

# Well Intentioned but Misguided

## – *a little knowledge is a dangerous thing!*

**Roland O'Connell** FIAVI, IAVI Second Vice President and member of the Commercial Panel, gives his opinion of the recent abolition of upward only rent reviews.

Firstly, I think it important to state that I have a degree of sympathy for the Minister for Justice, Equality and Law Reform in that while the existing Landlord & Tenant legislation had allowed for upward or downward reviews, a request to negotiate a lease with such a review clause was almost always met by a blank refusal from landlords. This was a non negotiable point.

A lease is like any other commercial contract negotiated between two parties. Both parties decide which points are particularly important to them and which are less so and then negotiate the terms of the lease. Over the last 20 years or so, upward only rent reviews have been of paramount importance to landlords whereas for tenants, while upward or downward rent reviews were important, they obviously were not as important as other elements in the lease. One of the reasons for this may be that despite the cyclical nature of the property market there has not been an occasion where rents have fallen dramatically as they have done recently.

Until recently both the Landlord & Tenant law and VAT regulations conspired against the granting of medium term leases. Until the recent changes, only office tenants could contract out of their renewal rights arising in leases of greater than 5 years. Until the changes last year in VAT rules, it was nigh impossible to grant a lease for between 10 and 20 years without the landlord suffering a major penalty.

These issues combined in forcing both landlords and tenants into considering only very short leases or very long leases. Landlords felt that if they were granting long leases, the minimum they should expect was that the initial rent would be maintained or bettered in future. Indeed, in the case of new development it would have been very difficult to obtain bank funding without this.

As we IAVI members act on behalf of both tenants and landlords, it is in our interest and that of our clients that the widest choice of solutions are available for both tenants and landlords to ensure that in each particular transaction a result which suits both parties can be achieved.

The difficulty with the Minister's action is that he has reduced the options available to well advised tenants and landlords. I object to this and see it as a retrograde step.

The Minister seemed to miss the point that there are circumstances where a tenant may wish to agree to an upward only review. For example, a major office tenant may be happy to trade an upward review pattern in return for a longer than standard rent free period as this in turn may cover their fit out costs. This option is no longer available to them.

In the immediate future the new review pattern should not worry landlords unduly as new leases being granted today are at low rent levels and it is reasonable to expect that in 5 years time rents will be higher.

In the case of expiring leases, it had been the case that landlords normally conceded lower rents to tenants on renewal in exchange for keeping upward only reviews but this cannot now happen and therefore landlords are likely to get higher rents on renewal.

This change in legislation will delay the return of development in the market place and indeed reduce the scale of development when it returns.

Funding for new development will be extraordinarily difficult to obtain as a minimum return cannot be confidently predicted.

Apart from the knock on affect this has on the construction sector, and indeed government revenue, it is also very bad news for the tenants in the market. For the economy to work effectively as a whole it is essential that there are developers who will take the risk to construct high quality new retail, office and industrial premises to the requirements of the market place.

Tenant requirements change over time and if high quality new buildings meeting these changed requirements cannot be provided viably then Ireland will become an inefficient place to trade or operate for all types of commercial tenants.

The recent changes to Landlord & Tenant and VAT legislation have allowed landlords and tenants to negotiate flexible short and medium term leases as well as long term leases thereby giving a range of options comparable with any other economy. It is especially disappointing in these circumstances, where the market has made great strides forward, that the recent legislation will restrict the choices open to well advised tenants and landlords.

Recent leases often had rents linked to turnover or the CPI, or similar indexes, which demonstrated the market's ability to adapt to meet current requirements.

The Minister's action has brought added uncertainty to an already difficult market. It has reduced values for all commercial property overnight at a time when this could not be more unwelcome. The uncertainty which it brings to the market will make property less attractive to both national and international investors

The legislation has reduced choice and decreased values. It will result in shorter leases, a desire for mutual rather than tenant only break options and could bring more frequent reviews. In the short term it will be a headache for valuers and rent review specialists as comparative evidence will be harder to analyse – how much should open market rents be discounted when used in evidence in the case of an existing lease with an upward only review pattern?

In the longer term it has reduced the attraction of property as an investment and has made new development much more difficult to fund. More importantly though, it will restrict tenants' choice although this will only become evident as the market strengthens.

By simply allowing well advised tenants and landlords to contract out of the provisions of this Act the Minister could restore the level of choice the market needs. This would at least allow an option to tenants who need new buildings developed for them or who need extended rent free periods for reasons previously set out.

The property market has proved itself to be able to adapt to change and it will adapt to this change also; however what is currently seen as a change for the worse could immediately be seen as a change for the better if an opt out provision was provided for. ♦