



Lessons for Lessors

COMMERCIAL LEASES

Avoiding the Common Pitfalls



BLUE OCEAN LAW GROUP

Commercial Leasing

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IMPORTANT NOTICE

This guide has been prepared to provide general information only and is not intended to be comprehensive.

The content does not constitute legal, financial or taxation advice and should not be relied on as a substitute for obtaining legal, financial, or other professional advice.

This guide is designed to help you ask the right questions and focus on the legal advice you will need to avoid common pitfalls and expensive misunderstandings that could cost you and your business.

It offers guidance on how to secure a commercial lease with reduced risk exposure and lower management overheads for greater protection and return on investment.

You must seek specific professional advice tailored to your circumstances before taking any action based on this publication.

Should you require legal advice, please contact us.

Our contact details are on page 14.





COMMERCIAL LEASES

Introduction

Securing a quality lease enhances the performance of your commercial property as an asset.

At the same time, minimising risk and costly management overheads is equally essential to prevent escalating administrative and monetary costs.

Retail leases are regulated by legislation that restricts and overrides lease terms, such as those relating to rent reviews, the responsibility for the lessor's costs, and security deposits.

In contrast, leases for non-retail commercial property – such as office spaces and warehouses – are not similarly regulated. The terms of a non-retail commercial lease are therefore largely a matter of agreement between the lessor (i.e, landlord) and the lessee (i.e, tenant).

Consequently, the content of non-retail commercial leases can vary substantially depending on the details of the property and surrounding circumstances, the bargaining power of the parties and the negotiation and drafting abilities of their solicitors.

In this guide, we will be exploring non-retail commercial leases, specifically, and examine how a carefully drafted and tailored non-retail commercial lease agreement can facilitate you in:

- streamlining negotiations;
- avoiding misunderstandings;
- protecting your rental income;
- avoiding/reducing costs;
- preventing costly potential disputes; and
- minimising vacancy between leases.

BEYOND GETTING THE RIGHT LESSEE

Setting the parameters of your Commercial Property



Every lease should be tailored to match the lessee and overall circumstances.

A high-quality lease investment begins with setting the parameters of your lease to ensure that a prospective lessee first meet your criteria for key terms including:

- lessee credentials,
- lease duration,
- rent rates, and
- business type.

WE EXAMINE IN THIS GUIDE HOW A CAREFULLY DRAFTED AND TAILORED NON-RETAIL COMMERCIAL LEASE AGREEMENT CAN PUT THIS INTO PRACTICE FOR YOU.

COLLATE AND HIGHLIGHT THE KEY TERMS

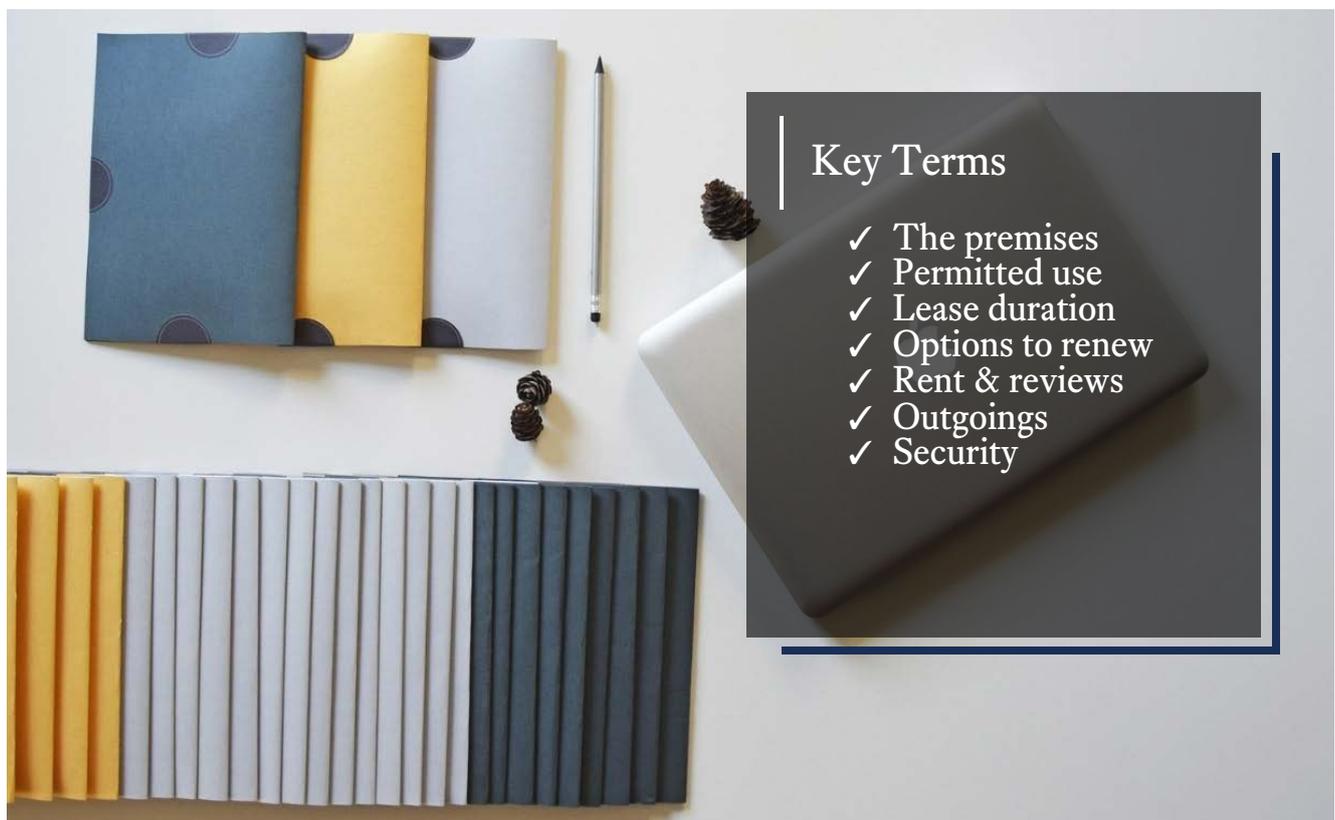
Regardless of its type, commercial leases will frequently have comparative rent terms.

While the rent structure may vary, all leases include a standard set of key terms.

In the lease, clearly set out the key terms in a reference schedule at the front of the agreement.

This adds clarity and speed in negotiations as well as an easy reference in administering and enforcing the lease. If the lessee is paying for outgoings in advance, specify the estimate of the first year's outgoings upfront as this will form the basis for calculating outgoing amounts.

You will particularly want to understand the following terms:





REMOVE HINDRANCES TO THE NEXT LEASE

Where the lessee will have an option to renew the lease after the initial term, be clear about the renewal conditions.

Making the renewal subject to no subsisting default by the lessee can help to motivate the lessee to rectify any default before the renewal.

Specify a fixed option expiry date, commonly 3 months before the end of the current term, to give yourself sufficient time to find and secure the next lessee if the existing lessee chooses not to renew.

TERMS EXPRESSLY ALLOWING YOU AND YOUR AGENTS TO PUT UP "FOR LEASE" SIGNS, AND HAVE REASONABLE ACCESS TO THE PREMISES FOR VIEWINGS, BEFORE THE EXPIRY DATE HELPS TO PREVENT HINDRANCES TO SECURING A SEAMLESS RENEWAL OR NEW LESSEE AND THEREBY REDUCE OR AVOID ANY VACANCY.

BE SPECIFIC ABOUT RENT REVIEWS

Rent reviews in non-retail commercial leases are a matter of agreement between the parties.

The lease should include a right for the lessor to review the rent annually.

Rent reviews can provide for fixed percentage increases as well as adjustments in line with inflation or current market conditions.



RENT REVIEWS OFTEN CAUSE DISAGREEMENTS, SO BE SPECIFIC ABOUT HOW EACH REVIEW WILL BE CONDUCTED AND HOW ANY "MARKET RATE" REVISION WILL BE DETERMINED.

For long leases and renewals, a market-based rent review every 3-5 years, and at the commencement of each renewal period, will help to re-align the rent with the current market conditions.

In such cases, provide for a professional determination in the event of any disagreement about the revised rent and make that determination final to avoid unnecessary legal costs.



OUTGOINGS PAYABLE BY THE LESSEE

Lessees are usually responsible for charges, duties and impositions relating to the use of the leased premises.

The responsibility for outgoings in a non-retail commercial lease is a matter of agreement between the parties – unlike retail leases, these are not regulated by statute and it's up to the lessor and the lessor's solicitors to ensure that the lease agreement sets this out clearly and precisely.

Where the lessee will contribute to any rate, tax, maintenance, or service to the premises, specify each item along with the proportion for which the lessee will be responsible.

Where any part of the premises, common areas or facilities are shared, be specific about the apportionment of outgoings relating to them.

THE LEASE SHOULD ALSO ADDRESS OUTGOINGS THAT CANNOT BE PARTICULARLY IDENTIFIED OR ESTIMATED AT THE COMMENCEMENT OF THE LEASE, SUCH AS REPAIR COSTS.

RETAIN ADEQUATE SECURITY



A cash deposit or bank guarantee will provide relief in the event of any breach by the lessee.

This includes the failure to pay money due (e.g, rent, outgoings) as well as repair costs if the lessee does not properly restore the condition of the premises at the end of the lease.

The security amount is often expressed in terms of several months' rent.

Where the lessee will be responsible for GST and outgoings, increasing the security amount by the proportionate GST and estimated outgoings will strengthen that security in your favour.

IT IS IMPORTANT FOR THE SECURITY AMOUNT TO BE INCREASED TOGETHER WITH RENT AND TOPPED-UP IF AND WHEN YOU ARE FORCED TO CLAIM ANY PART OF IT.

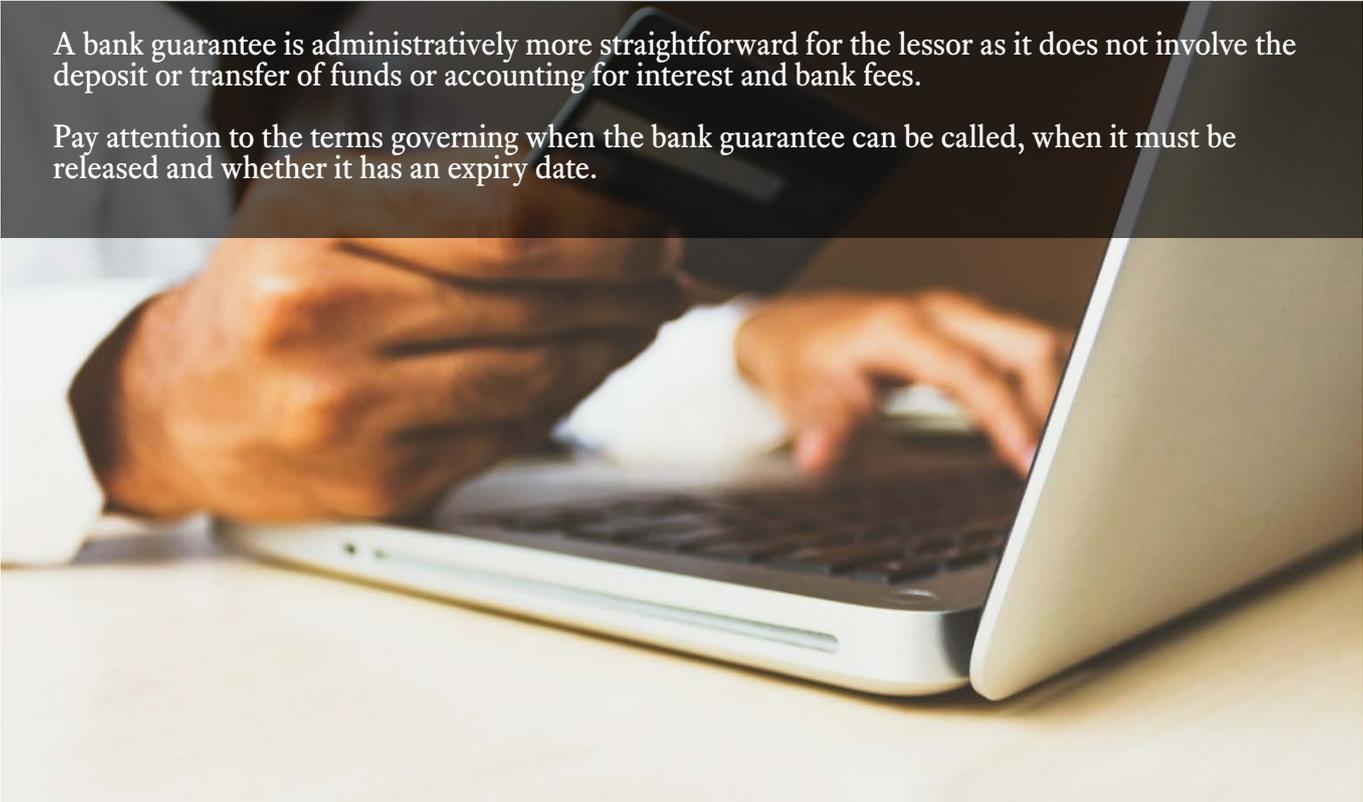
RETAIN ADEQUATE SECURITY

Be mindful of monies that will only become due, or amounts that will only be known, after the end of the lease, such as make-good costs.

The lease should provide for the security to be retained until the make-good has been completed and there can be no further claims against the lessee.

A cash deposit is typically held in a separate bank account, with amounts being transferred between yourself or your managing agent and that separate account.

Be specific about whether the lessee will be entitled to interests earned on that deposit and whether the lessee will be responsible for the related administrative costs.



A bank guarantee is administratively more straightforward for the lessor as it does not involve the deposit or transfer of funds or accounting for interest and bank fees.

Pay attention to the terms governing when the bank guarantee can be called, when it must be released and whether it has an expiry date.

A FAILURE TO RETAIN ADEQUATE SECURITY CAN CAUSE YOU TO BE OUT OF POCKET BY THE TIME YOU CONSIDER EVICTING A LESSEE IN DEFAULT, IN WHICH CASE YOU MAY STILL BE FACED WITH FURTHER COSTS OF EVICTION, REPAIRS AND REPLACEMENT.



ASSIGNMENT / TRANSFER

The lessee will often want to assign (i.e, transfer) the lease – e.g, in the event of a sale of the lessee’s business. In some jurisdictions, legislation restricts the lessor’s ability to withhold consent to an assignment.

For the lessor, the incoming tenant’s type of business, reputation and financial standing are paramount when considering whether to consent to the assignment as those factors will affect the new tenant’s ability to uphold the lessee’s obligations.

In the context of a sale-of-business, the lessor is not privy to the same due diligence information as the lessee, so a well-drafted lease will enable the lessor to make inquiries about the incoming party and its business.

To protect the lessor, the lease should require the lessee to obtain the lessor’s consent to the proposed assignment and permit the lessor to refuse consent if not reasonably satisfied as to the reliability of the new tenant.

The agreement should set out:

- the criteria that apply to the assessment of the incoming tenant’s reliability; and
- the conditions that the lessor can attach to any given consent.

The reasonableness of a lessor’s refusal to an assignment is a matter of fact which, unsurprisingly, has been frequently contested in court.

A well-drafted lease can help you secure your interests as lessor by empowering you to:

- assess the incoming tenant’s financial standing and ability to uphold the lessee’s obligations;
- require an increased security amount and other conditions to the consent if you consider them appropriate in light of the incoming tenant’s risk profile; and
- refuse consent to the assignment if you are not reasonably satisfied.

THE LEASE AGREEMENT SHOULD ALSO TREAT CHANGES TO THE CONTROL OF A CORPORATE LESSEE – E.G, AS A RESULT OF A SALE OF THE SHARES – IN THE SAME WAY AS AN ASSIGNMENT.

THE LESSEE'S BUSINESS

Be specific about the nature of business and activities for which the lessee will be permitted to use the premises, as well as the activities that the lessee will be prohibited from conducting at the premises.

It's also important to ensure that:

- the lessee's business activities at the premises will not cause the lessor to be in breach of any laws or regulations; and
- the lessee has all appropriate insurances.

The lease should be drafted to minimise the possibility of nuisance or inconvenience to surrounding tenants and neighbours – e.g, noise, smoke, heavy traffic, etc.

Know the Lessee

Conduct inquiries about your prospective lessee and its business to minimise any difficulty in collecting rent and to avoid other problems including:

- breach of the law, by-laws, or regulations;
- complaints from other tenants;
- damage to your property; and
- your insurer increasing insurance premiums.

Your solicitor can assist you with background checks on the prospective lessee to reveal any signs of financial trouble or history of disputes.

COSTS

THE COSTS OF NEGOTIATING, PREPARING, AND EXECUTING A NON-RETAIL COMMERCIAL LEASE ARE COMMONLY PASSED TO THE INTENDING LESSEE.

THE COST OF REGISTERING THE LEASE, WHERE APPLICABLE, IS ALSO USUALLY THE LESSEE'S RESPONSIBILITY.

ABOUT BLUE OCEAN LAW GROUP

INNOVATIVE COUNSEL[IC] + GOVERNANCE RENEWAL INCL.
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