

BUYING OR RENTING PREMISES

Buying Premises

Obviously property ownership is a major commitment. The large capital expenditure will either tie up cash which could otherwise be used to alternative effect within the company, or absorb a large percentage of your borrowing facility from your Bank or Funder. By contrast, renting involves comparatively low initial outlay and provides longer term flexibility if the business needs to move, increase or indeed shrink.

The Main Reasons for Buying

For a cash rich business property can be an investment providing a good long term return. Like so many asset classes property is cyclical and both investment values and rental incomes will vary with the cycle. However over the longer term property has always provided a good return comparative to the stock market, provided the premises are relatively standard and of a so-called "institutional " quality. The more bespoke the premises the less likely they are to provide a good investment and there would need to be other reasons for justifying the capital expenditure.

Indeed it may be the non-availability of an appropriate building that leads a company into building or buying and adapting existing premises for their own use. Over the longer term the company will pay less for their premises than had they been able to occupy under a lease and rented. For basic institutional property this is likely to be between 10 and 15 years, whereas for the more specialist properties, a period of ownership would need to be in excess of 20 years before a significant advantage would accrue.

Another reason for owning your own property can be a useful and tax efficient way for shareholding directors to either benefit from or finance their own company. In the last few years there have been a number of new ways in which company directors can put company assets into a pension scheme.

Property owning gives greater flexibility to companies. There is no landlord to answer to and the premises can be adapted or extended to suit the businesses needs. Furthermore when

circumstances change the property could be used under a "sale and lease back" to raise capital to finance alternative investments, buy additional companies, or finance growth.

Looking for Suitable Premises

Most businesses will employ a Commercial Agent to guide them through the process of identifying the right type of building and shortlisting suitable premises.

It is fairly obvious that a list of selection criteria needs to be provided to the Agent to help them sift through the available options. In our experience it is almost never possible to find exactly the right building to match all the key considerations. It is therefore best to set an acceptable band for each of these criteria or to rank them in order of priority. In our experience would-be owners rarely allow sufficient time and availability within the market at any given date will often determine the outcome.

Once a shortlist of two or three properties have been identified, your Agent can begin to discuss terms with the various vendors. Negotiating through an intermediary generally gives greater flexibility and avoids any loss of face. Your Commercial Agent will give you advice on price based on the available comparatives. This is not an exact science and is only the starting point for negotiations which will be influenced by the vendor's needs to sell, any other buyers in the market, the availability of funding, the costs of adaptation and any liabilities to be inherited concerning condition or environmental issues. You will need professional help with these issues. Gleeds can provide all the building related support you may need and we have a strong relationship with Corporate Property Partners who can provide Agency, Investment, Valuation and Ratings advice.

When draft Heads of Terms are exchanged more detailed advice will necessary to enable you to finesse the deal. At this point you would need to instruct a building survey making sure it includes advice on the cost of backlog repairs and any deficiencies from current Building Regulation or other Occupational Standards. In addition it would be sensible to obtain Environmental Reports as part of your legal Due Diligence.

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These matters can take some time and it may be sensible to ask for an exclusivity period from the vendor during which time they are prevented from selling to other parties. In a particularly buoyant market, vendors might ask for a non refundable deposit.

Renting

Rented premises can be occupied either under licence or under a lease.

Licence

A licence is probably most easily thought of as a watered down lease. The obligations upon the tenant are fewer and less onerous but equally there are less protections and a landlord can terminate a licence at short notice. Generally this form or arrangement is only appropriate for relatively short terms of occupation. A period of six months would be common but to two years is not unknown.

Many start-up companies or small office based businesses occupy premises called "Serviced Offices" which provide support services. In addition to the premises themselves, the landlord or provider may offer a common staffed reception, building security, secretarial or telephonist support together with meeting rooms for hire by the hour, IT and other facilities. Often the rental and servicing costs are bundled into a single monthly payment, the rental component of which may be higher than is normal for longer duration leased property. In effect the business pays for flexibility, being able to occupy and terminate occupation at short notice. The tenant will generally be heavily constrained, for example being unable to alter the premises at all and having no right to remain if the landlord chooses to terminate the licence. This form of arrangement can be used when premises are subject to redevelopment whilst the landlord is waiting for the necessary planning and other permissions to be granted.

Lease

A lease is generally used where a long term commitment is envisaged and is a much more complicated document. You would be wise to obtain both building surveying and legal advice before entering into any such agreement.

Leases generally last from 10 to 25 years although there has been a pattern recently of shorter lease lengths, often this is only allowed by a break clause. A break clause is an option which can be exercised by either the tenant or the landlord to terminate a lease early and is usually subject to defined and quite precise requirements. A minimum notice period is likely to be required (usually 6 or 12 months) in which time is of the essence such that if a break date is missed the next opportunity may not arise for another 5 or 10 years.

Since leases are of long duration it would be unreasonable for the initially agreed rent to be sustained throughout the period. Consequently one of the most important clauses will be the one dealing with the rent review mechanism. Rent reviews can be related to open market rent or fixed in terms of an Indicator such as the Retail Price Index or Industrial Building Index. The clause will also deal with the arrangements if an agreement cannot be reached and will probably involve the appointment of an Independent Expert or Arbitrator.

In addition to paying the quarterly rent, usually required in advance, the lease will set out your obligations for meeting service charges. These apply in multi-occupied premises and cover items such as heating, lighting, electricity, water, maintenance, insurance and security provide in common for all users by the landlord. The method of calculation is critical and should be clearly understood and recorded in the Lease Document. If you occupy a rented property as a single occupier it is more likely that you will be responsible for repairing and maintaining the premises directly together with the utility charges. In other words, these are direct costs you will need to deal with and you will not be required to reimburse the landlord. Understanding the exact arrangements and ensuring they are fair is a crucial part of any legal Due Diligence prior to taking occupation.

The headline figures are usually easy to establish and understand. Care needs to be taken in looking for hidden costs. Often repair and replacement expenditure does not fall in an even pattern. It will be important that your Building Surveyor establishes the pattern of expenditure over the preceding years together with the condition of the building immediately prior to your occupation. If major items such as boilers and roofs need

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overhaul, it may be possible to avoid funding backlog repairs which should have been carried out prior to your occupation. Alternatively it may be possible to agree a cap on the rent or service charge costs to ensure these are not transferred to you as an incoming tenant. On some buildings there may be a sinking fund to cover the cost of major repairs.

For leases of less than 10 years tenants can side-step some repairing obligations by agreeing a Schedule of Condition with the landlord prior to occupation. This will usually relate to a clause in the lease under which the tenant is not required to maintain or return the premises at the end of the lease period in "any better condition than identified by the Schedule of Condition dated *****". Your potential landlord may be able to recover for wear and tear by the outgoing tenant under a Schedule of Dilapidations. If the premises are not newly refurbished or redecorated there may consequently be a pot of money to allow you to carry out the work and often a rent free period is agreed to provide suitable compensation. Any Building Surveyor should be able to provide appropriate advice as to the right level of compensation.

Over and above matters of backlog repair, major plant replacement and dilapidations, due consideration needs to be given to any alterations you may require to make the premises suitable for your occupation. For these reasons we always

recommend a full pre-acquisition building survey is carried out (see separate advice sheet) to establish the suitability of the premises for your business and both initial alterations and planned future maintenance along with the costs of the same.

It is particularly important to consider what may happen at lease expiry or if you wish to leave early. Ordinarily the lease will be covered by the Landlord and Tenant Act 1954 which will give you the general right to renew the lease provided you have not breached any of the covenants. If the landlord proposes a lease which is "outside the Act" discuss this carefully with your legal adviser.

Even if you do not have the ability to terminate the lease before the normal expiry date, you may have the option to assign the lease or under-let to another tenant. Again the exact wording of the lease will be critical in determining your flexibility together with any liabilities you may take on to guarantee the next tenant's rental payments.

Generally speaking there will be little opportunity to negotiate a licence and much more flexibility in taking on a lease. Consequently it is recommended you hire a good solicitor and have professional advice on the building to ensure that it meets the appropriate standards and that you are not making yourself liable for unnecessary or unwarranted costs.

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