

Costs to Expect When Renting Business Premises

Introduction

This guide will explain:

- How to prepare yourself for the costs you might have to pay if you are going to rent business premises
- What types of costs are likely to be involved in renting business premises?

How to prepare

Paul Creavin, a business advisor at NWES London shares his tips. Planning ahead is crucial. Anyone thinking about renting a business premises needs to treat it as a core part of putting together their business plan:

"Think about why you need the premises and what difference it is going to make, and whether it matches the needs of the business. Through the business plan you can make a case for whether or not you take up the premises," he says.

"You need to establish what difference the premises are going to make once you get the key in the door. Think about the physical environment. Is it convenient enough to reach for clients and staff? There's no point being up a small side street if you need 24-hour access or footfall, but not everybody needs a primary site. Then you have to think about the configuration – it's a question of thinking about whether it does what you need it to do."

Affordability is the critical issue and you need to ask yourself whether you can raise the money required and pay the debt or rental payments. Do your sums to see if you can afford it. There is a risk that a business taking on premises can spend all of its money and have no working capital left, and then find that lenders aren't prepared to lend to them anymore. To avoid getting yourself into this situation, Paul advises businesses to carry out a 'liquidity analysis'. Paul also gets his clients to think about the **operational costs** of running the business and what impact taking on commercial premises might have on these:

"I get people to look at liquidity and what impact it will have on cashflow and working capital. I also look at their profitability and what impact it has on the break-even point.

"It's making sure there is enough room for the sales to dip and you can still cover your costs. A good exercise is to look at a scenario where you achieve 100% of your sales targets, then reduce that to 75%. Can you still cover your costs if you don't hit those targets or is it game over? You can even take that down to 60%.

"When I am doing a break-even analysis, if there is only the capacity for the sales to fall by 10% then I would say that is a risk. Carrying out this sort of analysis over these three levels is very useful. I also get people to do profitability forecasts. Is the core activity profitable? You need to look at all of that information."

Paul urges people to be aware of what they are letting themselves in for, and also encourages them to take professional advice, for example from a commercial property agent, accountant, surveyor, and lawyer.

What types of costs are likely to be involved in renting business premises?

Businesses are all different but here are some of the costs you need to think about:

- **Premium:** When a lease is sold there may be a premium payable. Sometimes the landlord will charge a premium. Sometimes a tenant may sell a valuable lease and charge a premium for it to the new tenant. This is called "assignment" - see our How To Guide on "Assignment and Subletting"

- **Stamp Duty Land Tax:** Tax may be payable on the purchase. If so, this will be paid by the person buying the lease. Please seek specialist advice on tax issues
- **Rent Deposit:** Sometimes the landlord might require a tenant to provide a rent deposit. This is a cash deposit, which is usually transferred to a locked account. The landlord is allowed to withdraw money from the rent deposit to cover any costs if the tenant causes any property damage or is late paying rent. If this happens, the landlord can ask the tenant to put money back to the deposit account and top it up. Normally, the tenant gets the deposit back once the lease has expired and they have complied with all obligations in the lease
- **Rent in advance:** The tenant will have to pay the rent either monthly or quarterly in advance. It is usually payable whether the landlord demands it (ie invoices it) or not. Interest and other penalty charges are usually payable to the landlord if rent is paid late
- **VAT on Rent:** VAT may be payable on rent. The tenant should keep VAT records in good order if they are able to reclaim this VAT
- **Rent Reviews:** be aware that your lease is likely to have a rent review at some point. You will need to try and budget for future increases in the rent. If the rent does go up, your business rates are also likely to increase in line with this. Please see our How to Guide "Lease length, break clauses and rent reviews"
- **Business rates:** Business rates are taxes paid on commercial premises. They are usually paid by the occupier of leasehold premises and the lease will provide that the tenant has to pay them. Local authorities issue the business rates bills each year, between February and March. Business rates are based on the annual market rent value. This valuation is carried out by the Valuation Office Agency (VOA), using other rents in the local area to calculate an average. These values are usually examined every five years and take into account the size of the property and its usage. For example, factories and shop floors are likely to have a higher rateable value than stock rooms
- **Utilities:** The tenant will have to pay the usual gas, water, and electricity bills for utilities that they use
- **Service charges:** If a business tenant is renting part of a landlord's building such as an office space, they will typically be charged for a proportion of services such as maintenance of central heating, lifts, porters, security, lighting, disposal of rubbish, gardening or cleaning of common areas. The tenant may also be charged for service costs such as parking or access roads and may have to pay these costs even if they are the only tenant. These are referred to as service charges
- **Buildings insurance:** Either the landlord or the tenant must insure the property under the business lease. In a case when the tenant is asked to insure the property, you must check whether the lease has any particular requirements regarding the level of cover, the risk covered and the name of the insured parties. Where the landlord insures the property, the tenant usually has to pay a proportion of the premium payable for the insurance
- **Other insurance:** The tenant will usually need to take out the usual insurances for public liability, accidental damage, business interruption, and so forth
- **Fit Out Costs:** The tenant will usually have to bear the significant fit out costs of preparing the property to fit their specifications and meet their requirements. These can often be very significant. Bars and restaurants in particular will have very high fit out costs. Think very carefully about how you budget these, and how you expect to get them back

- **Repair costs:** Under a commercial lease, tenants usually have to carry out repair works. Sometimes, the lease will also impose repairing obligations on the landlord. The tenant is required to keep the property in repair, even if it was not in a good state of repair at the date of the lease
- **Professional fees:** It is recommended that you seek professional advice from a surveyor and a solicitor when entering into a commercial lease. Their fees will also need to be budgeted for. VAT will be payable on those fees
- **Lease renewals:** If you have a “renewable” lease then there will be costs associated with agreeing a new lease with your landlord. See our How To Guide “The Landlord and Tenant Relationship”
- **Landlords consents:** Sometimes landlords are allowed to charge fees for their consent to alterations, assignment, and sub-letting. Those will usually be the landlords’ “reasonable” professional fees. What “reasonable” fees are may be debatable, but your professional advisors should be able to give you an idea. Confusingly these are often called ‘licences’ but should not be confused with
- **Licences such as liquor and premises licences:** these are likely to be application fees and professional costs involved in applying for any licences
- **Planning permissions:** If you need to get any planning permissions then these will also require application fees and professional fees
- **Statutory obligations including gas, electricity, water/sewerage, asbestos register:** Again, these will involve costs of having a tradesman or other specialist carry out these works
- **Dilapidations:** You should take a surveyor’s advice on this issue and also consider making provision for it in your accounts. See our How To Guide “Dilapidations”
- **Other End of Lease Costs:** At some point your lease will end, if you do not renew it. You will have, in addition to dilapidations, costs of reinstating alterations, and removing your fixtures, fittings, and other items. You may also have the costs of selling your lease or agreeing a surrender with your landlord

REMEMBER

- Before signing a commercial lease, business owners should consider the financial commitment they are making themselves liable for.
- The lease will usually outline whether a particular cost will be paid by the tenant or the landlord.
- You should always take professional advice from a surveyor and a lawyer before signing a lease.

Further support

The London Growth Hub has published this series of ‘how-to’ guides to help businesses rent or buy commercial property. [This flowchart](#) will help you identify the most relevant ‘how-to’ guides for your business.



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