

A Guide to Leasing Commercial Property

Leasing commercial property is the process of taking on the right to use a property for business purposes and involves signing a lease agreement, which is a legally-binding contract between a landlord (the lessor) and a tenant (the lessee). This is one of the most important commitments for a business owner, so getting it right is essential.

At Butcher & Barlow LLP, we are commercial property law specialists, so we have put together a comprehensive guide to leasing commercial property to help you prepare.

What to look for in a Commercial Property

From a business perspective, the first step in the process is to find the right property – and this step is one of the most important. You have to consider the present, the future, and account for a large number of variables – whether that is the location, the facilities, or the costs involved.

As a business owner, you are likely going to be thinking about all the aspects of your business while weighing up the right space. For example, you should consider the location for the commute of your employees, and/or the transport links for distribution, and/or the footfall for custom.

The facilities your new premises have to offer are also important. Whether that is space, the furniture to hold all of your employees, adequate Wi-Fi speeds, kitchen facilities, etc. – they all make a difference to the running of your business and the satisfaction of your employees.

Costs, local amenities, the length of the lease, and even the impression the space gives to employees and customers alike should all influence your decision.

What is the process?

While there are only a few steps involved in entering into a lease, these steps can be intricate and confusing if you are not completely familiar. Here is a step-by-step guide to the different stages of the process of signing:

By definition, a **lease agreement** is a contract between the owner/manager of a property (the lessor) and someone who will use the property (lessee). The lessee does not have the same ownership rights to the property as the lessor, but will have responsibility for its condition and sometimes other things like insurance and maintenance.

Find a Property and Make an Offer

The first step in leasing a commercial property after having identified an appropriate property is to register your interest with the landlord.

Heads of Terms

The **heads of terms** of a commercial lease is a non-binding agreement that outlines the basic terms of the lease, usually produced by the landlord or the landlord's agent.

At this stage, you may wish to seek legal advice if you do not understand the implications of any of the terms put forward by the landlord before agreeing to these terms.

The heads of terms will be negotiated and sent to the relevant parties, including both parties' solicitors as they precede the lease itself. The heads of terms will be used by the landlord's solicitor to prepare the lease itself.

Landlord Sends Documentation

The landlord will now instruct its solicitor to prepare the relevant documentation and send it to the tenant's solicitors. They are expected to send:

- the draft lease;
- evidence of the landlord's legal title to the property;

- replies to the standard commercial property enquiries given by the landlord; and
- if negotiated as part of the heads of terms, a rent deposit deed and/or licence for alterations.

A **rent deposit deed** is used to document a deposit the landlord requires a tenant to pay upon completion of the lease as security in case the tenant fails to pay the rent under the lease, or otherwise breaches the lease. A rent deposit deed will normally document the circumstances in which the landlord would be entitled to draw on the tenant's deposit to top up a missed rent payment, or carry out repairs to the property, for example.

The **licence for alterations** is a document between the landlord and the tenant that documents the landlord's consent to the tenant to carry out alterations at the property. Normally, details of the alterations will be requested by the landlord before providing approval and then any approved alterations will be set out in the licence document which both parties then sign.

Approved Form

Once both solicitors are in touch with each other, they will go back and forth to negotiate the document on behalf of their respective client in order to reach an agreement on the approved form, which is the version of the lease that both parties agree on. This will – potentially – include compromises made by both parties, and the final form of the lease will depend on each parties' negotiating strength. However, the final form of the lease should be the closest to an agreement that satisfies the requirements of the landlord and the tenant.

The Lease Is Received and Signed

Now both parties will receive copies of the lease to sign, as well as any rent deposit deed or licence for alterations, if these have also been agreed.

Completion

Completion, in relation to a lease transaction, is where the landlord's and the tenant's solicitors speak with each other and agree to date the lease agreement. The landlord must then hand the tenant the keys to the property, and the provisions in the agreement become binding on both parts.

Once everyone has signed the lease, the deal can be completed. Usually, the landlord and the tenant will receive copies of the lease agreement for their records. The tenant's solicitor may now also be required to register the lease with the Land Registry and submit any Stamp Duty Land Tax (SDLT) return, including making payment for any tax due. Whether a Land Registry application and SDLT return will need to be submitted will depend on the length of the lease and the amount of rent payable.

What are the Fees?

As with any property acquisition, there are fees involved with leasing commercial property. While not all fees apply to every commercial lease, it is definitely important to find out at the outset what costs will be involved, and to remain aware of them throughout the transaction itself, and when creating your budget once you are up and running in the property.

Rental Costs

Naturally the largest cost involved in a commercial property lease is the rental costs, which you will need to keep aware of and continue to monitor. In some cases, rental costs may be subject to change (via a 'rent review' process) throughout the lease and if this is the case, your solicitor should report to you in full as to the terms of any rent review. The details will be set out in the lease agreement itself.

Many small businesses/start-ups will have a guarantor on their lease. This provides extra security for them, and for their landlord, in case they cannot make payment on their rent. Furthermore, there may be a rental guarantee included in the agreement.

A **guarantor** in a lease agreement is a third party who signs their name to the contract and agrees to pay the rental cost if the tenant cannot pay and to comply with all of the other obligations in the lease which the tenant has agreed to.

Rental guarantee is a form of insurance that may be requested by a landlord. The tenant has the final say on whether they choose to put up a guarantee, but not doing so could make reaching an agreement less likely. Caution is, however, always advisable when making these kinds of guarantees. As the tenant, consider the impact of the guarantee being called right away and how it would affect you.

Professional Fees

There are certain professionals who may be able to help you with your commercial property lease in addition to a solicitor – particularly in relation to ensuring you get the right terms.

The main professional, other than a solicitor, you will need to hire is a surveyor, who will be able to help with the negotiation and approval of the heads of terms. Surveyors can advise as to what is 'normal' in the property market and as to the appropriate level of rent which should be set in the lease. If you are a tenant, it might also be a good idea to have a survey of the property carried out to ensure you are aware of any defects which might become your responsibility via the lease.

If you are a landlord and you choose to use an estate agent to locate a suitable tenant and negotiate the terms on your behalf, you should also factor in the estate agent's commission.

Business Rates

Calculated according to the rental value of the property, business rates are based on a system from the Valuation Office Agency (VOA). Business rates are a tax on property used for business purposes and the rate is reviewed by the VOA every five years so may be subject to change.

Insurance

Contents insurance is a must for any business, so that is a guaranteed cost. Depending on the terms of your lease agreement, you may also be responsible for covering building insurance, so keep that in mind when factoring in costs.

Contents insurance for a commercial property is a type of business insurance that protects the contents of your commercial premises, including possessions and equipment, typically in the event of fire, flood, or theft.

Building insurance is used to cover the costs of repair or rebuild to the property itself, which might be used in the event of fire, flood, theft, natural disaster, or other damage such as burst pipes.

Running Costs

Standard running costs of commercial premises are not usually included in the cost of rent, so should be factored in separately. This will include utilities such as gas, electric, and wifi.

Energy Performance Certificate (EPC)

A legal requirement for any commercial property to have before the lease is completed, an Energy Performance Certificate (EPC) is something that is usually handled by the landlord but you should make sure it has been done. If you are a landlord you must make sure you can provide a new tenant with an up to date EPC for the property and it must show that the property meets the legal minimum energy efficiency standards which have become more stringent in recent years.

EPCs are not a requirement if entering a licence or renting serviced office space.

Deposits

As mentioned above, in many cases, your landlord will ask for a deposit upfront. This is most often equal to between three and six months' rent.

A deposit is the tenant's money, and not the landlord's. It is used as a guarantee and should always be returned to the tenant once the lease has expired, unless the landlord has had to withdraw funds to cover costs. Costs withdrawn from the deposit by a landlord may cover damage to the property, late rent payments, or payment if the tenant defaults on the lease agreement.

A rent deposit deed should be drawn up and agreed, setting out the terms on which the tenant's deposit is to be held by the landlord and the circumstances in which the landlord may draw on the monies.

VAT

Some commercial properties have been elected for VAT, which will be payable on the rent and service charges of the property. You should check the status of this with your landlord while/before terms of the lease agreement are outlined.

Service charges

If the property is part of a larger building, unit or situated on an estate (for example a retail or industrial park), the tenant may be responsible for costs incurred by the landlord in cleaning, lighting, heating, maintaining, and repairing other parts of the building or estate that the tenant uses, which might include things such as car parking areas and corridors.

What is the Contract/Agreement?

The actual contract/agreement involved in leasing commercial property is what most people are intimidated by, and for good reason. Lease agreements can be complicated and difficult to understand for non-solicitors, which is why it is always recommended that you work closely with a legal professional when enquiring about commercial property.

In essence, a lease is a legally-binding contract that sets out the terms of the tenancy agreement between a landlord and a tenant. They offer more stability than a licence, which typically lasts a shorter amount of time and means the tenant does not have as many rights in connection with the property.

Additional information

The average length of a lease is now around 4.5 years, although they can be up to 999 years long. In recent years, leases have generally become shorter in order to offer landlords and tenants more flexibility.

To help leases remain as flexible as possible, clauses such as rent-free periods and break clauses are included.

A **break clause** can allow one or both parties to terminate the lease on notice – usually six months' notice. There can be strict conditions attached to break clauses and you should seek advice from your solicitor in relation to the effect of any conditions attached to a break clause.

What else is there to look out for?

You should remember the provisions in your lease agreement, and perhaps keep a note of any relevant dates on a calendar or in your diary. Some key things to remember are:

- proposed service charges;
- rent reviews and their frequency;
- subletting policy;
- assigning the lease;
- restrictions on carrying out alterations to the property;
- repairing and decorating obligations; and
- personal guarantee.

According to the Royal Institution of Chartered Surveyors (RICS), the above are all essential pieces of information that will be useful for how you use and utilise your commercial space throughout the duration of your lease.

What is included?

As well as the above, the following information will be described in your lease agreement as standard:

- names of all parties involved,
- property address,
- rent including how it is paid and when,
- deposit details including amount and security and when it may be withheld,
- start and end date of tenancy including any other important dates,
- obligations of landlord and tenant,
- bills and utilities and service charges the tenant is responsible for,
- any included or relevant clauses (such as a break clause),

- who is responsible for alterations, repairs, and maintenance, and
- whether subletting is permitted.

Butcher & Barlow LLP

While commercial property leasing can be complicated, it is worth spending the time and money to get all of the aspects we have mentioned throughout this guide right to give you the best chance of having a successful tenancy arrangement.

If you would like to speak to one of our specialist solicitors about a commercial property lease transaction, you can contact our commercial office at Gadbrook Park, Northwich by calling 01606 334309 or filling out our simple contact form. We will then be able to direct you to the right department and begin to help handle your enquiry.

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