



COMMERCIAL LEASING

For a tenant, leasing a commercial property is often the largest fixed cost of their business. It is a complex process, and it is important that it's done right to protect against unforeseen costs. For a landlord, they often have a large number of tenants in their commercial building, so it is important that the leasing arrangements are fair and consistent to attract the highest calibre tenants.

The form of lease most commonly used for commercial leasing throughout New Zealand is the Auckland District Law Society Deed of Lease ('**ADLS Lease**'). The most current version is the 6th edition, which was released in November 2012. There are therefore a large number of ADLS Leases in the market place that are written on earlier versions.

TENANT'S ISSUES

It is not uncommon for tenants to enter into an agreement to lease without first seeking professional advice. By doing so, a tenant is not always fully aware of their obligations, which can lead to unanticipated costs. Issues in the ADLS Lease that are not commonly understood by tenants include:

- ◆ Rent review provisions and, in particular, the 'rent ratchet clause', which prevents the rent being reduced on a rent review, even if the current market for the premises on review may have gone down;
- ◆ Tenants' maintenance and reinstatement obligations, which can lead to significant, and often unforeseen costs;
- ◆ Failure to notify the landlord that they want to renew the lease within the specified time frame in the lease;
- ◆ Difficulty assigning or subletting the premises because of a narrow 'Business Use' definition or onerous conditions imposed by the landlord prior to consenting to an assignment or sublease;
- ◆ Liability to pay the reasonable legal costs of the landlord in respect of preparation of the lease, any renewals, rent reviews and/or variations of lease; and
- ◆ The effect of the 'Improvements Rent' provision.

LANDLORD'S ISSUES

For landlords, the most important consideration is to attract and retain high quality tenants, so as to maximise the yield from their commercial property. This is not always as easy as it sounds and there are many challenges for landlords along the way. Some of the important considerations for a landlord include:

TERMS OF THE LEASE

Apart from the obvious provisions around the description of the premises, annual rent and the term of the lease, other important provisions of the ADLS Lease are:

- ◆ Property outgoings;
- ◆ Rent reviews;
- ◆ Maintenance obligations;
- ◆ Permitted use of premises;
- ◆ Insurance obligations;
- ◆ Damage & destruction of premises;
- ◆ Assignment & subletting;
- ◆ Lease renewals; and
- ◆ Guarantors.

The ADLS Lease addresses each of these issues. However, one size invariably does not fit all and it is important, whether you are a tenant or a landlord, that you understand the provisions of the lease that you are proposing to enter into, so there are no surprises down the track.

LANDLORD'S ISSUES (CONTINUED)

- ◆ Whether a personal guarantee should be obtained and from whom, or alternatively, whether a bank bond should be required;
- ◆ Tenants' fit out and any costs for the landlord associated with this. If the landlord is going to carry out these works, then consideration also needs to be given as to how those costs will be recovered;
- ◆ Consideration of the landlord's maintenance obligations, which includes weathertightness;
- ◆ Whether or not the landlord can meet its insurance obligations. This is particularly important considering the changes in the insurance industry following the earthquake events in both Christchurch and Wellington;
- ◆ How a landlord can cancel the lease in the event that the tenant is in default of its obligations; and
- ◆ How the landlord can apportion property outgoings and whether for example, the landlord management costs can be factored in.

EARTHQUAKES

Following the earthquake events in Christchurch in 2010 & 2011 and the more recent events in Wellington, issues around the seismic performance of a building have become a significant concern for both landlords and tenants.

The safety of all commercial buildings in the event of an earthquake is assessed using the New Building Standard ('NBS'). The minimum NBS compliance standard for a commercial building is currently 34%. However, many local authorities are (or are considering) imposing a more robust minimum compliance standard of 67% of NBS. The higher the NBS rating of a building, the lower the risk of the building needing to be demolished following an earthquake event and, more importantly, the lower the risk of the building causing injury or death.

The NBS rating of a building is a significant consideration for both landlords and tenants, but for very different reasons.

Landlords have to consider the 'tenantability' of their building, as many businesses are having to address the issue of staff retention, where they occupy buildings that are below 67% NBS. The requirement to carry out strengthening works is also a significant concern for landlords (both in terms of the costs and in terms of access), where a building is in part or wholly tenanted.

Tenants also have to consider the NBS rating of the building and whether earthquake strengthening will be required in the short to medium term. They may be able to stay in the premises while strengthening works are carried out on a reduced rent, or they may be required to vacate the premises.

There are many things to consider for both a landlord and a tenant prior to entering in a lease and the costs of getting it wrong can be considerable. It is always recommended that professional advice is sought, so that the obligations contained in the lease are fully understood and executed by both the tenant and the landlord.

MORE INFORMATION

If you're thinking about entering into a lease, need some advice or have any questions — give us a call or send us an email for more information.

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