

Leaker Partners
Corporate and Commercial Lawyers

***COMMERCIAL LEASES:
Some Key Issues for Tenants to Consider***

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LEASE INCENTIVES

➤ CAREFULLY CONSIDER THE FORM OF INCENTIVE

- Rent-free period- Outgoings and car bay costs are not usually included.
- Fit-out costs (whole or part): Who will own fit-out? Consider the transfer duty implications.
- Reduction in Rent- can this be spread over the whole term or must it be taken upfront?
- Combination of both- discuss any tax implications with your accountant.
- What is the current vacancy rate in the area? Can you negotiate something better?
- Perth's vacancy rate hit its highest level in 21 years in February 2016 (source: www.afr.com/real-estate/commercial/perth-office-vacany-rate-is-the-highest-in-21-years-20160203-gmkdk1)
- Be careful of incentive repayment terms e.g. a breach by the Tenant, or assignment may require repayment of the full incentive.

Remember the incentives will not last forever and you will be locked into the terms of the lease once it has been signed!



RENT AND RENT REVIEWS

- Does the rent shown include GST?
- When is it paid? Weekly/monthly in advance? Does the payment schedule fit with your expected cash flow?
- How and when is the rent reviewed?
 - Generally reviewed yearly but can be done more often.
 - Make note of timeframes to respond to new rent proposed. A non-response may be deemed acceptance.
 - CPI Adjustment: Which index is used? This should be specified.
 - Market Review: usually done by mutually appointed valuer if agreement can not be reached. What is and is not included? E.g. tenant improvements, rent free periods are usually excluded. When is this done? Usually done at exercise of an option period.
 - Can the rent decrease if the market has fallen? Usually there will be a 'ratchet clause' not permitting the rent to drop below previous year.
 - Fixed increase: Are you comfortable with the amount?
 - There may be a combination of methods for review: e.g. market plus fixed or CPI plus fixed.
- **NB: Retail Shops Leases cannot use more than one method at a time nor contain a ratchet clause.**



OUTGOINGS

- When are outgoings payable? Usually from date of access e.g. during fitout or early access.
- Rent free periods do not usually include outgoings.
- What is included in the outgoings? Review copy of statement of outgoings for previous year. Review actual definition of outgoings in lease which may be more comprehensive.
- Are there any costs you consider should be covered by the landlord? E.g. building insurance, structural maintenance, air con repairs etc.
(NB some outgoings can not be recovered under a Retail Shops Lease).
- When are these payable? When due or estimated for the year and payable monthly?
- When and how is a reconciliation done?
- What is your right to review the outgoings? What level of disclosure is required? **(NB outgoings notices required under Retail Shops Lease).**



PERMITTED USE

- Make sure your intended use is clear- Consider use now and in the future
- Be broad to capture all business activities. E.g. wholesaling, manufacturing, repairing, retail sales etc.
- A broad definition will also allow a business to grow and diversify
- Consider assignment- a multi-use facility will be more attractive to a potential assignee.
- Does the Landlord exclude warranties concerning the use of the premises?
- Conduct your own due diligence as to the suitability of Premises for intended use. E.g. a barista training school may require more power point outlets for all coffee machines.



Term of the Lease



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➤ Initial Term:

- Is the term long enough to support the goodwill of your business and recover rental investment?
- Is security of location an important factor?
- A longer term might be used to negotiate a lower rent
- If you cannot commit to a long initial term consider breaking it into option periods e.g 2+2+2 or 3+3 etc.

➤ Option Period:

- Should give Tenant the option to renew but not an obligation.
- How is the option exercised? This should always be done in writing.
- When must it be exercised? Make sure you diarise the renewal date. (Landlords are only required to remind tenants of renewal date under a Retail Shops Lease)
- In what circumstances can a Landlord refuse the further option? Usually if the Tenant has defaulted- ensure the Landlord is required to have given Tenant written notice of default and opportunity to rectify it.
- Is there a Market review on option? Ask for new rent information in writing at least 3 months before option term.



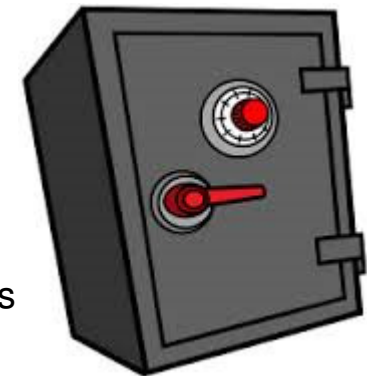
SECURITY

➤ TYPES OF SECURITY:

- Security bond: what are the conditions? Is the Landlord entitled to the interest?
- Bank guarantee: ensure you speak to your bank early and provide them with a copy of the terms of the bank guarantee in the lease. This can often take time as a bank may not agree to the conditions of the bank guarantee in the lease and further negotiation with the Landlord is required. Typically 3-6 months rent plus outgoings plus car bay.
- Personal/director's guarantee: Avoid these if possible. Can be useful if cash flow is an issue and bank guarantee can not be provided.
- Charge over Business assets: This can affect tenant's ability to obtain finance.
- Charge over personal assets: This might include the residential home. Avoid this if possible.
- **DO NOT GIVE MORE THAN ONE TYPE OF SECURITY.**

➤ WHEN CAN IT BE USED?

- Typically where the Tenant has failed to make payment when due
- Is the Tenant required to repay the bank guarantee once it has been used?
- Can the Landlord require an increase in the bank guarantee if the rent increases



ASSIGNMENT AND SUBLETTING

➤ WHAT ARE THE CONDITIONS?

- No breach by Tenant- ensure landlord is required to have issued written notice of breach and reasonable time to rectify it.
- All rent and other moneys are up to date
- The assignee is of good financial standing
- The assignee will provide the security required by landlord- ensure this is not more than what the tenant had to provide.
- Does the tenant remain on the hook even after assignment? (this is not permitted under a Retail Shops Lease)
- Ensure the Landlord can not unreasonably withhold its consent to an assignment /subletting (**N.B This automatically applies to Retail Shops Leases**).
- What activities constitute an automatic assignment? This usually includes a change to the control of a company tenant e.g. 50% shareholding. Consider how this may affect future capital raising or bringing in new partners.



REFURBISHMENT AND MAKE GOOD PROVISIONS

➤ Refurbishment:

- Is the tenant required to refurbish the premises during the term? This might be required every 2-5 years during the term or just on the option period. Is this reasonable?
- What does a refurbishment include? Ensure this is clear in the lease e.g. two coats of paint, new carpet etc.
- Budget for this.



➤ Make Good:

- Think about the end of the Lease at the beginning of the Lease!
- Negotiate a schedule of items to be made good.
- It is crucial to be clear on what is required at the end of the Lease. Can the fit-out stay or is a basic shell required?
- A property condition report should be signed off at the beginning of the Lease
- Be clear on who owns what at the beginning of the Lease. Does the fit-out belong the Tenant or Landlord?
- Budget for this. A cash settlement is an alternative.



REGISTRATION OF THE LEASE



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➤ WHY REGISTER:

- A Tenant's interest in Land under a lease for more than 5 years (including option terms) will be destroyed on the transfer of the Land. (Section 68(1) *Transfer of Land Act 1893*).
- A Tenant's interest under a Lease with a term of not more than 5 years will not be destroyed.
- Registration will prevent the Tenant's interest being destroyed on the transfer.

➤ WHO REGISTERS:

- If the Lease is silent on the issue there is no law that requires either to register.
- Usually a Landlord will register the Lease at the cost of the Tenant

➤ HOW TO REGISTER:

- The Lease must be in "registrable form" in accordance with Landgate requirements.
- Consent of any existing interest holders registered on the Lease must be obtained such as mortgagees.

➤ CAVEAT:

- Will protect a Tenant's interest in a Lease with a term of more than 5 years
- Only requires lodgment of copy of executed lease and caveat form with Landgate. Consent of prior interest holder not required.
- **WARNING:** Without the prior consent of an interest holder, the interest holder is not bound by the Tenant's leasehold interest in land. E.g mortgagee could object.
- **Registration is always recommended over Caveat where possible.**



THANK YOU

Disclaimer: Please be aware this information is of a general nature only and is not intended to constitute legal advice. We highly recommend specific legal advice is sought for your particular situation. Please contact Victoria Brasted of Leaker Partners on +61 8 9324 8590 or Victoria.brasted@leakerpartners.com.au

