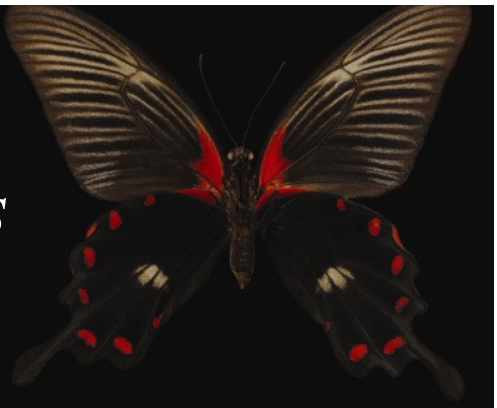
TRAVERS SMITH

Compensation & alterations

Landlord & Tenant Act 1927



Most commercial leases contain restrictions on the scope of any alterations or improvements that a tenant can make to the let premises. Commonly, this takes the form of a tenant covenant prohibiting any alterations to the exterior and structure of the premises. Internal, non-structural alterations are usually permitted with the consent of the landlord.

Leases of commercial premises typically include an obligation on the tenant to reinstate the premises at the end of the term. This is usually a pre-condition of the landlord granting permission for alterations at the outset.

The right to compensation for improvements

The Landlord & Tenant Act 1927 ("the Act"), sections 1, 2 and 3, give a tenant who has made improvements to a premises during their tenancy a right to compensation at the end or earlier determination of the tenancy. This can occur even if the landlord did not consent to the improvements. Although there are many pre-conditions which must be satisfied in order that a tenant may gain compensation, parties cannot contract out of this statutory right.

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There are certain improvements which do not give rise to a claim for compensation by the tenant:

- tenant's and trade fixtures which the tenant is by law entitled to remove;
- improvements made pursuant to an obligation for which the tenant received valuable consideration.

The requirement to give notice of improvements

In order to be able to claim compensation under the Act, the tenant must have served notice on its landlord of its intention to carry out improvements together with a specification and plan showing the proposed improvements, before commencing work. The notice must refer to the tenant's rights under the Act and be sufficiently detailed for the landlord to be able to assess the proposed works and to decide whether it wishes to carry them out itself.

If notice is served on the landlord and the landlord does not respond within three months, the tenant is entitled to complete the improvements described in the notice. If the landlord should object to the proposed alterations and litigation ensues, a court will either certify the improvements as being proper or prohibit the improvements.

Should the court decide that the improvements are proper, or the landlord not reply within three months, then the tenant will have the same right to compensation as if the landlord had consented to the works.

If the landlord consents to the proposed works, the tenant can require the landlord to give written confirmation that the works have been properly executed in accordance with the Act. In long leases, where the landlord who permitted the improvement may have assigned the reversion before compensation is claimed, this can obviate problems in providing evidence that compensation is due.

Alterations covenant in the lease v "improvements" under the Act

Any alterations that render occupation of the premises more beneficial to a tenant constitute improvements for the purposes of the Act, including demolition of part and almost any scope of works the tenant desires. If the tenant can show that the alteration or improvement is calculated to add to the letting value of the property at the termination of the tenancy, is reasonable and suitable to the character of the property and will not diminish the value of any other property which belongs to the landlord or to any superior landlord, then the landlord may not apply contractual restrictions in the lease to prevent the tenant carrying out the works, even if, in the absence of the Act, the landlord's refusal of consent to the works would not be unreasonable.

Whilst obtaining supporting evidence that these criteria have been met may be difficult for a tenant, many alterations do fulfil the criteria, entitling a tenant to

carry out alterations legally that would otherwise render it in breach of its lease covenants when its landlord has refused consent or its lease does not permit them. Obtaining the court's declaration that the improvements are proper is a fairly time consuming and expensive process, however, which is probably why few tenants resort to this.

Time limits for bringing a compensation claim

There are time limits within which the claim for compensation for improvements must be brought:

- where the tenancy is terminated by notice to quit, whether it is given by the landlord or the tenant, the claim for compensation must be made within three months of the date on which notice was given;
- where the tenancy ends by virtue of the tenancy period expiring, the claim for compensation must be made not earlier than six nor later than three months before the end of the tenancy.

It is thought that the right to compensation is not carried over into the new tenancy when a lease is renewed, but this is a matter of some debate.

Amount of compensation payable

The maximum amount of compensation that can be claimed by a tenant under the Act is the lesser of:

- the net addition to the value of the holding as a whole which may be determined to be the direct result of the improvement; and
- the reasonable cost of carrying out the improvement at the termination of the tenancy.

In relation to the first of these, the intentions of the landlord after the termination of the tenancy are relevant. If the landlord intends to demolish the property, make structural alterations or change the use of the property, this will be taken into account in deciding what additional value is attributable to the improvement. There may be none.

Conclusion

In practice it is rare for a tenant to take the steps required by the Act when carrying out an improvement to enable it to claim compensation under the Act, but it is an avenue open to a tenant who has made improvements to a property. It is important when acquiring leasehold property to identify any works which may qualify for compensation and to see if any notice has been served in relation to them. If no notice has been served then a tenant cannot bring a claim for compensation.

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