

# What is Essential in Lease Agreements Regarding Office Space

Companies planning to lease office space, while selecting the most advantageous market offer, tend to concentrate mainly on financial lease terms proposed by developer, building location and its standard. Although, the key element in an office space lease process is a lease agreement – a document which legally regulates relations between a landlord and a tenant. It is essential to focus on many details of the agreement to avoid doubts in a future.

## Subject of Lease

It is important to determine a subject of a lease in details. Lease area includes not only office area with internal communication area, social and sanitary rooms, terraces for a tenant sole use – net office area, but also a proportional share in common areas of the building and parking places as well. Common areas of the building are areas, which are used by all tenants in the building, for example: main lobby in the building, lift lobby, some sanitary rooms, halls. To calculate a total monthly rent add-on factor, constituting equivalent of a tenant share in common areas, is added to net office area.

The lease area may be measured according to different norms, which may lead to significant differences in an office unit lease area. For example Polish Norm PN-70/B02365 dated June 30<sup>th</sup>, 1970 assumes a core and shell measurement not including plaster, but PN-ISO 9836-197 dated October 27<sup>th</sup>, 1997 assumes a measurement including plaster. More examples of such discrepancies may be listed. In our opinion it is important to clearly define a method of lease area measurement in the lease agreement.

Lease agreement shall include among others: a detailed description of unit a subject of a lease, detailed information regarding location of the unit in the building, number of land and mortgage register, plot of land number, site plan of the building and floor plan with marked unit a subject of a lease.

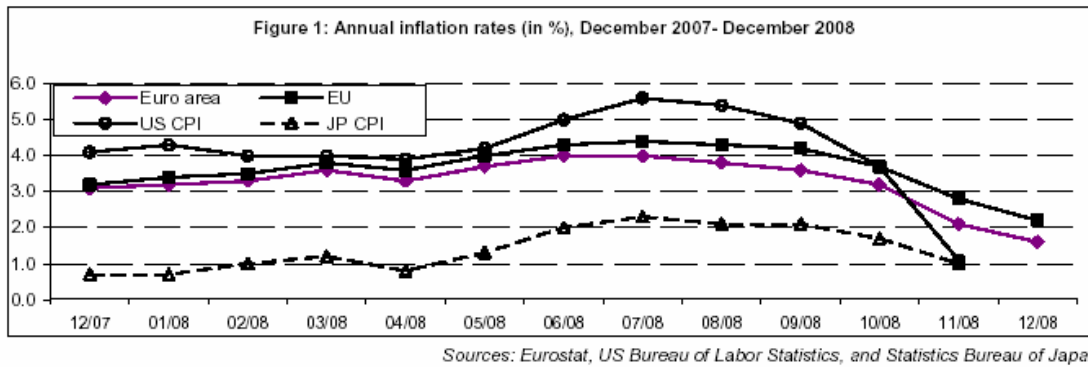
## Lease Term

Lease agreements in Poland may be signed for a limited or unlimited period of time. Class B and A office buildings accept usually minimum between 3 and 5 years lease term respectively. Beginning since 1 January 2009 companies may enter up to 30 years lease, which is a significant increase of a limited lease agreement term, comparing to earlier regulations. Recent regulations are convenient for tenants, who due to very specific expectations and needs towards a standard of space have to adapt premises to their requirements on their own cost.

## Rent and Indexation

The tenant is obliged under the lease agreement to pay the rent to the landlord. Rents in modern office buildings are usually quoted in EUR but tenants are obliged to pay an equivalent of agreed rent in PLN. To calculate the equivalent, it is a common practice on the market to use average exchange rate EUR / PLN quoted by National Bank of Poland on the day accordingly defined in the lease agreement – usually it is the day of issue of the invoice or the day preceding issue of the invoice.

The rent is usually indexed annually by the agreed in the lease agreement price index. The most common indices are Harmonized Indices of Consumer Prices (HICPs), which are harmonized consumer prices indices for member countries of European Union. When HICP is equal to 0 or less, rent usually remains on the same level and is not indexed. HICPs are used for international comparisons of inflation and are published on the monthly basis by Eurostat. In December 2008 the inflation rate in European Union was equal to 2,2 %, while in European Monetary Union countries was equal to 1,6 %.



Eurostat publishes also following indices:

- EICP (European Index of Consumer Prices for EU-15), which is an indicator of consumer prices for 15 member countries of European Union (EU-15). EICP is a weighted average of HICP indices for each of considered countries. The index had been basically calculated for 15 member countries up to April 2004 – this is the reason for naming the index EICP for EU-15. Beginning from May 2004, after European Union extension, the index is calculated basing on HICPs of 25 countries – this is the reason for naming the index EICP for EU-25;
- EEAICP (European Economic Area index for EEA), which is the consumer price index for European Economic Area;
- approximately 100 sub-indices for each member country and Norway and Iceland, with corresponding weights and weighted averages;
- Special Aggregates, which are special categories indices, for example: goods, services, energy.

### Operating Expenses

Operating expenses include costs covered by the landlord related to possession, maintenance and operating of an office building. Operating expenses in modern office buildings shall include among others:

- costs of maintenance of external / green areas, facade and roof of the building;
- fire protection and fire detection systems;
- lift maintenance;
- cleaning of common areas;
- security;
- main lobby reception services;
- waste disposal;
- water, heat and electricity supply to the building;
- insurance policies covered by landlord;
- property taxes;
- property administration and management, technical services;

- costs of maintenance, operational, renovations and repairs.

Operating expenses shall be covered by a tenant on an 'open book' basis – considering real costs covered by a landlord, for example media consumption measured by metres, or on the basis of invoices issued by sub-contractors.

The tenant is obliged under the lease agreement in modern office buildings to pay monthly pro rata payments regarding operating expenses. Reconciliation of covered by a landlord operating expenses takes place annually after end of each calendar year – usually a landlord presents to a tenant a statement regarding landlord's expenditures during reconciled year.

In case of real costs of operating expenses proves to be higher than already paid advance payments during the year, the tenant is obliged to pay a remaining sum to the landlord. In case of overpayment landlord is obliged to credit overpaid amount against future payments, or pay back overpaid amount.

### **Lease Security**

The tenant is obliged under the lease to deliver to the landlord security deposit or bank guarantee. The most common practice regarding the amount of a security is equivalent of three months payments of rent, including car parking places rent, operating expenses and VAT.

From tenant point of view, possibilities and rules of making use of the security by the landlord must be strictly regulated. In case of modern office buildings landlords expect the tenants to deliver a bank guarantee issued by a reputable bank acceptable by a landlord.

Security shall be valid over the whole lease term. A most common practice is to extend a validity of the security by an additional period of time up to three months after a lease expiry date. This practice is applied due to the fact that a landlord receives invoices for services included into operating expenses in different terms and is not able to reconcile with a tenant the costs of operating expenses at the day of lease expiry date. In case of a bank guarantee is valid for a shorter term than a lease term, the guarantee shall be regularly renewed according to payments due at the day of a guarantee extension.

The landlord is entitled to make use of the security when a tenant breaks his obligations under the lease agreement – for example: tenant does not pay the rent and / or operating expenses, tenant does not cover the costs of repairs of damages caused by him, his employees or guests, tenant does not pay contractual penalties in case of not keeping the date of return the premises to the landlord. If the landlord makes use of the security before the termination of the lease, the tenant is obliged to restore the security to the agreed amount in the lease agreement.

### **Insurance**

Both landlord and tenant shall be secured with a proper insurance coverage. The landlord shall be secured against following:

- third party insurance;
- insurance against loss and damage;
- insurance against loss of profits.

The tenant shall be secured against a loss and damage of his equipment, as well as should have a third party insurance.

### **Summary**

Above mentioned aspects of a lease agreement are basic and extremely important to take care of in order to properly regulate relations between a landlord and a tenant. We have presented

some of important regulations which should be considered before a signature of a lease agreement. At the same time different standards of lease agreements may be met, depending on a building class and landlord experience. In case of modern office buildings lease agreements are most complex and regulate many aspects concerning a lease of space, which requires wide and detailed experience field. That is why using experienced external real estate advisors / consultants may benefit with reducing tenant risks during a space lease process.