

COMMERCIAL PROPERTY LEASES – BEWARE OF THE PITFALLS!

INTRODUCTION

Commercial leases are founded in contract and regulate the duties and obligations of the landlord as owner of a premises and the tenant as occupier. Opinions on what covenants and conditions should be contained in the lease will differ depending on whether you are the landlord or the tenant.

The purpose of this article is to review the position from a tenant's perspective and outline the typical clauses which arise in a commercial lease and the pitfalls associated with those clauses.

ARE ALL COMMERCIAL LEASES THE SAME?

No and each lease needs to be reviewed carefully against the property being let. For example, the obligations a tenant may take on in a lease of a newly constructed retail unit would differ from the obligations a tenant would be willing to take on in a lease of a Georgian building or protected structure.

In addition, the severity of the obligations imposed on the tenant does tend to vary depending upon the length of the lease. For example, shorter term leases normally impose less onerous obligations than longer term leases.

WHAT ARE THE KEY CLAUSES IN THE COMMERCIAL LEASE I NEED TO CONSIDER?

In a negotiation of all commercial leases there are a number of clauses upon which most

discussions will take place. These are as follows:-

- **Repairing Obligation**

It is crucial that a tenant understands the extent to which they are obligated to repair the property under the repairing obligation in the lease. Standard wording which will be inserted in leases by solicitors for a landlord will include “to keep” the Demised Premises and “to put” the Demised premises in a state of good repair and condition. From a literal reading, this may not cause concern, however case law has held that such wording can impose a full scale repairing obligation to include the structure of the buildings.

- **Yield Up Clause**

This clause deals with the condition in which the property must be returned to the landlord when the lease expires. Remember the lease can expire either by surrender or by the exercise of a break option. Alternatively, it will run its course and end when the term runs out. A tenant must be cognisant that when the lease ends the landlord will expect the property to be returned in a condition which complies with the lease terms and in particular the repairing clause. The cost of bringing the property to a standard which complies with the decorating and repairing obligations can be considerable.

- **Rent Review**

Where the lease runs for more than five years it will normally incorporate a rent review clause. The rent review clause will specify how the rent will be reviewed and in particular who can trigger it.

- **Service Charge**

Much discussion and negotiation can take place on this clause. A tenant must be wary with such clauses, as without there being limits or controls on what the tenant can be liable to contribute to by way of service charge, a tenant can find itself open to potentially large claims and requirements to contribute to sinking funds and structural repairs.

- **Break Option**

Such clauses will allow a tenant to terminate the lease on a specific date. A tenant must take extreme care with such clauses. A notice period will normally be specified (e.g. 6 months advance notice must be given) and this period must be strictly adhered to. Likewise, any conditions in the clause to which the entitlement to exercise the option is said to be subject must be complied with. Otherwise, the landlord may argue that the break option has not been validly exercised.

WHAT PRECAUTIONS CAN I TAKE TO PROTECT MYSELF?

The terms of every lease are subject to negotiation. In reality, the financial strength of the tenant and the landlord will dictate what is contained in the lease. A number of precautions we advise our clients to consider are as follows:-

- **Repair Clause /Yield Up Clause**

A thorough structural survey should be arranged at the outset by the tenant. If structural defects are identified then these elements should be excluded from the repairing obligation of the tenant.

Obviously a tenant should try to limit the extent of the property which it agrees to repair. For example, the costs of keeping the external structural walls, foundation and roof in repair are substantial.

It is advisable to have a Schedule of Condition annexed to the lease. This is a photographic survey of the property showing the condition the property was in at the point the lease commenced. It is useful if the repairing obligation is linked to this. This avoids disputes in the future and benefits both the landlord and tenant as it gives clarity on the standard to which the property must be kept.

- **Rent Review**

It is of crucial importance that the tenant retains a right to call for the rent review. In many leases this right will be drafted as being the prerogative of the landlord only. Obviously, if the rent is likely to go downwards upon a rent review, then a landlord

will not call for the review thus leaving the rent at the existing level.

The rent review clause will contain “assumptions” in respect of the property. These set out the theoretical standard to which an arbitrator or expert conducting the review gauges the property against the market rent. These need to be reviewed with care.

- **Service Charge**

Clearly if a tenant agrees an internal repairing lease then there should be an exclusion on an obligation to contribute to structural repairs or a sinking fund which could be imposed indirectly via the service charge provisions. Caution must be exercised here.

- **Break Option**

Restrict the conditions which must be complied with by the Tenant to exercise this option. In reality, it should be the service of notice only. An obligation upon a tenant to have complied with every condition of the lease at the point of serving the notice should not be accepted as otherwise, the landlord can use any issue of non-compliance as a ground for challenging its valid exercise.

CONCLUSION

The vast majority of the text of any commercial lease deals with obligations on the part of the tenant. For this reason, it is essential that tenants fully understand the import of the obligations they are signing up to. Tenants should not accept a lease purely on the basis of being told by the landlord that it is “a standard lease”. The fact is that each covenant in a lease imposes a legal obligation on the tenant and the tenant needs to understand the effect and potential liability that such clauses impose.

LEGAL NOTICE

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