

Institution: University of Reading
Unit of Assessment: 16 Architecture, Built Environment & Planning
Title of case study: Commercial Leases Policy and Practice
<p>1. Summary of the impact</p> <p>Research undertaken at Reading by Crosby/Hughes/Devaney and retirees Murdoch/Baum into commercial lease law, policy, practice and pricing since 1993 has driven Government policy and supported industry change within a significantly altered leasing environment in the UK. During the REF period, research conducted at Reading has continued to influence the self-regulation of the industry, acted as a catalyst for a new retail lease and significantly influenced industry solutions concerning aspects of commercial lease pricing. Specifically the impact has been on:</p> <ul style="list-style-type: none"> - The contents of the Commercial Leases Code of Practice currently in use; - The 2009 Government policy statement through its monitoring research into the 2007 Code; - Industry methods for the pricing of lease incentives through authorship of evolving Information Papers and Guidance Notes within the RICS Red Book; and - Industry wide agreement to produce new property rental value indices and equivalent yield series affecting over 21,000 commercial properties, worth over £140 billion, held within the Investment Property Databank (IPD).
<p>2. Underpinning research</p> <p>Since 1993, the University of Reading programme of research into commercial leases has been led by Professor Crosby (1993 to date) and undertaken in conjunction with Murdoch (SL Law 1993-09), Professor Baum (1993-98), Hughes (Assoc Prof, 2003 to date) and Devaney (Lecturer, 2012 to date). It is based on 3 Government and 4 industry funded projects and has two strands running in parallel; policy and practice. Both strands have informed each other.</p> <p>The impetus for this research was the UK commercial property crash of 1989/90. Up to this point the commercial leasing market was largely unregulated, but the economic crisis led to a perception of market failure within the leasing market and the clamour for government intervention from tenants and their representative bodies. Specific problems were seen as information asymmetry in the market (resulting in tenants being unable to make informed decisions), a distortion of the normal market forces of supply and demand at rent review, and a lack of transparency in the market. In 1993, the UK Government consulted on legislating in the specific areas of upward-only rent reviews, confidentiality clauses and rent determination processes (DOE, 1993). Baum, Crosby and Murdoch were asked to contribute to a response by major property owners (Association of British Insurers and the Investment Property Forum (IPF)). The research concluded that the UK commercial property market would suffer a 4% fall in value if upwards-only rent reviews were banned in new leases. The outcome of the consultation was the introduction of a voluntary Code of Practice in 1996. The Reading research team was commissioned (through competitive tender in 1997) by the UK government to monitor the operation of the first Code and also successfully tendered on two further occasions in 2002 and 2008 to monitor later versions of the Code. On the first two occasions the brief was to investigate the success of the first two editions of the Code and to provide a critical analysis of the changing nature of the commercial leasing market. The third commission was to investigate the dissemination of the latest 2007 version of the Code. Research methods included extensive reviews of the legal and property market context, detailed quantitative analyses of changing lease terms and qualitative research into the process by which this change was taking place. It also included a critical evaluation of valuation methods for assessing both rents and capital values. To accomplish this, the Reading team conducted postal and interview surveys of landlords, tenants (and their advisors, including letting agents and legal representatives) and lenders. They then constructed and evaluated case studies of specific transactions and formed and analysed large scale data sets of: the national and local economy; national, regional and local property markets; and, most importantly, Government and private data of commercial property lease terms [Outputs 3:1, 3:2, 3:4, 3:5].</p> <p>This policy strand to the research identified major changes to the leasing environment driven by a combination of market conditions and response to Government pressure on the property industry to deliver a changed leasing environment. Leases were found to be getting shorter and more diverse although rent reviews were still almost always upwards-only. The research revealed the terms that were of concern to tenants in leasing, such as the ability to assign or sublet unwanted space. However, both the first [3:1] and second reports [3:2] found that the Codes of Practice were not well disseminated and therefore had little direct impact on specific transactions, but that there</p>

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were clear signs that the Codes had long-term impacts on flexibility and choice within leasing markets. They also revealed that small business tenants (SBT) lacked awareness of property matters and often took leases on the first terms offered; usually without taking professional property advice [3:1, 3:2, 3:4]

Dissemination to, and use of the Code by, SBTs became the main question for the Reading team in their third Code monitoring research project. The team found that the 3rd edition of the Code was not well disseminated and was rarely used directly in negotiations except by a few large tenants; SBTs were not often being informed of the existence of the Code by their advisers [3:5]. Finally, the policy research programme identified major issues with the ability of the market to price the more diverse lease terms introduced by the changing leasing environment [e.g. 3:2]. Therefore, in parallel with the policy research programme, the Reading team has also pursued this pricing research agenda in cooperation with the property industry. Peer reviewed research published between 1998 and 2001 culminated in output [3:3] outlining one of the major pricing issues identified above; the unreported variation in assumptions concerning leasing incentives within rental value estimates. These estimates are a basic input into all commercial property valuations and form the basis of property market indices. Industry based research outputs from the programme include lead authorship of the first draft of RICS valuation information paper (VIP) on the analysis of lease transactions published in 2006 setting out suggested solutions to the valuation problems. Updated versions now appear in the RICS Red Book as UK Guidance Note No.6. More recently, also building off the findings of [3:3], [3:6] has been used as the industry consultation paper for redesigning the rental value and equivalent yield indices of IPD, the leading commercial property database in the UK. This paper analysed the various valuation approaches for assessing the value of leasing incentives and identified the process by which they are transformed into rental value indices. The research method included a quantitative analysis of the impact of the different inputs into the valuation methods and a back-casting of past rental value and incentives data to test the performance of the various possible approaches. It concluded with recommendations for industry on the preferred most practical solution for the generation of more accurate indices of rent and yield within IPD.

3. References to the research

Funded research projects:

- Commercial Leases : A Critical Evaluation of the DoE Proposals. Funded by the Investment Property Forum and the Association of British Insurers, £5,500.1993.
- Open Market Rental Value. University of Reading Research Endowment Fund, Boots Properties and The RICS Education Trust. £50,000. 1996.
- Business Space Changes and Lease Structures. Funded by RICS, £35,000. 1996-97.
- Monitoring the Commercial Leases Code of Practice. DoETR, £56,110. 1997-99.
- Monitoring the Code of Practice for Commercial Leases. Office of the Deputy Prime Minister, £165,000. 2003-05
- Evaluation of small business tenant legislation in Australia, RICS and IPF Education Trusts, £5,000. 2006.
- Monitoring the 2007 Code of Practice for Leasing Business Premises, CLG, £55,000. 2008-09
- Constructing an effective rental value index, IPF, £5,000. 2012-13

Outputs

In addition to the project reports, outputs include 9 peer reviewed international journal outputs, an industry consultation paper, a professional guidance note within the Red Book and 14 professional journal papers since 1995. It also includes 43 invited seminar papers to industry and an invited paper to the House of Lords All Party Committee on retailing.

Indicative selection of the research outputs

- [1] Crosby, N., Murdoch, S. and Markwell, S. (2000) *Monitoring the Code of Practice for Commercial Leases*. Department of the Environment, Transport and the Regions (DETR): London. Not available on-line
- [2] Crosby, N., Hughes, C. and Murdoch, S. (2005) *Monitoring the 2002 Code of Practice for Commercial Leases – Final Report*. Office of the Deputy Prime Minister: London.
http://webarchive.nationalarchives.gov.uk/20081205143343/http://odpm.gov.uk/pub/260/Monitoringthe2002codeofpracticeforcommercialleasesPDF1537Kb_id1128260.pdf
- [3] Crosby, N., and Murdoch, S. (2001) Basis of rental value for performance measurement systems. *Journal of Property Research* 18(2): 123-40.

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- [4] Crosby, N., Hughes, C. and Murdoch, S. (2006) Flexible property leasing and the small business tenant. *Journal of Property Research*, 23 (2): 163-188. doi: 10.1080/09599910600800518
- [5] Crosby, N., Hughes, C. and Murdoch, S. (2009) *Monitoring the 2007 Code for Leasing Business Premises*. Communities and Local Government: London.
<<http://webarchive.nationalarchives.gov.uk/20120919132719/www.communities.gov.uk/documents/regeneration/pdf/1273120.pdf>
- [6] Crosby, N. and Devaney, S. (2013) *Constructing an Effective Rental Value Index*. IPF Research Short Paper Series No 18, Investment Property Forum: London.
https://www.ipf.org.uk/home/research/research_archive/default.aspx

Quality of the research

The quality of the research is suggested by the number of peer reviewed papers including 4 submitted to RAE 2001 and 2008 [e.g. 3:3; 3.4]. Outputs [3:1] and [3:2] were also submitted to RAE 2001/8 and [3:2] was described by the then president of the RICS as “one of the best research documents of its type I have ever seen” [5:1].

4. Details of the impact**Background to the impact**

This research has had impact on both policy and industry practice within the UK through the various editions of the Code of Practice, each incarnation being shaped as a direct result of Reading research. This stands alongside the development of industry guidance notes and consultation papers on lease pricing, directly impacting on professional practice and industry change. This impact is long term, commenced before the REF period and continues throughout this period.

Specifically, before the current REF period, the changing policy agenda was directly related to the findings of the Code Monitoring reports [3:1 and 3:2]. Evidence includes specific mentions by Raynesford, Cooper and Chancellor Brown in Ministerial Statements (2000, 2005) and the 2005 Budget Speech (http://webarchive.nationalarchives.gov.uk/20100407010852/http://www.hm-treasury.gov.uk/d/bud05_chap03_229.pdf Para 3.119, Page 76).

New policy strands which emerged following identification within the Reading research were dissemination of the Code and small business tenants (a major theme of the current REF period), Code revisions and assignment and sub-letting. The latter policy initiative led, a month after the Ministerial Statement in 2005, to the British Property Federation initiative, recommending members not to impose onerous alienation clauses within existing leases, an initiative that has lasted throughout the REF period. Industry funded research also impacted on the policy agenda. For example, Reading contributed to the industry response to the 1993 Government consultation which resulted in Government opting for a voluntary rather than a legislative solution and later research for the RICS identified occupier concerns with the leasing environment. These findings informed the research questions for the second Code Monitoring Report [3:2].

REF period impact**Research continues to impact on self-regulation of the industry**

In the present REF period the research programme continued to impact on policy and industry change. First, “*research published by Reading went some considerable way in informing the members of the lease code working group as to its task*” [5:5] of redrafting the current Lease Code. It is still in place and a “*continuingly influential guidance note to the property industry*” [5:1]. The findings of Reading’s 2009 report [3.5] on dissemination provided government with the evidence to maintain pressure on the industry, so playing a clear and continuing role on the government’s approach to self-regulation of commercial property leasing. This can be seen in the ministerial response to the report: “*This [Reading] report about dissemination and use of the 2007 Code paints a very disappointing picture. It suggests that small business tenants are not receiving any substantive information on the code from any source*” which led to the policy statement to call on the property industry “*to redouble efforts to disseminate and use the code*” and “*In particular, the professions-surveyors and solicitors-have a special responsibility for making it available.*”

(<http://www.publications.parliament.uk/pa/cm200809/cmhansrd/cm090703/wmstext/90703m0001.htm>). It gave “*additional impetus to those involved in industry to ensure that small business tenants have access to the advice they need*” [5:5]. The Government response to the Portas review in 2012 illustrates that the findings on dissemination continue to influence Government policy on small business tenant awareness [5:5] and that the Government is aware of the role played by the

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professional institutions, a role highlighted by the findings of the 2009 Reading research report [3:5]. *“We are currently working on various options for disseminating the Code, targeting small businesses and landlords who could benefit most from the guidance offered by the Code. We have written to key industry players such as the British Property Federation, Royal Institute of Chartered Surveyors and the Law Society, to urge greater promotion of the Code. We are already discussing a dedicated awareness-raising event with the British Property Federation and The Royal Institute of Chartered Surveyors. The Royal Institute of Chartered Surveyors will also undertake a campaign to communicate the Code, and the need to abide by it, to its 60,000 members.”*

(https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/7525/2120019.pdf.)

Research is catalyst for new retail lease

A joint RICS and British Retail Consortium (BRC) new retail lease for small businesses was launched in 2012. This lease is short, is written in plain English and provides flexible terms for a lease of up to five years with no rent review. It is to be read in conjunction with the current Code for Leasing Business Premises. This lease is a direct result of the government policy focus on small businesses in leasing, which came about because of the Reading research findings in 2002 and 2005, reinforced by the 2009 research findings on the vulnerability of small business tenants in the leasing process. The Government (BIS) has linked this development directly to the 2007 Code. (<https://www.gov.uk/government/news/new-lease-to-make-life-simpler-for-small-businesses>). The role of Reading research in that process is confirmed by the chair of the BRC Property Advisory Group (It *“would not have happened without the resultant debate and negotiation within the industry following the publication of [Reading’s] commercial lease research”*) and the chair of the working party which produced the standard lease stated that the 2009 Monitoring Report (3:5) helped *“to ensure that the form of lease such tenants are expected to sign is more reasonable”* [5:5].

Commercial lease pricing and the treatment of leasing incentives

The third and fourth major REF period impacts arising from this extended research programme are on commercial lease pricing. The PI, through membership of the RICS Red Book editorial board and Property Valuation Forum in the 1990s and, more latterly, in his current dual roles on the RICS Valuation Standards Board and IPD Industry Consultative Committee, has been at the centre of industry discussions surrounding leasing incentives including their impact on rental valuation and on index construction. First, having drafted the RICS VIP in 2006 on leasing incentives, the content of the RICS VIP has remained the main guidance to UK valuers throughout this REF period and has been upgraded into an RICS Red Book Guidance Note. The Red Book and associated papers are the major source of valuation guidance for all Chartered Surveyors operating in the UK and overseas. Its practice statements are mandatory on all surveyors [5:4].

Second, the PI identified issues with the application of the leasing incentives at the 2000 IPD industry conference, (3:3), and, as stated by the Founding Director of Investment Property Databank, has been *“heavily involved along with us at IPD and the RICS in a 12 year debate concerning the most appropriate industry response”* to these issues [5:2]. This culminated in the IPF funded consultation paper [3:6] setting out the solution to the identified problem. Following industry wide circulation of the paper, written responses and a series of follow-up seminars with the Reading research team, the changes to the indices have been agreed. This agreement accepts the Reading format for new rental value and equivalent yield series covering 21,000 commercial properties worth £140 billion. The claims for impact of the Reading research on this process are supported by IPD, RICS [5:4] and IPF [5:3]. For example, *“Not only have Crosby and Devaney identified and investigated the problems ..., they have also worked hard to identify the most pragmatic and implementable solution”* [5:3].

5. Sources to corroborate the impact

In addition to the references above, the following testimonials are available upon request:

1. Former President, RICS and Senior Partner, Chase and Partners.
2. Director of Investment Property Databank
3. Director of Research and Projects, Investment Property Forum.
4. Head of Global Valuation of the RICS.
5. Chair of Small Retail Business Lease working group.