

Negotiating Commercial Leases: Laying the Foundations

Written by one of Coleman Greig's experienced property lawyers, Andrew Grima, this article is the first in a planned series that will highlight some of the major issues facing a business when negotiating a commercial lease.

Introduction

One of the most frequently recurring problems encountered by the Property Team at Coleman Greig is when a client comes to the firm with problems that have arisen from a lack of adequate foundations being laid at the start of a leasing deal.

If the lease on a property you wish to occupy is constructed without the right foundations, a great deal of money – which is usually not budgeted for – might be needed to rectify the damage caused. The result can be the same if the foundations are not set in place during a leasing negotiation.

Following is an overview of the steps that can, and should, be taken to establish the right foundations and the issues surrounding this stage of the leasing process.

The Foundations

The major components of a leasing transaction are the "terms". The basic terms of any commercial lease may include:

- Rent – How much? When is it due? How will it be reviewed? How will it be calculated? Is GST payable?
- Other Payments – Will outgoings be payable? If so, what items and how is the contribution calculated?
- Term – How long will the lease be for? Will there be an option to renew?
- Security – will a bank guarantee or cash bond be required? If so, how much? Will personal guarantees also be calculated?
- Premises – What comprises the area being leased? Are there common areas to be shared? Are there additional areas being licensed such as storage, seating or parking?
- Repairs and maintenance – Who will be responsible? Is there a distinction between servicing as opposed to replacement of capital items?
- Make good and redecoration – What is the extent of the tenant's obligations? Has a condition report been completed at the start of the lease that can be used as a reference point later?
- Other special conditions – Is there anything specific to this deal such as responsibility for works, commencement conditional upon approvals, or fit-out contribution payable?

Another aspect of solid foundations in a leasing transaction are the enquiries which need to be made by the parties such as:

- A Title search to ensure the property being leased is owned by the landlord and to ensure that there are no existing tenancies or other encumbrances on the title which may have an impact on the proposed lease.
- Enquiries into the suitability of the premises for the permitted use – are approvals required for the use or fit out works, or for a specific type of use such as liquor licence or Pharmacy Board Approval? Is there sufficient parking or loading spaces for staff and customers? Will the floor of the premises be able to sustain the weight of the racking, fit out, vehicles, other equipment and stock? Is the sprinkler system adequate and if not, who will pay for the upgrade?
- Condition – Are there any structural defects which need to be rectified? Is there evidence of asbestos, contamination or other environmental damage?

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- Disturbances – Are there any redevelopments or re-zoning planned for the premises or its surrounding buildings?
- Once all of these foundations have been considered, you need to “lay” them to ensure they are in place.

Laying the Foundations

The foundations of a leasing transaction are set down in writing – usually in the form of a heads of agreement (“HOA”) or letter of offer (“Offer”).

It is important at this early stage of a transaction that each party decide whether they will negotiate and prepare the HOA or Offer themselves or whether they will engage agents to negotiate on their behalf and solicitors to prepare and review the HOA or Offer.

Irrespective of who is involved in the preparation of the HOA or Offer, it is important that the document reflects the terms referred to in section A above so that the right foundations are set.

There are some issues which can arise during the process of negotiating and recording the foundations. These may include:

- The importance of the way you conduct yourself during negotiations – i.e. you should ensure that you do not engage in conduct that is misleading or exploit your bargaining position. You run the risk of the other party relying on this to seek appropriate redress later on such as setting aside the transaction or a damages pay out.
- Is a HOA or Offer a binding agreement? There are no definite rules, but by at least saying that the HOA or Offer is subject to the parties entering into a formal lease, it is less likely to be construed as binding. The courts will look at all the evidence such as the conduct of the parties, oral and written representations, and correspondence between the parties.

- In the case of a retail lease, it is most important to not take occupation or pay rent until the lease is signed. Otherwise you run the risk of being bound from the time you take occupation and you will not be able to withdraw from negotiations if you cannot accept the terms of the lease.

- In the case of lease that is not for retail premises, you take occupation and spend money on a fit out (or allow this to happen if you are a landlord) at your peril. This is because unless the HOA or Offer are construed as binding, if the lease is not signed either party may be able to walk away from the deal.

Other Issues

At the lease negotiation stage, if you are a landlord you should be looking into the credit worthiness of your tenant to assess their long term ability to pay the rent. You may well need to increase the level of security you are seeking from your tenant such as increasing the amount of the bank guarantee or personal guarantees.

If you are a tenant, you should be looking into what insurances the landlord will require and what you are able to put in place. You should check with your insurer to ascertain the extent of the liability covered by your insurance. You should also find out from your bank how quickly it will be able to provide a bank guarantee and what security it will seek from you to provide the bank guarantee.

Conclusion

Once the right foundations have been put in place in a leasing transaction you will then be in a position to enter into negotiations for a more formal lease.

If the foundations are solid, the rest of the transaction should proceed efficiently to the benefit of both parties. In our next article on commercial leasing, Andrew will map out some of the most important aspects of the formal lease.

For more information on commercial leasing and ensuring your legal rights, contact Andrew Grima at agrima@colemangreig.com.au or ph 02 9635 6422.