



Make-good clauses have clout

Innovative commercial solutions that suit both tenant and landlord should be the goal of any make-good agreement.

Make-good provisions are found in most New Zealand commercial property leases and supported by legislation and case law.

These provisions oblige tenants to reinstate the landlord's property when the lease ends to comply with repair obligations, by either undertaking physical works or compensating the landlord with a financial settlement.

David Guy heads up the Bayleys building consultancy team which offers a full package of technical and professional services associated with all the practical aspects of acquiring, developing, leasing and maintaining property across a building's life cycle.

Guy says the team works with both landlords and tenants and has recently

acted for several major corporate occupiers who needed to downsize their existing building footprint to match their current in-office workforce needs.

Hand-in-hand with such decisions comes an appreciation of the costs involved with any make-good or reinstatement obligations on their current leased space – an important factor when looking to move premises.

"Make-good obligations can be a significant cost consideration when intending to exit a lease," he says.

"Some clients overestimate these, some woefully underestimate, while others have made no provision to address make-good costs at all which has repercussions for any potential move. For the latter, this can impact business continuity and create conflict with the landlord."

Bayleys' building consultancy team undertakes Make-Good Assessments to assist clients with strategic workplace planning and to help them develop cost-effective strategies for discharging their leasehold repair obligations.

It all hinges on the condition of the building at lease commencement and occupiers should get a detailed Premises Condition Report before signing a lease as this time and date stamps the state of the building for reference at lease end – and hopefully mitigates any friction.

"The purpose of a make-good clause is to protect the landlord from having to pay for repairs that were caused by tenant negligence or use of the property.

"In the current market, commercial landlords generally prefer financial settlements as these allow them to decide on the scope and extent of works best suited to maximise future rental returns on their property.

"Tenants, meanwhile, are keen to minimise their financial exposure to make-good claims, and in some cases



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MANAGING DIRECTOR, BAYLEYS
BUILDING CONSULTANCY

are looking to reduce their residual leasehold repair costs by assigning or sub-leasing surplus space."

Guy says occupiers and landlords need to fully understand the extent of their obligations under the lease agreement and should ensure that any make-good clauses are clear and unambiguous to reduce risk at the end of the lease.

"In our experience, landlords who haven't sought professional advice often either don't know about make-good or have little appetite to enforce it. Consequently, they may find themselves financing a much larger share of construction costs necessary to re-let their buildings.

"Experienced landlords tend to be highly aware of the value of make-good within their lease portfolio and major corporate occupiers, some of which have dedicated property teams, are well-advised and highly aware of the full extent of their leasehold repair exposure.

"However, smaller businesses are all too often blissfully unaware of the potential sting in the tail that waits at the end of their property lease."

In Guy's considerable experience in the property market here and abroad, "reasonable" make-good claims settle relatively quickly. However, when either side takes an "unreasonable" stance, the matter can become unduly lengthy and expensive.

"Property leases generally include provisions for dispute resolution, but our view is that these are often the wrong tools to resolve make-good disputes. They are expensive to implement and take a long time to reach a conclusion.

"With the right advice, fair and reasonable make-good settlements can be agreed in good faith. These should include innovative commercial solutions that fit the needs of both parties."

Tenants are generally obligated to remove all property belonging to them on exit, and to leave the space tidy and



clean. Beyond this, they would likely be expected to repair any damage caused while in occupation, and reinstate fixtures, flooring, partitions etc that may have been removed by them at the time of occupation.

When occupiers install a bespoke fitout tailored exclusively to their line of business, having premises returned to original condition in a timely manner is crucial for landlords who generally need to re-enter the leasing market to secure a new tenant. In some instances – like the industrial logistics sector or hospitality, there may be some advantage to the landlord in retaining some of the infrastructure for a new occupier and negotiating a cash settlement with the vacating tenant.

SECTOR NUANCE

In the industrial leasing market, Bayleys national director industrial and logistics, Scott Campbell says the capital outlay involved in racking and office fitout can be a significant handbrake for a new occupier hence some landlords may consider cash-out settlements.

“Some building owners are prepared to negotiate with the outgoing tenants to take over the racking and office infrastructure to make the property more attractive to the leasing market when it is advertised. In some cases, they lease the racking back to a new occupier as an income strand.

“Ordinarily under a make-good clause, all racking, plant and machinery would be removed, flooring returned to original, and any office space associated with warehousing reinstated to the condition it was in at lease commencement.

“If prepared to negotiate with the landlord, the occupier can exit without having to pay removal or make-good on racking bolt holes and the like, which can be costly.



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SCOTT CAMPBELL
BAYLEYS NATIONAL DIRECTOR
INDUSTRIAL AND LOGISTICS



“This does rely on a tenant being fully across costings but for some, freeing themselves of any physical make-good works is worth it solely for the time saved when navigating an exit from one property and a move to another.”

Bayleys national director retail, Chris Beasleigh says the level of make-good in the retail leasing market generally depends on the type of retail business involved and the degree of fitout specialisation.

“For more bespoke retailers, a lease is likely to contain a detailed make-good provision as any fitout installed may be of no use to another occupier, and would limit the retail tenancy’s appeal in the rental market.

“However, for hospitality venues like restaurants, an allowance may be made to leave the extraction, kitchen and bathroom fitout in place as they could be used for the next tenant.

“Likewise if a tenant puts in air conditioning, that may be agreed to be left in after the tenant leaves.

“So there’s no set rule in the retail space, however, any fitout that could benefit the landlord and a new occupier seems to be a negotiable point on exit.”

Bayleys is currently marketing the former Burger King Albany premises located at the coveted intersection of Apollo Drive and Rosedale Road for sale or lease, with partial fast-food business fitout in place.

“With Burger King rationalising its North Shore presence given it has multiple stores in the same catchment, there’s an opportunity for an owner-occupier or investor to scoop up the building which has enviable profile and visibility and is well-poised for another drive-through fast-food operation or conversion to a restaurant or other food and beverage facility.

“While the fixed chairs, tables and kitchen equipment will be removed, they are leaving in the restroom



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CHRIS BEASLEIGH
BAYLEYS NATIONAL
DIRECTOR RETAIL

amenities, walk-in fridge, ceiling, lighting and extraction so it’s largely good to go for a new occupier to rebrand and start business.”

In the office space, Bayleys national director office leasing, Matt Lamb says the trend towards occupiers wanting turn-key, fully-fitted office space is largely negating make-good obligations as the fitout belongs to the landlord.

“Naturally, fair wear and tear provisions still apply with any make-good generally around patch and paint to blemished walls.

“The cost of fitout to an occupier is really driving demand for plug-and-play space that is fully kitted-out and is seamlessly transferrable to a new tenant.”

INDEPENDENT CONSULTANCY

Platform Group provides independent project advisory for a wide range of clients and specialises in commercial office, workplace design and independent project/cost management services.



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MATT LAMB
BAYLEYS NATIONAL DIRECTOR
OFFICE LEASING

It takes an end-to-end approach and Platform’s managing director, Jeff Cowan says he’s currently working with multiple corporate clients consulting on workplace solutions that seamlessly integrate and align with each individual company’s business and property objectives.

“Communication and engagement are key and through a collaborative approach incorporating workshop sessions, the Platform team drills down into the company’s primary goals and objectives relating to their current and future special requirements. This is supported by a process and programme linked to the tenants’ commercial objectives.”

Platform works with a combination of both tenants and landlords. For relocating tenants, Platform can support the assessment of any liabilities with their existing tenancy including costs associated with physical works needed to be undertaken in accordance with their original lease make-good or reinstatement obligations.

“As third-party advisors, we can clearly assess obligations under the lease to support parties’ agreement on works to be fulfilled, or suggest an amicable cash settlement arrangement which is an increasingly preferred option.”

“Generally it comes down to the original lease documentation from day one of the tenancy agreement which should outline clear obligations and responsibilities between the parties, but sometimes there are grey areas.

“Some leases are very onerous on the tenant and have Premises Condition Reports and plans attached. But although they can appear very detailed, phrases like ‘fair wear and tear’ are still open to interpretation.”

Cowan says as a generalisation, when a lease ends, tenants will tend to take a conservative position on costs to reinstate, while landlords would take what he calls an “optimistic” approach.

“Somewhere in the middle is where agreement will be reached, but generally, the landlord would be looking to have the premises returned to base build open-plan as at day one of occupancy and this would be documented with a plan or schedule attached to the lease.”

It is important to note any residual value and quality of the tenant’s existing fitout which could benefit the landlord when looking to re-lease the space and while subjective, is something both parties need to consider, says Cowan.

“If the tenant has had a significant lease term and the fitout is somewhat dated and inflexible, then it’s less likely there’s residual value for the landlord in terms of its intrinsic worth to new tenants.

“Over the last four-to-five years, we’ve seen tenants tending to negotiate a nil reinstatement commercial position relating to reinstatement obligations at lease commencement – dependent on the



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JEFF COWAN
MANAGING DIRECTOR,
PLATFORM GROUP

grade (A, B or C) of the building and length of term.

“Cash settlements are more likely for A-grade space with modern fitout suited to today’s working styles that could easily transfer to an incoming occupier, whereas a landlord would tend to want the occupier to fund reinstatement to base build for a C-grade tenancy.”

Cowan says it’s important that all parties have a pragmatic and practical approach around CAPEX on the asset.

“I don’t believe there’s any existing tenancy that would suit any one incoming tenant absolutely perfectly, and feel any existing fitout would be modified by around 40 percent, with the balance retained as residual value – excluding soft fitout.

“Design-wise, we also work to maximise integration of the landlord’s base build and any planned fitout as there could be cost savings in the vicinity of 25-30 percent to be realised by coordinating planned services into the landlord’s base build programme and this applies to both new and existing properties.

“It really doesn’t cost the landlord more and especially on large tenancies of more than 1,000sqm, there are some significant efficiencies of time and cost if services integration is optimised.”

As referenced by Lamb of Bayleys earlier, Cowan notes a swing to landlords providing full turn-key or plug-and-play fitout packages for smaller tenancies with all-inclusive leases negotiated largely on sqm occupancy making it easy for a tenant to move in without worrying about upfront CAPEX other than furniture, data and power.

“The other trend is more corporate backfill space available in the leasing market – in the 1,000-4,000sqm range – and there is undoubtedly residual value in existing fitout to an incoming tenant where a cosmetic refresh may be all that’s needed to customise the space to their requirements.”

