

A new era for commercial leases?

The Law Commission consults on reforms to commercial leasehold

Recent announcements have made clear the government's lack of enthusiasm for the lease as a model of ownership for residential property. By contrast, there is no suggestion that leases will be abolished for commercial property, but the Law Commission is consulting on potential improvements to the system.

These cover three areas:

- (a) avoiding unintended restrictions on commercial transactions as a result of legislation designed to protect tenants from unfair property liabilities;
- (b) removing criminal sanctions for letting a shop, restaurant, or office space in a building containing residential flats; and
- (c) updating security of tenure legislation to reflect the modern letting market.

Reforming the 1995 Act: avoiding barriers to commercial transactions

Before 1996, a tenant remained liable under the terms of the lease even after assigning it. The Landlord and Tenant (Covenants) Act 1995 fixed that problem by automatically releasing tenants and guarantors from their obligations on an assignment of leases granted on or after 1 January 1996.

Limited exceptions were permitted, principally in the form of an authorised guarantee agreement ("AGA"). This allows an outgoing tenant to guarantee the performance of the immediately incoming tenant, but not to stay "on the hook" following a subsequent assignment.

The 1995 Act and its widely drafted anti-avoidance provisions have provided plenty of work for the courts and resulted in a series of unintended consequences that have frustrated commercially sensible arrangements. There is no suggestion of overturning the core principles of the 1995 Act, but the Law Commission's provisional proposals address key problem areas.

The current position makes assignment within a group difficult by preventing:

- a guarantor of a tenant from guaranteeing the obligations of an assignee of the lease; and
- the tenant from assigning its lease to its guarantor.

These restrictions are often unhelpful for both the landlord and the tenant. There can be sound commercial reasons why all parties may want to allow, for example, a parent company to repeat a guarantee on an intra-group assignment or to become the direct tenant under a lease it previously guaranteed. Unfortunately, both have been prevented under the current legislation.

This has led to some difficult distinctions. A guarantor may provide a sub-guarantee of the outgoing tenant's obligation under its AGA, but not a direct guarantee of the incoming tenant. The Law Commission's proposal to create an exception permitting repeat guarantees within a group and enabling group guarantors to take an assignment of the lease is welcome.

The Law Commission is also considering changes to the rules in relation to partnerships, which can be tricky when it comes to holding property. The balance between commercial freedom and tenant protection may be more difficult to strike here, but we expect this to be of less relevance to most commercial investors.

Reforming the 1987 Act: removing criminal sanctions for commercial letting

It is perhaps not widely appreciated that a landlord risks criminal sanction if it leases a commercial unit without first notifying its residential tenants in the building and giving them a right of first refusal. This results from the somewhat blunt formulation of the Landlord and Tenant Act 1987.

The Law Commission proposes to permit the grant of a lease that is (or is intended to be) exclusively occupied or used for non-residential purposes without triggering this right. This solves an inconsistency in the law whereby an exception exists for individual flats, but not for commercial units. The reform would be welcome as the current law clearly goes beyond what was intended from a policy perspective and serves no protective purpose for tenants.

That said, wider reform is still required to simplify and clarify the inconsistencies and complexities of the right of first refusal regime and to assess its usefulness and overlap with other collective enfranchisement and management rights. The Law Commission has declined to take the opportunity to reconsider the appropriateness of the criminal sanction for non-compliance and to explore the introduction of a more proportionate civil penalty.

Reforming the 1954 Act: modernising business tenancy renewals

The Law Commission has published its second consultation paper on the reform of security of tenure governed by the Landlord and Tenant Act 1954.

Removal of short leases from security of tenure. Currently, only leases of six months or shorter are excluded from the security of tenure regime. The proposal to increase that threshold to two years would reduce the scope of tenancies that will benefit, and is perhaps better aligned to the tenants who need it. Landlords granting short-term lettings (for example, in the flexible office or pop-up retail markets) will welcome this proposal, reducing the procedural requirements associated with contracting out tenancies which are rarely intended to benefit from security of tenure in practice.

Removal of periodic tenancies. Despite being entered into for the flexibility they offer, periodic tenancies cannot currently be contracted out of the security of tenure provisions of the 1954 Act. The Law Commission favours the removal of all periodic tenancies from the scope of the 1954 Act.

Turnover rent. The Law Commission recognises the shift in the market that has resulted in the widespread use of turnover rents. The potential for turnover rents on renewals is welcome in principle, given the wider commercial context. However, given the current capacity constraints on the court system and the complexities in determining turnover rent, there may be formidable challenges where parties are unable to agree renewal terms.

Procedural reforms. While the contracting-out model is being retained, it may also be modernised. The proposed new approach is for contracting out to take place within the lease itself and to replace the cumbersome statutory declaration process with a prescribed warning and declaration within the lease. This would be a further welcome change.

Greener renewals. The Law Commission recognises the importance of addressing environmental concerns in leases and seeks views on whether environmental matters should be a "relevant circumstance" for the court to take into account.

Next steps

The consultations ([Commercial leasehold: overcoming barriers to transactions](#) and [Business Tenancies: the right to renew](#)) represent a welcome and necessary effort to improve commercial leasehold law. Both close on 16 September 2026, after which the Law Commission will publish a final report setting out its conclusions and recommendations to the government.

Investors and occupiers alike will be interested in the implications of these proposals and should take the opportunity to make their views known to the Law Commission. We would be happy to discuss areas of interest in more detail.

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