

**COLEMAN
GREIG
LAWYERS**

**Top tips and
tricks when
leasing
Commercial
premises**



YOUR FUTURE COMES FIRST

Table of Contents

Introduction	3
Heads of Agreement	4
Property subject to the Lease	4
Lease Period.....	5
Option to Renew	5
Rent.....	6
Rent Reviews	7
Outgoings	7
Availability of Services.....	9
Security Deposit or Bank Guarantee.....	9
Who is the Lessee?	10
Common problems often only discovered after occupation.....	10
Lease Costs	12
Permitted Uses.....	12
Sub-letting and Transfer.....	13
Insurance and Indemnities	14
Encumbering the Lease.....	15
Defaulting	15
‘Making Good’ at the end of your Lease.....	16
Do your Due Diligence.....	17
Finally, remember that you’re working with draft documents	17
Why Coleman Greig?	18

Introduction

For most businesses, their location will be of vital importance to their success, however many business operators don't have the luxury of owning the premises that they operate from.

Accordingly, dealing with a commercial lease will be a necessity at some point in time.

Obtaining security of tenure and avoiding having to move locations regularly will be key to managing costs and productivity. Behind wages and stock, rent is often one of the largest ongoing overheads most businesses incur - making the lease one of the most important internal documents that a business is likely to have to deal with.

Like many legal documents, leases can be long and often written in confusing or cumbersome language. It's no surprise many people don't get past the first few pages before they give up trying to make sense of it all! Understanding the content, meaning and effect of your lease can enable you to extract the maximum value and commercial advantage from the premises.

This publication outlines some of the key considerations when dealing with a lease, and highlights some helpful tips and potential traps to consider before signing your lease.

This publication outlines key considerations when dealing with a lease



Heads of Agreement

Whilst the Heads of Agreement is not a binding lease in its own right, it is often used as the 'term sheet' during the negotiation phase, which once agreed, will be used by the lessor's lawyer to prepare the formal lease. Often lessors or their agents will require a proposed lessee to sign a Heads of Agreement and pay a deposit (typically one month's rent) before the lessor will instruct their lawyer to prepare the formal lease. You should also be careful to ensure that the Heads of Agreement clearly state that it is not the intention of the parties to be bound by the Heads of Agreement.

If the lessor or their agent wish to issue a Heads of Agreement it is important to make sure that it clearly outlines each of the key terms agreed to in principle. Failing to address an area of concern in the Heads of Agreement will always make it more difficult, time consuming and costly to subsequently seek to have a relevant section of the lease amended. Sometimes, such a request will be rejected by a lessor purely on the basis that a proposed lessee signed off on an element of the deal in a Heads of Agreement.

Whilst there is no obligation to enter into a lease that you are not satisfied with (even if you have signed the Heads of Agreement) you may well incur wasted time, effort and costs if you subsequently refuse to enter into a lease prepared in line with an executed Heads of Agreement.

Property subject to the Lease

It is very important that the lease accurately and clearly describes exactly what is being leased. It is preferable that a plan showing the location and dimensions of the property being leased is attached to and forms part of the lease. Things like car parking and separate storage areas should also be clearly marked on the plan. This will help ensure you know the exact area(s) you are entitled to use under this lease. Of course, you should check the plan carefully to ensure that it reflects your physical inspection of the property.

Lease Period

A lease grants the lessee the right to occupy and have quiet enjoyment of the premises for a stated fixed period of time. Irrespective of who may own the property and whether it is sold during the lease term, the lessee has the right of occupation for the period of the lease.

Option to Renew

Leases can contain option(s) for renewal of the lease. If properly exercised these options grant a further term of lease to the lessee on the same terms as the original lease.

An option to renew is something that is for the benefit of the lessee, NOT the lessor.

In order to be secured, an option must be exercised by the lessee in the specific manner as set out in the lease. Often this requires written notification to the lessor no earlier than 6 months and no later than 3 months before the expiry of the initial term of the lease. To ensure the option is secured, the procedures for exercising the option need to be strictly observed. If you are late giving notice you will lose your option for renewal.

The entitlement to renew the lease for the option period is often conditional upon the lessee's compliance with the lease obligations. Payment of all amounts due under the lease and compliance with things such as building rules are of key importance leading up to the renewal period.

**You should
check the plan
carefully**



Rent

The headline issue for any lease is the cost of occupation – the main factor being the rent.

It is important for any prospective lessee to do their research and know what the prevailing rates are for the types of premises you are looking for in your area. Make sure you are comparing like for like, as differing styles of properties in different locations are not always good comparators. Know what the key features are of each location such as parking, access to public transport and other critical infrastructure.

It is also a smart move to figure out the type of lessor you will be dealing with. Is the property owner an institutional investor who has the means to offer attractive incentives but will be inflexible on the lease terms? Or, are you dealing with a mum and dad investor (think SMSF) who may not have the means to help contribute to your fit-out costs or discount your rent in the early months, but may be willing to be more flexible on the terms of the lease?

When negotiating the rent be careful to ensure that a generous incentive is not being made up for in an inflated rate of rent, or likewise that low rent is not being covered by inflated outgoings.

It also pays to keep in mind that incentives to have a lessor's tradespeople conduct fit-out works may not be true or full value incentives if the claimed value of the building works has been inflated. In this instance, it may be better to take the equivalent sum in reduced rent and have your own tradespeople complete the work.

As with most things in business: know the market, do your research, and be clear on what you want and what you can afford – and don't stretch beyond your limits.

Rent Reviews

Typically speaking, the rent in a lease will increase each year on and from the anniversary of the lease. Ordinarily rent will be reviewed based on CPI, a fixed percentage or market review. Which method is best? This is all a matter of perspective and the status of the general economy – much of which cannot be readily predicted at the outset of a longer term lease. Usually upon the exercise of an option term, rent will be subject to a market rate review with a rider that it cannot be less than the rent at the time of review. Whether these ‘rider’ clauses are fair and reasonable is subject to plenty of debate and of course there is no right or wrong answer, but attention still needs to be paid to the issue.

Outgoings

In addition to rent, a lessor will ordinarily require a lessee to pay the costs associated with their occupation of the premises. These costs are only recoverable if they are set out in the lease. The Retail Leases Act restricts which outgoings can be recovered from a lessee but otherwise the issue is entirely subject to agreement between the parties, hence great care and diligence is required to ensure that only fair and reasonable outgoings are included in the lease.

Outgoings are a critical part of the total occupancy costs of leased premises. Outgoings are enforceable in the same manner as the rent, so should be treated with the same attention and importance. Cheap rent is only a good deal if the outgoings are fair and reasonable and within prevailing market rates.

The headline issue for any lease is the cost of occupation



The most common types of outgoings include:

- Local council rates and charges
- Land tax
- Water rates
- Costs of repair (other than structural repairs)
- Cleaning to common areas
- Security to common areas
- Landscaping to common areas
- Water consumption to common areas
- Electricity to common areas
- Waste removal
- Management costs
- Air conditioning (centralised systems)
- Lift maintenance
- Fire protection maintenance & certification
- Building insurance
- Levies and contributions levied by the owners corporation or any strata managing agent

Care should be taken to exclude special levies associated with the capital improvement or repairs of the building.

Depending on the type of property, you may have to pay all or a percentage of the outgoings relating to the premises. This percentage will usually be worked out based on your portion of the floor space compared to the lettable area of the entire building. Sometimes in larger corporate buildings, you may only have to pay any increase in outgoings from year to year using a base to calculate from.

For retail leases, the lessor disclosure statement must provide an estimated cost of the outgoings to be paid per annum.

Availability of Services

Lessors will generally commit to taking certain steps to ensure that services (such as lifts, air conditioning and electricity) are available to the leased premises. However, lessees should seek a clause in the lease allowing for a rent abatement provision, in the case that important services are inoperative for any extended period of time. Otherwise, lessees can find themselves liable to pay the full rate of rent even when they may be unable to use the premises or the premises are not in their optimal state.

Security Deposit or Bank Guarantee

Every lease will require the lessee to provide a security bond. This is an amount of money intended to incentivise the lessee to comply with their obligations under the lease, and to partially secure the lessor against loss for things such as non-payment of rent or damage caused to the premises.

This security bond may take the form of a cash payment to be held by the lessor or their agent, or a bank guarantee. The amount is entirely negotiable but will usually be referenced to a certain number of months of rent and outgoings. You should also check whether your bank will require an expiry date on the bank guarantee.

Outgoings are a critical part of the total occupancy costs



Who is the Lessee?

If you choose to enter into a lease using a company or corporate structure, a lessor will often require you to give a personal or director's guarantee. The effect of a personal guarantee is that the lessor may recover any rent, damages or other amounts due under the lease from the guarantor(s) personally if the lessee fails to pay them. The guarantee will often be irrevocable until all amounts due and owing under the lease are satisfied. Guarantee clauses often provide very significant and far reaching obligations and liabilities to the guarantors.

Directors and business partners must consider matters relating to personal guarantees and the liability relationship between one another carefully. Guarantees are not easy to get out of and careful consideration should be given in relation to them before they are entered into. For example, what will happen if one of the guarantors wants to retire or leave the business but may still be subject to the guarantee? Personal guarantees should not be given lightly - ever.

Common problems often only discovered after occupation

Without doubt, the two most common practical issues experienced by lessees associated with the day-to-day occupation of leased premises are car parking and air conditioning.

Some premises will come with a set number of car parking spaces. It is important to know which car parking spaces are yours and whether these are exclusively yours or rather a part of common area available for anyone to use. Whether the parking spaces are secure is also very important. Having other people gaining access to and using your spaces without permission can be infuriating for lessees.

Sometimes car parking spaces are not a part of the premises (for example, they may not form a part of the title of the premises you are leasing) and as such may be granted to you subject to a licence to occupy. Whilst licences to occupy often provide less security of tenure and can often be terminated on a short period of notice, many car-parking licences will be tied to the term and/or termination of a lease. This means whether you need the car parking spaces or not you may be forced to pay for them for the full term of the lease. Make sure that car parking is dealt with clearly and adequately in the lease or related licence to occupy.

In terms of air conditioning, it's important to physically identify where the air conditioning zones are, where the thermostats are located and whether you can adjust the temperature within your premises. Depending on the nature of the building the premises may be serviced by a central air conditioning system for the whole building, individual units for each premises or a combination of the two. If the premises have a central system for the building, the outgoings of the building will include the service and repair costs of the system.

If the premises have individual units for each premise, be wary of the lessor requiring the lessee to service and maintain the units at their own expense. Many of the clauses of this nature are unreasonable and unfair and can impose huge financial burdens on the lessee. Incoming lessees should insist on a full service report on the system before they occupy so they can be clear as to whether the system was fully operational and properly maintained by the previous occupant. Otherwise, a new lessee may end up bearing the costs of repairing a system that was neglected by the previous occupant and/or the lessor.

**We are
committed
to providing
excellence in
legal services.**



Lease Costs

Historically, it has been customary for the lessee to pay the lessor's reasonable legal costs for preparing the lease. However, everything is negotiable. In more recent times it has become more readily accepted that each party will bear their own costs associated with the lease, but of course this is subject to agreement being reached on the issue.

If the lease is to be registered, it is most likely that the lessor will require that the lessee cover the cost for this to be completed.

Permitted Uses

You may use the leased property only for the permitted use stated in the lease.

This is separate and unrelated to what uses the property is zoned for as approved uses. We strongly recommend that all lessees check with the relevant local council about its requirements to allow you to use the property as you wish – covering town planning controls, health and safety and building issues. You can order council searches on the property to determine what the property has been zoned for and any likely council changes that may affect the property.

Just because you have agreed to a permitted use for the premises with the lessor does not mean that you are lawfully allowed to use the premises for that purpose, pursuant to zoning laws and regulations.

If you cannot use the property for your desired (permitted) purpose due to zoning issues it will be very unlikely that you will be allowed out of your obligations to pay rent and outgoings pursuant to the lease. The obligation to check zoning and approved usage of the premises will always rest with the lessee.

Sub-Letting and Transfer

Most leases will state that a lessee cannot sub-let or assign the lease without the lessor's consent (which the lessor can withhold). Sometimes the lessor's ability to withhold consent can be absolute, and other times it can only be withheld if certain matters arise such as:

- the new lessee proposes to change the use of the property; or
- the new lessee has "financial resources or retailing skills" inferior to those of the existing lessee.

The lease will set out the specific processes that must be followed in order to seek the lessor's consent to sub-let or transfer the lease. The provisions are often critical if the lessee wishes to sell their business and the premises is a critical element of the business. If you cannot transfer the lease, the business may not be saleable or at least may not obtain the highest price possible.

**The lease
will set out
the specific
processes
that must be
followed**



Insurance and Indemnities

A lease will likely require the lessee to take out a minimum amount of public liability insurance and in some instances, plate glass insurance. The lessor should be made to insure the building against fire and damage – however as set out above this may in turn be a cost that is contributed to by lessees via the outgoings.

Often if what a lessee does in the property increases the risk of loss and the lessor's insurance costs go up, the lessee will have to pay the extra premium.

Typically, the lessee must provide the lessor with a copy of the required insurance policies at the time of entering the lease. Many leases will require that those policies either note the lessor as a co-insured or at least as an interested party. Some leases will even go to the extent to direct you as to how, when and where any insurance payouts must be paid.

It is very important to provide a copy of your lease (or at least the insurance policy requirements sections of the lease), to your insurance broker to ensure that you can in fact obtain policies in the terms required by the lease. It is not uncommon for insurers to refuse to issue a policy in the exact terms required by a lease. Unless you negotiate to amend those requirements under the lease you can find yourself in technical breach of the lease. These types of breaches can often be exploited by unscrupulous lessors who may be looking for any reason to terminate the lease for breach if it suits their purposes to do so.

It is also conventional for a lessee to indemnify the lessor against certain losses. Of particular concern, however, are indemnities that make the lessee liable for the actions of its visitors outside of the leased premises (e.g. if a visitor damages another part of the lessor's building or property), irrespective of the degree of control that the lessee has over those people. This can cause problems in the future for shareholders of a lessee company who may wish to sell their shares or the lessee directly if they wish to sell the business as a whole, as prospective purchasers may reduce the price they are willing to pay to reflect the risks inherent in such indemnities.

Encumbering the Lease

Most leases prohibit the lessee from encumbering their interest under the lease. Where the lease contains such a prohibition and the lessee has entered into a General Security Agreement (formerly an all-assets fixed and floating charge), the lessee may find themselves in immediate default under the lease. Lessors may learn of this and keep such a default up their sleeve to be used in their favour should the need arise.

If you have a General Security Agreement in place (which would be required for any type of overdraft account or financial accommodation by a bank), the lease should expressly exclude this so as to avoid any claim of technical default.

Defaulting

If you default on the payment terms of rent and/or outgoings your lease will likely impose a rate of interest on the overdue amount. Further, if you fail to pay any amount due under a lease, it will most likely entitle the lessor to re-enter the leased property and retake possession.

The lessor should be made to insure the building against fire and damage



‘Making Good’ at the end of your Lease

When the lease ends it is most likely that the lessee will be required to take out all of their fixtures and fittings, and ‘make good’ any damage caused during their occupancy and/or in removing their fixtures and fittings. Irrespective of how new, nice, reusable or expensive your fit-out may be, most leases will require you to remove it at your own cost (which is often not insubstantial). If you do not remove your fixtures and fittings on time, they are most likely to become the property of the lessor, and the lessor can, at the lessee’s expense, attend to the make good. Consider these additional factors:

Deemed holding over

Some leases oblige the lessee to pay rent as though it was holding over until it has complied with its make-good obligations in full. Depending on the precise wording of such leases, this can enable lessors to rely upon immaterial errors by the lessee in complying with its make-good obligations as an excuse to continue to charge the departed lessee full rent while the lessor finds a replacement lessee.

Interaction with sub-letting

Lessees should be wary about sub-letting premises for the balance of a lease term, as this can leave them with insufficient time at the end of the sub-lease to comply with their own make-good obligations.

Structural soundness and weatherproofing

Lessors’ standard leases rarely oblige lessors to keep the building structurally sound and weatherproof. In the absence of such an obligation, circumstances can arise under which it is very difficult for the lessee to comply with its general repair obligations.

Payments to avoid make-good

Some lessors may be willing to grant a lessee an option to pay a pre-determined ‘make-good amount’ in lieu of performing an end-of-tenancy make-good of the premises. This provides the lessee with the flexibility to continue to carry on its business in the premises until the end of the lease term, if they would prefer that over vacating early and continuing to pay rent while the make-good is being performed.

Do your Due Diligence

Research the premises and the surrounding area, walk through the premises a number of times (with and without the agent), ask for documents, reports and evidence about factors and issues that are important to you. Talk to the other occupants of the building and even the outgoing tenant (if you can) – they'll tell you the things that the lessor and the agent won't!

Finally, remember that you're working with Draft Documents

Remember, when a draft lease or Heads of Agreement is put forward they are no more than drafts. Subject to an agreement being reached, a lease can be amended in any number of ways. Everything is open to negotiation. It is important to know what you need and what you would like in the document and prioritise these items accordingly. If you cannot get a lessor to agree to the items you need, then careful consideration should be given to passing on the property and continuing the hunt for the right premises.

With careful research, appropriate amendments and a clear understanding of your final lease document and its requirements, your business will be perfectly positioned to make the most of your new location.

Why Coleman Greig?

At Coleman Greig we are proud of the reputation and respect we have earned as Greater Western Sydney's leading law firm.

The depth and breadth of expertise we offer, combined with our ability to pre-empt client needs and deliver individually tailored legal solutions, continue to position us at the forefront of cutting-edge legal services and ensure that we continually surpass client expectations.

Commercial Client Services

- Commercial Advice
- Corporations Law
- Mergers & Acquisitions
- Franchising
- Intellectual Property
- Employment Law & WHS
- Competition & Consumer Law
- Debt Recovery & Insolvency
- Commercial Litigation
- Dispute Resolution & Mediation
- Commercial Property – Sales & Leasing
- Property Law
- Building & Construction
- Business Succession Planning
- Public Notary Services
- In-House Training & Compliance Services
- Taxation Advice
- Trusts
- Tax Disputes

Personal Client Services

- Family Law
- CG Family Law Mediation & Arbitration
- Wills and Estate Planning
- Special Disability Trusts
- Probate & Administration
- Succession Planning
- Conveyancing
- Retirement Living
- Superannuation and SMSF

Disclaimer: This publication is indicative only. It is provided for the purposes of encouraging you to realise how complex and important the law is and the legal ramifications that can occur. It is not legal advice and you are not to rely on it as formal advice. This paper is not an alternative to reading all of the laws, policies and procedures that apply to you. You must read them in their entirety, act in accordance with their requirements & apply them to your situation. The law changes rapidly and this publication may not be up to date. Each situation is different and you should seek legal advice regarding any legal matters that arise for you in your circumstances.

COLEMAN GREIG LAWYERS
YOUR **FUTURE** COMES **FIRST**

Liability limited by a scheme approved under Professional Standards Legislation.

CONTACT US
+61 2 9895 9200

www.colemangreig.com.au