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The ins and outs of a commercial lease deposit

Written by eProperty News

A deposit is a predetermined sum of money which a tenant is required to pay the landlord before taking occupation of any commercial premises.

“This deposit is kept by the landlord to serve as security during the period of the lease,” says Leon Breytenbach, National Manager of the Rawson Property Group’s commercial division. It is kept in the event that the tenant defaults on the rent, fails to pay an operating service or municipal account, or causes damage to the property.

Specified deposits

Commercial property deposits are higher than residential property deposits. “The current industry norm is that the tenant pays only one undefined deposit amount to be used for any or all of the three scenarios mentioned,” Breytenbach explains. However, best business practice would suggest three separate, specified deposits provided: one for rental, one for damages and one for services. This would prevent the landlord from using the whole deposit on one of the three possible payment defaults.

In the event that the landlord needs to utilise a portion of one of the deposits, the tenant would be required to replace the amount, thus ensuring that a full deposit is available at all times for any future default or repair. It would be necessary to include a clause in the lease contract outlining the three separate deposits as well as their specific purposes. Another reason to distinguish between the deposits is because different deposits may take different amounts of time to be reimbursed at the end of the lease.

How is the deposit determined

The deposit amount is usually determined based upon the monthly rental for the property. It may, for example, be set at the value of two month’s rental. However, the final amount will ultimately be decided upon between the tenant and the landlord. In most lease agreements, there is a rental increase which commences after the first 12 months. This means that once the escalation of the monthly rental amount has taken place, the deposit, equivalent to two month’s rental, will need to be topped up by the tenant in order that the full deposit is held in reserve. “It is important that this top up is agreed to by the tenant and stipulated in the lease agreement” Breytenbach advises.

Interest on the deposit

The commercial and residential rental markets are distinctly different in the way in which they deal with interest accrued on a tenant's deposit. In the residential market, a landlord is obligated by law to place the deposit received from the tenant into an interest-bearing trust account.

At the end of the agreement he must return the deposit as well as the accrued interest to the tenant, presupposing there was no damage to the property. "In the commercial rental market, the landlord is required to keep the deposit in a trust account," explains Breytenbach, "but there is no legal requirement to reimburse the interest which was accrued on the deposit." Though this is common, it is recommended as best practice that provision be made in the lease for the return of both the deposit and the interest thereon.

Return of the deposit

In the final month of the lease agreement the tenant may not decline to pay the monthly rental as a means of recouping his deposit. "The timeline for the return of the deposit must be defined in the lease agreement," Breytenbach explains. However, a factor which could impact upon when the deposit will be returned is whether the property is in a satisfactory condition at the end of the lease. If part of the deposit is needed to restore the property to its original condition, be it due to damages, or if services or municipal accounts have not been paid by the tenant, some or all of the deposit will need to be utilised to settle these costs.

A carefully constructed lease agreement is essential to the landlord and the tenant. Both parties must fully understand every part of it as well as agreeing to specific clauses such as those referring to rental or deposits. This will minimise the chance of misunderstandings occurring at the end of the lease, allowing for an amicable parting of the ways.