



Legal update — March 2017

Commercial property Rent deposit deeds: let battle commence!

Pioneering — Bahrain — Construction — Public sector — Energy — Real estate — London — Tax — IT — Dubai — Manchester — Connecting — Knowledge — Pragmatic — Malaysia — Exeter — Thought leadership — Housing — Agile — Creative — Connecting — Private — Local government — Manchester — Environment — Focused — Islamic finance — Projects — Abu Dhabi — Corporate finance — Passionate — Employment — Regulation — Procurement — Expertise — Specialist — Planning — Investment — Committed — Delivery — IT — Go — IP — Corporate — Infrastructure — Value — Development — Private wealth — Oman — Governance — Birmingham — Corporate finance — Dynamic — Pensions — Dispute resolution — Insight — Banking and finance — Arbitration — Diverse — Regeneration — Care — Communic

It is not uncommon for landlords to request a rent deposit from an incoming tenant or assignee where there are doubts about its financial covenant strength and/or its ability not just to pay the rent, but also comply with its other covenants under the lease.

The preferred starting position for many landlords is a rent deposit paid to them absolutely on completion of the lease so that the funds are readily available if they need to be drawn upon. The document will usually contain a promise from the landlord to return the deposit balance to the tenant either at the end of the term or on an earlier event (such as a lawful assignment) provided there are no outstanding costs or tenant breaches.

However, it is becoming increasingly common that tenants are pushing back on this structure; usually citing risks about the landlord's solvency and therefore the tenant's ability to recover its rent deposit were the landlord to become insolvent.

Whilst this may be less contentious where the landlord is a UK incorporated company or fund –referring the tenant to the landlord's financial position at Companies House or reputation in the commercial property market may do the trick – the issue can still lead to prolonged negotiations.

What does the tenant want?

What happens if the tenant will not pay the rent deposit outright to the landlord? There are two alternative structures that we tend to see – one being the rent deposit is held by the landlord on trust for the tenant and the other that the rent deposit is expressed to remain the tenant's money, but is held by and 'charged' to the landlord. Whilst both may give the tenant comfort if the landlord becomes insolvent, there may be issues for the landlord.

The trust structure - albeit recommended by the Lease Code 2007 – may not only have unexpected tax consequences, it may also create unintended fiduciary duties (inherent in a trust structure) for the landlord

unless expressly dealt with in the drafting of the deed. With the second option, uncertainty as to what the landlord is actually taking security over could raise questions about the validity of the charge (one approach is for the tenant to charge its ability to recover any deposit balance) - changes to registration of charges at Companies House (so that rent deposit deeds cannot be registered from 6 April 2013) have not helped either.



Source: Shutterstock

What is the alternative?

So how to get the deal over the line if this becomes a sticking point? One potential option is for the deposit to be held by a third party as stakeholder, perhaps a managing agent regulated by RICS or a firm of solicitors regulated by the SRA. Although this option may involve additional cost to the landlord – the stakeholder usually charging a fee for this service – knowledge that the stakeholder owes mutual duties to both parties, may be attractive and dispenses with the charging issue.

Summary

1. When negotiating a rent deposit, it is important to remember the overriding principle as to why the landlord has asked for a rent deposit in the first place! The alternative of personal or bank guarantees may be less palatable to a tenant.
2. To reduce the risk of a deal stalling, the structure of a rent deposit should be discussed at the outset and agreed at the heads of terms

Published by
Trowers & Hamblins

Trowers & Hamblins LLP
3 Bunhill Row
London
EC1Y 8YZ

t +44 (0)20 7423 8000
f +44 (0)20 7423 8001

www.trowers.com

Trowers & Hamblins LLP is a limited liability partnership registered in England and Wales with registered number OC337852 whose registered office is at 3 Bunhill Row, London EC1Y 8YZ. Trowers & Hamblins LLP is authorised and regulated by the Solicitors Regulation Authority. The word "partner" is used to refer to a member of Trowers & Hamblins LLP or an employee or consultant with equivalent standing and qualifications or an individual with equivalent status in one of Trowers & Hamblins LLP's affiliated undertakings. A list of the members of Trowers & Hamblins LLP together with those non-members who are designated as partners is open to inspection at the registered office.

Trowers & Hamblins LLP has taken all reasonable precautions to ensure that information contained in this document is accurate but stresses that the content is not intended to be legally comprehensive. Trowers & Hamblins LLP recommends that no action be taken on matters covered in this document without taking full legal advice.

stage. Asking for legal input at this point may prevent unwelcomed additional time and costs being incurred during the legal process.

March 2017 © Trowers & Hamlins

For more information please contact

Andrew Williams
Professional Support Lawyer
t +44 (0)20 7423 8019
e ajwilliams@trowers.com

Giovanni Castronovo
Associate
t +44 (0)20 7423 8671
e gcastronovo@trowers.com
