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Commercial Property Law

Guide to Negotiating Leases



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This guide is by no means comprehensive and landlords and tenants are advised to seek out independent legal advice when negotiating a lease.

When renting a commercial property tenants are asked to sign a lease agreement or licence, which is a legally binding contract between a tenant and the landlord.

The term, or length of a lease, is negotiable but commercial leases typically range between three and 25 years. A lease will usually offer a business greater long-term stability than a licence.

Commercial leases in England and Wales fall into two categories, which are commonly referred to as either being 'inside the Act' or 'outside the Act'.

The former offers 'security of tenure' under the Landlord and Tenant Act 1954 ("the Act") while the latter is expressly excluded from the Act.

The type of commercial lease in place is important when understanding a tenant's rights to renewing their lease.

To help you understand the process of leasing a property, our experienced Commercial Property team have put together this useful short guide.

Rent repayment terms

From the outset, it is important to factor in when rent will be payable to ensure tenants can manage their finances. Commercial rent payments are typically due quarterly, in advance, for example, on March 25, June 24, September 29 and December 25.

However, an increasing number of landlords now accept rent payments monthly, which may help a business with cash flow.

Additional service charges or insurance will usually be itemised separately but are also payable at the same time.

Guarantees

A tenant may be asked to provide a guarantee for the rent, particularly if the business is a start-up or a landlord has concerns about future payment of rent.

If a person is asked to be a guarantor, they should seek legal advice as, depending on the terms of the lease, if the company ceased trading, they could potentially be liable for rent payments.

As well as conducting detailed checks on tenants, landlords are encouraged to carefully screen guarantors to ensure they can support the rental payments should the tenant get into arrears or vacate the property without notice.

Commercial licences

Licences are typically offered for a much shorter period than a lease and are popular among newer or smaller businesses who want to "test the waters", for example, by opening a pop-up retail unit.

A licence fee instead of rent is paid either in advance, weekly or monthly depending on the terms of the agreement, lasting up to six months.

As licences are a short-term option, it is important to know that there is no automatic right to renew, as is offered under some leases.

Negotiating a lease

Entering into a commercial lease agreement often involves protracted negotiations on both sides to secure the most advantageous terms.

Tenants are advised to seek advice at an early stage to ensure that their needs are properly met both now and, in the future, especially if they are seeking a long lease over many years.

On the other hand, landlords should conduct thorough due diligence and background checks on tenants to ensure they have the means to make rent payments and do not have any red flags from the past that suggest they will be an unsuitable tenant.

Once a tenant's offer is accepted, the landlord, their commercial agent or solicitor will provide a document, which outlines the key points of the agreement.

This is known as 'heads of terms' and is not legally binding at this stage. The document will include several details including:

- A description of the deal and type of agreement
- Rental value along with payment arrangements
- Proposed date of completion.

Once heads of terms are agreed, tenants are advised to arrange a building survey to assess the condition of the commercial property and any likely repair or maintenance costs that are required.

“ Unlike a residential let, commercial tenants are usually responsible for the cost of repairs and if they are leasing the entire building, the full obligation typically lies with the tenant. ”

Tenants should, therefore, arrange a Schedule of Condition report, which sets out the exact condition of the property using photographs. This is then attached to the commercial tenancy agreement to document the condition of the property prior to the lease.

A local search by a legal team will also reveal if there are any plans, which may have a negative impact on the building or the wider area, as well as any other restrictions such as listed building status or conservation requirements.

Rent-free periods

A rent-free period, as the term suggests, is a set period of weeks or months where tenants do not pay any rent whatsoever. Such deals are often offered as an incentive by landlords when the commercial market is slow.

A rent-free period is often included at the start of a lease although it can be offered at any point during the term of the lease.

It is often possible to negotiate an attractive rent-free period as compensation for any disrepair found during the building survey, or as compensation for 'fit out' works – particularly if it adds value to the landlord's building.

Exchange of contracts and completion

Not unlike residential conveyancing, once contracts are exchanged, the terms of the lease will be legally-binding.

A deposit will usually be paid at this point, with the balance of the first quarter's rent and any other service charges payable on completion.

Lease renewal

When a commercial lease comes to an end, the actions each party needs to take depends on whether a lease is inside or outside the Landlord and Tenant Act.

If a lease is 'inside the act' the tenant has the right to automatically renew at the end of the term because they have "security of tenure". Such leases may only be ended by either the tenant or landlord serving the correct form of notice at the appropriate time.

When a lease is granted inside the Act, a landlord can only regain possession of the property under certain circumstances, such as development purposes or because a tenant has breached the terms of the lease.

When a commercial lease comes to an end, if a tenant wishes to renew their lease, they will normally have the right to remain in the property while new terms are negotiated.

If a lease is 'outside the Act' a tenant has no automatic right to renew at the end of the term, potentially meaning that they could lose their business premises with little or no notice.

Regardless of whether a lease is inside or outside the Act, it is important to plan and enter into negotiations well in advance. It is typically recommended that this is done at least six to 12 months before the lease end to allow sufficient time for negotiations.

Lease renewals can be complex so we recommend seeking early advice from our Commercial Property team who can help negotiate a renewal on favourable terms.

Renegotiating an existing lease

When the economy is in difficulty and trading conditions are tough, rent on commercial premises can be a significant drain on a business and its resources.

Although recent media reports have suggested that certain High Street retailers have successfully forced their landlords into renegotiating better lease terms, it is important to remember that a lease is a legally binding contract. As such, unless a business goes into administration due to insolvency, tenants are expected to pay rent on time.

In practice, many landlords are aware that if a business has genuine financial difficulties, taking a hard-line approach may result in the company folding altogether, leaving an empty unit with no rental income.

In such circumstances, a landlord may be willing to consider changing the terms of a lease so seek advice from our Commercial Property team as early as possible.

We have successfully acted on behalf of many clients to negotiate:

- Moving from quarterly to monthly payments
- Rent reductions linked to a tenant's business turnover
- Rent holidays
- Adding or removing break clauses.

Here to Help

Mackrell's Commercial Property team can assist you with all aspects of renting a commercial property and negotiation of a lease, whether you are a tenant or a landlord. To find out how our specialists can help you, please contact us.

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