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Commercial lease rent reviews – part 1

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Summary

One of the most important terms of any commercial lease is the one setting out how rent is to be reviewed. 'Annual CPI and market on exercise of option' is common formula for retail shops and small to medium commercial premises, but there are alternatives.

This update, in three parts over the next three weeks, looks at common and less common ways to review rent, as well as some current trends we see in review provisions.

CPI reviews

The most common form of rental review we see is one determined by calculating the corresponding annual movement in the CPI: All Groups for Sydney or Melbourne. It has the advantage of being easy to calculate and both landlords and tenants seem ready to accept it as 'fair', at least in current times of low and steady positive inflation.

Unsurprisingly, CPI reviews encounter more resistance from tenants as inflation increases and from landlords when changes in the CPI are very low or negative (in recent times, the Sydney CPI has only declined over two quarters, June and September in 1997).

Perceived inflation volatility tends to drive both parties away from CPI toward a more certain method.

Fixed reviews

Fixed annual increases have always been popular in new commercial buildings, because the landlord and its lender can see exactly what the rental income will be and budget accordingly.

There is the obvious risk that someone will end up out of pocket compared to annual CPI reviews if the rate of inflation moves away from the percentage used in the lease, but both parties benefit from the certainty of rent throughout the lease term.

Next week

Part 2 will look at market reviews and explain some of the less common jargon: ratchets, caps and collars. The following week, part 3 discusses current trends in rent reviews

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