

NOTES ON LEASING A COMMERCIAL PROPERTY

For the use of the clients of
Baldock Stacy & Niven



What is a lease?

A lease provides you with a legal right to occupy the premises and sets out the agreement between you and the landlord. The landlord is often referred to as the lessor. The tenant is often referred to as the lessee.

If you comply with the terms of the lease, the landlord cannot evict you, sell the premises without recognising your right to occupy them, interfere with the business you operate from the premises or charge you any moneys not covered by the lease.

Why is a lease required?

A lease protects you by setting out all the terms agreed between the landlord and you. A lease ensures that you can operate your business from the premises. There are normally many issues in the lease and the lease can last for a long time. Unless these terms are in writing, there can be disagreements as to what was previously agreed.

Exactly how much will it cost me to occupy the premises?

The rent, the outgoings and rent reviews vary from lease to lease and are set out in the schedule to the lease. When reading a lease you need to read the bulk of the document to understand what the lease is about and refer to the items in the schedule attached to the lease to check the specifics of your occupation of the premises. To avoid misunderstandings all items in the schedule should be completed or marked "not applicable".

Rent

This is the amount payable by you to the landlord for occupation of the premises. The rent you were quoted by the landlord or his agent would have been described as "including outgoings" or "excluding outgoings". If it was "including outgoings", sometimes called a "gross rent" this is the only amount you should be required to pay on a regular basis under the lease.

If the rent has been expressed as a "net rent" this means the amount of rent payable to the landlord before outgoings are recovered from the tenant.

The rent is normally subject to review at various times during the lease. The timing of those reviews and the basis of the reviews must be set out in the lease. You may have been quoted the rent on a per metre basis or as \$x/m². If this is the case the rent in the lease will be expressed as a figure which is calculated by

multiplying the rent/metre² by the size of the premises.

Outgoings

Rents are usually quoted 'excluding' outgoing. It sounds less that way. It is very important to understand from the lease exactly what outgoing you will be liable to pay to the landlord. Remember these are payable in addition to the rent.

The lease document sets out the type of outgoing you will be liable for. The schedule sets out the percentage of those outgoing you are to pay. This is usually 100% of the outgoing for the premises you are occupying. If the premises are part of a building and the percentage of outgoing is less than 100%, this percentage is the proportion the premises represents of the building.

It is normal but not essential in a lease that you pay outgoing or increases in outgoing from a base date. Outgoing are some of the landlord's expenses in owning the premises. These can include such items as:

- council rates;
- water rates;
- land tax;
- management fees;
- security;
- strata or other levies;
- cleaning, etc.

In some cases you are not charged the actual outgoing relating to the premises but increases in outgoing.

Increases in outgoing are increases above the amount the landlord is required to pay for certain things at an agreed date. For example, you may only be liable for increases in outgoing above those payable at 1 July 2010. In that case if the Council rates as at 1 July, 2010 are \$1,000 and increase to \$1,100 on 1 July, 2011 you will be liable for \$100.

The combination of rent and outgoing to be paid is a matter for negotiation. In addition to the rent and outgoing the lease may require you to pay interest if you are in arrears paying the rent or other payments under the lease.

GST

In most cases the landlord will be liable for payment of GST. The landlord will want to pass this cost onto you. You must be aware whether the rent payable includes GST or whether GST is an additional cost. In most cases you will be entitled to an input tax credit for GST paid on rent.

Term

This is the length of time the landlord and you are committed for.

There are a number of factors which may influence the term of the lease required by you. If the business is a new business you might want a short lease, so as not to be committed too long if the business is not successful. However, if a lease term is too short a business may not be saleable without the landlord's agreement to extend the lease or grant a new lease. Therefore it is a good idea, if you are not sure, to negotiate a shorter base term with several options.

If during the term you decide to vacate the premises for any reason, it is best to try and find a replacement tenant yourself. If you cannot find one, or are unable to you are technically liable for the rent to the end of the term. However, in those circumstances the landlord has a responsibility to limit, or legally speaking 'mitigate' its losses. This means the landlord has a responsibility to make all reasonable efforts to relet the premises as soon as possible after you vacate.

As with any problem, especially financial ones, the worst thing to do is ignore the problem and hope it will go away. If you find you are having difficulties continuing with the business, approach your landlord, and discuss the problem. The landlord may prefer to accept a lower rent than have the premises vacant.

Option

The landlord may grant you an option to renew the lease. In some cases they may even grant you an option to purchase the premises or a first right of refusal if they decide to sell the premises. However, this is not common.

Generally, an option gives you the right to renew the lease for a set period of time as set out in the lease. The landlord is bound to accept any renewal for the option period provided you comply with the terms of the lease to exercise that option.

It is most important that the option be exercised correctly in the manner and within the time allowed. At the time the option is exercised you shouldn't be in default of any of the essential provisions of the lease.

You are not bound to exercise your option; however, having one means you have the choice to renew the lease for a further term. This is a very important consideration when you take into account any goodwill you are creating at the location during the term of the lease.

Most problems you may encounter during the term of your lease can be dealt with. The one thing you cannot fix is if you lose the option to renew by not exercising it in accordance with the terms of the lease.

Before deciding to exercise the option check how the rent for the renewed term will be calculated. If it is market rent make sure you find out how much that rent is likely to be. If you exercise the option you may be bound to a rent which the business cannot afford. If this is the case you should try and negotiate a better rent with the landlord before exercising the option, being careful not to run out of time.

It is imperative you make a note of how and when to exercise the option and diarise the appropriate dates.

As in most cases the lease will be for at least 3-5 years this is the sort of detail you may well forget. Therefore, record the date and how to exercise the option from the beginning of the term. We suggest you enter these details in your diary or on a calendar on the last day of each year of the term of the lease. Give yourself several reminders during the last year of your lease.

The lease will provide the exercise of the option during a specific period eg. no earlier than 6 months from the expiry date of the lease and no later than 3 months from that date. You lose the right to renew if the option is exercised outside these dates.

Personal guarantee

If you want to use a company or trust to enter into the lease, the landlord may wish to obtain personal guarantees from the directors or shareholders of the company.

A personal guarantee is a promise by the guarantor to pay the landlord if the company or trust entering into the lease does not pay or fails to meet any of its other obligations under the lease.

It is important that you use the right entity as the tenant. This is usually the entity which operates the business. For the entity to be a legal entity it must be a natural person or an entity with legal status, such as a company. If you operate your business under a business name the party entering into the lease, as the tenant, should be the entity that owns that business name. A business name is not a legal entity.

Bank guarantee or security deposit

In addition to or in place of a personal guarantee a landlord may require a bank guarantee or cash deposit from you. A bank guarantee is a promise by your bank to pay the landlord an amount up to the limit of the bank guarantee if you break the terms of the lease. A bank guarantee or cash deposit is desirable to the landlord as it avoids the need to go to court to enforce payment of the amount agreed. You will have to give a bank some security to obtain a bank guarantee.

In most cases the amount of the guarantee or security deposit is equivalent to 3 months' rent.

It is a good idea if the lease requires a bank guarantee or security deposit to try to negotiate that there is no personal guarantee. As in all cases the giving of a personal guarantee should be avoided. A lease is one of the few transactions where this can be avoided on the basis of providing an alternate guarantee.

Maintenance

Normally you are responsible for the day to day maintenance of the premises and the landlord is responsible for all structural repairs. These obligations can change if the landlord and tenant agree otherwise.

The lease should be carefully checked to ensure you do not, without realising, accept an obligation to make structural repairs which could be very expensive.

Also it is a good idea to take photographs of the condition of the premises before occupation to avoid arguments later.

Use

The lease normally states the use you may use the premises for. The use specified in the lease must accurately and fully describe your intended use. The fact the lease permits a type of use, does not mean that the use is permitted by local council zoning. Check the permissible use for the premises with the local council for the area where the premises are located.

The fact that a use is permitted by the local council may not be enough to start operating the business. You need to find out whether you have to apply to the council for consent for your intended use of the premises. Unless there has been a business of the same type in the premises prior to your tenancy this type of approval is usually required by the local council.

Even if the same type of business operated from the premises previously you must check with the local council that the use was approved by them.

When checking with council ask for a search of the premises, which should confirm the ownership of the premises by the landlord. If there is any discrepancy between the owner of the premises, as disclosed by the council records and shown on the lease, you will need an explanation and proof from the landlord that it is the correct party to enter into the lease, as landlord.

Also remember that the local council may need to approve the signage you intend to use in connection with your business, particularly if there are signs attached to the premises or on an awning or structure overhanging the footpath. Check this with council also.

You apply for local council consent by lodging a Development Application with council.

Check with the council how long their consent is expected to take.

In addition to obtaining local council approval for the use of the premises you will most likely need a

Construction Certificate in respect of any structural building work you intend to carry out.

To avoid doubt and the problem of council rangers stopping your builders or closing you down it is best to discuss your plans with the planning and building departments.

To negotiate an appropriate rent free period you will need to know how long any approvals are likely to take. You should also take into consideration such other matters as:

- how long it will take to have telephone lines and any other services connected to the premises;
- the availability of workmen to fitout the premises; and
- any delays obtaining your staff, equipment, stationery and any other items needed for your business.

If you intend to operate a specialised business from the premises you may need other licences or consents. These are matters that need to be checked out with the appropriate licensing authority .

Assignment/sub-letting

Generally the lease does not allow a tenant to assign a lease or sub-let any part of the premises without the consent of the landlord. The landlord should not be entitled to refuse consent unreasonably

The landlord will in most cases request references, particularly financial ones, in relation to the person or company who you want to sublet or assign the lease to.

You should check this type of clause carefully, because consent to assignment does not necessarily release the outgoing tenant from all obligations under the lease. If the incoming tenant breaches the lease, the landlord may have rights against you as the original tenant. If this is the case ask the landlord to amend the lease.

Insurances

In most leases the only insurance you are required to take out are a public liability policy for the amount set out in the schedule. The landlord must keep the property insured against fire and the usual risks.

In addition to the insurances required under the lease you should insure your fixtures, fittings and equipment. You should also consider a loss of income policy and sickness and accident insurance for yourself or other key personnel. Your staff must be covered for workers compensation insurance.

It is important to check the clauses of the lease in the event the premises are damaged or destroyed. You should check what moneys are payable and whether or not the landlord is required to reinstate the premises. No compensation is payable if the lease is terminated in these circumstances. You should have insurance to cover this possibility.

Alterations and building works.

You can only alter the premises and make structural changes with the consent of the landlord. If you need to carry out any works you should advise the landlord or its agent before entering the lease and get written approval to carry out the work. You may only carry out the works in a proper and workmanlike manner and with the consent of the local council or other authorities eg. the local water board. You should also get the landlord's approval to any signage you are planning in connection with the business.

What other rights or obligations do I have?

In addition to the rights and obligation discussed you have the right to:

- quiet enjoyment of the premises during the term of the lease, subject to the landlord's rights to inspect the property, as set out in the lease;

- the landlord repairing any structural problems, not caused by you;
- the landlord paying all outgoings for the property (even if you are liable to repay these) as they fall due;
- access to any common areas or services of the building of which the premises forms part;
- the landlord maintaining any common areas or facilities, including lifts, toilets, air conditioning etc; and
- the landlord obtaining the mortgagee's consent and registering the lease.

The most common default by tenants involves the non-payment of moneys payable under the lease. If you are 14 days or more late making payments due to the landlord the landlord can demand possession of the premises or enter and take possession of the premises. In most cases you will also become liable for interest on those moneys.

If the tenant breaches any terms of the lease the landlord has the right to issue a written notice advising details of the breach and a time during which the default must be rectified. The lease will set out what constitutes a default and the consequences of the default.

It is important to remember that a lease provides that the tenant is liable for the landlord's costs enforcing the lease if the tenant is in breach.

At the end of the lease you are obliged to vacate the premises and return it to the landlord in the condition required by the lease. If the lease is terminated the landlord has the right to remove your goods, fixtures and fittings and dispose of, or charge you for storage of those items.

If the landlord allows you to remain in possession of the premises at the end of the term, without giving you a new lease, you become a monthly tenant. Either party is required to give the other one month's notice to terminate the monthly tenancy.

Some complexes have building rules. You will be given a copy of these rules and expected to comply with them. If the premises are part of a strata title complex you will be premises required to comply with the strata by laws and the strata levies will be included in the outgoings.

DISCLAIMER

This Guide has been prepared to help you to understand the legal aspects of buying a commercial property. It is not intended to be a kit setting out the procedures for buying or selling a commercial property and therefore does not seek to deal comprehensively with each step along the way nor with all the problems and difficulties, which need to be examined in the course of buying.

You should not rely on the contents of this publication without first obtaining our advice.