This is to help the mortgagee protect its security asset.

6. **Some matters to deal with following the Grant of a Lease:**

• **SDLT and Land Transaction Returns:** the grant of a lease will be notifiable to HMRC for SDLT purposes and you will have to submit a land transaction return, unless it falls within one of the following categories:

  • if the lease is for a term of 7 years or more and there is a chargeable consideration (other than rent) of less than £40,000; and the “relevant” rent is less than £1,000;

  • if the lease is for a term of less than 7 years it will not be notifiable and will not require a land transaction return if the chargeable consideration does not exceed the zero rate threshold (meaning that it does not consist of or include any amount in respect of which tax is chargeable at 1% or more or any amount in respect of which tax would be chargeable but for a relief).

• **Registration:** leases granted for a term of more than 7 years (and certain other leases) must be registered at the Land Registry. Once the registration has been completed, a title information document will be issued to the person who lodged the application. This is an official copy of the register and title plan, but it is not a document of title and has no legal status.

• **General:** documents relating to a lease have to be kept by the landlord and you for a number of reasons including title, enforcement and taxation. Following the grant of a lease the original documents should be kept by the relevant party for at least the length of the lease. In addition to the lease itself, these documents may include:

  • LTA 1954 contracting-out notices (or certified copies of them);
  • any landlord's consents (such as a licence for fitting-out works);
  • any superior landlord's consents;
  • any side letters or deeds; and
  • any other ancillary documents (such as collateral warranties or a rent deposit).

You should also keep copies of documents that may be needed in the future, particularly if the tenant decides to assign the lease or underlet later on. These include (certified) copies of the landlord's title documents, copies of planning permissions and copies of materials supplied in reply to pre-contract enquires.

• **HMRC Requirements:** in relation to SDLT, you will have to keep records for at least 6 years from the effective date (even if the lease will end before then). If a further Land Transaction Return has to be made after the grant of the lease then records have to be kept for at least 6 years from the date of the later Return (again, even if the lease will end before then). A further Return may be needed following a rent review and will be needed where there is a turnover rent.

Records also have to be kept for VAT and corporation tax reasons.
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