

Ep.133

Understanding commercial leases and Lease Assignment Agreements what to look out for

 TALKING
LAW

WITH MARK GARDINER



Talking Law

Episode 133 - Understanding commercial leases and Lease Assignment Agreements what to look out for

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Transcript

Joanna:

Hi, it's Joanna Oakey here and welcome back to Talking Law, a podcast proudly brought to you by our commercial legal practice Aspect Legal. Now today we have on the show Mark Gardiner from our very own Aspect Legal team. And of course, we're here to talk to you today about the various considerations when you are leasing premises. Mark is a fabulous person to talk about this topic because he has decades of experience dealing with businesses and leasing requirements. Now today, Mark and I get stuck into the sorts of things that you should be thinking about when entering into a lease. We discussed the terms of the lease what's covered in the lease, we talk about options. And when in the lease negotiations, you will be in the greatest position of power. And of course, we talk about a whole heap of traps and tips concerning leasing. So without further ado, here we go with our discussion with Mark. Hi, Mark, welcome onboard to talking loss. So good to have you on the podcast today.

Mark:

Thanks, Jo. A pleasure to be here.

Joanna:

Fabulous, fabulous. Now, of course, today, we're talking about all of the considerations when you're entering into a lease. Now, I just want a note for our listeners. This, of course, is relevant when you're entering into a new lease. But it also might be relevant. When you're looking at renewing the term of your lease, it might be a great opportunity for you to jump on board, realize there are some issues with the lease and seek to have some changes made. Or indeed if you're a buyer, and looking out for things within the lease that might be particularly relevant for you to understand with that business moving forward. So Mark, why don't we kick it off, maybe what we can do is we can take it in turns throwing up some ideas of the sorts of things that we think our listeners should be on the lookout for about leases, and maybe even some war stories. I love the war stories. So why don't we kick it off with you Mark, what do you think is one of the most important things for people to look out for in a lease. So maybe you're one of those traps, one of the things that people often don't realize is super important in looking at the lights.

Mark:

I guess the key is to start with these to make sure that the lease documentation prepared matches what the prospective tenant has agreed with the agent so that is in terms of the length of the lease, both in terms of the initial term, and the options to renew that both the length of the option term and the number of option terms. That's critical. Make sure that you look at what is covered by the amount of rent you're paying. Is it a lease that has rent plus outgoings? Or is it what's called a gross lease? What outgoings are included? And then understand what the outgoings are. What are your obligations in terms of cleaning the premises? Sourcing power for the premises? Are you free to go to any power supplier? Or are you locked into the building or shop power supply arrangements? What are your obligations in terms of land tax or insurance of the premises? People who aren't familiar with a commercial lease may be surprised that if they're leasing an entire building, they may well be liable for ensuring the entire building. So what are the insurance requirements?

Joanna:

I just want to highlight that as well because I do think you know the land tax insurance they are things that you know, the elements of leases that businesses who aren't used to dealing with leases regularly just may not even realize that you know they'll be required to pay so it's a really good point.

Mark:

And also look at his parking included the other parking spots reserved Can you put your name on the beach Milan in the carpark says reserved for you and your customers. Do you have signage rights to the building? Can you put up a sign in your window which can be seen from outside they're kind of just little things to start with? And then anything, there are some major issues around the end of the lease, what does the end of the lease look like? And do you have to make it, we've had instances where a clause requires the stripping of an office back to the concrete shell. So removing all the cabling, all the wiring, all the air conditioning, that needs to be provided for generally speaking in the, in the accounts, of the leasing company,

because it's the significant speed at the end of the lease period?

Joanna:

Well, that's a really good point. And if you're, if you're taking on a lease, and you're considering a potential future sale of your business, that might happen during the lease term, be aware that a buyer might come in and want you to make some sort of adjustment from the purchase pricing relation to those obligations into the future about make good of the premises.

Mark:

Yes, that's right. It's difficult to know sometimes what that adjustment might need to be because often, the extent of making good at the end of the lease period is a little discretionary on the landlord's part, landlord may say I want you to take it back to the bare concrete shelf because that's what the lease requires you to do. Or he may want to have a go at leasing the premises with an existing fit-out and see if there's a prospective tenant He wants that fit-out. So there might need to be a financial adjustment at the end in any event, but when you're selling the business, and or assigning the lease, you don't quite know what that's going to look like. So there needs to be some preparedness to negotiate and adjust at that time.

Joanna:

Yeah. And just be aware, you know, I guess just obviously, you've talked about this requirement that might be in there to bring the premises right back to base. You know, that means ripping out all of your fixtures and fittings, patching the walls, repainting, or the walls, indeed, you'll probably, you know, almost always be required to do a full repaint. These are the sorts of things that I find often, you know, tenants, incoming tenants can be a little bit surprised the first time around.

Mark:

That's right, particularly when the premises, like a medium-sized office suite, you may well inspect a premise that has an existing fit-out, it has partition walls that has meeting rooms, it has cabling for data and power, but the lease may say at the end of the lease period, you're required to take it back to the concrete shell, which means ripping all that out. And that impacts a couple of things impact the cost at the end of the lease, but it impacts upon your timing. So if you were looking at moving into different into new premises at that point, then you've got to bear in mind that you need to be out of your existing premises well ahead of the lease expiry date, because you need to get tradespeople into what's called deficit the premises to how to make good premises.

Joanna:

And I think you have to bear in mind, you might therefore be paying rent at two places during that time, because you still have to pay rent while you whilst you're you know,

Mark:

that's right, you either do it at the end of the lease prior to the lease end date. Or there could be a negotiation with the landlord where you have time after that lease end date to do they make good. But either way, there's certainly rent being paid.

Joanna:

All right, so make good and I'm glad we spent a bit of time on that. Because that is I think that's a really important element. And one of the things I guess just to throw in here, the terms of the lease can be negotiable, sometimes. So you know, just because this is a position that has been set out in the draft lease document that you've received, as an incoming tenant doesn't mean there's no ability to negotiate it, but you just have to be aware that landlords have different levels of, you know, acceptance of negotiation under these sorts of things, say for example, and make good. So it's worth giving it a go. But just be aware, that there may be things you may not be able to get out of those draft leases,

Mark:

That's right. It's sometimes quite subject to market conditions, and also the history of the premises. So if the premises have been empty for some time, and the landlord has not been receiving rent, then he may well be prepared to negotiate more when there's a tenant. If the if it's a high-demand area if the tenant the outgoing tenant is he's just about to leave or he's just left. Then the landlord may say, Well, I've got plenty of time to get another tenant without it impacting me financially. So no, I'm not going to negotiate. There's me there are my lease terms, take it or leave it. So you need to be aware of what's going on in the marketplace when looking at negotiating,

Joanna:

and I also find there's sort of two other factors that I often say number one, the landlord itself, you know, so the sophistication of the landlord, is this, does this landlord have many premises? Or is this you know, a mum and dad investor that holds these premises, you'll have a very, very different level of negotiation between those two different types of landlords generally.

Mark:

And you can cut both ways, you may well find that the more sophisticated the landlord is, the more prepared they are to negotiate. Because I understand that negotiation and leasing are quite common. If it's a mum and dad, it's a superfund investment, where they don't have a lot of capital readily available to them. They're relying upon the rent, they may well be not prepared to negotiate. They just want to keep their premises occupied. So yeah, can cut both ways. Some of the big landlords on the other hand, just go no, these are our standard terms. Take it or leave it.

Joanna:

That's right. Yeah, that's it.

Mark:

So one thing we haven't talked about is rent-free periods.

Joanna:

well, yes, really good point. Yeah, yeah, let's talk about that

Mark:

Yeah, it goes back to that market conditions test I was talking about before, where if the premises are empty, and the landlord is not receiving rent, he may not be looking for a long-term tenant, so it doesn't happen again. And you have may have the ability to negotiate a time where your rent-free or rent is reduced, particularly if there is some fit-out work required. Where you do a deal with the landlord, where you pay

reduced rent for an extended period, or you pay no rent for two or three months, enables you to get into the premises fitted out, get it ready for your occupation. So something to think about negotiating if you can now. You never have a stronger negotiating position, than before you sign the lease.

Joanna:

you know, that was exactly what I was going to say before, but then we went into rent-free, which is exactly right on point because this is absolutely the area where you know, you the position that you create, as you go into the lease will never you will never be in a better negotiating position than right beginning generally speaking,

Mark:

It's like dating for the first time. Everyone's super nice to each other.

Joanna:

Hahaha yes, that's right. But the warning is, you know if you might be in these premises for a long time, I tell you what, you want to get in and start negotiating these things to the extent that you can, that first time through because after that, you know, the landlord knows that it's difficult for you to leave. And even if you haven't got a high fit-out cost. It's you know, it's painful for anyone to move premises. So you know, your strength is right in the beginning.

Mark:

That's exactly right. Anybody who has tried to move their internet provider, change their power supplier, or change the way their telephones it's difficult to negotiate to price. So at the outset, yesterday, we talked briefly then upon the end of the lease, one thing that people need to think about, and bear in mind and diarize and calendar is option periods. So I said, one of the things to think about is how long is the lease? What are the option periods? Now, an option period means that you have a right to renew the lease on the same terms. That is really important, there may well be a rent adjustment at that point, but no other terms of the lease, generally speaking, change at that point, you simply as a tenant, simply notify the landlord that you wish to exercise your option, and you'll then locked in for the next period, whatever option period might be, if you miss that date, two things might happen. One, the landlord might say, Well, I'm leaving it to somebody else. Or secondly, he may say, Well, we're going to significantly change the model of renting, we're going to move maybe from a rent review market rate to a much greater rent increase. So it's important to exercise the options when the timeframe says you must exercise them by and what that time might depend a little bit sometimes on the length of the lease, say a five-year lease may have an option, what's called an option exercise period of between six and three months before the end of that first term. Whereas a shorter lease might have a shorter exercise period, there might be between three and one months before the end of the lease. So it's important that a tenant sort of makes sure that those dates go in the diary.

Joanna:

And on options, you know, I mean, options are a beautiful thing for a tenant in that this is the opportunity to have the right but not the obligation to have the premises for an extended time. And this is super important for you to understand if you're in a particularly if you're in the type of business, where premises might contribute strongly to the value of your business and you're looking at selling at some point, and or you'll

fit-out costs are high if you have to move. So something really important to bear in mind. But a little bit of a warning here, we had a client who came in a couple of weeks ago, and they were looking at preparing their business for sale. And as part of the reading for sale, we had a look at the lease. And one of the provisions about the exercise of the option for the future was that they lost the right to exercise options into the future if they had been in default, during the lease term. And unfortunately, this seller had had a time when they had defaulted under the lease. And so I just thought that's important for you to understand, because if you're considering, you know, if you're in a tight financial position, and you're considering the sale of your business, it's really important to understand if being late in your rent might impact other things like for example, the ability to form a new buyer to take on options under the lease because you've defaulted during that lease term. And for buyers as well, you know, a really good thing to ask as you're coming in if you identify this in the lease for a business that you're buying, understanding the extent to which there may have been a default under the lease that may have impacted the ability to exercise those options into the future. So there you go. Aren't there some Barb's out there, Mark?

Mark:

Perhaps it's a really good reason why prospective tenants should get their lease reviewed by a law firm.

Joanna:

Boom. There you have it, there you have it. All right. Now, what else have we missed out here, I think we've covered a lot of use of the premises, I guess that's another thing, you know, that is worth mentioning, as we going through some of these top areas, at least

Mark:

A lease always describes what the premises may be useful. If you're looking at renting premises, the goal would be to make sure that the term is as broad as it possibly can be. So that if you're looking at assigning a lease at some point down the track or potentially changing your own business, you're not prevented from doing that by the lease being prescriptive as to what the premises can be used for.

Joanna:

Wonderful. And look, I guess the last area unless there's anything else that we've forgotten that you want to throw in, but the last area that I think deserves a bit of discussion is that area of, of security. So a landlord will require security. And there are different ways that we can approach security, quite often a landlord will start with a personal guarantee, perhaps in addition to a bank guarantee or security bond, what are your thoughts on dealing with this, I mean, where we can, we'll try and, you know, remove the personal guarantee. But that can only work sometimes, and other times it doesn't.

Mark:

The personal guarantees you alluded to it, should be avoided at all costs. The reason being is what it's doing is changing the liability for the obligations of the lease from the company that might be the tenant to potentially the director and owner of the company. There are a lot of people who don't necessarily appreciate that they will be bound by the terms of the lease for the entire lease period. So let's say someone comes in and has a three-year lease, one year in the business is not going well.

They're struggling to make payroll, maybe struggling to pay the rent, and they want to close the business down because it's just not working despite their best efforts, no matter how hard they work. They then might come to a law firm and say, How do I terminate this lease? And the answer is, well, you're potentially liable for paying the rent until the end of the term of the lease. Now, if you're a company that is having some financial issues, it may well be considered that you liquidate the company and seek to avoid that debt. But you may still be liable as a guarantor on the lease for those lease obligations until you can take steps to end the company structure. So it's very difficult sometimes to limit your losses. So that's a personal guarantee. Avoid them if you can, if you but sometimes you can't, so limit them. If you have to give them limit them to the rent. Limit them in terms of time then in terms of dollars, if it's possible, but we talked about bank guarantees before, in terms of going about getting a lease, a bank guarantee can take some time to organize with the bank. If you're looking at a rent-free period, or if you're looking at early access to premises, you won't be able to get access to the premises until you can satisfy the landlord that you have the bank guarantee in place. So to speak attention, start that process early. It can take a while, banks can be hard to deal with.

Joanna:

with such a good point. Really good point on timing and such a good point on personal guarantees. Well, look, that's been a great discussion about leases. today. I just want to say a huge thank you for coming on to the show.

Mark:

It's a pleasure anytime.

Joanna:

Well, that's it for this episode of Talking law. We hope what we've discussed puts you in good stead for any upcoming lease negotiations, and helps you wrap your head around what considerations are most relevant to you. Now if you'd like more information about this topic, head over to our website at www.talkinglaw.com.au or link straight to it from our show notes where you'll be able to download a transcript of this podcast episode if you'd like to read it in more detail. Of course, our show notes here, as I said, will also link straight through to that page. There is that page you'll also find details of how to contact our Legal Eagles at Aspect Legal about anything related to this topic, or head over to our website at www.aspectlegal.com.au to book a free 15-minute discussion with our legal team. Well, that's it I hope you enjoyed what you heard today. If you did, don't forget to subscribe to Talking Law on Apple podcasts or your favourite podcast player to get notifications straight to your phone whenever a new episode is out. We also love hearing feedback so please leave us a review and rating if you're already one of our subscribers or even if you're listening to this podcast for the first time as a bit of a PS we've got a fabulous new segment coming up for you Ask Me Anything. Those quick questions you have at the end of a meeting or phone call with a lawyer. Now is your chance to ask them for free. There will be a link below here or in the show notes or visit our podcast page and there will be a button there ready to go for you to submit your questions. Well, thanks again for listening in. This has been Joanna Oakey and Talking Law a podcast proudly brought to you by Aspect Legal. See you next time.