

Your first commercial lease – the key concepts

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Signing a commercial lease is a big decision, whether it's for an office, retail space or café/restaurant location. In this article, we'll consider the key concepts to keep in mind when you're entering your first lease of premises.

In New Zealand, you will generally be asked to sign an ADLS lease (a template prepared by the Auckland District Law Society). This is a good base, but you'll need to understand exactly what you're signing up for, and what you can do to improve your position.

Understanding the standard obligations

If you're not familiar with the ADLS lease, 3 important aspects to be aware of are: outgoings, personal guarantees, and reinstatement obligations.

Outgoings are costs you pay on top of rent – for example, rates, utility bills, and rubbish removal costs. What some don't realise is that this also includes the landlord's insurance premiums, and insurance excess in respect of a claim. You can request an indication of what your outgoings might be before you sign a lease, so you understand what you are committing to.

If you enter into a lease as a "guarantor", this means you are on the hook for all of the tenant's obligations under the lease, including rent and outgoings. So, if the tenant (e.g. your business) stops paying rent, you have to pay the rent yourself. You may want to seek legal advice if you are providing a guarantee as it may affect your ability to obtain any finance in your personal capacity (e.g. a mortgage). Personal guarantees are often requested from the director/s when the tenant is a company.

Reinstatement obligations cover what state you need to leave the premises in at the end of the tenancy. If you make any alterations or additions to the premises, the landlord may require you to remove these and "make good" (fix) any damage that occurred over the course of the tenancy. Also, you will need to remember to seek the landlord's written consent before making any alterations or additions to the premises.

Tailoring your lease to suit

Once you've understood the standard obligations, you can tailor the rest of the lease to suit your situation.

What term are you willing to commit to? A longer term gives more security, but also locks you in for more time (which means paying rent for longer). You may be able to achieve the same result with shorter terms and multiple rights of renewal. A renewal lets you as tenant choose to extend the lease or not – but the landlord doesn't get a corresponding right to require you to extend.

The initial rent is important, but make sure you understand rent reviews. These reviews might be annual, every few years, or aligned with renewal dates. They can be linked to the market rent for the property, or they can increase by the Consumer Price Index – effectively a measure of inflation. In a period of low inflation, this might mean a 1 to 2% increase, compared to a market rent review, which could increase the rent by 10% or more.

A challenge with commercial leases is the uncertainty the future holds – particularly in today's Covid climate. It is vital to have a thorough understanding of your legal obligations (or engage a lawyer that can explain them to you) before you make a long-term commitment. And if you do make a lease commitment and your circumstances change, it's always worth communicating with your landlord – you can vary a lease at any time, if you can both agree the changes.

Wade Pearson and Caity Peacock are lawyers in law firm Gallaway Cook Allan's commercial team in Dunedin. This article is general in nature, so don't use it as a substitute for legal advice.