

pcl.lawyers



# Guide to Commercial Leasing

The essential “must know” guide

# Contents

This guide is those who are looking to lease a retail or a commercial space in Australia. It is to help tenants get an understanding of the process and tips on avoiding some of the pitfalls. That said landlords will benefit from this as well. Hopefully, you will find it helpful.

## LEASE ESSENTIALS

Negotiating a lease	3
Market research	4

## UNDERSTANDING THE MARKET

Vacancy rates	5
Make a business plan	5
Good record keeping	5
Intended use of the property	6
Plans of the tenancy	6
Services & facilities	6
Condition of the property	7
Building rules	7
Neighbours	7
Insurance	8
Incentives	9
Fit out	9
Per Square Meter (SQM) rates	9

Key money	9
Options	10
Rent reviews	10
Fees & legal costs	11
Outgoings	11
Retail leasing	12
Shopping centres	12
Due diligence	13
Heads of agreement	14

## THE AGREEMENTS

The commercial lease	15
Director's & Personal Guarantees	16
Security Deposits	16
Assignments, subletting and transfers of lease	17
Defaults	18
Make good	18
We Can Assist You	19



## LEASE ESSENTIALS

# Negotiating a lease

Negotiating a commercial or retail lease can be a daunting task if you haven't done so before as a tenant or a landlord. The lease can add or diminish value to the commercial property so getting it right is very important for the landlord. It will also be a key factor in how they structure the negotiations to preserve their property valuation. It is important for the tenant to understand how the landlord wants to structure a deal and why.

For business owners the security of your premises and ability to run your business successfully will impact your business valuation too.

Rent and premises will have a great part to play in the financial welfare of both the landlord and tenant.

Commercial leases are not regulated by relevant state legislation. The terms of a commercial lease are negotiated between landlord and tenant.

Retail leases are more prescriptive as they are regulated by relevant state legislation. Irrespective of the type of lease, there are a lot of aspects of a lease which need to be considered, some more complicated than others.

Irrespective of whether it is a commercial or retail lease, a good commercial lease lawyer will be able to guide you, whether you are a landlord or a tenant, through the negotiations and assist you in getting the best deal while limiting your liability and exposure.

Our commercial leasing guide is designed to give you an overview of the process and what to consider. Our commercial lease lawyers outline the potential traps and provide tips. This guide is written for commercial tenants, but landlords will also find it helpful.

## UNDERSTANDING THE MARKET

# Market research

It is important to ask the right questions and get a full understanding of the market when you are looking for your commercial premises. You should also have a clear indication of what your business needs to operate well.

Having a clear plan is important when you start talking to leasing agents.

Occupancy rates, A, B, C grades of buildings, SQM rates, incentives, NABERS ratings and more are all terms and information you will have to get across and quickly. Leasing agents can be helpful with providing this information but beware as they may only present the favourable facts to you.

Bear in mind that agents are acting for the landlord and will in most cases aim to achieve the best interests of their client. Speaking to a few different agents will help you get across the market quickly.

Landlords have their own business plans and many have either positive or negative reputations in the market place. Depending on your business and the type of tenant you are this may impact the landlord's willingness to lease to you. Some landlords look to secure a certain type of tenant over another. It is important to know who the landlord is and what their plans are for the building.



## UNDERSTANDING THE MARKET

# Vacancy rates

Vacancy rates in the market will be a major factor impacting the value of the lease.

Considering what the future forecasts are on vacancy rates will help you forecast:

- what your rent review valuation might be down the track
- whether you can easily assign the lease if you need to leave for any reason

**TIP:** There are many expert reports done on commercial property markets by large commercial investors or institutions and most leasing agents will have access to these.

# Make a business plan

Finding out what suits you and your future business is important and will reflect what sort of initial lease term and options you might want to negotiate.

If you are a retail café space you may not have plans to outgrow your space but may need additional space for stock. If you are a restaurant with cooking facilities required, you will most likely need a proper kitchen to be able to operate your business. There are also requirements for conducting a licensed premises that you need to be aware of. It is hard, but you do have to make some considered calculations about whether the premises will suit you and for how long if you are a growing business. Making considered projections will help you negotiate the best lease terms.

# Good record keeping

Taking notes and keeping information provided by the landlord or leasing agent can be helpful later if any misrepresentations are made. Numbers get thrown around a lot through negotiations and how a lease is packaged can change with incentives. To get the best deal you may need to refer back to previous sqm rates.



## UNDERSTANDING COMMERCIAL LEASING CONCEPTS



### **Intended use of the property**

One critical item for consideration is for what you intend to use the premises. There can be planning restrictions from Council, Government or the landlord that restrict the use. Getting this and any other permit requirements sorted out will be key to operating your business in the premises.

It can easily be overlooked in the initial process and you may need to consult a town planner and/or apply to council for a permit.

### **Plans of the tenancy**

Getting clarity on what you are leasing and what is included is vitally important. Either a plan should be provided and/or a list of inclusions given. If you expect car parking or storage not indicated on the plan to be included this needs to be documented.

### **Services & facilities**

A lease should also clearly outline the building facilities and what services are available for use by tenants. This can be important if you need to apply for a permit and require toilets or wheelchair access. What forms common property or shared facilities and the use of those facilities should all be clearly documented.

## UNDERSTANDING COMMERCIAL LEASING CONCEPTS



### Condition of the property

If you have certain manufacturing requirements or want waterproof premises, be sure to check the condition of the property. Most landlords are slow to fix issues and make building repairs and these may be easier to negotiate from the outset if known.

### Building rules

Most commercial buildings will have rules which tenants must comply with under the lease, such as garbage disposal times and use of the common property. If you have certain requirements, you should get a copy of the rules early.

### Neighbours

It is important to check the neighbours. Most tenancies are impacted by other tenants at some stage and is a common source of disputes. There can be issues with noise, smell and more.

# Insurance



Most commercial leases will require the tenant to obtain and maintain insurance over its property. As insurance premiums and the availability to obtain insurance differ widely depending on the risk, checking the cost of insurance should be part of your due diligence.

**Insurance usually will have to cover the following:**

- Business interruption
- Theft, Fire & Property Damage
- Public Liability
- Tenant's fitout replacement value
- Plate Glass Insurance



## UNDERSTANDING COMMERCIAL LEASING CONCEPTS

# Incentives

Incentives can come in many different ways such as contribution to fit out, rent free periods etc. Mostly, it is a discount on the rent. It could be used upfront or spread over the life of the lease.

Incentives may or may not be transferrable with the lease. All these factors should be carefully considered as they can save you a lot of money.

# Fit out

Fit out is commonly offered as an incentive. Fit out contributions and getting early access to the premises to fit it out can be things that are negotiated into your lease. Sometimes the landlord will have its preferred fit out provider stipulated in the lease. Terms like this should be checked so that you aren't paying more than what you can negotiate privately.

Getting the fit out to work with services in the space can be tricky. It can be costly to fit out a space to your requirements and the wrong fit out can cost you in the long run if the space is not efficient. Building permits, obtaining quotes, access for trades, fire safety are common items to be sorted through.

There is a lot to consider when planning your fit out so ensure that the terms in any Heads of Agreement and the Lease (and where applicable, Fit out Agreements) are properly worded. This way you will have the time and access to the property to get the works done and your business up and running.

# Per Square Meter (SQM) rates

Work out what your sqm rate is with and without incentives, outgoings and GST. Understanding what you are paying by deconstructing the deal will help you compare premises and get the best deal.

# Key money

Key money is uncommon but might be required for certain properties. Key money is a one-off payment made to the landlord to secure the lease. Depending on the location and type of premises, it may be a viable commercial option, however, seeking or accepting key money or any consideration for the goodwill of any business for a retail lease is prohibited under the Retail Leases Act 2003 It has been usually associated with very high-end or popular locations. It is best to speak to a leasing lawyer before entering into any negotiations which involve key money.

## UNDERSTANDING COMMERCIAL LEASING CONCEPTS

# Options



The ability to renew the lease by having an option is an important consideration. Consider the length of each option term and how many options you want. This will give you greater security over your business premises if you intend to stay there for a long period of time. If you believe you may outgrow the premises or ultimately sell the business, you should negotiate the option terms to suit your business growth and sale plans. A potential buyer will often prefer a long lease term.

## Rent reviews

Rent will increase each year in most commercial leases. There are several methods for calculating rent increases and usually the future market conditions will determine what is the best choice. A fixed price increase might be more beneficial if you think inflation or CPI may go up.

A market review is typically done once an option is renewed. It may be initiated by the landlord or the tenant and the market rent will commence at the start of the new or further term. It may not be favourable to the tenant if the valuation increases dramatically. Understanding how market rent increases are calculated will help you make a decision.

You will not know until the time arises what is the best choice, but you can make an informed decision now.

These are the three different mechanisms used in rent reviews:

- 1. CPI (Consumer Price Index):** Increased in line with the inflation rate for that year/period;
- 2. Fixed price:** Rent is increased by a fixed percentage amount (e.g. 2%, 3%, 4% etc.); and
- 3. Market review:** An assessment of the current market rent for the premises is made (usually by a valuer) and the rent is increased according to that valuation.

Where the landlord and tenant cannot agree on the market rent, a specialist retail valuer will be appointed to determine the rent. The process is rigid, so it is highly recommended to seek legal advice prior to doing this.

## UNDERSTANDING COMMERCIAL LEASING CONCEPTS

# Fees & legal costs

Many leases require that the tenant pays for the landlord's legal fees in negotiating and preparing the lease. This needs consideration because under retail leases legislation, the landlord is prohibited from passing on the initial costs of preparation of a new retail lease to the tenant. A lease lawyer can review this and determine what is appropriate in the circumstances.

# Outgoings

Outgoings can cause a lot of financial pain if not properly considered. Proper due diligence and asking the right questions can be helpful.

Common Outgoings include:

LAND TAX	ELECTRICITY & GAS
COUNCIL RATES & OTHER LEVIES	SHARED FACILITIES - SUPPLIES & MAINTENANCE COSTS
WATER	LIFT MAINTENANCE
HEATING AND COOLING	SECURITY & FIRE SAFETY ETC
OWNERS CORPORATION FEES	WASTE REMOVAL
INSURANCES	

Concise legal advice.  
Commercial understanding.

## RETAIL

## Retail leasing

Retail leasing is more regulated and provides more protections to the tenant than other commercial leases. Retail leasing also varies from state to state. A clause in a retail lease which contravenes the retail leases legislation is void and unenforceable. As such it is critical to speak to a commercial lease lawyer before you sign any new leases.

Understanding what type of lease you have is important. It is not the landlord or agent that decide what a retail lease is, but the law. Understand the fundamental differences to determine what type of lease you need.

[more on Retail Leasing v Commercial Leasing](#)

## Shopping centres

Shopping centres can have a variety of additional rules and requirements for tenants under the lease. One of these that you should consider carefully is turnover rent.

### Turnover rent

Turnover rent is rent which is calculated as a percentage of the gross sales or turnover of the tenant's business once that turnover exceeds a certain monetary threshold. Depending on the margins of your business and what the profit spread is, turnover rent can really hurt retailers. Getting the right financial advice here is important.



## DUE DILIGENCE



## Due diligence

Doing proper due diligence will depend on the complexity and nature of your business. This may not be dependent on your size, but rather your requirements.

Due Diligence is usually a period of time that can be negotiated in the Heads of Agreement.

This allows for you to have access to the premises to allow trades or others through to inspect the premises as well.

This can be important to getting your business setup and running faster. Proper planning will help consider any fit out, building applications, fire safety requirements, reports, permits and more. It is important if you are leasing for the first time or the first time in a while to be as thoroughly organised as possible.



## THE AGREEMENTS

# Heads of agreement

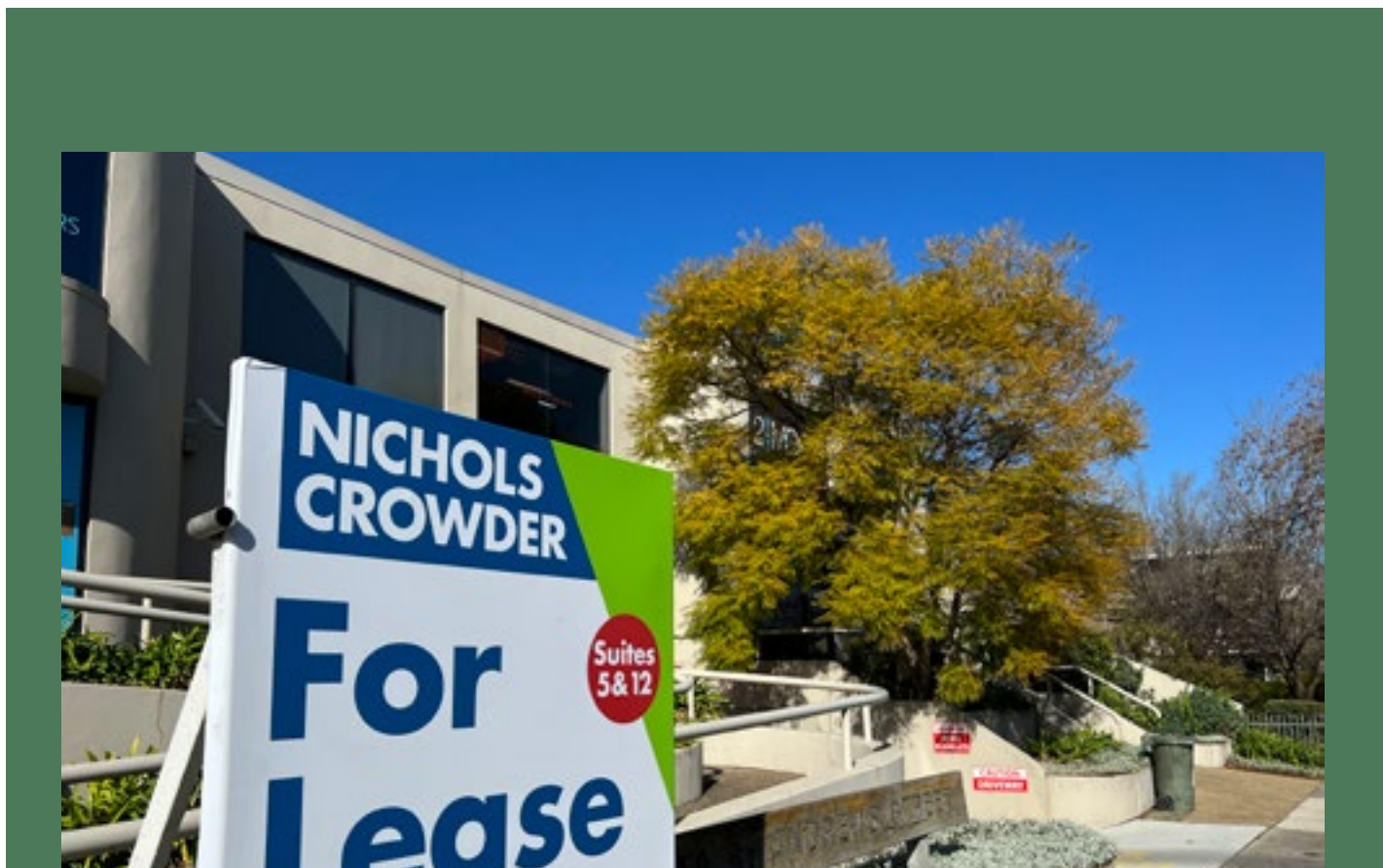
Once you have decided on a premises you may enter into a Heads of Agreement with the landlord. You should get legal advice as quite often the terms, even standard terms, can be problematic to renegotiate later.

The Heads of Agreement can be binding in certain circumstances. It is important to have a clear exit clause should further due diligence uncover issues.

The Heads of Agreement is used to draw up the lease agreement. This is an important lever in negotiations. If the key terms and

considerations are clearly outlined in the Heads of Agreement, it will make the formalisation of the lease much easier.

Usually when signing the Heads of Agreement you will be asked to make payment for one month's rent in advance and to pay for the landlord's legal and other fees as well. Deposit refunds and other costs also can be negotiated by your lease lawyer. The deposit may not be refundable, so it is necessary to have the Heads of Agreement reviewed by a commercial lease lawyer before you sign it.





## THE AGREEMENTS

# The commercial lease

The lease document will typically be drafted by the landlord's lawyers, which may include special conditions. It is important to get your lawyer to review the lease terms and that they are what you agreed to in the Heads of Agreement. Proper legal advice from an experienced lease lawyer at this stage is crucial.

The lease will also come with a lot of other boilerplate clauses that need to be considered. These fine print terms can be very cumbersome on the tenant. Usually there is some negotiation or redrafting of these terms.

These terms are important to your business's financial viability and success. Once you have the lease you should prioritise the most important terms you want to negotiate on and what ones you can live with. If the terms are too restrictive and the landlord won't budge it may mean that you don't proceed with the lease.

As a tenant, it is likely that won't get all of your requested changes, so you may have to forgo some to get the deal done.

The lease negotiation stage can be protracted in larger leases. If there isn't a lot of competition you may have more bargaining power and get a deal done quickly. So it is important to understand the landlord's position and the market conditions.

Unless the Heads of Agreement is legally binding, the lease will not be legally binding until the lease is signed.

There are real commercial considerations your lawyer can help you with when negotiating the terms of a commercial lease.



## Director's & Personal Guarantees

Depending on the lease and the premises there is usually a requirement for you to give director's or personal guarantees.

If you are giving a director's or personal guarantee you will need to be aware of the extent of the guarantee as it can impact on your personal assets.



## Security Deposits

You will usually be required to pay a security deposit (bond) under the lease. This is either paid in cash or a bank guarantee is provided to the landlord. The amount of the security deposited to be provided under a lease is negotiable.

## END OF LEASE CONSIDERATIONS

# Assignments, subletting and transfers of lease

There may be a whole range of reasons as to why you might need to assign, sublet or transfer a lease. It is important to properly consider these terms in this regard, to protect yourself from any additional duress or loss if you need to end the lease early.

Having flexibility is important. It may be highly unlikely that you need to use these clauses, but if you do they become very important.

A tenant is often required to pay the landlord's costs of the assignment, subleasing or transferring the lease.

A lease lawyer can review and negotiation more favourable terms if needed.





## END OF LEASE CONSIDERATIONS

# Defaults

It is important to understand what constitutes a default and what the penalties or costs might be if you are in default under the lease.

A lease lawyer will explain what your lease says regarding a default and check any penalty rates to ensure they are not overly excessive.

# Make good

Most leases require the tenant to restore the premises to the original condition by removing their fixtures and fittings etc. This can be an expensive end to a commercial tenancy if not thought through and negotiated carefully.

The landlord may require certain specific conditions to be met in making good and/or reinstating the property at the time of vacating, for example, using full plaster sheets instead of patching up the walls.

If the improvements you are making to the premises are extensive, consider what you need to do to remove them. It is helpful to ask the landlord what items he or she is happy for you to leave in the premises, thereby reducing your make good costs.

Make good could be negotiated to be a payment in lieu out of making good.

It is highly recommended to speak to a commercial lease lawyer prior to finalising a new lease.







## We Can Assist You

The PCL Lawyers our commercial leasing team is extremely experienced in dealing with retail and commercial lease matters for tenants and landlords. We have deep leasing experience across multiple industries such as shopping centres and lease disputes.

Please contact our team on 1300 907 305 or complete our [contact form](#) to discuss your lease issue and find out how we might be able to assist you.

The above should not be construed as legal advice.

It is always critical to obtain legal advice in relation to your individual circumstances as every case is different.

### Our Lease Lawyers



**Christopher Karatselios**  
Associate Partner



**Ruith Schofield**  
Senior Associate



**Ian Isaacs**  
Senior Associate

## Contact Us

### MELBOURNE

Level 14, 90 Collins Street  
MELBOURNE VIC 3000

1300 907 335  
03 8397 5000

### SYDNEY

Lawson Place, Level 2,  
Suite 209, 80 Elizabeth Street  
SYDNEY NSW 2000

1300 852 667  
02 9127 2000

### BRISBANE

Waterfront Place  
Level 34, 1 Eagle Street  
BRISBANE QLD 4000

1300 794 559  
07 3179 7000