

The Leasing Process

A guide to leasing commercial property







Introduction

The main difference between a commercial lease (or “tenancy”) and a residential lease is that the Residential Tenancies Act 1986 does not apply to commercial leases. Commercial leases are governed by the Property Law Act 2007.

The parties are at liberty to negotiate specific terms in the lease agreement that suit their particular requirements.

In New Zealand we are using the Auckland District Law Society (ADLS) 5th edition 2012 (4) for the Agreement to Lease and 6th edition 2012 (4) for the Commercial Deed of Lease.

The information contained in The Leasing Process is intended to provide general information in summary form, current at the time of printing. The contents do not constitute legal advice and should not be relied on as such. Specialist advice should be sought in particular matters.



Key people and roles

Real Estate Salesperson

- They find suitable premises for your business
- Negotiate the lease terms between the Landlord and Tenant, often prior to the lawyer engagement
- Draw up the Lease Agreement
- Collect the deposit
- Arrange takeover of premises

Lawyer

- Draw up the Deed of Lease
- Manages the renewal of lease process
- Manages the rent review process
- Handles lease disputes
- Manages lease terminations
- Court applications for relief from forfeiture

Landlord/Lessor

They own the building and keep it watertight and structurally sound
Negotiate the lease terms and sign off the lease

Tenant/Lessee

The tenant must pay the rent and outgoings when it is due under the lease and keep the premises in good repair

Property Manager

The landlord may have appointed a Property Manager who assumes the role of owner in collecting the rent and looking after property maintenance and issues.



The rights and obligations of the parties

- The tenant must pay the rent and outgoings when it is due under the lease
- The tenant is responsible for the care and maintenance of the premises and grounds
- The tenant must pay GST on rental payments and other Tenant costs
- The landlord is entitled to enter the premises at reasonable times to view

the state of repair. The landlord can serve the tenant with a notice requiring the tenant to repair any defect for which they are responsible for under the lease within a reasonable period of time specified in the notice

- Statutory notice periods must be complied with before landlords can re-enter and cancel a lease



The landlord or tenant may be a company

Frequently one, if not both, of the parties to the lease will be a company. A landlord may require a personal guarantee from a representative of the Tenant Company, usually a director or major shareholder. The effect of this is that the guarantor will be personally liable for any amount owed by the company in the future. This requires individual's signatures to be witnessed, and for corporations, usually two directors, must sign.

The term of the lease

The term of the lease is usually negotiated in years. It needs to be long enough to invest in the location goodwill but not so long that if you fail you are not tied to it for an unrealistic time period.

New buildings demand a longer period of lease term, typically 8 – 10 years.



Rights of Renewals (ROR)

What is a right of renewal?

It is an option granted to the tenant to enter into a new lease with the landlord. It is not an extension of the existing term of the lease. A right to extend the term of the lease is distinct from the Right of Renewal.

Does the landlord have a choice whether or not to renew the lease?

No - as long as the tenant complies with any pre-conditions contained in the lease.

How is the right of renewal exercised?

Usually by notice in writing to the landlord within certain time frames set out in the renewal clause (usually 3 months). A deed of renewal is usually entered into after the renewal is exercised. This deed of renewal is the formal granting of the new term.

It does not create an opportunity to re-negotiate or introduce new terms.

What should be included in the lease agreement?

In order to be valid, a commercial lease must include the following elements:

- The lease must be for a time period that is certain or can be calculated
- The tenant must be granted the legal right of exclusive possession of the property
- The lease must be properly created as a legal contract

A written lease ensures that the parties know exactly what their rights and obligations are.

The parties are at liberty to negotiate specific terms in the lease agreement that suit their particular requirements. Because of the nature of commercial property and its uses, the parties may wish to provide in the agreement for issues such as ownership of fixtures and fittings and the intended uses of the property.

Most commercial leases are not registered in New Zealand.

Cost of lease and who pays?

The real estate salesperson does not charge for drawing up a lease agreement.

Thereafter any legal costs are paid by the person requesting the work.

Guarantees

The landlord may require a personal guarantee. This means that the person signing as guarantor is fully and completely liable for the whole of the lease obligation for the term of the lease. Talk to a lawyer first before signing.

Rent

The tenant pays the rent by monthly payments, in advance plus GST. Usually the landlord asks for 2 months in advance at the start then continues as monthly in advance payments.

There is no bond in a commercial lease.

The rent negotiated can be either net (excludes outgoings) or gross (includes outgoings) plus GST.

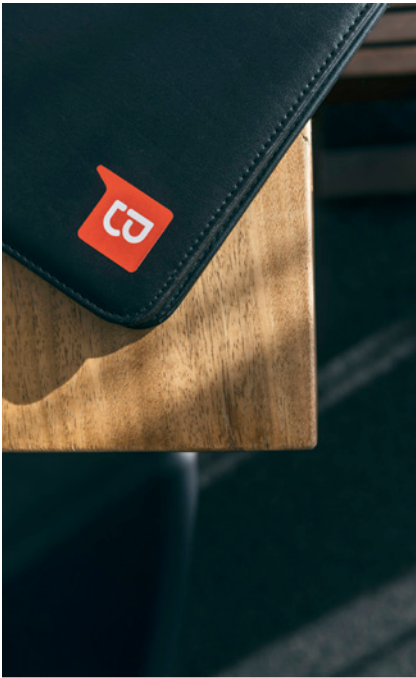
The landlord must follow a set procedure to cancel a lease for unpaid rent and/or other breaches.

No Access Period

During the formalisation of your agreement, you will need to consider the "no access period".

This is a period of time due to an emergency where you may not be able to conduct your business due to the premises being partially damaged or fully destroyed.





Rent reviews

Leases generally contain provisions for the rent to be reviewed and increased every two or three years.

If a rent review date is approaching, attention to the lease terms is vital to ensure that the best possible negotiating strategy is prepared to ensure proper outcomes.

Rent review methods may include fixed increases, structured increases or reviews to market levels.

CPI, or a margin over CPI, is another common rental structure. Often review clauses comprise a combination of these throughout the term of a lease.

A ratchet clause indicates the rent cannot go below existing levels on review even if market rents have fallen generally.

A carefully negotiated rent review clause is very important.

When initiating a new lease legal advice should be sought.



Outgoings (operating expenses or opex)

These are the costs associated with the building such as rates, insurance and compliance, amongst others.

The tenant usually pays those costs however the terms and conditions can be negotiated.

The tenant pays utilities e.g.: phone, power, gas, water etc.

If the tenant occupies a portion of the total building, then the tenant only pays those costs associated with their area and an apportionment of the common areas.

The cost of car parks (per park) varies depending on the location and whether



covered or not. Typically these costs vary from \$10 to \$35 per week per park in regional centres and up to \$60 per week in major cities.

Ask for a breakdown of which expenses will apply from the commencement of the lease.

Improvements rent percentage

If the Landlord is obliged by the Building Act or similar to make any alterations to the property, then the rent can be increased until the next rent review date.

E.g. Landlord spends \$100,000 with an improvement rent percentage of 15%, and then the tenant would pay an additional \$15,000 per year until the next rent review date.

Multiple tenancies – The \$100,000 might be assigned \$50,000 to tenant 1, \$30,000 to tenant 2 and \$20,000 to tenant 3. Provided the improvements rent percentage is the same for each tenant, the landlord will get the same amount back as if it were a single tenancy.

Landlords Building Insurance

The ADLS form of lease provides that the landlord will insure the premises.

Type A: Full replacement and reinstatement OR

Type B: Indemnity to full insurable value

You should ask which one your landlord has and delete either A or B in the lease.

The tenant usually pays the premium as part of tenants' outgoing expenses.

Retail tenants should check on the plate glass window wording and excess in case of vandalism.

Public liability insurance is essential.

Redecorating and refurbishment

The tenant can sometimes be responsible pays for the cost of decoration inside and the exterior of the building however this depends on the terms of the lease.

There is often a 'make good' clause at the expiry of the lease which may require the tenant to reinstate the premises to the state as at commencement of the lease.

If the tenant has modified the building during the term of the lease, e.g. fixtures, chattels or signage, the landlord may ask the tenant to reinstate the building to how it was on commencement date.

We would recommend taking of photo's at the lease commencement.

Strategic lease planning

Before you start viewing properties, draw up a check list:

- Size of space required
- Location
- Budget for rent and outgoings
- Finish standard
- Heating requirements
- Parking requirements
- Access for trucks
- Number of offices and meeting rooms

Don't be concerned if the building does not meet your exact requirements. Most Landlords are willing to look at refurbishment or altering internal layout to suit incoming tenants. The costs may require an increased rental.

You may decide on a new build to meet your business requirements. Ask your salesperson for a selection of vacant sites that could be available for a design build.

The Lease

Ask for a copy of a lease from your salesperson or lawyer to study the terms and conditions prior to drawing up an offer.

Generally the Real Estate salesperson draws up the Agreement to Lease, once this agreement is signed by both parties, the landlords lawyer will then draw up a full Deed of Lease.

The Agreement to Lease is a blueprint for the full Deed of Lease

Sub-Lease

Lease from one tenant to another (called sub-tenant or sub-lessee). The agreement between the landlord and the first tenant remains in force and governs the terms of the sub-lease. The length of the sub-lease must be less than the unexpired term of the tenant's own lease of the property.

Assignment of Lease

Transfer by the original tenant (the assignor) of his or her rights to another tenant (the assignee) to use the leased property. However, the assignor remains liable under the original lease contract unless expressly released by the landlord for the duration of the term within which the lease was assigned.

Terminating a Commercial Lease

1. The rent payment must be at least 10 workings days overdue
2. The Landlord must give written notice to the tenant of its intention to cancel the lease. The notice must also disclose the tenants right to apply to a court for relief against cancellation of their lease.

3. Included in the notice must be the reason the lease is being cancelled, the amount that must be paid to remedy the situation and the period in which the amount must be paid (which must be at least 10 working days from the date the notice is served on the tenant) and consequences of non-payment within the period.
4. The tenant has the right to apply to a court for relief against cancellation of their lease.
5. If the amount is not paid within the time specified in the notice, then the landlord can cancel the lease.
6. This means the earliest a landlord can terminate a lease is when the rent is already in arrears by at least 20 working days.
7. Distraint – the landlord cannot take the tenants plant, equipment, chattels or stock to pay for rent arrears. The landlord can then sue the tenant for the rent arrears and any other breach of the lease.

Mutual cancellation of Lease (Surrender of Lease)

If the tenant and the landlord agree to cancel an existing lease then a Mutual Cancellation of lease can be prepared by lawyers.

Notice to Tenants of Assignment of Commercial Lease

This notice must be given by the landlord of the building to all leasehold tenants following the sale of the premises to a new owner. The notice also instructs the tenants that rent is now to be paid to the new landlord.





An Overview

Entering into a lease is a serious financial commitment so it is essential to get proper legal advice from a commercial property lawyer who specialises in this area before signing and be aware of the true cost of being a tenant.

In almost every case, problems occur as a result of having signed a poorly understood or poorly constructed lease agreement.

Understand the lease process, from beginning to end... It's not rocket science, just good business practice.

If you are looking for a more in-depth discussion, you will want to make an appointment with your Commercial salesperson. By making their level of knowledge available to you, the lease negotiations should be a pleasant and successful experience.



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