

Understanding a Commercial Lease

When renting business related property, it is important for both Landlords and Tenants to understand the relationship they are entering into and the rights and obligations that they each have. The document that governs this relationship is usually a Commercial Lease.

So what is a Commercial Lease?

A lease is a legally binding contract that gives you certain rights to a property for a set term. A commercial lease is used when leasing property used primarily for a business.

You should never sign a lease without understanding all of its terms and conditions. If you don't understand what you are agreeing to, you could experience serious financial and legal problems.

It is important to properly investigate the property and lease document before you sign. It is a good idea to ask us to explain the main clauses of the lease to you. We can give you legal advice, draft new clauses and help you negotiate the terms and conditions to suit you.

Important issues to consider when entering into a lease

A commercial lease will usually contain terms dealing with items such as:

Rent: How much is the rent and when is it due? The amount of the rent will usually be calculated based on the area of the premises. This may not always be as simple as it sounds if the shape of the property is irregular or the area includes a lift, more than one floor, outdoor area or interior walls.

Rent Increases: Rent will usually increase annually during the term of the lease, with increases determined by a fixed percentage, be market based or tied to the CPI. It is common for CPI or fixed reviews to occur during the term of a lease and for a market review to occur at the expiry of the initial term and at the start of each option period.

Security Deposit: The landlord will usually ask for some form of security from the tenant in case the tenant defaults on their obligations (eg. not paying rent). The security is usually for an amount equal to 3-6 months rent and is often by way of bank guarantee. If the tenant

is a company, then personal guarantees from the company's directors may also be required. The lease should also specify the terms regarding return of security deposit. In terms of the security, a lot depends on the prior experience and business experience of the tenant, as well as their financial position. If the tenant has limited financial experience in the proposed endeavour, then the landlord will usually ask for a longer security of up to 6 months. If the lease is being transferred, the landlord could seek an alteration to the security deposit if the incoming tenant does not have strong prior business experience in the proposed venture, or if their financial situation is fairly weak.

Term of the lease: The lease should set out the length of the lease, any options to renew the lease and any terms relating to the renewal. A landlord will generally want a longer initial lease term (typically 3, 5 or 10 years) whereas the tenant is likely to want a shorter period (1-3 years).

Option to Renew: An option allows the tenant to continue leasing the property on similar terms at the end of the initial period of the lease for a further defined period and rent (subject to any review). An option gives the landlord potential greater security of income, and gives the tenant the ability to make longer term plans for their business.

Knowing the procedure for exercising the option, especially when the option can be exercised, is critically important.

Improvements: A lease should address what improvements or modifications can be made to the property, who will pay for the improvements, and whether the tenant is responsible for returning the property to its original condition at the end of the lease.

Description of the property: The lease should clearly describe all of the property being leased, including bathrooms, common areas, kitchen area and parking areas. A plan of the property could also be included.

Signage: Any restrictions on putting up signs, say that are visible from the street, will be included in the lease. Also, local zoning regulations need to be checked to determine what other limitations may apply.

Use of the property: Most leases will include a clause defining what the tenant can do on the property (eg. what type of business can be conducted at the premises). A tenant should ask for a broad usage clause just in case the business expands into other activities. Ask your local council if your business can operate in your desired

location. Also consider the council's development plans for the area.

Outgoings. The lease will set out who is responsible for costs such as utilities, property rates & taxes, insurance, and repairs.

Insurance. You should contact your insurance company and discuss the clauses in the lease referring to insurance so you fully understand what is required by the lease.

Exclusivity clause: This is an important clause for retail businesses renting space in a commercial complex. An exclusivity clause will prevent a landlord from renting neighbouring space to a competitor.

Assignment and subletting: A tenant should maintain the right to assign the lease or sublet the space to another tenant. Usually the tenant is still ultimately responsible for paying the rent if the business fails or relocates, but with an assignment or sublet clause in place, the business can find someone else to cover the rent (subject of course to the landlords approval.).

Maintenance & Repair: The lease should clearly set out who is responsible for maintaining or repairing the property and the fixtures and fittings during the term of the lease.

Termination: The circumstances under which the lease will be terminated should be set out in detail in the lease.

Costs: The landlord may want the tenant to pay the costs of preparing the lease, and this should be clearly set out in the lease. In Retail Leases the landlord cannot pass the cost of preparation of the lease on to the tenant. In relation to transfers of leases, even in a retail lease situation, the landlord will seek the legal costs of their lawyers in relation to the securing of consent to the transfer. This cost is passed on to the vendor/outgoing tenant.

Retail lease or general commercial lease?

The *Retail Leases Act 2003* has specific legislation relating to retail leases. This legislation is designed to provide additional protections to retail tenants and imposes a range of obligations on commercial landlords, when compared to non-retail commercial leases.

For a new retail lease, the landlord is legally required to give the tenant:

- a written lease with matters agreed to and signed off by both parties.
- a copy of the proposed lease as soon as the lease negotiations start
- a disclosure statement.

- the Victorian Small Business Commissioner Information Brochure as soon as the lease negotiations start.

The disclosure statement outlines important information about the lease, for example:

- the term of the lease
- whether there are options for further terms
- the occupancy costs for leasing the premises (including rent and any outgoings)
- specific information for shopping centre leases
- the tenant's fit-out requirements
- if there are any relocation or demolition clauses

Conclusion

Although many of the terms of a commercial lease are fairly standard, it is important that you fully understand your rights and obligations, especially the provisions which relate to retail leasing.

It is a good idea to ask us to explain what clauses in the lease mean and to get our assistance in checking the terms and conditions so that they suit you.

Need more information

If you or someone you know wants more information or needs help or advice, please contact us on (03) 9600 0162 or email info@lordlaw.com.au.