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YOUR COMMERCIAL & RETAIL LEASING UPDATE

10 TIPS FOR TENANTS NEGOTIATING A COMMERCIAL LEASE WITH THEIR LANDLORD

October 2021

The following tips will provide an overview for planning a negotiation with your Landlord.

We often get asked about the most common areas that a commercial Tenant can negotiate with their Landlord. It is very important to keep in mind that the Landlord is looking for the best financial return on their property and will put their initial asking position to the Tenant hoping that their proposed “wish list” terms will just be accepted and signed off.

It is generally accepted practice for a new lease or a renewal to be negotiated to reflect the trading strength of the tenant, the mix of terms being negotiated and the underlying market conditions.

1. RENT

The rent is the most obvious and common area that Tenants focus on. The first thing **not to do**, is negotiate the Landlord’s asking rent. This is the rent that they would like to receive and most likely not the market rent. The market rent is what the tenancy can be leased for today in the current trading environment if it was vacant.

Rent creep is more pertinent to renewing Tenants that may have experienced annual rental increases over the time they have occupied the premises.

Sometimes with new lease negotiations, it may make sense to pay a little more than the market rent to secure other, more important incentives outlined below.



2. INCENTIVES

Landlords are motivated to secure the right tenant for their property and in some areas of commercial property, the total incentives package could represent 20% to 25% of the total rent over the term of the Lease. There isn't a magic formula when it comes to incentives, it really depends on the commercial framework of each deal and how confident a Tenant might be in negotiating. Typical incentives are as follows:

- **Leasing Incentive:** An amount of money contributed by the Landlord to a Tenant as a cash incentive to lease the tenancy.
- **Fitout Incentive:** This is an amount of money made available by the Landlord as a contribution towards the cost of fitting out a tenancy.
- **Work done by the Landlord at their cost:** A schedule of work, usually relating to building improvements paid for by the Landlord.
- **Rent Free Periods:** A number of months where no rent is paid, giving the business an opportunity to get established prior to rent commencing.

3. LEASE TERM

An important consideration in a commercial Lease is the lease term. If a Tenant invests a significant amount of money into a fitout, it is in their best interests to allow sufficient time to spread that investment over the term of the Lease to recover the investment.

Having enough time to develop the business into a sustainable venture or a saleable asset is important.

Landlords are more likely to provide more attractive incentives for longer leases as well as providing adequate tenure to an incoming owner in the event of a sale by the Landlord.

4. ANNUAL RENTAL INCREASES

Landlords generally increase the rent by an annual percentage, as a way of keeping the rent in line with inflation. In periods of low economic growth, this is another way for Landlords to profit from Tenants. For long standing Tenants who might position themselves in the same location for two renewal cycles (15 years) at 5% per annum, the compound increase is 108%.

Comparing the current rent to the market rent at renewal time will save tens of thousands of dollars.

5. SECURITY DEPOSITS AND BANK GUARANTEES

Security deposits and bank guarantees are a form of surety or risk mitigation for the Landlord in situations where they may have provided a sizable incentive or where a business may be relatively new and untested. These guarantees can be sizable amounts of money that the Tenant needs to have tied up for long periods of time.

In situations where the Tenant has a long and reputable trading history and/or the investment in a fitout has been depreciated over a period of time, it is reasonable to negotiate the partial or full refund of the security amount, back into working capital of the business.



6. PERSONAL GUARANTEES

Landlords like to take security over Tenants personal assets to protect the value of the Tenants total rent liability. For high profile or desirable Tenants with a successful trading history or in situations where it is in the best interests of the Landlord to lease a tenancy, personal guarantees can be negotiated out of a transaction.

In some situations, a Tenant could increase the security deposit to eliminate the need for a personal guarantee or limit the personal guarantee to a fixed amount, rather than it being unlimited.

7. MAKE GOOD

The make good clause stipulates how a Tenant must return the tenancy when they eventually vacate. This clause is often overlooked and if properly negotiated can save tens of thousands and sometimes hundreds of thousands of dollars.

The make good clause usually stipulates that a Tenant will return the tenancy to a vacant shell and base building services. This can be very expensive if the tenancy has been leased to the Tenant as a fully fitted out premises.

Other clauses include the tenancy being returned in the condition it was at the commencement of the lease. This can be problematic if parts of a fitout have been removed as part of a refurbishment.

Negotiating this clause prior to entering the lease is essential.

8. PERMITTED USE

The permitted use relates to what the Tenant will be using the tenancy for. It is in the interests of the Tenant to negotiate a broad usage clause as it will provide flexibility and options to develop the business in the future. Once the lease is agreed and signed, changes to what a Tenant can do in the tenancy will not be possible without an amendment or variation to the lease, a lengthy and costly process and is always subject to the Landlords approval, which may not always be given.

9. CARPARK SPACES

Carparking can be a valuable component of a Lease. Not all tenancies automatically come with carparking included and negotiating them as part of the total deal could be advantageous for the Tenant.

10. EXCLUSIVITY

Depending on the Tenants type of business, it may be beneficial to negotiate that the Tenant's business category can be the only service provider / retailer providing a specified service or product.





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