

GUIDE TO COMMERCIAL LEASES

Acting for the Leases

1. Leasing in NSW

Different legislation applies to commercial and residential leasing in NSW.

In NSW, all commercial Leases are governed by the *Real Property Act 1900* (NSW) and the *Conveyancing Act 1919* (NSW). Commercial leases that are classified as retail leases under the *Retail Leases Act 1994* (NSW) are also governed by that Act.

2. Leases under the Real Property Act

Commercial leases are usually comprised of two parts. The first two pages consist of the dealing form entitled 'Lease', which is obtainable from the website of Land and Property Information NSW (LPI).

The terms and conditions of the lease are usually contained in a further document referred to as 'Annexure A', which is attached to the LPI front page. Together, these documents form a commercial lease.

2.1 Early Possession

Possession of premises should not be given to a lessee until all lease documents have been executed. If there is urgency in granting access or possession to the lessee (and there often is) then possession should only be given if a temporary lease is signed. It is a prudent practice to create a temporary lease with a term of only a week or two while the paperwork for a longer standing lease is being drawn up.

2.2 Negotiating Terms

Requests for alterations of the lease should be made in one letter, listing all the amendments sought by the lessee. Once a response is received from the lessor's solicitor, the lessee may make a decision as to whether to proceed to sign the lease with the terms as agreed.

2.3 Execution

Once the lessee agrees to proceed with the lease, the lessor's solicitor should provide a final execution copy of the lease as agreed with the lessee's details, rent and term details, and send two copies to the lessee for execution.

The lessee's solicitor should then return to the lessor's solicitor:

- The lease executed in duplicate;
- Proof of insurances (usually certificates of currency for public liability and plate glass insurance as a minimum);
- Bank guarantee;
- Cheques for:
 - Security bond (usually 3 months),
 - Rent in advance (usually 1 month),
 - Registration fee of \$104 payable to 'Land and Property Information'.

The lease should be executed by the lessor and registered. An executed and registered copy of the lease should be given to the lessee in due course.

2.4 Duty

Stamp duty is no longer payable in respect of leases entered into after 1 January 2008, however duty does remain payable on the following:

- transfers or assignments of lease;
- surrenders of lease;
- leases or agreements for lease for which a premium is paid; and/or
- leases entered into pursuant to an option if an amount is paid or payable for the grant of the option.

If the transfer is part of a sale of business, then duty is \$10.00 in addition to the duty paid on the sale of business.

2.5 Registration

Leases for terms including option periods that in total exceed three years must be registered to be effectual at law (Real Property Act 1900 Section 41).

While leases under three years in duration do not need to be registered, it is prudent to register the lease. Registration of the lease puts everyone on notice that a lease affects the property.

2.6 Bond

All leases generally require the lessee to pay a bond to cover any non payment of rent. The most common practice is to request a bond that is the equivalent of three months rent plus outgoings plus GST. Greater bonds of up to say, six months may be accepted in lieu of providing a directors guarantee.

2.7 Security Deposit

Bonds may be held by solicitors or real estate agents in trust or controlled money accounts. The deposit holder should be specified in the lease.

2.8 Bank Guarantee

By providing a bank guarantee, a lessee guarantees payment to secure the leasing arrangement without tying up working capital. Security for a bank guarantee can be provided from a range of assets including cash and real estate.

The main drawback is the extensive paperwork, fees, and delay imposed by most banks and lending institutions in granting bank guarantees.

For a bank guarantee to be acceptable, it must:

- Be in the correct amount;
- Be drawn in favour of the landlord;
- Be assignable;
- Not have an expiry date;
- Be unconditional and irrevocable; and
- Describe the bank guarantee purpose as: "For all obligations of [lessee name] under the lease for premises at [address] and any licensed area or other rights ancillary to the lease".

2.9 Legal Costs

It is customary for the lessor to request that its legal costs be paid by the lessee, although this is not always agreed to. The most common practice in the current market is for each party to pay his/her own costs.

3. Leases under the Retail Leases Act

Commercial leases that are also classified as retail leases under the *Retail Leases Act 1994* (NSW) are also governed by that Act.

4. Acting for the Lessee

4.1 Searches

The lessee client should be advised to make inquiries of the property and lessor similar to what they would make if buying the property. The longer the lease the more extensive the searches should be. You should consider also the context. When leasing a retail shop in a shopping complex, structural issues may not be as relevant as when leasing a free standing building or warehouse for the purpose of installing heavy manufacturing machinery.

4.2 Company Searches

You must obtain a current extract to determine:

- Who the directors are – the lease should be signed by two directors of the company pursuant to Section 127 of the *Corporations Act 2001*.
- If not signed by directors, whether the person signing has authority?
- Whether the lessor may be later able to argue ultra vires (“beyond the powers”) by claiming an authorised representative of the company purported to enter into a lease when they in fact had no authority to do so?

4.3 Bankruptcy Search

A bankruptcy search is a prudent measure if the lessor is a natural person.

4.4 The Property

The following searches may be necessary:

1. Title search
 - a. Is the lessor the owner of the land?
 - b. If the property encumbered? If mortgaged, the mortgagee’s consent will be required.
2. S149 certificate (planning)
 - a. Does the current planning environment allow the proposed use by the lessee?
 - b. Does the use require Develop Consent? If yes:
 - i. What conditions are attached to the Development Consent?
 - ii. Have the conditions been satisfied?
3. Building and pest inspection
 - a. Is the building sound?
 - b. Are there major works required?
 - c. Are these works likely to be disruptive to the lessee’s business?

4.5 Points to Negotiate

Obtain the client’s instructions regarding the specific use of the property. Usually the client will volunteer any special features they require, but it is worthwhile getting into some detail about how the client intends to use the property, what hours they intend to keep and what issues may arise in terms of what the terms of the lease allow.

The lessor often requests that their legal costs and disbursements be paid by the lessee. The lessee either resists this entirely, or agrees to pay half. In the current market it is usually the lessee who prevails and each party pay their own costs.

You should also consider:

- After hours access to premises.
- After hours air-conditioning. There are often high hourly fees associated with having air conditioning switched on after hours.
- Car parking.
- Signage of the lessee. Is it important to the lessee to display signage. There are often restrictions as to the type of signage that can be used.

- Signage of the lessor – this is usually in the form of a ‘to let’ sign displayed three months before the end of term. This may have a negative impact on the lessee’s business and does not need to be agreed to.
- Cleaning of common areas.
- Access to and cleaning of shared bathroom facilities.
- Garbage disposal.
- Medical waste disposal.

5. Options

5.1 Option to Renew

The terms of an option for renewal should be clearly specified. The most common practice is to give the lessee a period in which to exercise the lease which is no earlier than 6 months and no later than 3 months before the end of the lease term.

The option usually requires the lessee to be in compliance with several important lease terms. The usual requirements are that: the lessee must have punctually paid rent and observed the covenants in the lease; that there is no subsisting breach of any lease covenants by the lessee at the date of serving notice of exercise of the option; and that the lessee must observe the lease covenants from that date to the expiry of the current lease term.

The option should specify the terms of the renewed lease. Usually the terms will be the same as the terms of the original lease, minus the option clause. You will need to check that the arrangement for payment of legal costs and disbursements of the renewed lease is specified in the option clause or is adequately covered by the lease provision dealing with costs. Also, the option clause should specify that the new lease or extension of lease term is to be registered.

5.2 Option for Renewal under the Retail Leases Act 1994 (NSW)

The terms of renewal, preconditions and the time and mode of exercise of an option for renewal are not regulated under the *Retail Leases Act*. The law relating to options generally applies, including Sections 133C, D, E, F G of the *Conveyancing Act*.

5.3 Determination of Current Market Rent for Options

Rent reviews are most commonly annual, by either fixed percentage or CPI. Market rent reviews are almost always at the end of the lease term and before the beginning of any option term.

Beware of a ‘ratchet’ clause – a clause that provides the rent cannot fall below the existing rent. When acting for the lessee, it is a good idea to negotiate for the removal of this clause.

6. Transfer of Lease

‘Transfer’ and ‘assignment’ are interchangeable terms.

Consent cannot be unreasonably withheld by the lessor unless the lease expressly prohibits assignment, which is relatively rare.

If there is no clause regarding assignment, then the lessee may assign the lease without the consent of the lessor: *American Dairy Queen (QLD) Pty Ltd v Blue Rio Pty Ltd* (1981) 147 CLR.

A transfer of lease often forms part of a sale of business. The agreement for sale of business ought to have the current lease attached to it as a disclosure document, and the sale of business is usually condition upon the lessor granting a transfer or a new lease.

7. Pre-Lease (Agreements to Lease)

It is a popular practice for parties to enter into an informal agreement to lease commonly referred to as 'heads of agreement' or 'memorandum of understanding' prior to consulting a solicitor.

7.1 Incentives, Rent Free Periods

Lessors will often offer generous incentives to lessees in order to induce them to enter into a lease. These often include rent free periods, rent reduction periods, legal expenses and contributions of the lessor toward fit out. These incentives are usually contained in a separate deed called an 'Incentive Deed'. The main reason for this practice is that leases when registered can be accessed by the general public via LPI searches. Therefore, incentives should not be included in the lease itself so that they remain confidential and the lessor's bargaining power is not undermined.

7.2 Car Parking

Sometimes a car parking licence will be provided as separate to the lease, rather than having parking rights in the main lease.

Beware of the Parking Space Levy (PSL) which was introduced to discourage car use in major commercial centres. Also be aware that car parking can be taxed as a fringe benefit.

7.3 Subleases

When the lessee creates a sublease, the lease is then often referred to as the 'head lease'. The formal requirements of a sublease are similar to that of a lease.

The grant of a sublease without the consent of the lessor may be a breach of the lease. However, consent may not be unreasonably withheld: s 133B (1) of the *Conveyancing Act*.

7.4 Variation of Lease

The lessee and lessor can agree to vary the terms in a lease. This does not necessitate creating a new document. The existing lease can be altered by lodging a 'variation of lease'.

7.5 Peripheral Agreements

In addition to the lease itself, there are often one or more ancillary documents that function together with the lease. These include agreements to lease, incentive deeds, car parking licences, mortgages and other charges.

An agreement for lease is used when a lessee/lessor may wish to agree on the terms of a lease before actually entering into a full written lease. An exchange of correspondence may not be sufficient to constitute an agreement for lease: *Azkanaad Pty Ltd v Galanos Bros Pty Ltd (2008) NSWCA 185*. The solution is executing an agreement to lease in written form that may be signed by way of acceptance.

7.6 Mortgages and Charges over Leases

Often the terms of a lease prohibit the lessee from granting any mortgage, charge or encumbrance over the lease at all. If that prohibition is omitted, the lessee's entitlement to mortgage the lease is unrestricted.

A compromise, which provides sufficient scope for lessees and protection for lessors, is to include a qualified prohibition against mortgages over leases, giving the lessor the absolute discretion to grant consent.

7.7 Lease Disputes

It is not essential to include dispute resolution provisions in a lease, but if they exist they should be followed prior to commencing litigation.

If the *Retail Lease Act* applies, disputes must be heard by the NSW Administrative Decisions Tribunal. If not, disputes may be litigated in the Local, District or Supreme Court systems.

7.8 Non-Payment of Rent

When a lessee falls into arrears, the lessor's entitlement to terminate the lease by re-entry will usually be contained within an express clause in the lease.

Section 85(1)(d) of the *Conveyancing Act* allows the lessor to re-enter the premises if rent is in arrears for a period of one month even though no formal demand has been made.

The legislation requires that the lessor's right to terminate cannot be exercised unless the required statutory notice has been given to the lessee: [s 129 Conveyancing Act](#). The notice is mandatory and cannot be contracted out of in NSW. The form of notice is provided in [Schedule 6 of the Conveyancing Act](#).

CHECKLIST WHEN ACTING FOR THE LESSEE

1. Pre-lease agreements

- Is there a pre-lease agreement/memorandum of understanding/heads of agreement entered into by the parties or by a real estate agent on behalf of the lessor?
 - If yes, note what needs to be reflected in the lease
- Has the lessor paid any money to the lessor or real estate agent?
 - If yes, is the deposit refundable or can costs be deducted?

2. Is the lease subject to the *Retail Leases Act*?

- Minimum term 5 years unless s16 Certificate provided
- Is the shop listed in Schedule 1?
- Is the shop in a shopping centre?
- Is there an exclusion? Section 5

If the Act applies:

- Retail Tenant's Guide sent to lessee
- Lessor's disclosure statement
- Lessor cannot have costs of preparing lease paid by lessee

3. Does the lease need to be registered?

- Under 3 years, including option: NO
- Over 3 term, including option: YES

4. Is the lessee in occupation?

5. Obtain certified copies of:

- Lessee's ID
- Particulars of experience: CV highlighting relevant experience
- Particulars of assets and liabilities: schedule of assets and liabilities, tax returns
- Particulars of financial resources: real estate owned, money to invest?

6. Advise on lease, suggest amendments/deletions

- Parties: title search to determine lessor on the lease is the owner
 - Bankruptcy search if natural person
 - ASIC search if company
- Premises
 - Confirm street address – folio identifier.
 - Mortgage? If yes – mortgagee will be required to consent = extra cost for lessee
- Term of the lease
 - When does the term begin?
 - When can the lessee occupy?
- Option
 - Is there an option?
 - When can it be exercised?
 - Retail Leases Act may request determination of market rent prior to exercising the option.
- Rent
 - Is rent inclusive of GST?
 - Advise rent + GST figure in case client overlooked it
 - Is client registered for GST?
- Rent reviews
 - Rent reviews usually occur annually on the anniversary of the commencement date.
 - A market rent review normally occurs at the end of the term/when the option is exercised.

- Outgoings
 - What percentage or amount is the lessee liable to pay for outgoings?
 - Request previous quarter figures from landlord.
- Abatement of rent
 - Is there a clause providing that should the building be destroyed, the rent will cease until the building is restored? No lessee should sign a lease without such a clause. If its not there, ask for it to be included.
- Assignment and sub-letting
 - Does the lease allow it?
 - No assignment clause? Unlimited right to assign.
- Repairs
 - The lessee is responsible for repairs caused by use of the premises or damage caused by the lessee, with the exception of fair wear and tear.
 - Repainting clause – how often?
- Insurances
 - Usually lessor required public risk insurance to the extent of \$20 million
 - Plate glass
 - Workers compensation
 - Personal property
- Default and essential terms
 - Advise client of essential terms
- Duty
 - Stamp duty is not payable on commercial leases in NSW. Transfers only.
- Use of premises and Councils consent
 - The lessor gives no assurance that the premises may be used for the permitted use named in the lease
 - Any current DA'
- Car parking
 - Car parking included?
 - Does client expect/require parking?
 - Does client need car park for other reasons?
 - Parking space levy to be paid by lessee?

7. Points to negotiate

- Get instructions from client

8. Letter to lessor's solicitor requesting amendments/deletions

9. Attend to execution of lease with client, request cheques for registration

10. Return executed documents with cheques, request copy of registered lease from lessor's solicitor

Precedents:

- Agreement for lease
- Bank guarantee requirements letter for bank
- Car Park Licence
- Caveatable interest for option to purchase
- Checklist for assignees solicitor
- Checklist for assignor's solicitor
- Checklist for Lease Lockouts
- Checklist when acting for the lessee
- Checklist when acting for the lessor
- Deed of assignment of lease with guarantor
- Deed of consent to mortgage over lease
- Deed of consent to sublease
- Incentive deed
- Lease Annexure A
- Lender's deed of consent to lease
- Letter advising lessor regarding lockout
- Letter to lessee's solicitor enc lease and incentive deed
- Letter to lessee's solicitor enc bank guarantee requirements
- Letter to lessee's solicitor enc lease, car parking licence and incentive deed
- Letter to lessee's solicitor seeking particulars of lessee
- Letter to tenant advising on lease
- Right of entry notice for door
- Notice of early rent determination
- Notice to lessee of breach of covenant
- Option to purchase
- Retail lease
- RPA signing provisions
- Sublease Annexure A