**CPI Rent Reviews in Commercial Leases**

Recently, there has been a change in leasing practice and it has become more and more common for rent reviews of commercial leases to be linked to movements in the Consumers Price Index (“CPI”).

Previous versions of the Auckland District Law Society’s (“ADLS”) Deed of Lease have provided for a change of rental to be calculated by way of a review of the current market rent. For example, the rent review process set out in clause 2.1 of the ADLS’s Fifth Edition (2008) Deed of Lease allows either the Landlord or the Tenant to give notice no earlier than three months prior to the rent review date, and no later than the next rent review date, specifying the annual rent proposed as the current market rent as at the rent review date.

The party who receives the notice, within 20 working days, give a notice of objection, disputing the rent proposed. However, if the party who receives the notice fails to give a notice of objection within the specified time, that party is deemed to have accepted the proposed rent. If no agreement can be reached, the new rent will be determined by arbitration, or if both parties agree, by registered valuers acting as experts.

An alternative to a market rent review is a CPI rent review.

Increasingly landlords will prefer a CPI rent review over a market rent review because it provides certainty as to annual rent increase and reduces the cost of the process due to the fact that a valuation is not required. A CPI rent review is less likely to result in disputes as the figures are given by the Department of Statistics and the calculations are uncomplicated. It also removes the chance of disputes over what constitutes the current market rent of a particular property.

One concern with a CPI rent review is that it simply ensures that the rent increases in line with general inflation. It will not take into account any increase in property values in the market that is greater than the CPI, meaning the CPI adjusted rent could end up being less than the true market rent.

The ADLS’s Sixth Edition (2012) Deed of Lease makes it possible to employ a combination of both a market rent review and a CPI rent review. For example, a Landlord could elect to have a CPI rent review every three years and a market rent review on renewal of the lease. This would provide some level of protection for the Landlord in the event that an imbalance develops between the CPI adjusted rent and the true market rent.

The CPI rent review contained in the most recent ADLS Deed of Lease allows rent to be adjusted on the basis of increases and not decreases in CPI using the mathematical formula set out in clause 2.5 of the Deed of Lease. Outside of the ADLS’s standard form Deeds of Lease, there are a wide variety of other formulae currently in use. For example, some formulas specify that CPI be capped at a certain percentage, some formulas provide that CPI be plus a certain percentage or margin, some formulas state that CPI be calculated on a compounding basis and some formulas are based on CPI but incorporate a turnover component. For non-standard ADLS rent
review clauses, it is worthwhile ensuring that the formula being used is mathematically correct. Examples have been found where the formulas have not been typed accurately causing a CPI adjustment formula not to allow any increase.

Govett Quilliam acts for a number of commercial property owners locally and nationally. Our team is experienced in the preparation, drafting and review of commercial leases including rent review mechanisms. If you have any questions about this article please feel free to contact Ross Fanthorpe or any other member of our Commercial division.

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