Short Leases and Formality

Mark Pawlowski asks whether it is time to rethink the formality requirements in section 54(2) of the Law of Property Act 1925

As we all know, s.52(1) of the Law of Property Act 1925 provides that a deed must be used in order to create a valid legal lease unless the lease falls within the so-called "short lease exception" contained in s.54(2). The exception is significant because it confers full legal status on those who hold short-term letting agreements thereby absolving many thousands of landlords and tenants from the inconvenience of having to use the formality of a deed. Section 54(2) states:

> "Nothing in the foregoing provisions of this Part of this Act shall affect the creation by parol of leases taking effect in possession for a term not exceeding three years . . .at the best rent which can reasonably obtained without taking a fine."

There is little controversy surrounding the requirement that the term of the lease must not exceed three years. In 1677, the Statute of Frauds was passed providing (in s.1) that all leases created by parol and not put in writing and signed by the parties should take effect as leases or estates at will only. The effect of this provision, therefore, was to introduce the requirement of writing in order to elevate the lease beyond a mere tenancy at will. Section 2 of the Act, however, excepted leases for a term not exceeding three years at a rent of two-thirds (at least) of the full improved value of the land. Short oral leases were, therefore, treated as legal leases under the exception. A further change was enacted by s.3 of the Real Property Act 1845, which provided that a lease required by law to be in writing made after 1 October 1845 should be void unless made by deed. Parol leases not exceeding three years falling within the exception contained in s.2 of the Statute of Frauds 1677 Act were, therefore, exempted from the requirement of a deed.

Taking effect in possession

The requirement that the lease must take effect in possession was added for the first time by s.54(2) of the 1925 Act as it did not appear in its forerunner, s.2 of the Statute of Frauds 1677. The reason for its inclusion as a condition is not immediately apparent from the legal literature of the day. There is no obvious explanation given for its inclusion in any of the leading textbooks at the time and there is only scant reference to it in the current books on land law and landlord and tenant law. The most likely explanation for its first appearance in s.54(2) is to be found in the corresponding abolition of the doctrine of *interesse termini* under the 1925 Act, which allowed for all terms of years absolute to take effect at law or in equity without the need for an actual entry by the tenant onto the demised property. Despite its

abolition, however, for all term of years absolute under s.149(2) of the 1925 Act, the draftsman of the 1925 Act felt it necessary to preserve the old law by re-introducing the requirement of a "taking of possession" by the tenant into s.54(2) so as to elevate parol leases not exceeding three years (falling within the subsection) into full legal leases in the absence of a deed. This requirement, therefore, was added to s.54(2) for purely historical reasons in order to satisfy the old common rule that, without an entry by the tenant, the tenant was not possessed of his term and had no estate in law. It is questionable, therefore, whether this requirement continues to have any substantive merit in modern leasehold law.

Apart from being an historical anomaly, the requirement that the lease take effect in possession gives rise to unnecessary complexity in the law. The condition is met, where, for example, T signs a six-month assured shorthold tenancy agreement and takes up possession of the demised premises on the day he signs the agreement. If, however, T signs his agreement on one day and, by the agreement, is not allowed to move into the property until a day or some days, weeks or months later, the tenancy does not "take effect in possession" in accordance with s.54(2): see, *Long v Tower Hamlets Borough Council* [1998] Ch 1 97, where a quarterly tenancy created at the start of September to begin some three weeks later was held not to take effect "in possession" and, hence, required a deed to generate a legal tenancy.

Short reversionary leases

Section 54(2) also needs to be looked at in the context of the registration requirements for reversionary leases. Section 27(2)(b)(ii) of the Land Registration Act 2002 requires leases taking effect in possession after the end of the period of three months from the date of grant to be registered under the Act. The rationale for this category of leases requiring registration is to secure discovery of the existence of reversionary leases by a purchaser of the landlord's estate who may not otherwise be able to do so because the tenant will not be in possession of the demised property. Short reversionary leases, however, taking effect in possession *within* three months of their creation, remain outside the registration regime largely because they were felt by the Law Commission to create "no significant conveyancing difficulties" to prospective buyers of the land.

Moreover, short reversionary leases, not being legal, are excluded from the unregistered interests which override first registration and registered dispositions. Although an interest belonging to a person in actual occupation will override both first registration and registered dispositions, a tenancy granted to take effect in possession at some time *within* three months of the grant will not qualify if the tenant is not in actual occupation at the time of first registration or the registered disposition. An amendment to s.54(2) of the 1925 Act so as to allow for the creation of legal leases not exceeding three years and taking effect in possession "within three months of creation" would avoid these difficulties as a tenancy agreement granted for a term to start within three months would automatically override any third party rights as a legal lease (regardless of whether the tenant is in actual occupation). In particular,

the tenant would not remain vulnerable to third party purchasers from the landlord prior to taking up possession of the land.

Best rent reasonably obtainable

The requirement that the lease is at the best rent reasonably obtainable without taking a fine also appears to have been added for the first time by the Law of Property Act 1925 as it does not feature (at least in these terms) in the original Statute of Frauds 1677. Here again, the legal literature of the time provides no insight into its rationale except that it appears to have been inserted into s.54(2) as a modern equivalent of the earlier requirement, contained in s.2 of the 1677 Statute, for excepted leases for a term not exceeding three years, that they be at a rent of two-thirds (at least) of the full improved value of the land.

Interestingly, the courts have been provided with two opportunities to consider this requirement but, unfortunately, its current meaning still remains largely unclear. In *Fitzkriston LLP v Panayi* [2008] EWCA Civ 283, the phrase was held to mean the market rent for the demised premises. However, in *Looe Fuels Ltd v Looe Harbour Commissioners* [2008] EWCA Civ 414, the phrase was interpreted as covering the situation where the rent payable under the tenancy was way in excess of the market rent. Which approach is correct? Although the *Looe* decision does not expressly refer to a subjective approach to ascertaining the best rent, it does seem to point in this direction with the emphasis being placed on the *actual rent* as agreed between the parties, whereas the *Fitzkriston* decision (by adopting a market rent) clearly envisages an *objective* approach to the question. The phrase "best rent" may, therefore, mean a rent at market value or above (but, presumably, not below) that value. As mentioned earlier, the clear rationale behind s.54(2) is to exonerate landlords and tenants from the burden of using a deed to formalise their short-term tenancy letting arrangements. In keeping with this policy, it is submitted that the amount of rent payable by the tenant (and regardless of whether or not a fine/premium is paid) should be treated as entirely irrelevant in determining whether the tenancy does, or does not, fall within the short lease exception.

Conclusion

So where does this leave us? As matters currently stand, only leases of seven years or more need substantive registration under the Land Registration Act 2002, even though it is possible to voluntarily register leases between three and seven years. Registration is also required, as we have seen, for leases granted more than three months in reversion (regardless of whether the lease is granted out of registered or unregistered land). Given these registration rules and the current complexity in the law, it is submitted that the preferred solution is to introduce a simplified version of s.54(2) which would allow for the creation of legal leases for a term not exceeding three years, irrespective of whether a "best" rent and/or a premium/fine is payable, provided the lease takes effect in possession within three months of the date of its creation. Thus, a lease would fall within the short lease exemption and be legal if the tenant's

entitlement to take up possession arose at any time within three months of the date of signing the tenancy. As such, it would automatically override and bind a purchaser of the landlord's estate. Such a reform would bring s.54(2) into line with current registration requirements for reversionary leases; protect many short-term tenants against purchasers of the landlord's reversion; avoid a number of other practical difficulties; more accurately reflect the realities of the short-term residential letting market and bring much needed simplicity to our existing law.

Mark Pawlowski is a barrister and professor emeritus of property law, School of Law, University of Greenwich.