Morris
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Understanding Outgoings in Commercial Leases

What are Outgoings in Commercial Leases all about?

Outgoings are often broken up into categories of expenses:

Statutory Outgoings usually means government charges, like:

- general rates
- land tax
- water rates
- sewerage rates.

Building Outgoings usually mean the expenses for managing and maintaining the Premises or the whole Building, like the cost of:

- building insurance
- waste management
- cleaning
- security
- repairs and maintenance
- air conditioning
- property management
- even body corporate levies if the Premises is a strata property

Sometimes a Lease may require the recovery of only some types of costs within a category but not others, eg. recovery of statutory outgoings and insurance costs.

Some expenses cannot be recovered from a Tenant, such as depreciation and sinking fund charges.

Outgoings are the costs that the Owner incurs in its ownership of the property, and Owners often recover these property costs from their Tenants in part or in full, in addition to the Tenant's Rent.

Understanding Outgoings can mean the difference between a great leasing deal and a nightmare of unexpected costs.

Not all Leases recover Outgoings from the Tenant in the same way. Some Leases only ask the Tenant to pay Rent and does not require the Tenant to pay any Outgoings, other Leases have the Tenant pay all Outgoings, and other Leases still are somewhere in between.

Outgoings recovery can be a real "mix and match" of terms, obligations and costs. We break down some common Outgoings recovery methods below.

Gross Lease

If your Lease does not require the Tenant to pay any Outgoings, this is known as a **"gross lease".**

The Tenant generally only pays:

- Rent; and
- Consumption of its own utilities and expenses.

A gross lease is generally favoured by Tenants because there are no unforeseen Outgoings expenses. The Rent is paid and adjusted in accordance with the Lease, but there are no other hidden costs of occupying the Premises.

Net Lease

Your Lease may require the Tenant to pay all of the Statutory Outgoings, or all of the Building Outgoings, or both. This has the effect of passing those holding costs from the Owner to the Tenant.

A Lease which requires the Tenant to pay both Statutory Outgoings and Building Outgoings, this is known as a **"net lease".**

Statutory and Building Outgoings recovery is the most onerous form of Outgoings recovery and is often favoured by Owners because they aren't subject to any risk of increasing holding costs.

If entering into Lease which has any element of Outgoings recovery, Tenants should be provided with an estimate of Outgoings to ensure that the Tenant is prepared for their Outgoings liability.

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Leasing Terminology Demystified

Demolition clause: a right of the Owner to notify the Tenant that the Tenant must vacate because the Owner wants to redevelop the Property.

Disclosure Statement: the summary of the Tenant's obligations which must be provided at least 14 days prior to the commencement of the Lease.

Heads of Agreement: the documents which sets out the broad agreement between the Owner and the Tenant, which is agreed before the Lease itself is prepared. Read this carefully before signing!

Incentive: a bonus by the Owner to the Tenant to induce them into the Lease of the Premises. Could be rent-free period, a cash contribution or a fitout. Ask us first, as incentives have different tax treatments and may cost you!

Make Good: the works that the Tenant must do to fix up the Premises before it leaves at the end of the term. Beware and ensure you understand the make good provisions. These can come at a significant cost.

Option: when the Tenant has the right to extend or renew a Lease on the same terms as their current Lease, it's called an option period. Often paired with a market rent review.

Registration: when the Tenant's Lease is noted on the title to the Property, which protects its interest especially if the Owner sells or tries to lease the property in the future.

Rent Increases: Rent typically goes up every year, whether by CPI, a fixed amount or percentage, or in line with market ('market rent review').

Term: the length of time a Lease goes for. Not to be confused with the terms and conditions of your Lease!

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Semi-Gross Lease

Some Leases require the Tenant to pay for increases in Statutory and/or Building Outgoings (or some of them) over a Base Year, say the financial year ending 30 June of a given year.

This means that the Owner will only ever pay the Outgoings at the level they were in that Base Year.

In addition to Rent, the Tenant must pay to the Owner any Outgoings that the Owner incurs that exceeds what the Outgoings were in that Base Year.

This Outgoings recovery strategy is sometimes called a **"semi-gross lease"** or you may hear the agent talking about "increases". While not widely used nationally, this form of Outgoings recovery is relatively common in the ACT and its regions.

It can be difficult to anticipate how Outgoings will increase and therefore an estimate of the actual Outgoings that the Tenant will need to pay may not be forthcoming.

In a semi-gross Lease, while Outgoings recovery is generally less than in net leases, it is difficult for the Tenant to plan their cash flow and expenses.

Before entering into a semi-gross Lease, ensure you confirm what the Outgoings were in the Base Year to ensure the Tenant is aware of and prepared to pay those increases in Outgoings, whatever they end up being.

Tenant to Pay Proportionate Share in Outgoings

Whether net or semi-gross, the Tenant's liability for Outgoings will usually relate only to the proportion of the Building that the Tenant occupies, expressed as a percentage.

For example, if the Tenant occupies the whole of a Building, it will be responsible for 100% of the Outgoings that Tenants are responsible for in that Building.

However, if the Tenant occupies half of the Building, the Tenant should pay 50% of the Outgoings that Tenants are responsible for in that Building.

In some instances, such as shopping centres and large buildings, Tenants may be responsible for very small percentage shares of the Outgoings.

Disclosure Requirements

For Leases covered by the *Leases (Retail & Commercial) Act 2001* (ACT), Owners are required to give Tenants a Disclosure Statement which includes a reasonable estimate of the Outgoings which the Tenant must pay.

If the Owner does not provide adequate disclosure, the Tenant may not be required to pay Outgoings claimed later.

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We believe in sharing knowledge, experience and ambitions so that together we can build something bigger than ourselves and better than what came before.

Sound good? Let's chat.

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