

Guide to Entering into a Commercial Lease

If you are setting up a business or looking for larger premises to expand, finding the right property to rent which best suits your requirements is an important decision. It should not be undertaken lightly as it is usually a big financial commitment and it is more complex than buying a property outright. The obligations are very different from a residential tenancy, which is why commercial leases are often very lengthy documents. It is essential that you fully understand the nature of the lease and are comfortable with the obligations you are making.

What is a commercial lease?

- It is a right to exclusive possession of land which comes to an end after a determinable period of time
- It is a legally binding contract between a legal owner (Landlord) and an occupier (Tenant) which sets out the terms under which a Tenant can occupy business premises
- There are no specific rules regarding its format & structure – this can vary depending on the Landlord or the nature of the premises

Lease Negotiations & Heads of Terms

Once you have negotiated the basic terms of the Lease with the Landlord (or more commonly with the Landlord's agent who is usually a qualified surveyor) the agent will draw up the "Heads of Terms" which will set out brief details of the proposed arrangements. This will form a framework that the legal documentation will be based upon. (although the Heads of Terms themselves are not legally binding).

Checklist of points often included in Heads of Terms:

- Details of the Property -what is included
- Parties – who will be entering into and signing the Lease? It is usually the Landlord and the Tenant but could also include a guarantor
- Length of the Lease
- Initial rent and review details
- Rent deposits/Guarantees - a Landlord may require a rent deposit or if the tenant is a company personal guarantees
- Service Charge details (if you are only leasing part of a building)
- Repairing and Insuring obligations
- Type of lease e.g. whether a Headlease or a Sublease
- Alterations - usually you will need the Landlord's permission to make internal non structural alterations and will not be allowed to make structural alterations
- Future Dealings -there will be restrictions on disposing of your interest in the Lease such as a requirement of first obtaining the Landlord's consent and providing guarantees and whether or not you can share the property or sublet it
- Security of Tenure - whether or not the tenant will be entitled to a new lease automatically at the end of the lease
- Use - check that there is both the Landlord's agreement to the intended use of the property but also whether the correct planning is in place for that use

Definitions

Commercial leases can sometimes be a minefield of legal jargon. You may come across some of the following phrases when negotiating and entering into a lease:

- **Heads of Terms** - as referred to above this is a non-binding summary of the proposed lease terms as agreed between Landlord and Tenant at the conclusion of negotiations.
- **Term** – an expression referring to the period for which the lease will run
- **Headlease** - also referred to as a superior lease. This is entered into by the freehold owner of the property with a Tenant
- **Sublease** - also referred to as an underlease; entered into by a Tenant who already has a Headlease with another party ("subtenant" or "undertenant"). Both the Headlease and the sublease will run together.
- **Assignment** - the transfer of all the tenants obligations and rights to another party ("Assignee") for the remainder of the time left to run on the lease with residual on-going obligations under the lease for the Tenant (see notes on Authorised Guarantee Agreement below)
- **Security of Tenure** - an automatic statutory right for a commercial lease to (where the Tenant is in occupation and carrying on a business) to be renewed at the end of the term, subject to certain exceptions, such as the Landlord demonstrating an intention to redevelop
- **Contracted Out Lease** - a commercial lease where the parties have agreed that security of tenure will not apply
- **Authorised Guarantee Agreement** ("AGA") – a type of personal guarantee which a Landlord usually requires from a tenant assigning their lease to a new tenant; the guarantee will bind the Tenant to the lease obligations if the new tenant defaults. It will be effective as long as the new tenant remains the tenant under the lease
- **Covenants** – a promise to do something e.g. pay rent, or repair the property
- **Service Charge** – there are certain costs that may be payable on top of the rent, particularly if you are leasing part of a building occupied with other tenants. A service charge is a contribution towards the Landlord's costs incurred in keeping shared spaces such as toilets or car parking areas in good order
- **FRI Lease** – a full repairing and insuring obligations lease; the tenant is responsible for all repairs to the whole of the property including the main structure, although the Landlord will usually insure the property and the tenant will reimburse the insurance premium to the Landlord (often known as "insurance rent")
- **Open Market Rent Review** – a rent review by reference to the annual rent obtainable in the current market place as at the review date and is usually on an "upwards only" basis i.e. will not be reduced if the market rent is less than the current rent.
- **RPI Review** – a rent review by reference to the Retail Price Index
- **Rent Deposit** – an initial sum paid to the Landlord at the beginning of the lease to be held in the Landlord's bank (usually in a separate designated account) as security for compliance with the lease obligations. If for example you fail to pay the rent or keep the property in repair the Landlord will be entitled to offset these costs against the deposit.
- **SDLT** – Stamp Duty Land Tax – can be payable on a new lease even though you are not buying the property. It is calculated by reference to the length of the lease and the rent (plus any VAT payable on the rent) and a formula applied. If the lease is for 7 years or more you will need to file an SDLT return with the Inland Revenue even if no actual SDLT is payable.

There is no such thing as a "standard" lease"! Given the complexities of leases with plenty of pitfalls to watch out for, it is a good idea to seek specialist legal advice.

Crombie Wilkinson Solicitors are experienced in dealing with lease arrangements and can identify potential problems at the outset and explain and guide you through the obligations so that you are comfortable before you make a legally binding commitment to proceed. We can also help to try and negotiate lease terms on your behalf should anything become unclear.

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