

## Property leases: breaking the shackles



### Use the break clause in your lease to negotiate better terms

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Every day, SME commercial property tenants leave far too much money and value on the table and end up being locked into lease contracts having been out-negotiated by their landlords.

Research confirms that the propensity for business owners to exercise their lease break provisions has been growing sharply since 2000. In 2005, 41% of leases with break clauses saw the breaks implemented almost double the rate recorded in 1998.

The principal reason for the rise in exercising break clauses has been the degree to which a property might be over-rented. Where this is the case, 61% of tenants exercise their break options compared with 31% when the rent is at, or around, market levels. In these instances, the message is clear; the majority of businesses exercising breaks take the opportunity to reduce their costs.

Interestingly, when tenants renewed their leases, 25% were re-let at the same annual rent as was payable prior to the lease expiry. By contrast where the company left the property and the landlord had to re-let the space, this falls to 12%.

This invites the question as to what did the 39% of tenants of over-rented property do instead of exercising their break? The answer is probably nothing. By playing the captive audience, many tenants put up with the status quo and suffer reduced profitability by paying too much rent by comparison with the market.

### Negotiate hard

So what should your clients do to avoid the trap of being out-negotiated. First, they should make sure all their leases are on a database. They should have all key dates plotted to make it easy to plan ahead. And clients should plan two years ahead.

Research the local property market to establish rental levels and establish what kinds of incentives are on offer. Clients should open negotiations sooner rather than later with their landlord and, in so doing, keep the threat of the relocation option open for longer.

Clients need to be certain about their business needs and the associated space options. It's worth paying for advice that looks at the issue from all sides and establishes a clear negotiation framework a 20% saving in rent will make any adviser's fees look cheap by comparison. Clients should remain detached and very clear. If they can't get a resolution with their landlord then they must be in a position to carry through any plan to move.

### Rising demand

Rents are rising again this is most evident in central London, but there are signs of it extending into major provincial centres. In its 2007 second quarter review, the Royal Institution of Chartered Surveyors (RICS) said demand for commercial property was at its highest rate since 2001.

At the same time, incentive packages are falling breaks are slowly becoming harder to negotiate and incentives are gradually reducing in value. Vacancy rates are falling and little new space has been built over the past three years. All of this means pressures on business margins will continue.

Rather than sit around and wait for their lease to expire, there are good reasons why SMEs should be proactive in managing their property and workplace burden.

Whenever you think of property costs just remember how much turnover/revenue you need to earn to pay

for each pound of cost. The Bootle Report (2002) commissioned by the RICS asserted that British businesses were wasting more than £18bn through inefficient use of their property. A sobering thought. Taking stock of your property situation and taking advantage of lease breaks should at least allow you to toast your success.

### Leases decoded

Pressure from increasing legislation has led to improved self-regulation in the property industry with the launch this year of The Code for Leasing Business Premises in England and Wales 2007.

The code offers specific advice and guidance on the principal elements that might be found in any lease such as asking rents, break clauses, service charges and ongoing management.

For an occupier taking space, the choice to acquire a property is based on other more important things than whether the landlord follows the code. However, the code tries to simplify the wording so a lay person can understand what they might be signing up to.

Bear in mind, though, that, as a lessee, if you want to offload surplus space, then you should follow the provisions of the code in the same way any landlord should do. Your scope to change the terms of any sublease to reflect the code will be limited by the existing lease. It's worth approaching landlords to see if they will agree to a variation of the relevant terms. They should do this before they put your surplus space on the market.

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