

Australia

The Immigrant's Guide to Retail



Hymie Zawatzky

HYMIE ZAWATZKY

AUSTRALIA THE IMMIGRANTS GUIDE TO RETAIL

VOLUME 1

- **BUYING INTO A RETAIL FRANCHISE**
- **SIGHT SELECTION FOR A STORE IN A FREE STANDING TENANCY**
- **NEGOTIATING A LEASE TO OPEN YOUR OWN STORE**

Hymie Zawatzky was himself an immigrant to Australia. His first hand experiences in gaining credibility in a new country led him to write “*Australia - the Immigrants Guide*”, distributed in numerous countries.

His current series of guidelines for the potential immigrant seeking to open and run a retail business in Australia has been divided into 3 volumes.

- Volume 1 deals with the decision to go into a retail business in a new country
- Volume 2 deals with managing the business and keeping it successful
- Volume 3 deals with selling or handing over the business to your family

Copyright © Hymie Zawatzky 2011.

All rights reserved. No part of this book may be reproduced or transmitted in any form or by any means, electronic or mechanical, including photocopying, recording or by any information storage and retrieval system, without prior permission in writing from the author.

NOTE:

This is a guide. It is not a substitute for obtaining legal advice about your lease, finances or taxation. Nor is it a replacement from a qualified financial advisor. You are encouraged to seek such legal and financial advice where necessary

DISCLAIMER:

At the time of going to press, all information in this book was accurate as the author was able to ascertain within reason. All references to private or state organisations are gratuitous and the author has no financial interest in them and does not stand to benefit from them in any way

First Published in Australia in 2011 by
Veritax Business Consultants Pty Ltd
16 Eildon Street
Doncaster Vic 3108
Australia

Website: www.placeofbooks.com

Cover Design by BookPOD
Cover images by iStockphoto

ISBN: 978-0-9871340-0-4

A Catalogue-in-Publication is available from the National Library of Australia.

To my wife Joan

TABLE OF CONTENTS

INTRODUCTION	11
PREFACE	13

PART 1 FRANCHISING

CHAPTER 1

WHAT IS A FRANCHISE?	19
----------------------------	----

CHAPTER 2

THE ADVANTAGES AND DISADVANTAGES OF OPENING A FRANCHISED RETAIL BUSINESS	23
---	----

CHAPTER 3

FRANCHISEES AND FRANCHISORS - THEIR LEGAL RIGHTS AND OBLIGATIONS.....	27
• FEDERAL LEGISLATION:.....	27
• DOCUMENTS THE FRANCHISOR MUST GIVE THE FRANCHISEE:	28
• WHAT ARE THE FUNDAMENTAL CONDITIONS OF A FRANCHISE AGREEMENT?	28
• WHAT ARE THE MAIN ISSUES COVERED BY THE DISCLOSURE DOCUMENT?.....	34

- RECENT NEW AMENDMENTS TO THE CODE 39
- DISPUTE RESOLUTION AND COSTS OF MEDIATION (UNDER THE NEW CODE AMENDMENTS)..... 41

CHAPTER 4

THE FRANCHISEES CHECKLIST - BEFORE PROCEEDING WITH THE PURCHASE OF A FRANCHISE 47

PART 2
SITE SELECTION FOR A LEASE FOR A STORE
IN A FREE STANDING TENANCY

CHAPTER 5

SITE SELECTION AND POSITION (IN STRIP CENTRES AND STAND ALONE SITES)..... 55

PART 3
THE DO'S AND DON'TS OF NEGOTIATING A
LEASE IN A SHOPPING CENTRE

CHAPTER 6

THE BASIC FUNDAMENTALS OF A LEASE AND WHO ARE THE PARTIES TO A LEASE..... 61

CHAPTER 7

THE LAW RELATING TO RETAIL TENANCIES IN AUSTRALIA..... 67

CHAPTER 8	
WHAT TYPES OF LEASES WILL YOU HAVE?	69
CHAPTER 9	
HOW WILL THE SIZE OF THE PREMISES AFFECT THE LEASE?	75
CHAPTER 10	
IN WHAT NAME SHOULD THE LEASE BE ENTERED INTO?	79
CHAPTER 11	
RENTAL CONSIDERATIONS	81
CHAPTER 12	
HOW TO ADMINISTER THE LEASES IN YOUR PORTFOLIO	85
CHAPTER 13	
OUTGOINGS CONTROL AND MANAGEMENT	89
CHAPTER 14	
DISCLOSURE STATEMENTS	111
CHAPTER 15	
ADMINISTERING THE FIT OUT OF THE PREMISES	125

CHAPTER 16
ADMINISTERING TURN KEY PROJECTS 133

CHAPTER 17
OPTION RENEWALS AND EXERCISING YOUR OPTION
UNDER THE TERMS OF THE LEASE 135

CHAPTER 18
RIGHT TO RECEIVE COMPENSATION FROM A
LANDLORD IN A SHOPPING CENTRE IF YOUR TRADING
ACTIVITY IS DISRUPTED BY THE ACTIONS OF THE
LANDLORD 139

CHAPTER 19
LEASE IMPLICATIONS OF UPSIZING THE PREMISES ... 143

CHAPTER 20
RELEF AGAINST FORFEITURE OF THE LEASE WHERE A
LANDLORD LOCKS OUT A RETAILER..... 145

CHAPTER 21
SOME ADDITIONAL TERMS AND CONSIDERATIONS
THAT COULD BE INCLUDED IN LEASE OFFERS 147

CHAPTER 22
SOME ADDITIONAL ADVICE DEALING WITH A
LANDLORD IN AN ECONOMIC DOWNTURN..... 155

CHAPTER 23
PURCHASING A NEW STORE AND TAKING OVER AN
ASSIGNMENT OF THE LEASE FROM THE EXISTING
TENANT OR ASSIGNING YOUR LEASE TO A NEW
OPERATOR..... 157

CHAPTER 24
WHAT CONSTITUTES RETAIL PREMISES SO THEY FALL
UNDER THE PROTECTION OF THE RETAIL LEASES ACT
IN VICTORIA?..... 161

CHAPTER 25
WHO IS RESPONSIBLE FOR PAYING THE LEGAL COSTS
IN PREPARING A LEASE AND THE STAMP DUTY ON
SUCH LEASES?..... 177

CHAPTER 26
CHECKLIST OF TENANTS RIGHTS UNDER THE RETAIL
LEASES ACTS AND OTHER PROTECTION UNDER THE
VARIOUS STATE ACTS 181

CHAPTER 27
SELLING THE BUSINESS AND USING YOUR RETAIL
LEASE TO MAXIMUM ADVANTAGE..... 193

GLOSSARY OF TERMS 197

INTRODUCTION

Many new migrants arriving in Australia have gone on to open retail businesses and become part of the successful retail scene. However, some small businesses have found themselves in financial difficulties, not due to lack of hard work on the part of the franchisee or independent owner, but through a lack of understanding of the basic requirements of running a small business in Australia.

Over the past 20 years in my role as a business consultant, I have assisted new migrants with their lease negotiations with landlords in shopping centres, strip centres and in the CBD. I have also assisted large companies in setting up retail franchises. I am, therefore, familiar with the problems facing franchisees and the pitfalls they face in deciding to go into the retail market. I have tried to use my vast knowledge and experience in this area of business, as a source for writing this series.

Use this book as a guideline to ensure that your business does not fail. We are living in tough times, tougher than we have seen for many years. No new retailer can take any aspect of his business for granted. To survive in this current climate, each stage of your business venture, must be given your close attention. Each aspect must be carefully monitored, from negotiating your lease to managing the business, and perhaps selling it one day to go on to other business ventures.

This book is being written in the hope that it will help new citizens to our country, make a good start to their new life in Australian retail business.

PREFACE

Migration to Australia and the opening of retail businesses by migrants has been one of the driving factors in the growth of the Australian retail sector. The well-known Myers Department Stores, founded by Russian migrant Sydney Myers, is a typical example.

Many migrants to Australia, with qualifications or without, have gone into retail businesses as the only way of survival. This is what they know from their countries of origin or what they turn to as their best option. Once they have established themselves, some migrants have bought the property in which their stores are located, while others even venture into property development.

Many overseas companies have brought their skills and retail experience from their own home countries to Australia. These include chains like McDonalds, Starbucks, Footlocker and Aldi Supermarkets.

Retailers have traded successfully in the City and in strip centres along the main roads of our sprawling suburbs. In the 1960s and 1970s shopping centres become very much part of the Australian shopping experience. Many retailers, including new migrants, moved away from strip centres in the suburbs to shopping centres. Nowadays, retailers have a choice as to the location of their businesses, with some retailers trading equally successfully in a strip centre. Suburban strip centres have become pleasant places to shop, with adequate parking facilities provided by the local council

Unless you own the property, the fundamental document that allows you to enter into retail business, is the retail lease, which

you enter into with the landlord. However the intricacies of negotiating a lease and determining whether you can make a living from a retail business, is no easy task for a newcomer!

The new migrant, hoping to sign a lease with a landlord may run into all sorts of unforeseen problems. The landlord could have difficulty evaluating the new migrant's retail experience, with that of other retailers in Australia. Expectations of both parties may differ, so that in the end the landlord may refuse the migrants application for a lease.

If a new migrant wants to go into a retail business, these are the options open to him:

- Take up a franchise with one of the many retail franchise businesses currently operating in Australia.
- Find a shop in a relatively busy shopping centre where the landlord is prepared to accept his overseas retail experience
- Open a store in a strip centre or on a freestanding site.

In this book we will look at the impact of the new migrant's decision and the traps, legal implications and leasing pitfalls to be avoided.

The purchase of a franchise is very much determined by the franchisee's rights as contained in a number of legal documents.

Before we sign a legal document, we should all read the fine print. The franchisee needs to know and understand all the implications of the franchising agreement and disclosure statement. Often it is worth seeking advice if you are uncertain of meanings or implications of what is in these documents. Better safe than sorry, where your money and your family's welfare are concerned.

It is worth your while taking the time and the effort to acquaint yourself with the details of your franchise, before you sign the documents, as they have been described in this book. It is always best to be knowledgeable and to be on the winner's side. Remember that knowledge is power, and power will be your strength in your negotiations with a franchisor.

There are many cultural values and philosophies that migrants bring from their countries to Australia, all of which help them succeed in retail. The Confucian values of hard work, self discipline, delayed self gratification for the sake of long term benefits, frugality, a high importance placed on education, xiao-sun or filial piety of total obedience and reverence for ancestors and parents, are important in entrepreneurial success also in Australia.

To assist readers in understanding the legal and accounting terms used in the book, a glossary has been included.

PART 1

FRANCHISING

CHAPTER 1

WHAT IS A FRANCHISE?

A franchise can be defined as a business arrangement, which allows a business to operate under an established brand name.

The franchisor that owns the brand name, grants the franchisee wanting to set up the business, the right to sell the brand name product.

The arrangement is contained in a franchise agreement, which sets out the terms of the arrangement.

Disclosure Statement

Before a franchise agreement is signed, a franchisor must always provide the franchisee with a disclosure statement. There are two types of disclosure statements:-

- The Long Form Disclosure statement where the franchisee expects to have an annual turnover of more than \$50000 at any time during the franchise agreement
- The Short Form Disclosure statement where the franchisee expects to have an annual turnover of less than \$50000 at any time during the franchise agreement

Talk to a lawyer or consultant about which document applies in your circumstance.

The disclosure statement and the agreement, as well as the conduct of the ongoing arrangement between the parties, is governed by the Franchising Code of Conduct. The code applies

to all franchises made, renewed or transferred after 1 October 1998.

A number of important issues were raised by franchisees with the Australian government about the code and the difficulties they were experiencing. The federal government of Australia then undertook a substantial review of the code, and as a result, major amendments now apply to any franchise agreement entered into, renewed, transferred or extended after 1 July 2010. We will look at these in more detail in Chapter 3.

Remember the franchising Code of Conduct makes it compulsory for a franchisee to obtain proper financial advice before signing the agreement.

Franchise Costs and Fees

Before deciding on entering a franchise agreement, look at the costs involved, very carefully. You may find that there are far more additional costs than you expected.

Franchisors charge the franchisee a once-off charge to buy the franchise and then either directly or indirectly, a fee for the use of their brands and to participate in their systems.

Franchise up-front and set-up costs can vary from \$10,000 to \$1million depending on the type of business, size of premises, the cost of stock to be held and the fitting out costs.

Some franchises are set up in the form of a sharing of profits basis, where the franchisor may retain 50% of the company, in exchange for 50% of the profits of the franchise. Often the franchisor will be responsible for paying the rent of the store as part of the profit sharing arrangement. This method reduces the initial going-in cost to the franchisee.

Franchisees are usually asked to pay an ongoing fee for franchise support, which may be a percentage of sales or a fixed amount. Fixed amounts can be from \$100 per month, while percentage fees also known as royalties, may range from 2% to 15% of sales, plus a further marketing percentage of sales, to cover the costs of marketing the franchise.

Other franchise costs could include an in-store display fee, particularly for fashion or footwear franchises, or even a computer fee for producing a monthly comparison of the performance of your franchise, against the performance of other company owned stores.

To cover such “extra” franchising costs, it is essential that your business plan must show that the franchised business will have to earn additional gross margins, over and above the normal margin, for similar retail businesses, which do not have any franchising costs.

CHAPTER 2

THE ADVANTAGES AND DISADVANTAGES OF OPENING A FRANCHISED RETAIL BUSINESS

Often, new migrants with sufficient cash resources, and many years of retail experience in their home countries, find themselves frustrated in dealing with the major landlords. As an alternative, they take the route of going into retail business by way of franchising.

In such an instance, the franchisor that owns an Australian established company with a retail record, and is known to most landlords, holds the lease, and enters into a franchising agreement and licensing arrangement with the franchisee.

There are a number of advantages and disadvantages of taking this route to opening a retail business.

Advantages:

- You have the right to use an *established* trade name in comparison to the cost of establishing your own name or brand.
- There is an immediate entry into the market.
- Your product is more likely to receive public acceptance.
- The franchise is usually a proven business model with a complete franchise format.

- You will receive adequate training from the franchisor and his staff, which will give you a good grounding, especially if you have not been in that area of retail previously.
- Your business will usually form part of a national advertising program that is likely to benefit your sales. As indicated earlier, this comes at a cost and you may have to pay a contribution such as a percentage of sales, to such a program.
- The franchisor will have established reliable sources of supply and group purchasing through the network and this will result in better bulk discounts for you.
- There is always on going support if you run into difficulties.
- If you have to sell your business, it could be easier than anticipated as the franchisor may have a pool of potential franchisees wishing to buy an established business.
- The franchisee has already done sufficient research to gauge whether the franchised store will work in a particular location or shopping centre.

Disadvantages:

- As you will be bound to a franchisor for the term of the franchise agreement, that can be up to 5 years or more, it is essential that you find a franchisor that is both competent and ethical.
- Not all franchises are soundly based or well run. Speak to a number of other franchisees and canvass their opinions about the franchise and the franchisor.
- Be aware that some established retailers may use franchising as a way of unbundling stores from their network that are not performing well.

- Business failures by franchisors can bring unbelievable pain to franchisees. They may find themselves left in a business without a lease, as the landlord has withdrawn the lease from the failed franchisor. Renegotiating the lease directly with the landlord into your name may be very costly.
- You will be bound by the strict format of running a business with little scope to buy products outside the established product range.
- Regular checking by the franchisor's monitoring staff on how you are doing may become intrusive in what is essentially your business.
- As indicated earlier, many franchising systems include charges for display, advertising, administration and IT information, which the franchisee may feel is not required. Nevertheless the costs of these services will continue for the term of the agreement.
- Bad performance by other franchisees in the retail network may adversely affect your business reputation.
- A number of franchises are financially constructed in such a way that the family has to become fully involved in the business, but there is no adequate salary compensation for spouses and children who may be working part time.
- There is no guarantee that the business will work in your particular franchised region or shopping centre.

Despite the above comments, Australia has a very successful franchise retail sector. It is well regulated with good trade practice legislation and an ever improving code of conduct aimed at giving people a fair chance to succeed.

In taking this route to a retail business, the new migrant is likely to be more successful if he takes a franchise in an industry that he knows from his home country, as this will ensure that the transition is as easy as possible. It is also advisable to select the sort of franchise where he is most comfortable and confident and suits his personality.

If you do not have an outward going personality and do not relate easily to new people, it may not be in your best interest to take up a food or restaurant franchise that requires constant interrelationship with customers.

As more and more retailers are franchising their businesses and selling franchisees to new migrants, it is important for the migrant retailer to understand the legal position regarding franchisees in the various states.

The rights of franchisees with regard to their leases have now, in a number of states, been incorporated into retail tenancy legislation. This protects new migrants and others. It is essential then that the franchisee is aware of his rights under the legislation.

CHAPTER 3

FRANCHISEES AND FRANCHISORS - THEIR LEGAL RIGHTS AND OBLIGATIONS

Most countries with franchise regulations or legislation often require disclosure by the franchisor to potential franchisees. It is the same in Australia

The franchisee and the franchisor both have rights and obligations under Federal as well as State Legislation. We will now look at these rights:

FEDERAL LEGISLATION:

The federal legislation governing franchising is contained in an act known as the **Trade Practices (Industry Codes – Franchising) Regulations 1998** which incorporates the Franchising Code of Conduct.

Every franchisee or proposed franchisee needs to obtain a copy of the code either from the franchisor or from the **Office of Drafting and Publishing Attorney-General's department Canberra Number (F2010C00457)**

The fundamental documents in any franchise arrangement are the franchise agreement, the disclosure statement and the franchising code.

We will now look at these documents in more detail and see what they contain and how it protects the franchisee.

DOCUMENTS THE FRANCHISOR MUST GIVE THE FRANCHISEE:

The franchisor must give the franchisee:

- a disclosure statement
- a copy of the franchise agreement, in the form it is to be executed and
- and a copy of the code

The disclosure statement must be given at least 14 days before the franchisee either enters into the franchise agreement, or pays any non refundable money to the franchisor or his agent or associate.

The franchise disclosure statement must also be given to a franchisee proposing to renew or extend the term of the franchise agreement.

If the franchisee makes a written request, the franchisor must provide the franchisee with a current disclosure statement within 14 days of **their written** request. Remember that a franchisee can request a disclosure statement only once in any 12 month period.

WHAT ARE THE FUNDAMENTAL CONDITIONS OF A FRANCHISE AGREEMENT?

The code prescribes a number of specific conditions that must be included in all franchise agreements. These are as follows:

COMPULSORY CONDITIONS COVERING:

A Cooling off period:

- The code provides that a prospective franchisee is entitled to a cooling off period of seven days after entering into a franchise agreement (this is not the case of a renewal extension or transfer of the franchise) or making any payment under the agreement whichever occurs earlier.
- If the franchisee terminates the agreement during the cooling off period he is entitled to a refund of all payments less any reasonable franchisor's expenses (which must be spelt out in the agreement) within 14 days.

Membership of franchise associations

- The franchisor is prohibited from preventing franchisees forming an association with other prospective franchisees for a lawful purpose.
- It is unlawful for franchisees to meet and make a contract or arrangement or arrive at an understanding for the purpose of fixing, controlling or maintaining the price that they will charge for goods and services.

A clause which prohibits the inclusions of any general "release from liabilities" by the franchisor or the release of waivers of representations" given to the franchisee by the franchisors during negotiations

- A franchise agreement must not contain or require a franchisee to sign a statement that releases a franchisor from general liability towards the franchisee.

- A franchise agreement entered into after 1 March 2008 must not contain or require a franchisee to sign a waiver in respect of any verbal or written representation by the franchisor.

Franchisees right to transfer or novate a franchise agreement

- The code provides that a franchisee has the right at all times to transfer or novate a franchise agreement. The request to transfer or novate must be in writing and the franchisor may not unreasonably withhold consent.
- The only reasons that a franchisor can withhold consent is if:
 1. The transferee is unlikely to meet the financial obligations of the agreement.
 2. The transferee does not meet a requirement of the agreement.
 3. The transferee does not meet the franchisors selection criteria.
 4. The transfer will have an adverse affect on the franchise system.
 5. The transferee does not agree in writing to comply with the obligations under the franchise agreement.
 6. The franchisee has breached the franchise agreement and has not remedied the breach.
- The franchisor is deemed to have consented to the transfer or novation if he does not object to the transfer within 42 days of the written notice
- Whilst the franchisor has the right to exercise his discretion in objecting to a transfer or novation, he may not be permitted to act unconscionably in the exercise of his discretion

Renewal of the agreement when it expires

- The franchisor is not obliged to renew the franchise agreement when it expires, unless there is an option for a further period and the franchisee exercises the option as per the requirements of the agreement.
- However, if the agreement runs for more than 6 months, the franchisor must notify the franchisee as least 6 months before the end of the term of the franchise agreement whether it will be renewed or not. If it is to be renewed, then enter into the new agreement with the franchisee
- If the agreement is for less than 6 months then 1 months notice is required

Termination of the franchise agreement

- The franchising code sets out specific requirements where parties seek to terminate a franchise agreement. These essentially cover 3 circumstances:-
 1. Where the franchisee has breached the franchise agreement.
 2. If special circumstances apply in the code, which permits the franchisor to terminate the agreement.
 3. Where the franchisee has not breached the agreement and the franchisor seeks to terminate the agreement in accordance with its terms, but without the consent of the franchisee to its termination.
- In the first case where the franchisee seeks to terminate the agreement because of the breach of the agreement, the franchisor must give the franchisee 30 days notice in writing, of its intention to terminate the agreement. The franchisor must stipulate exactly what needs to be done to remedy the breach.

- If the breach is remedied within the prescribed time frame, the franchisor can no longer proceed with the termination unless there are special circumstances. These circumstances are listed as follows:
 1. If the franchisee no longer holds a licence required to carry on the franchise. For example in the case of a liquor retail franchise, where the franchisee has lost his liquor license.
 2. If the franchisee becomes bankrupt or insolvent or puts his affairs under administration
 3. If the franchisee voluntarily abandons the franchise
 4. If the franchisee is convicted of a serious offence
 5. If the franchisee operates the franchise in a way that endangers public health
 6. If the franchisee is fraudulent in connection with the operation of the franchise or
 7. If the franchisee agrees to the termination of the agreement

- If the franchisor decides to terminate the agreement, having given proper notice of his intentions, without the franchisees consent, the franchisee has the right to use the dispute resolution procedure as contained in **Part 4 of the Code**

Leases and Licence agreements

Usually the agreement also includes a copy of the lease for the premises and or any licence agreements giving the franchisee the right to occupy the premises.

Sometimes franchise lease arrangements are complicated and tricky. For instance the lease can be in the name of the franchisor and the franchisee is expected to be responsible for paying the rent directly to the landlord. He may also be required to give the landlord a “back to back” guarantee in respect of the bank

guarantee the franchisor gave to the landlord in support of the lease. In other cases the lease is in the name of the franchisee who is responsible for paying the rent and providing the bank and other guarantees.

We will look at the negotiation of leases and the requirements of landlords in respect of leases in the later part of the book. We will also look at where the franchisee sells the business and then has to go through the process of assigning the lease to the new franchisee.

Act in Good Faith

The code provides that nothing in the code limits any obligation imposed by the common law on the parties in a franchise agreement to act in good faith.

What other responsibilities does a franchisor have before entering into the franchise agreement?

Before a franchisor can enter into, renew or receive a non refundable payment relating to a franchise agreement, the franchisor must obtain a written statement from the prospective franchisee that they have received, read and had a reasonable opportunity to understand the disclosure statement and code.

The franchisor may not enter into a franchise agreement, unless he has received a statement signed by the prospective franchisee, confirming that they have been given advice about the proposed franchise agreement by an independent legal adviser, business adviser or accountant or have been told that they should obtain advice from such advisers and have decided not to seek it.

DISCLOSURE STATEMENTS:

WHAT ARE THE MAIN ISSUES COVERED BY THE DISCLOSURE DOCUMENT?

Information contained in the disclosure statement provides the basis for thoroughly analyzing the potential for a franchise and whether you will have the expertise to run such a business successfully. It also allows the franchisee the opportunity to investigate the franchisor with whom he is about to “get married to” for 5 years or more and to determine whether all the information contained in the statement is truthful and accurate.

The following specific points in the disclosure needs to be looked at and to be further investigated by any proposed franchisee before entering into any agreement.

About the Franchisor:

➤ Details of the number of franchises in operation

The following information must, in terms of the code, be included in the disclosure statement

- Information about existing franchises including locations, contact details and when each started the franchise.
- Information about past franchises including number of businesses transferred, terminated, bought back or not renewed in last three financial years. This information to include contact details if available.

Comments: The number of franchises provided some measure of stability and experience of the franchisor. Your risk may be reduced when you select a franchisor with a large number of franchisees.

Just as important is the number of franchises that have been closed or repurchased by the franchisor. A large number will usually mean that there have been problems in the past. The more franchises that have experienced problems, the greater is your risk in purchasing a franchise.

Talk to some of the current franchisees and in particular some of the past ones, who can offer you a unique insight into franchisor treatment and the service provided to franchisees.

Also do not be afraid to ask other franchisees whether the profit they make each year is close to what the franchisor told them to expect.

➤ **Information about the relevant experience of each officer of the franchisee**

The following information must in terms of the code be included in the disclosure statement

- Information about the relevant business experience of each officer of the franchisor
- The name of the agent where you must make payments

Comments: The experience of both the management and directors of the franchisor can be critical to the competence of the franchisor. They should have sufficient experience to that they can sufficiently add to your business experience. They should

also have a special knowledge and understanding about the type of business operation they are selling.

Length of experience often indicates stability and a higher potential for franchises to succeed in the future

➤ **The financial stability and business reputation of the franchisor**

If not mentioned in the disclosure statement, the franchisor must disclose materially relevant facts within a reasonable time or not more than 14 days of the franchisor becoming aware of such facts including

1. A change in the franchisor's majority ownership.
2. Details of Criminal and Civil legal proceedings involving the franchisor.
3. An award in arbitration against the franchisor.
4. Insolvency of the franchisor.
5. The existence and content of undertakings or orders under section 87B of the act against the franchisor

Comments: The potential franchisee should request a copy of a certified financial statement from the franchisor, which should indicate a financially healthy organization. In addition, taking out a Dun and Bradstreet credit report on the franchisor, should bring to light any of the issues in item 1 to 5 above or any ongoing litigation against the franchisor.

➤ **Details about the site and territory**

The following information must in terms of the code be included in the disclosure statement

- The territory to be covered by the franchise and if occupied by a previous franchisee, the circumstances why the previous franchisee ceased to operate.
- Details of the exclusivity or non exclusivity of territories.

Comments: A territory may be defined as a suburb, a city or even just a particular shopping centre.

It is important that the franchisee has exclusivity to that territory defined in the statement.

- **Types of training and other assistance offered to the franchisee**

The following information must in terms of the code be included in the disclosure statement

- Details of franchisees requirements for the supply of goods or services.

Comments: This can include whether the franchisee will be offered the right to be supplied with the whole range of products sold by the franchisor.

One of the most important services offered by the franchisor is training. The amount of training that you receive can be critical to your success. The best training programs will include a combination of classroom training and on the job training. There should be at least a few weeks training for it to be most effective

There must be a large amount of assistance provided with the start up of the business. This is the most difficult period and requires the most assistance. There should be continued assistance offered

regularly as well as during any unexpected crises. For example, if the franchisee takes ill and cannot operate the franchise for some time.

Whether the franchisor will supply a manual setting out how the franchise model and all its operations are to operate, should also be looked for by the franchisee in the disclosure statement.

➤ **Financial arrangements and future profitability of the franchise**

The following information must in terms of the code be included in the disclosure statement:

- The conditions of financing arrangements offered by the franchisor
- Earnings information about the franchise based on reasonable grounds
- Any obligations for the franchisee to enter into other agreements such as leases, subleases, hire purchase agreements or security agreements
- Establishment costs of the business.

Comments: The franchise fee and the capital costs of establishing the business are the biggest obstacles for most potential franchisees. Once you establish your own net worth, discuss with your banker the amount of money you can borrow.

Determine from the franchisor what assistance the franchisor can provide for financing your business. This may include the costs for the franchises fee, equipment supplies and operating capital. If this is to be in the form of an agreement, make sure that you

carefully examine the interest rates and loan conditions. Have the entire document also checked out by your financial adviser.

Also determine how long the franchise is expected to operate before revenue will be sufficient to cover expenses. This will help you to calculate the amount of funds that you will need to cover this deficit.

RECENT NEW AMENDMENTS TO THE CODE

As mentioned earlier, because of many complaints submitted by franchisees, a productivity commission was set up to examine the industry, and as a result the federal government recently implemented a series of major changes to the code, with the express benefit of assisting franchisees and to give confidence to those considering entering the sector. These changes came into effect on 1 July 2010 and new franchisees need to be aware of these and pay special attention to its implications. They included the following:

- More disclosure information by the franchisor at the start of the franchise, including a more simplified disclosure statement. The new migrant must ensure that he receives this new disclosure statement which is much more transparent than previously.
- A disclosure statement must now provide that like any business, the franchise or the franchisor can fail, and this could have consequences for the franchisee.
- Franchisors will be required to give franchisees 6 months notice if they do not intend to renew a franchise agreement. If the term of the franchise is less than 6 months, then only one months notice is required.

- Franchisors will be required to disclose to prospective franchisees more information on unilateral contract negotiations or confidentiality obligations.
- Franchisors will have to disclose whether it will require the franchisee to undertake unforeseen significant capital expenditure that the franchisor did not disclose before the franchisee entered into the franchise agreement.
- Franchisors must also disclose whether there are any requirements for the franchisee to pay a franchisor's legal costs incurred in a dispute resolution.
- In addition, the ACCC now has new powers to conduct random audits of franchisors to ensure that they comply with the law.
- For franchise agreements entered into in the financial year starting on 1 July 2011, 1 July 2012 or 1 July 2013, the franchisor must now disclose the circumstances in which the franchisor unilaterally varied a franchise agreement since 1 July 2010. After 2013, the variations in the past 3 years must be shown.
- Franchisors are also now required to disclose the circumstances in which they may unilaterally vary the franchise agreement in the future.
- Franchisors are now required to disclose details of the arrangements that will apply at the end of the lease term including:
 - ❖ Whether the franchisee will have any options to renew, extend or extend the scope of the franchise agreement or enter into a new agreement. If so, the process the franchisors will use to determine this.

- ❖ Whether the franchisee will be entitled to an exit payment at the end of the franchise agreement and if so how this will be determined.
- ❖ Whether the franchisee will have the right to sell the business at the end of the agreement and if so whether the franchisor will have first right of refusal and how the market value will be determined.
- ❖ How capital expenditure during the term of the agreement will be taken into account at the end of the agreement.

If you buy a franchise business from another franchisee, which may have been started prior to 1 July 2010, you may not qualify for these new amendments, so please check this.

DISPUTE RESOLUTION AND COSTS OF MEDIATION (UNDER THE NEW CODE AMENDMENTS)

- The code states that if either party refers a dispute to a mediator, both the parties must attend the mediation and try to resolve the dispute
- A party is thought to be attempting to resolve the dispute if they:
 1. Attend and participate in meetings at reasonable times.
 2. At the beginning of the mediation process, make their intentions clear as to what they are trying to achieve.
 3. Observe any confidentiality agreements.
 4. Do not damage the reputation of the franchise system.
- The parties to a dispute are equally liable for the costs of mediation unless they agree otherwise

- The costs of mediation includes the cost of the mediator, room hire and any expert reports that may be required as agreed by the parties

STATE LEGISLATION

Victoria is the most progressive of all states, dealing with retail tenancy legislation and how it affects landlords, franchisees and franchisors

Whilst it is not my intention to quote the act in its entirety, the following summary of the legislation needs to be noted by the immigrant franchisee.

SUMMARY OF THE VICTORIAN LEGISLATION

Victoria has introduced into its legislation, key changes on franchisors and franchisees and Victorian lease arrangements are as follows:-

- In the case of the franchisor entering into a lease with the landlord for premises after 1 May 2003, the provisions of the act apply from that date.
- Franchisors as part of the franchising process normally enter into a single unit franchise occupancy licence agreement. This allows the franchisee to occupy the premises leased by the franchisor from the landlord for the purpose of establishing and conducting or operating the franchise operation at the premises

- The franchisor normally requires the franchisee to pay the landlord the rent, outgoings, security deposit and any other requirement of the lease.
- The franchisee is also obligated to observe all the covenants of the lease imposed on the franchisor
- The franchisee must acknowledge that the terms of the lease will be adhered to as if it were the lessee
- Finally the franchisee acknowledges that where there is any inconsistency between the lease and the licence agreement the lease will prevail
- Usually the franchisee also agrees to have read the lease and is familiar with its terms

The arrangements between the franchisor, franchisee and landlord are also affected by the inclusion of these new provisions in the Victorian act in the following way:

Under The Act the Landlord May Reserve the Right to Refuse a Sub Lease, Mortgage Etc

Section 63 of the new Act stipulates that a retail premises lease may contain a provision allowing the landlord the absolute discretion to refuse to consent to:

- The granting of a sub lease, licence or concession in respect of all or part of the retail premises.
- The parting with occupancy rights to all or part of the premises.
- The franchisor mortgaging or otherwise encumbering the franchisors estate or interest in the lease.

- This last provision, if it becomes general practice, may make it impossible for franchisors to grant franchises and for franchisees to finance their fit outs by a mortgage of the lease.
 - Therefore franchisors that propose to establish a franchise in premises where franchisees may use the lease as security for finance, should negotiate terms in their leases to enable them to do what they need to do in connection with the franchise or the mortgage.
- **Section 63** also allow the landlord to become an active party to the franchise occupancy licence arrangement, both as to the vetting of the agreement and charging of a fee for this involvement.

Key Money and Goodwill Payments Prohibited

- **Section 23 of the Act** provides that "key-money" is prohibited as any form of payment by a retailer to a landlord or any consideration for the goodwill of any business carried on in the premises.

However, various other payments, which do not constitute rent, but are valid, are also set out in this section; These includes rent in advance, bonds, security deposits guarantees and even includes seeking and accepting payment for the grant of a franchise in connection with the lease being granted.

- Even more important from a franchising point of view **section 23(3)** specifically provides that the landlord may recover from the retailer costs reasonably incurred in investigating a proposed assignee of the lease or sub lessee of the premises (which the licence agreement confers)

- ❑ Thus both the licence agreement and details of the franchisee will in future be vetted by the landlord
- ❑ There appears to be no limit on the amount that can be recovered beyond what is reasonable.
- ❑ Since legal costs are no longer recoverable from retailers under the **Act in Victoria**, this cost may be a way of recovering such expenses for this exclusive possession

DISCLOSURE STATEMENTS BETWEEN FRANCHISOR AND FRANCHISEE

- If a franchisor proposes to grant a licence to a person to use all or part of the retail premises wholly or predominately for the carrying on of the business under a name or mark identifying, commonly associated with or controlled by the retailer or a person or corporation connected with the franchisor, then the franchisor must supply the proposed licensee *within 7 days before* the grant of the licence and
 - ❖ A copy of the disclosure statement given to the franchisee concerning the lease, and
 - ❖ Details of any changes that the franchisor is aware of or could reasonably be expected to be aware of which have affected the information in the disclosure statement since it was given to the franchisee
- Failure to give such a disclosure statement may attract a penalty of \$1000 or 10 penalty points
- It is thus essential that the occupancy licence agreement must contain a provision that the “franchisee acknowledges that he or she has received such disclosure statement within 7 days of signing of the licence agreement

- Since the franchisor will most likely have to get a new disclosure document from the landlord in order to give to the franchisee, sufficient time needs to be allowed for receipt of such a disclosure statement from the landlord.
- The franchisor must make a decision as to whether he wishes to have the franchisee under the Act or not. If not, this may be in conflict with the franchising code.
- If the lease is entered into between the landlord and the franchisee then the lease will automatically apply to the franchisee as if he were the tenant
- If the lease is entered into between the franchisor and the landlord and the franchisor enters into a licence agreement with the franchisee, such a licence agreement will now have to be approved by the landlord
- Disputes between the franchisor and the franchisee in relation to the premises will be treated as part of the overall franchising relationship and be subject to the provisions under the Trade Practices Act

This is a complicated section in the act and needs to be fully understood by any person acting either for the franchisee or the franchisor

The states of South Australia and West Australia have recently introduced franchising bills to examine the state regulation of franchising. Franchisees contemplating the purchase of a franchise in these states need to check the progress of these bills before signing any documents.

CHAPTER 4

THE FRANCHISEES CHECKLIST - BEFORE PROCEEDING WITH THE PURCHASE OF A FRANCHISE

The following is an additional checklist that I believe a franchisee should take into account before entering into the franchise.

The checklist has been divided into a number of sections as follows:

EXAMINING THE RETAIL PRODUCT

- Has the product been sold for a number of years in Australia?
- Is the franchise a single product franchise and is it sold throughout the year. For instance if it is an ice cream franchise, what will you sell in the winter months
- Is the product likely to be replaced by new technology in the short or medium term? How well placed is the franchisor to cope with such change if it should occur?
- Is the product capable of being sold on the internet?
- Does the company use the internet, face book or twitter as a marketing tool?
- Has the product particular qualities that give it a distinct advantage over its competitors?
- Is the product in a sector of direct retail, which is in decline like books or CDs which are well marketed on the internet?

- Is the product in a growth section of the retail market?
- Is the product exploiting a fad or current fashion which may be short lived?
- How competitive is the market for the product?
- How competitive is the price of the product?
- Will competitiveness be maintained?
- Is there the possibility of over saturation in the market for that product?
- What is the source of supply of the product? Is it a local or imported? If imported it may be subject to currency fluctuations?
- Are future supplies of the product certain?
- Are there alternative sources of supply of the product if a main supplier goes out of business?
- Are the products based on a trade mark or patent? If so how long, have these trademarks or patents to run?
- Has the franchisor got a long term contract with the supplier for the products?
- Are the products supported by guarantees and service facility support?
- Can a manufacturer easily by-pass a franchisor and set up his own supply to the market?
- What is the reputation of the product as to reliability in the minds of the public?
- What is the reputation of the main supplier?
- If it is a food product, has it undergone certification from the appropriate government authority?

- Do discount stores and mini major stores also sell the product and cut prices? You could be put out of business. We saw this recently in the photo processing industry.
- Are volume discounts earned from group purchases from one supplier passed on to all franchisees?

THE FRANCHISOR, HIS FINANCIAL POSITION AND BUSINESS ACCUMEN

- Always take out a credit check on the franchisor, either through your bank or a credit agency. Remember the financial failure of a franchisor may result in you, the franchisee losing your entire investment
- How long has the franchisor been in business?
- Has the franchisor previously been in total control of the chain, thus aware of all the strengths and weaknesses of the business? Is he now selling off the business to raise capital? Or does the franchisor simply have a single store and is more in the business of selling franchises than running businesses?
- Check the company records of director's interests. Particularly note if the franchisor has no interest in your main supplier.
- Speak to other franchisees to ascertain whether the franchisor is approachable and will continue to be, after you sign the agreement and whether you will be happy in being in a long term relationship with the franchisor.
- There should be a manual which clearly sets out all you need to know about the business and the product?

FINANCIAL LEGAL LEASE AND OTHER CONSIDERATIONS IN PURCHASING THE FRANCHISE

- Who has legal responsibility for the product if there are problems?
- What is the total investment and are there any hidden or additional costs?
- Will the franchisee have to purchase product or equipment for fitting out the shop from the franchisor? Will this be done at cost to the franchisee, or are there any extra costs, commissions or charges added on by the franchisor?
- Confirm the exact rate of the royalty. Ascertain whether this is to be paid on sales or on delivery cost. Make sure to work through an example of how it is calculated so that you have missed nothing.
- Ask what terms have been negotiated by the franchisor to pay the suppliers and whether there are any cash discounts available for 30 or 7 day payments.
- Be certain that the projected profits as set out in the franchisors marketing document, has been verified by an independent accountant.
- As indicated previously, discuss the legal terms of the agreement, particularly the termination provisions, dispute provisions and the exact definition of your territory with an independent lawyer.
- If your franchise is to a particular shopping centre, ascertain the past 5 year performance of that centre from a consultant, in respect of sales, traffic flow and sales per square metre for specialty tenants.

- Ascertain whether there are any new centres contemplated within 5 kilometres of your centre, which could draw traffic flow away from your centre.
- Try to get the franchisor to involve you in the negotiations of the lease so you are confident, that you are paying the best rental, and have secured the best lease conditions. If necessary engage an independent consultant to oversee it for you.
- Make sure you are aware of the total entry costs. Sometimes charges by landlords including, design fees, plan approvals of fit-out, survey fees, consulting and engineering charges by landlords will be passed on to the franchisee. These fees could be \$6000 or more and should be taken into account in the purchase price of the franchise.
- If you are considering a food business, ascertain whether you have a seating area in front of your store or kiosk and whether there is a store room available for storing product. These areas are usually covered by a licence agreement not with the landlord but with the centre's management.
- Make sure that you also receive a survey certificate showing the area that forms part of your tenancy.
- Even though the lease may be in the name of the franchisor, the licence agreement authorising you to occupy the premises may provide that you pay rent to the landlord. Make sure that you are aware of the implications if the rent is not paid on time, particularly in a major shopping centre.
- Leases are governed by state law. If for example you are in Victoria, make sure you know your rights under the lease as set out above.
- Make sure that any marketing funds are paid into a separate banking account. Also ascertain that the franchisor is sending

you a statement at least quarterly, showing balance in the marketing fund at the start of the quarter, plus contributions received , less expenses paid, resulting in the balance in the fund at the end of the quarter

THE DECISION TO GO INTO FRANCHISING

Having considered all that I have indicated above, the potential franchisee has to decide whether the franchise is for him or not.

No matter what franchise you will consider, there will always be positive or negative factors. If you are still not sure, why not use the ‘T’ method of decision making. Simply list the positive points on the left hand side of the ‘T’ and the negative points on the right hand side. Once the two lists are completed, assign each item a number to designate its importance to you. A simple scale of 1 for unimportant, 2 for somewhat important and 3 for very important can be used. Total the numbers for each side. The larger the numerical difference between these totals the more you can be sure of your decision

Your final decision to purchase should always result in enthusiasm and dedication for the undertaking.

PART 2

SIGHT SELECTION FOR A LEASE FOR A STORE IN A FREE STANDING TENANCY

CHAPTER 5

SITE SELECTION AND POSITION (IN STRIP CENTRES AND STAND ALONE SITES)

If you have decided not to buy a franchise, as it does not meet your criteria for a good retail business, the alternative option is to open your own store.

You are now faced with the following:

- Will you open your store in a free standing location or
- in a strip centre along the main street or
- Will you open your store in a shopping centre

If you are planning to go into a shopping centre, the landlord or his leasing executive will probably offer you a store that may be available at that time. If the landlord is planning an extension of the centre, you will more than likely be able to select a site where you want to be located in the new extension.

Shopping centres do, however, try to group retailers of a similar type in one area, such as fashion, food court or a general services area.

If you select to open your store in a strip centre or free standing location, the decision as to where to locate your store is more flexible. However, there are critical factors to which you must give your attention. They are set out below.

Remember there is more to choosing the location of your retail business, than picking the area you would like to trade in or a specific street. Although you may think that a given site may be in a good location, you need facts to support this idea. The following are the ideal site location characteristics that should be looked for by a new store owner, when identifying a good site for a shop or even a stand alone fast food franchise

A. POPULATION

- The population density of the trading area. Are there sufficient people in the area for you to make a living
- The demographic mix of target market. Are the people living in the area, the correct age and set to want your product
- The short term and long term growth of the area
- Whether the people in the area mainly own houses or rent apartments? This can often determine the socio-economic spend likely by each person in the area

B. EXPOSURE AND VIABILITY

- Are there new residential or business developments opening near by?
- What are the traffic flow and commuting patterns past the site
- The closer your business is to activity centers, like shopping centers, offices, government departments, hospitals and schools, the more likely your business is to succeed.
- The location near a tourist attraction or a site where special events are held periodically is also a good option.
- If you are looking for heavy consumer traffic, proximity to a major supermarket may be advantageous.
- Can you trade off your neighbors on either side of you?

- How many cars drive by the location per day?
- How many people walk past the location?
- What is the potential pool of employees available in the area to staff the business?
- What about traffic flow over weekends? Does this differ from weekday traffic?
- The zoning of the site for your type of business.
- Does the area suit your needs? You have to work there. Is it close to your home and if not how will this impact on your family?

C. ACCESSIBILITY

- Are there natural barriers such as large trees that can block visibility from the street?
- Is the store well lit at night? Is the area safe and is there security available? Is the area regularly patrolled by police?
- Can customers get in and out safely from the site's parking lot?
- Is the location close to freeways and public transport?
- What is the parking capacity at peak times? How many parking spaces are available to you?
- Are there road construction works in progress that will affect your business for some time?
- Is the site on the favoured or most frequented side of the street to support your business?

D. COMPETITION

- Where is your competition located?
- Is competition controlled or will you find several similar businesses springing up?
- Does the area still need your product or service, or has the area already reached saturation?

E. RESTRICTIONS AND OTHER CONCERNS

- Are utility services, such as power and water, already connected to the site?
- Check the reputation of the landlord to ensure that the shopping or strip complex is well maintained.
- Are there any signage restrictions by the landlord and or council that will impact on your business?
- Are there any environmental concerns or restrictions that could impact on your business?
- Does the property conform to the boundaries in its legal description?
- Are there any hidden costs, such as body corporate charges over and above normal rent and outgoing charges that you need to be aware of?

Do your homework before you enter into the lease and it will serve you well.

PART 3

THE DO'S AND DO NOTS OF NEGOTIATING A LEASE IN A SHOPPING CENTRE

CHAPTER 6

THE BASIC FUNDAMENTALS OF A LEASE AND WHO ARE THE PARTIES TO A LEASE

BASIC FUNDAMENTALS:

- The value of a well negotiated lease is absolutely vital for the new migrant going into the field of retail. It has been said that “the lease is the underlying document which gives value to your business”.
- To be a successful retailer it is important to understand the complex aspects of a lease and the various parties that are involved in a lease negotiation, each seeking their own advantage from the negotiation.
- **If at the end of the period, the landlord decides that he does not wish to renew your lease, there is nothing to stop him letting the premises to someone else.**
- **This is an important point to remember, as many people enter into lease agreements with the expectation that they will be offered a lease on renewal. This is not always the case and the new migrant retailer must take this into account in his financial calculations.**

SO WHO ARE THE PARTIES TO A LEASE?

- In any lease negotiation for a retail tenancy, there are a number of participants involved, such as the landlord, the tenant, the real estate agent, or the landlord's solicitor. Each participant seeks to gain something different from the negotiations and the needs of participants are frequently conflicting.

So let us now look at the parties to any retail lease negotiations.

A. THE LANDLORD/LESSOR

Generally the landlord tries to secure the following from the lease negotiation:

- An optimum rental for the available space, with minimum expenditure. He attempts to make the retailer responsible for paying as much of the maintenance and cost of upkeep as possible.
- He will also expect the retailer to restore the premises at the end of the lease term to the same condition that the retailer initially received it
- Naturally the landlord prefers retailers who have the resources to pay the rent and outgoings over the term of the lease.
- The landlord will also seek a watertight lease. ensuring his rights are fully protected. As the landlord is responsible for preparing the lease, it is often initially written by his solicitor and favours him or her.

Landlords generally fall into 3 categories

- Landlords of retail shopping centres, complexes or malls

- Landlords of single shops who are often private investors with properties in strips or stand alone premises
- Landlords who own commercial properties that may have a number of shops located on say the ground floor of the building

B. THE LESSEE/TENANT

Generally the migrant retailer will seek those conditions from the lease negotiations conditions that allow for a profitable operation of a business and the building up of the goodwill value of the business. These are some of the conditions a retailer looks for in a lease:

- An affordable rent for the duration of the lease.
- Security of tenure for the desired time.
- Protection from competition, particularly if the retail premises are in a shopping centre or even a strip centre where a number of shops are owned by the same landlord.
- Ensured non interference in the day to day running of the business.
- Conditions that will not impose additional financial burdens on the business.
- The ability to conduct a profitable business. This may ensure that the number of tenants selling the same products is “limited” within that shopping centre.
- To have the ability to sell the business and assign the lease with the minimum of problems so as to maximize the goodwill built up in the business.

C. THE LETTING AGENT OR THE MANAGING AGENT

- The letting agent or real estate agent is often the first port of call for many migrant retailers seeking retail premises in a strip centre.
- A number of the larger real estate agents also manage and lease space in small shopping centres as well.
- The agent often handles all the initial documentation during the negotiation process and usually receives a fee from the landlord for entering into the lease. The agent usually has a property administration agreement with the landlord and carries out various duties as agreed with the landlord.
- Some of the recent changes to retail tenancy legislation in Victoria now impose on the agent, the same responsibilities and liabilities as the landlord. Thus any responsibilities of the landlord with regard to say disclosure to the tenant of all circumstances that could affect the tenant's decision to enter into the lease, as provided for in the act, also apply to the real estate agent.

D. THE SOLICITORS

- There are usually two solicitors that act for parties to a lease. One is employed by the landlord and will usually prepare the lease from the commercial lease offer negotiated by the landlords leasing executive or agent. The other is the solicitor for the retailer who advises on his legal position. Many retailers now engage the services of a leasing consultant to help negotiate the lease and report on the documentation prepared by the landlord solicitor.
- In the case of franchisees, the retailer's solicitor will often prepare the franchise agreement to ensure that the duration of

the franchise agreement will coincide with the term of the lease.

E. GUARANTORS

- Where small retailer operators have formed a company to run the business, all the directors are usually required to personally guarantee the lease. If the business should fail then the landlord may proceed against the personal assets of the individuals who are the directors of that company.
- If you sign the lease in your own name or in a partnership name, you automatically place your personal assets behind the business without the need for a formal guarantee document. Again if the business fails, it will allow the landlord to proceed against you and your family's assets to recover outstanding rent.
- As the Australian Company Law only requires one director in a company, it may be advisable to have your family members as shareholders but with only you as sole director. This will to some degree protect the family assets that are in their names from landlords, in the event of the business failing

F. ASSIGNORS AND ASSIGNEES

- If a retailer wishes to sell his business during the term of the lease he will become known as the assignor and will require the approval from the landlord for the assignment of the remainder of the lease. The purchaser of the business then becomes known as the assignee.

CHAPTER 7

THE LAW RELATING TO RETAIL TENANCIES IN AUSTRALIA

The Australian Constitution provides the States and Territories with the power to enact retail tenancy legislation. Therefore in Australia, the laws relating to retail tenancies can differ between and from state to state.

It is most important for migrant retailers to be aware that if they open a store in more than one state, even when the landlord may be the same, they may find that a number of clauses dealing with rent, outgoings, market reviews, tenancy mix and a number of others clauses are different.

Providing that you are not a public company or your store is not greater than 1000m², most migrant retailers will find that they are covered by the retail tenancy legislation which is in existence in all states. This legislation goes out of its way to protect tenants who may feel that they may be” bullied” or “manipulated” by landlords during negotiations.

New migrants can at least feel comfortable that this legislation is in place to protect them, particularly if it is their first retail lease.

If you are a retailer who falls under the protection of the Retail Tenancy Act, there is one thing that you must remember when looking at the lease: That it is not the wording of the lease that counts but the wording of the Act.

It is important to know in your negotiations that:

“IF A CLAUSE IN A LEASE FALLS CONTRARY TO THE ACT THAT GOVERNS THAT LEASE, THEN THE ACT PREVAILS AND THAT CLAUSE IS VOID”

Thus, not only must the migrant retailer know the provisions of the lease, he must also be aware of the important provisions of the governing acts. This will be very important if there is a dispute between the wording in the lease and the act.

IS THERE A DISPUTES PROCESS?

Yes, every state and territory has a dispute process which is reasonably cost effective. The process may entail a simple mediation proceeding which may cost you a \$100, or if that is unsuccessful a full arbitration process. This is more expensive and decisions are final and binding on all parties other than if there is a mistake in law.

Many major landlords will try to avoid the arbitration process and as a result mediation has enjoyed a high degree of success in the last few years

CHAPTER 8

WHAT TYPES OF LEASES WILL YOU HAVE?

A shopping centre has a tenancy mix of a number of different types of tenants. The type of tenant that you are, determines the type of lease a landlord will enter into with you.

Tenants are usually classified in a shopping centre as being either anchor tenants which include supermarkets, full department stores like Myers or David Jones, discount department stores like Kmart, Target or Big W. Most of these stores are over 1000m² in size. Then we have mini major stores like Reject Shop, Rebel Sport or Best and Less who are of a size between 400 and 1000m². Finally we have speciality stores which include chemists, coffee shops, book stores, apparel stores and so on.

In the case of a **departmental store or supermarket**, the leases will usually be based on a nominal base rent per month or/plus a percentage on sales whichever is the higher. These leases usually provide for rates and taxes to be paid and certain specified outgoings attributable to that tenancy. Particularly, large outgoing costs like management fees, centre management and security costs are often specifically excluded.

In the case of **mini major stores**, the lease will usually be based on a low rent per square foot, plus a full share of outgoings or even a gross rent comprising the two.

In **specialty stores, retail stores or food outlets**, the lease will usually be calculated on a much higher rent per sq. metre, as well as a full share of outgoings. Most migrants and franchisees fall under this category.

It is important to remember that whilst the new migrant may be paying a higher amount for the rental of the premises, he enjoys the protection of the retail tenancy legislation as indicated, which most of the larger stores who are often public companies do not.

In West Australia, leases termed "semi-gross plus statutory charges" are often used by landlords to overcome the problem in the legislation which prevents them recovering management fees from tenants. This outgoing is incorporated into the rental portion of the lease.

Leases in medical suites, or government departments in the shopping centre are usually negotiated on a lease by lease arrangement. Quite often the group doctors in the medical suite will hold a head lease whilst the other semi medical tenants like pharmacists or optometrists will have a sub lease.

Stores in strip centres usually contain only a base rent component plus statutory municipal charges and land tax (sometimes recoverable from the tenant in that state). Some leases have been structured so as to recover part or all of the landlord's insurance cost of the building as well.

The best type of rent package to negotiate is a Gross Rent deal (one that includes a total occupancy figure covering both rent and outgoings) and which is usually expressed as a percentage of sales.

Landlords are not keen on this, as they want to be certain of the amount they receive for rent. It is detrimental for them in a time when we have a low inflation rate in Australia known as CPI. Outgoings, particularly statutory charges like rates and taxes often rise much quicker than CPI and having these capped at the same amount as rental increases, is not in the landlord's best interest when it comes to valuing the property.

However, this type of lease is often used by landlords for a temporary location for a retailer during the refurbishment of a shopping centre when the retailer wishes to remain in the centre, while waiting for the completion of their new store.

The next best rent package to be considered, is one where you pay a negotiated net rent amount and where the outgoings for the current year are considered to be the "base amount ". Outgoings during the lease period are only payable on your proportion of the amount in excess of the original base amount when the lease was entered into.

Most leases are based on an agreed cost per sq. metre plus outgoings_based on the area of the shop as a percentage of the gross lettable area of the centre or building.

TYPES OF SHOPPING CENTRES

Just like leases, not all shopping centres are the same. The rent that you may have to pay for a similar store, may be vastly different depending on the classification of the shopping centre.

The classification is in turn dependant on the size of the centre, who the major tenants are and the traffic flow to that centre. If a shopping centre has a department store like Myers or David Jones, it has a higher ranking and commands a higher rental than if it's

major tenants consist of discount department stores like Kmart, Target or Big W.

Also the number of supermarkets that a centre has as its anchor tenants, can determine the rent that you will pay under the lease.

In most publication dealing with shopping centres the following terminology is often used:

➤ **Regional Centres**

This is defined as a major integrated retail centre under a single management and has at least one department store or discount department store of a minimum of 10000 square meters. The centre will have a total reporting Gross Lettable Area (GLA) in excess of 25000 square meters. Alternatively if it has 3 discount department stores (DDS) with a minimum of 5000 square meters in size and a GLA of 50000 square meters it is also a regional centre.

➤ **Top 10 Regional Centres**

These are the ten highest ranked regional centres based on total reported turnover

➤ **Sub Regional Shopping Centre**

Usually consists of 2 major DDS and one or more supermarkets

➤ **Double DDS Centres**

A type of sub regional centre with 2 DDS

➤ **Single DDS Centres**

A type of sub regional centre with 1 DDS

➤ **Supermarket Based Centres**

These are usually less than 10000 square metres and comprise of one or more major supermarkets along with a collection of food and non food speciality shops and services in the same enclosed area.

➤ **Central Business District Centres (CBD Centres)**

These are centres located in the central business district of Australian Capital cities with either a national major or a significant arcade in their own right

CHAPTER 9

HOW WILL THE SIZE OF THE PREMISES AFFECT THE LEASE?

As can be seen from the previous chapter, the size of the premises will determine the rental per square metre that you will be paying. Landlords may quote you a base rental for the premises such as \$100,000 per annum. To this is normally added the cost of outgoings.

If your store falls under the retail tenancy legislation, you will be given an outgoings budget that indicates how the outgoings per square metre will be calculated in the following and subsequent years.

Landlords will often negotiate for the premises on the basis of say \$1000 per square metre for 100 square metres (subject to survey). Thus if the premises when surveyed are 102 square metres, the rental will not be \$100,000 but \$102,000. You may only find this out 3 months after you have commenced trading. Watch out for this technique.

SURVEY OF PREMISES

A way of protecting yourself is to negotiate a clause in the lease or disclosure statement, which provides that “irrespective of the size of the premises following a survey, the rental will not be greater than the \$100,000 as agreed. Then only the outgoings will be amended to comply with the surveyed size of the premises.

It may surprise you that landlords in most states charge the tenant for the costs of the survey. This cost may vary between \$400 and \$600.

As you have paid for the survey certificate, the migrant retailer must ensure that he obtains it from the landlord. This is to ensure that it complies with what was agreed in the lease negotiations.

If you have some reason to believe that your premises are smaller than the lease provides, do not be afraid to initiate your own survey. The survey should be conducted according to the **Property Council** method of surveying used since 1986. A copy of this method is obtainable on the Property Council website

SIZE OF YOUR STORE

Remember, outgoings are normally apportioned to you based on area. If you are already in your premises and you discover that the area of the store is smaller than the negotiated size, you may be able to obtain a refund on your outgoings and even your rent in some cases. This may be retrospective to the start of the current lease.

Also the size of the store will also be important if the lease has a market review provision in it. Valuers use the area of the store to determine the final market review determination.

The fit-out contractor, laying the carpets or floor coverings for the store are often excellent guides as to what the true size of the premises really is.

If new migrants take up a tenancy or a franchise, a coffee shop for instance, in a shopping centre that has a seating area of say 10m²

in front of the shop where their customers can sit and have their coffee, you might find that this area is not part of the lease area for the store.

In fact this area will be covered by a **separate seating licence agreement** (not a lease) entered into with centre management. This is usually charged at a nominal rental of \$1. The area normally does not attract any outgoings payable as it is located in the common area of the centre for which you are already paying outgoings.

Do not forget to make sure that this licence agreement runs for the same period as the lease for the store, and that this clause is entrenched in the agreement

CHAPTER 10

IN WHAT NAME SHOULD THE LEASE BE ENTERED INTO?

It is important that the migrant retailer, in consultation with his financial accountant, carefully consider the entity that will enter into the lease on behalf of the tenant, before signing any lease documentation. You need to then advise the landlord solicitor of the name you have selected.

The lease could be entered into, in the name of an individual or a partnership, a company or even a family trust. Each has differing tax considerations and you need to determine how this will affect you and your family. Otherwise you could be stuck with an unsuitable structure for 5 years or the length of the lease term.

If you are a pharmacist, optometrist or physiotherapist forming part of a medical clinic, you may as indicated previously, be only a sub-lessee of one of the doctors who holds the head lease. It is, therefore, imperative that your sub-lease is structured in such a way that it allows you or the other professionals to go in and out of the clinic without “disturbing the lease” or requiring a new lease to be drawn up each time.

You and your fellow health professionals may consider having the lease in the name of a management company running or controlling the clinic, with each participant holding a share in the management company.

Some retailer groups structure their leases in the name of a shelf company whilst the trading name of the business is kept in a separate trust, thus protecting the name in the event of bankruptcy.

CHAPTER 11

RENTAL CONSIDERATIONS

Besides the rent that is negotiated at the start of the lease, there are a number of other factors involved in establishing the rent over the term of the lease. New migrant retailers must be familiar with all of them. These are the most important factors to understand:

RENT FREE PERIODS

As an inducement to a retailer to enter into a lease, a landlord may offer a rent free period in the first year. This allows the retailer an initial cash saving to be set off against the high cost of fitting out and stocking the store. Such incentives have become quite common, particularly when existing shopping centres are being refurbished and the landlord is trying to attract new tenants to the centre.

In strip centres these rent free periods are also often offered where a store has remained unoccupied for a period of time and the landlord is keen to attract a good tenant.

Thus a retailer should always try to negotiate an initial rent free period of about three to six months, to allow him time to get the store up and trading properly before the first rent is payable. Even though he will not be paying rent, however, from day one he may have to contribute to outgoings and a possible marketing levy.

New migrants should be aware of a type of rent free offer that is not a real offer. Here the landlord uses the handover date as the commencement date of the lease even though it will take you a

month to fit out the store when you cannot trade. The problem with this type of deal is that the first rental increase comes in after 11 months trading and not a full year.

PERCENTAGE RENT PAYABLE

Some shopping centre leases include an additional rental known as percentage rental. Percentage rent is a form of “super rent” that you will pay if your store in the shopping centre is successful.

Depending on your retail classification, this rent is calculated by applying a fixed agreed percentage of say 8% of your annual sales and deducting the base rental. It has become a standard management practice in many leases to have percentage rent clauses.

From a landlord’s perspective, receiving some annual percentage rental may be valuable, but the real reason for chasing this is quite different. Under the various retail tenancy acts in Australia, landlords may not ask the tenants to provide their sales figures.

By using a “percentage rental” clause landlords are entitled to obtain the retailers annual sales figures on the assumption that they are checking whether any percentage rental is in fact payable.

The landlord or the agent can then determine what rental the tenant can afford to pay in future lease negotiations. At the same time it allows the landlord to plan for the future management and development of the centre.

Example of How the Percentage Rental is calculated

If your Sales for Year are	\$500000
The Agreed Percentage rental is	8%
The Base Rent for Year is	\$38000

Thus we calculate Percentage rent as follows

$\$500000 \times 8\%$	= \$40,000
Less Base Rental for year	\$38,000
Percentage Rent Payable	\$2000

This percentage rent is normally payable by the tenant 30 to 45 days after the anniversary date of the lease.

In some states, landlords try to get tenants to pay percentage rentals twice a year. This could affect cash flow as the higher Christmas sales can affect the amount payable. You may find yourself paying a percentage rental in the first half year and then have this money refunded after the next 6 months, as you have not reached the level of percentage rent payable. So the landlord has the use of your cash interest free for up to 6 months.

Landlords may also try to get the tenant to pay a provisional amount of percentage rent based on percentage rent payments in the previous year. Do not accept this type of clause. You must insist that when it comes to percentage rent, each year stands on its own.

ANNUAL RENT REVIEWS

Most leases provide for an annual review of rents. There is no ceiling on the amount by which the rent can increase. However it is required under retail legislation that a clearly defined formula by which the increase is to be calculated and is stated in the lease document. (For example 5% fixed increases per annum or CPI or the amount is established by a market review.) In some states annual increases take the form of a combination of increases for example CPI +2%. This combination is not permitted in Victorian leases. In Victoria it can only be CPI or a fixed percentage increase but not a combination of the two.

Remember that if the formula is not specifically included in the lease, then no variation of rent is permitted unless all parties agree.

Given that CPI increases are not the same for all states, a migrant retailer in Perth may have a larger CPI increase than a migrant retailer in Melbourne. To smooth out fluctuations for a retailer with stores in a number of states, always request that the CPI formula to be used in the lease will be the average CPI over the 8 capital cities.

CHAPTER 12

HOW TO ADMINISTER THE LEASES IN YOUR PORTFOLIO

The setting up of an occupancy cost control document is essential for the proper administration of your lease portfolio. If a new migrant is sufficiently successful and has more than 5 stores, maintaining such schedule is essential.

There are a number of helpful software packages on the market that offer this information. If you do not wish to go to this cost, you can set up on your computer a simple Excel spread sheet which, if kept up to date, will provide you with all the information that is required to monitor and administer occupancy costs.

The document is linked to a separate spreadsheet that monitors the moving annual turnover of each store in your network. It sounds complicated but is easy to work with and delivers precise information

What is Moving Annual Turnover

This is a term often used in retail. It refers to the turnover of the store for the 12 months to today's date. Thus, if we are at 30 April 2010, the moving MAT becomes the 12 months to 30 April 2010. Once we know the May sales, we will add this to the moving annual turnover figure and deduct May the previous year.

This is how to set up an Excel Spread Sheet

Three vertical line items are allocated to each store.

The following information is entered in each column about each store:

- Store Location and store number
- Store Size - in square metres
- Base Rent - \$ Total Base Rent per lease
- \$ Base Rent per square metre - by dividing total base rent by store size
- Percentage Rent:- Calculated on an ongoing basis as per formula in the lease
- Total Rent:- Adding base rent to Percentage Rent
- Rates and Taxes:- Rates and taxes on an annual basis;

Some landlords charge monthly, others quarterly and annually.

- Outgoings:- Enter total outgoings as per landlords estimate for the store.
- Marketing Contribution:- Enter total contribution as per landlords estimate for the store.
- Total Occupancy:- Total dollar value calculated by adding total rent, rates and taxes, costs outgoings and marketing contribution.
 - By Expressing the total occupancy cost as a percentage of the Moving Annual Turnover we now have the occupancy cost to sales percentage for that store

- By dividing the total occupancy cost by the store size we now have the total occupancy cost per square metre
- Sales MAT:- This is obtained by transferring the MAT from the attached spread sheet to this column for each store
- MAT per square metre:- This is calculated by dividing the MAT by store size
- Lease commencement date:- As per lease
- Lease expiry date:- As per lease
- Lease Term and options:- As per lease
- Date when option must be exercised:- As per lease
- Date of last rent review:- As per lease
- Details of last rent review:- As per lease.

However, if increase was waived or reduced by the landlord, this should be recorded here

- Date of next review:- As per lease
- Mode of next review:- Would either be a sum fixed per lease or a percentage increase or CPI or market review. If the lease ends on the date of the next rent review, we enter either “new lease” or “store closure.”
- Calculation of percentage rent:- This is usually a percentage of sales less
- base rent or a percentage over and above a threshold figure.
- Guarantee if and by whom:- As per lease
- Special conditions in lease:- As per lease. Also include notations here like “lease incentive \$20000 payable” or

“storeroom rent at \$1000 per annum” or “outgoings over base year 2009”

If we have the information available we could add 3 additional columns, namely

- Centre Traffic Flow:- As per information in Shopping Centre News etc
- Centre MAT:- As per information in Shopping Centre News etc
- Spend per visitor to our store:- Calculated by dividing our store MAT by centre traffic flow

CHAPTER 13

OUTGOINGS CONTROL AND MANAGEMENT

THE ISSUES YOU NEED TO BE AWARE OF WHEN DEALING WITH THE OUTGOINGS RENTAL CHARGE

Outgoings are very much an Australian concept, whereby tenants in a shopping centre are required to pay for the outgoings or costs of running the centre. This is normally proportioned and charged to tenants based on the percentage that the area of their store bears to the total area of the centre. In a large centre this could be \$225 per square metre or even more

At least one month before the commencement of the financial year landlords are obliged under the Acts, to provide the tenant with a schedule of budgeted outgoings for the centre and a calculation of how the tenant's portion has been calculated. Within three months after the financial year, the landlord must provide an audited statement of the outgoings for the year.

When the landlord's property executive quotes an outgoings rate per square metre, ensure that you know **exactly what outgoings that rate covers**. Some outgoings include municipal council and water rates as well as a land tax charge, while others do not.

If the above outgoings are excluded from the rate, you will be billed either directly by the State authority or council or the centre will pay the account and recover it from you periodically throughout the financial year.

When calculating your total occupancy cost before signing the lease, make sure that you include all outgoing charges both "direct and indirect."

Ensure that you are given a current schedule of outgoings with your disclosure statement and ask your solicitor to check that each item is covered by the lease. In later years this will protect you from new outgoings expenses being included without your knowledge/ permission.

Air-conditioning costs and their apportionment to tenants has also become a source of contention between landlord and tenant. Although one centralised system seems to service the entire centre, landlords contend that the major tenants have their own air-conditioning systems and as a result they should not have to bear a share of the air-conditioning expenses. This can result in an imbalance in the area over which such costs are apportioned to tenants. If you believe that you have been charged more than your portion for air-conditioning costs, request a plan of the air conditioning system together with an explanation from the centres engineers showing how your proportion is constructed.

As some tenants have their own compactors, centre managements have employed similar methods of calculating and apportioning waste removal.

If you are expected to pay this cost separately, ensure that you are given a clear explanation of the allocation of cost before you sign the lease. If you are still unhappy ask for the basis of the allocation to be included in the disclosure statement. This will protect you later, should you find that you have been charged incorrectly or that the ground rules have changed after you signed the lease.

Repairs and maintenance is another large expense in the outgoing schedule. Try to obtain a breakdown of how this charge is made up. Usually it comprises building, electrical, signs, car parks, locks and keys glass and so on. Though this does happen in Queensland some landlords in other parts of the country combine this cost to form a single expense.

In Queensland, if an outgoing represents more than 5% of the total outgoings it must be shown separately on the schedule.

Note that capital expenditure on the centre by the landlord must not form part of the outgoings. Always alert yourself to the possibility of capital expenditure being included in this outgoing cost area. In particular you should query this if you are moving into a centre that is new or the centre has recently had a major redevelopment.

Avoid outstanding building costs that are of a capital nature being included in repairs and maintenance cost of the following year.

Bear in mind that the act in Victoria covering responsibility for repairs and maintenance has changed. Now with the exception of deliberate negligence by the tenant, the landlord and not the tenant bears this cost of the repair.

If you are going into a centre where the majors are trading longer hours than most other tenants, do not be afraid to ask how these additional hours are being charged and recovered.

Ask for confirmation from the landlord as to whether this recovery of cost from the majors, will be offset against the general pool of outgoings before such pool is allocated to tenants, such as yourself in proportion to the area occupied.

Some leases contain a clause in the reference schedule that provides for example, that the store represents approximately 0.21 % in size of the gross lettable area of the total centre. Therefore you will be responsible for 0.21 % of the outgoings.

This may be accurate at the time, but remember that if the centre is enlarged after you have signed the lease, and the size of your store now only represents say 0.18% of the gross lettable area, some landlords could try to hold you to 0.21 % because this is stated in the lease you signed.

Therefore it may be wise to ask your solicitor to remove this clause from the lease or clarify it so that there is no confusion as to what your true share of outgoing is.

Since outgoings are calculated on the basis of the area your store bears to the total gross lettable area of the centre, it is essential that this calculation must be correct.

If you are in any doubt, ask the lessor to provide you with a reconciliation statement which shows you exactly how the area of the centre has been calculated, split into gross lettable areas and common areas.

Remember that if you are a mini major or a store occupying a large area in size in a shopping centre, and with outgoings costs of over \$225 per square metre the outgoings cost to your store could almost be as large as the rent.

It is best to be aware that over-budgeting of outgoings by landlords can cost the retailer cash flow. In the past landlords have been known to overstate proposed repairs and maintenance programs than was actually undertaken during the year In this way

they received a higher budgeted outgoings per month but were then quite happy to refund the money at the end of the year.

SO HOW DO WE CHECK THE OUTGOINGS SCHEDULES FROM LANDLORDS TO ENSURE THAT THEY ARE FAIR?

Landlords with June 30 year ends normally send the tenant a budgeted outgoings schedule for the next financial year in about May of each year.

They also send them an audited outgoings schedule in around September or October showing the actual audited outgoings for the previous year.

Recently some major landlords have changed to 31 December year ends and as a result the budgeted outgoings come out in November and the audited outgoings in March or April each year.

By then, unfortunately the tenant is already into the budget for the following year before the actuals for the previous year are known.

In any event, the budgets are probably prepared on the information available at the end of March.

It is vital for the retailer to monitor both the comparison of budget outgoings the present year against the budget of the previous year. Also he must monitor the actual outgoings of the previous year with the budget outgoings for the present year.

It is to your advantage to prepare the spread sheet both by dollar value and per square metre of the size of the centre.

TIPS TO WATCH OUT FOR WHEN ASSESSING THE OUTGOINGS TO BE PAID

The following two examples illustrate how careful the retailer must be when interpreting the outgoings payable by the tenant while negotiating the lease.

Example 1

A retailer negotiates a lease on a gross rental basis of \$180000 for the first year. This covers the rent, the outgoings and marketing levy. The landlord is then given the option of splitting up this amount between rent at \$100000 marketing levy of \$5000 and the balance of \$75000 to be the outgoings covering both statutory and variable outgoings.

In later years the rent will increase by the agreed amount but the outgoings will increase as per the budgeted annual outgoings, which may be at a much higher percentage than the annual rental increments.

It is important for retailers to ensure that the gross rental in year 1 does not exceed \$180000. Thus irrespective of what the final audited outgoings turns out to be, it should not exceed \$75000 in year one as agreed above. A lesser amount is acceptable but we should not accept an adjustment if the amount is in excess of \$75000 for the year.

Example 2

We have negotiated the lease on a net rent plus outgoings basis and we have received a budgeted outgoings schedule to the 30 June 2011 in the disclosure statement and say the lease commences on 15 May 2011. How then do we calculate the outgoings that should be charged for May?

First go to the lease to determine the basis of proportion of non monthly adjustments. Leases from some landlords provide for annual calculations to be adjusted on a monthly basis. Other landlords work on a 365 day basis.

Thus in the first instance we will divide the annual budget by 12. Calculate your proportion of share based on the proportion of the area of our store to the area of centre. This will give us the monthly amount.

Since one month is equivalent to 4.33 weeks and we occupied the premises for 2 weeks we can then divide the monthly amount by 4.33 and multiply by 2.

In the second instance we divide the total outgoings for the year by 365 days and then multiply the result by 15 days to arrive at the outgoings to be charged in May.

A useful guide for retailers in determining whether or not we are paying the right outgoings is to send to the landlord the following document, which asks the landlord to reconcile the size of the centre with the area over which outgoings are being apportioned

EXAMPLE OF A GROSS LETTABLE AREA RECONCILIATION SCHEDULE

NAME OF TENANCY

RECONCILIATION OF GROSS LETTABLE AREA USED FOR BUDGET YEAR ENDED	SQUARE METRES
---	--------------------------

**A. GROSS LETTABLE AREA USED AS PER BUDGET
CALCULATION**

**B. ADD/DEDUCT ADJUSTMENTS MADE IN
ARRIVING AT G.L.A. (IN A ABOVE) AS PER OUR
LEASE**

- i. Tenants not let at commercial rates**
- ii. Storage areas**
- iii. Public Library let at nominal area**
- iv. Other Community facilities let at nominal
rent**
- v. Mezzanine floors**
- vi. Decked areas erected in demised
premises**
- vii. Kiosks**
- viii. Ground Floor Service Areas, Trolley return
Bays, Parcel Pick Up, Covered Loading
Area**
- ix. Plant Nurseries**
- x. Stand Alone Tenancies - Garages, food
stores etc**
- xi. Temporary or casual letting areas**
- xii. Cinemas**
- xiii. Office areas**
- xiv. Health Studios**
- xv. Plant Room**
- xvi. Other (give details)**

**C. TOTAL LETTABLE AREA OF THE CENTRE
(A+ B ABOVE)**

D. COMMON AREAS

- INTERNAL CAR PARKING
- OTHER

E. TOTAL SIZE OF CENTRE (C+ D ABOVE)

Made up as follows; Anchor tenants
 Speciality stores
 Common Areas
TOTAL AS PER E ABOVE

**NOTE: SHOULD THE G.L.A. FOR THE COMING YEAR
BE DIFFERENT FROM THE PREVIOUS YEAR,
PLEASE GIVE DETAILS**

CONFIRMED AS CORRECT:

DATE:

SIGNATURE:

POSITION:

To determine whether or not the outgoings charged to you are fair and reasonable, the following checklist based on my experience over many years should be adopted by most retailers.

***TYPICAL RETAILERS CHECKLIST OF
OUTGOINGS EACH YEAR***

A. GROSS LETTABLE AREA (GLA)

- Is the G.L.A the same as last year?
If not, establish the reasons for change
- Check the G.L.A reconciliation form to see if landlord has changed the basis of calculating the G.L.A.
- Does the G.L.A. as calculated conform to the definition in the lease?

- If renovations or refurbishments are taking place in the centre over the 30 June period, check if additional area has been taken into account in determining the GLA calculation in the budget provided by the centre.
- If there are free standing tenancies at the centre, for example service stations, fast food outlets etc, check that they are taken into account in the calculation.
- Has the office area of the shopping centre been deducted from the GLA? Some landlords have taken legal opinion that has not as yet been challenged allowing them to deduct this area from the GLA. Challenge this if in doubt.
- Has the number of kiosks in the centre remained the same as last year? If kiosks are removed the area should they be included in common area and deducted off GLA. If new kiosks are erected GLA should increase and common area decrease.

B. CHANGES IN THE SIZE OF A RETAILER'S PREMISES

- Has the size of the retailer's premises changed from last year?
- Is the size still as stated in the lease? If not check that there is confirmation on file to this effect. (May include downsizing of premises during the year).
- If the size of your premises calculated on a percentage of the total centre, check the reference schedule of the lease to see how many decimal places the calculation is to be computed.
- Outgoings apportionment should always be made on same basis according to the reference schedule in the lease.

- Is the same percentage used in apportionment from year to year? Make sure to check if the centre has not increased in size as this could reduce the tenant's percentage.

C. VARIABLE OUTGOINGS - GENERAL CHECK LIST

- From the schedule supplied to you by the centre, prepare a comparison of the current budget year and the following budget year and note variances.
- On receipt of Actual audited outgoing, prepare a comparison of actual and budget for year and note the variances.
Now prepare a comparison of the actual audited outgoing for the previous year with the budget for the following year and note the variances.
- Compare variances above with the assumptions made by the centre in the preparation of the budget to see if the data is still valid. If a major variance has now been detected and not in your favour, request the centre for explanation and if unsatisfactory ask them to revise the budget, thus effecting a saving in cash flow during budget year.
- Check outgoing charged to the retailer with actual lease provisions. If the charge is not specifically contained in the lease, raise a query with centre. Note that the charge is possible subject to interpretation of lease wording, query as well.
- In Victoria the outgoing must *benefit* the premises to be able to be charged to the retailer. Thus if you are on the outside of a centre you should not have to pay for escalators, air conditioning etc.

- If you own more than one retail store, be sure to compare analysis of above with the landlords' other centres and note if any common trend emerges.
- If any concessions have been obtained or negotiated with landlord in a previous year, check to see it has been carried forward to the budget year.
- If, say, you are a pharmacy and trade outside the normal working hours of the centre for example to 9pm each night, you should either try to negotiate in your lease that your trading hours be included in the lease and not the centres trading hours, thus avoiding an after hours outgoings charge for say lighting and security

D. VARIABLE OUTGOINGS – (SPECIFIC EXPENSES)

1 Security

- Usually after the preamble to the outgoings clause, some landlords include a proviso stating that the management's responsibility includes " operation and management," of the centre.
- However, as you are paying for security, you should insist that leases include the words" and securing the centre". This may assist your insurance company recovering a theft claim from your store against the centre, should the centre fail to provide adequate security.
- If you are trading after normal trading hours and are forced to pay a fee per hour to the centre for this entitlement, you need to ensure that you are not paying this twice. Each payment for after hour's expenses should be deducted from the pool of outgoings before the balance of the pool is allocated to tenants.

2 Air Conditioning

- The cost of air conditioning of cinemas should be borne by the cinema operator directly. Ensure that the air-conditioning of cinema foyers is not included with your outgoings of the centre.
- In too many new leases, electricity charges for running air conditioning plants are purchased by the centre at bulk rates and charged to retailers at normal rates. Compare your store electricity costs per square metre, with the common area cost, to see if there is a difference.

3 Cleaning

- This cost often includes the salary of cleaners employed by the centre. Unless your lease provides otherwise, ensure that only the basic salary is charged and that no provisions have been made for long service or annual leave.
- Cleaning often includes waste removal. If your lease specifically excludes "wet refuse", ensure that this is deducted.
- Check to see if cleaning costs include cleaning of food courts and the salary costs of waitressing for common areas. Most new leases provide for such costs to be borne by food court retailers directly.
- Often these food court expenses are charged to food court operators as a "marketing levy". This is based on the total cost divided by the number of food court operators, thus avoiding the provisions of the tenancy acts which require the costs to be on an area of the store to the area of the centre basis.
- If the centre has an office tower, check the apportionment of costs between the common areas and the offices.

4 Insurance

- Establish the basis of insurance apportionment for landlords that have a portfolio of properties. Often this is calculated on the total value of buildings. If a landlord has a major property and the value of that building has fallen dramatically, other centres including the one in which you have your store may be absorbing a higher insurance allocation.
- In the case of centres owned by insurance companies, establish how the insurance cost was determined. Was it simply an internal charge, say within an insurance company that owns the property, or true market charge? The high cost of public liability insurance, needs to be carefully examined by retailers. For instance, major landlords who operate on a world wide basis, were particularly hard hit by events in the USA, following September 11, and their Australian Shopping Centres were hit accordingly. Assess whether this could have an affect on your insurance cost.

5 Car Parking

- Costs for car parking should normally only include line marking of bays. If you are charged an amount greater than \$5000, query this cost. You should not be charged for the capital costs of asphaltting.
- If a car park is let to a private contractor, it should be classified as GLA and not common area. Again this could affect apportionment of outgoings.

6 Energy Costs

- As indicated above, in the case of tenants using substantial electricity after normal hours eg cinemas, railway stations

etc, always check that reimbursement by these operators is deducted from the total energy costs before apportionment to the tenant.

- Test check the tariff ratings charged. It is necessary to ensure that you are paying the best tariff rate particularly as most shopping centres operate outside normal office hours.

7 Lifts and Escalators

- The energy costs of running these are often allocated to this cost and not to energy. Use the same principles as the air conditioning checklist.
- Some old leases refer to payments for lifts only. If a centre has been redeveloped and now includes escalators and travelators, you need to determine whether you will accept the costs for this extended range of equipment.
- If a bank of lifts services an office tower that is alongside or part of the centre complex, query whether you should pay for these costs, especially if the offices have been excluded from the GLA.

8 Repairs and Maintenance - General

- If the centre has recently been refurbished, check for sudden increases in budgeted repairs and maintenance. Landlords may try to apply post construction problems to repairs and maintenance outgoings.
- Investigate jumps in this cost in the year after a refurbishment, since this may now include maintenance agreements on equipment previously under guarantee.
- Note that the salary costs of maintenance staff can be included in this item. Ascertain from store management if

the maintenance staff are fully occupied in that centre or not. If not, ascertain how the cost was apportioned.

- In addition, unless the lease specifically states this, ensure that provisions for sick leave/annual leave/long service leave are not included in this cost.
- If the store is in Victoria, ensure that the maintenance cost follows the Act. If not they should it be borne by the landlord.

9 Gardening and Landscaping

- If this includes indoor plants, ensure that the capital cost of the pots is not included in maintenance charge.
- Periodically check with store management whether the centre has gardens. Knowing this will assist in testing if the charge is reasonable.
- Some leases provide for gardening to include “areas in the vicinity of the centre”. This could be future redevelopment land that must be maintained according to a council directive. Make sure that the cost is not being passed onto the retailers in the centre.
- Ensure that any landscaping costs are not of a capital nature. The test usually is, that the cost should not enhance the value of the centre but rather maintain the appearance of the centre.

10 Management Fees

- See more detailed analysis below

11 Miscellaneous Expenses

- Almost all outgoing schedules include such a cost. If the cost charges are over \$5000, ask for the details that make-up this expense.
- Ascertain if this cost includes a “community charge” - where the outgoing is attributable to say a library in the centre that does not pay outgoing as per its lease. Check that the outgoing are not included in the retailers pool of outgoing.
- If the costs are excessive, also query whether this includes any capital costs such as a new motor car for the centre manger etc.
- Some landlords have purchased capital items and by the use of operating leases or hire agreements, have turned a capital costs that are not recoverable, into an operating expense.
- In Victoria, **Section 41** of the act, more specifically defines Capital expenditure non recoverable from retailers as “on any areas used in association with a building and plant in a building”

12 Hydraulics/ Equipment Hire

- This expense cost classification is used in the main by one major property group. Hydraulics according to their chart of accounts, includes repairs and maintenance of sewerage systems.
- Firstly it is necessary to ensure that these expenses are not capital costs and that such costs are not being charged separately by councils as part of the statutory outgoing.

- Equipment hire usually includes scissor lifts and cherry picker equipment hired for roofs and lighting repairs which are genuine outgoings.
- However, this expense has now also become a dumping ground for lease back deals of shopping centre assets.

13 Outside the Lease Terms - " Acceptable" Outgoings

- From time to time, a retailer due to special circumstances at the centre, may negotiate as a "trade off" for other considerations by the landlord, to pay for outgoings outside the provisions of the lease.
- Ensure that these acceptable outgoings are authorised and fully documented and maintained with lease records. From time to time check to see if the circumstances that gave rise to such additional outgoing cost have changed.

MANAGEMENT FEES

VICTORIA

BACKGROUND

Section 49 of the Retail Leases Act 2003, places a limit on the recovery of management fees from retailers based in Victoria, who are subject to the act

INTERPRETATION OF THE ACT

- Such increase must not exceed CPI
- At the time of preparing the budgeted outgoings, only the CPI for the March quarter is available and must be the CPI percentage that must be used.
- The landlord in order to comply with the requirement of certainty and fairness as provided for in section 1 of the Act 1 should show this capping calculation of management fees on the budgeted outgoings statement, to indicate that he has complied with Section 49.
- As the section is clearly applicable as to when “the retailer is liable to pay” it seems logical that the cap applies when the retailer starts to make payments in terms of the budgeted outgoings (sent to him).
- When the actual management fees are determined for the year ended 30th June as certified by the auditors, the CPI adjustment will be recalculated.
- The management fees charged must comply with Section 49(a)(ii) and be exclusive of salaries and other administrative costs relating to the operation of that building or shopping centre.

- These costs are often shown by landlords on the outgoings statements as direct administration costs of the centre .eg centre management salaries. Then there are further charges termed management fees.
- Management fees are thus merely arbitrary outgoings charged by the landlord to increase his revenue without it being an actual reimbursement of a cost actually incurred. Thus one has to ask what an outgoing really is.

What then is an outgoing?

- Retailers under a retail lease where the premises are located in a shopping centre, are only liable to contribute to the outgoing of the landlord, if that outgoing benefits specific retail premises in the centre and that retail tenancy benefits the retailers premises.
- Remember that capital costs are not recoverable
- Management fees may, as part of the agreement to manage the centre, include elements of payment for some or all of the following
 - ❖ Development costs of the centre
 - ❖ Leasing fees for the first years income for new speciality Retailers
 - ❖ Fees for marketing and management of major Retailers
 - ❖ A fee based on a percentage of the assets in the property trust
 - ❖ A performance fee if the trust exceeds the growth of the property index on the Australian stock exchange

Under the Act in Victoria, these types of expenses clearly fall outside the definition of management fees that can be recovered as an outgoing from retailers with retail leases.

- Those Landlords who may have undertaken a substantial redevelopment of a shopping centre during the last 12 months, may be entitled to a major increase in management fees in future years, and they may be disadvantaged as the act is silent on this and the base management fee will only be subject to CPI increases. Once established, this may not be altered till a new lease is entered into.
- Clearly the 10% prescribed amount of the total outgoings which must be shown separately in the auditors report as set out in regulation 12 of the Act, possibly require both the landlord and the auditor to show a more detailed breakdown of how management costs are made up.
- It is important to remember that when the lease expires, the retailer who was cushioned for increases under the Act could now be liable for the full management fees proportion at the start of a new lease.

WEST AUSTRALIA

- No management fees may be recovered from the tenant in West Australia. Only the cost of managing the centre, that is centre management expenses and salaries and cost of a maintenance team may be recovered but not management fees.
- Recently more and more leases in shopping centres are negotiated on a gross deal basis plus statutory charges, thus incorporating the management fee into the rent.

CHAPTER 14

DISCLOSURE STATEMENTS

Current legislation in all states has made the disclosure statement between landlord and retailer the fundamental document in ensuring transparency prior to the entering into of a lease.

Migrant retailers should always insist on a Lessor's Disclosure Statement being given to them. It must contain all the information as contained in the schedule attached to the Acts in all states.

Remember the details as contained in the statement continue to be considered factual throughout the term of the lease and throughout the term of any renewal, pursuant to options contained in the original lease. If any of the representations are misleading, the retailer may recover damages.

It is vital that you insist on all details and representations given to you by the landlord or his representative during the negotiation phase, be included in the disclosure statement.

THE NEW UNIFORM DISCLOSURE STATEMENT HIGHLIGHTS

INTRODUCTION:

The states of Victoria, New South Wales and Queensland have agreed that there would be one uniform landlord disclosure statement which will apply in those states.

To confirm this new arrangement, all 3 states have passed and gazetted new retail lease regulations entrenching the use of this new disclosure statement that came into effect on 1 January 2011.

WHY THE CHANGE?

It was anticipated that the nationally harmonised form of Disclosure Statement will have benefits for both tenants and landlords.

Tenants will benefit from the increased disclosure by landlords regarding certain provisions in the Retail Leases Acts, so that they are better informed of their rights and obligations under the lease and thereby may make better decisions about their business and whether they still wish to enter into a lease.

Landlords will benefit from a reduced regulatory burden, particularly landlords who own and operate shopping centres in multiple states.

However, as the retail leases acts remain separate in each state, the implications and consequences of the new disclosure statement may still affect tenants differently in each of the 3 states. To date none of the other states have indicated any interest in joining into the Uniform Disclosure Statement.

WHAT HAS CHANGED?

The main fundamental change that we find is that there is no longer a separate disclosure statement for a shopping centre and a non shopping centre building or tenancy. In the case of a shopping centre tenancy, additional information is required.

WHAT HAS NOT CHANGED

- The new disclosure statement and lease must still be given to the tenant in terms of Section 17(1) at least 7 days before the lease is entered into.
- If a tenant has not been given a disclosure statement he/she may give the landlord or his agent no earlier than 7 days and no later than 90 days after entering into the lease, a written notice that the tenant has not been given the disclosure statement.
- In Victoria the tenant may then withhold rent until the disclosure statement is given and is not liable for rent from the day on which the tenant gave notice until the day the disclosure was given.
- The tenant may then terminate the lease by written notice within 7 days after receiving the disclosure notice.
- If the premises are not available for handover on the date specified in the disclosure statement, the tenant is not liable to pay for rent prior to that date.
- If any information in the disclosure statement is misleading, false or materially incomplete, or the tenant has not been given a copy of the proposed lease, then the tenant may give the landlord or his agent written notice of termination of the lease within 28 days of the tenant, either being given the disclosure statement, the tenant being given a copy of the proposed lease, or the date the lease is entered into, whichever is the later.
- The landlord still has the right to object to the termination on the ground that the landlord acted honestly and reasonably and fairly ought to be excused for the contravention and the tenant is substantially in as good a position as he would have been if there was no contravention.

- If the lease requires the tenant to pay or contribute towards the cost of a fit out, such a provision is void if that liability was not disclosed in the disclosure statement. This is particularly relevant in the case of category 1 works which the landlord usually does but is paid for by the tenant.

If on assignment of the lease, the tenant asks the landlord to give him a current disclosure statement from a specified date, that is within 3 months before the statement is given, this may entail the landlord or his agent to prepare a new uniform disclosure statement. The landlord or agent can still recover reasonable legal and other costs in connection with the assignment of the lease or sub lease.

- Even though you will notice that the new disclosure statement in section 14.2 allows for an outgoings under the heading of repairs for a “Sinking Fund for Repairs and Maintenance” the Victoria Act provides that a provision in a retail lease is void to the extent that it requires the tenant to make a contribution to a sinking fund for capital works.
- The Acts in the other states do allow for the creation of a sinking fund for future capital works which can be recovered from the tenant as an outgoing.
- As the new statement requires additional information to be given if the property is a shopping centre, the new migrant retailer must look at the act as to the definition of a shopping centre. For example, in Victoria the Act provides that a retail shopping centre means a cluster of premises that has all of these attributes:-
 - At least 5 of the premises are retail premises

- The premises are owned by the same person or have (or would have if leased) the same landlord or head landlord
- The premises are located in a single building or in 2 or more buildings that are adjoining, or separated only by common areas, or other areas owned by the owner of the retail
- The cluster of premises is promoted or generally regarded as constituting a shopping centre, shopping mall, shopping court or shopping arcade premises or separated only by a road

KEY ISSUES AND SPECIFIC ITEMS A NEW RETAILER SHOULD LOOK FOR IN THE DISCLOSURE STATEMENT

- Whereas the old Part 3 required the landlord to set out structures, fixtures, plant equipment and services to or in the premises provided by the tenant, which may or may not have been completed fully by the landlord or his agent, the new disclosure statement sets out a list of 22 items which are required to be highlighted as has been provided to the premises.
- In addition we have a new section 1.5 which requires disclosure of services and facilities for the benefit of the premises, for example security services, cleaning etc.
- Section 2.1. Description of permitted use is the same as Part 5 section B of the old statement, except it comes with a warning to the tenant that it should investigate whether the proposed use of the premises is lawful under relevant planning laws.

- Whereas the old lease requires the lessor to provide that the tenant will have the right to sell the following goods or services and what goods and services the tenant may not sell. The new section 2.2 requires the landlord to answer yes or no as to whether the whole of the permitted use is exclusive to the tenant.
- Whereas previously the landlord had to show the number of car parks in the centre in total and the number of car parking bays available for the tenants exclusive use, the landlord now has to show, in addition to the above, the number of available spaces for customers of the building/centre.
- Section 4 is a new requirement and requires the landlord to state yes/no as to with whether the premises are leases under a head lease or crown lease. If the answer is yes, the next question is whether the landlord has provided a copy of the head lease or crown lease to the tenant. In addition, section 4.1 requires the landlord to state the current term of such lease and whether there is an option to renew and for how long such options are for and the period.
- Section 4.4 also requires a disclosure by the landlord as to whether or not the head landlords consent is required for the proposed lease to be entered into between landlord and tenant.
- It is not necessary for a survey plan to be annexed to the disclosure statement.
- In section 7.1. the handover date (actual or estimated) must be shown if different from the date the lease commences.
- Whereas the old disclosure statement provided for only a list of the tenant's works to be performed by the tenant at its cost, before the commencement date of the lease and during the lease term, the new disclosure statement now requires in

Section 8.1, a description of works to be carried out by the landlord, before the lease commences.

- In addition, section 8.2 requires the landlord to provide an estimate of the expected contribution by the tenant towards the cost of the landlord's works as well as the costs in relation to any maintenance and repair outgoings which has been included in the schedule of outgoings.
- The landlord has to also state, which was not required previously, whether he (the landlord) has requirements as to the quality and standard of shop front and fit out. This may be by way of a fit out guide.
- The landlord must state whether the tenant is required to provide details of turnover.
- There is also a note in the disclosure statement, telling the tenant that the landlord may be prevented by the Retail Leases Act, from claiming certain costs e.g, recovery of land tax under section 50 of the Act and the landlord's liability for repairs under section 52. Also section 41 prevents the landlord from claiming any capital costs of the building in which the premises are located.
- Whereas previously the landlord merely had to state whether planning approval for any renovations, redevelopments or the extension of the centre had been obtained, now the landlord or his agent needs to state whether there are alteration works, planned or known to the landlord at this point in time, to the premises or building/centre including surrounding roads during the term or any other further term or terms.
- The new statement now requires the landlord or his agent to actually state the clause number in the lease dealing with the relocation of the tenant and with the demolition of the premises or centre/building if applicable.

- The landlord must now provide the core trading hours specifically relevant to the tenant (not the shopping centre/building) on a day by day basis, including trading on public holidays. Thus, if a trader like a pharmacist or a gym or video shop works outside the normal centre hours, this must now be stated.
- This raises the question as to whether the tenants trading hours, if agreed, will not be subject to a late night trading charge for hours worked outside normal centre trading hours.
- There is a further clause which provides for whether the tenant is permitted access the premises and centre/building outside trading hours.
- Whereas previously the landlord had to show the number of retail premises in the Centre, the new statement requires the landlord to state the number of shops.
- The new disclosure statement requires the disclosure of annual turnover figures of the centre for the previous accounting period, if collected by the lessor.
- The turnover will have to be declared on either a GST inclusive or GST exclusive basis, which may be different from what is often declared in shopping centre reports, which includes GST in turnover figures.
- This will again give tenants access to confidential information and may cause some problems in negotiation, particularly if figures show a downward trend.
- The new disclosure statement requires the disclosure of information for speciality shops, for previous accounting period, and on a per square metre basis.
- Again the information must be provided if collected by the landlord.

- The information must be identified into no less than 3 categories namely food, non food and services.
- The new section 23 of the new statement requires the disclosure of the expiry date of leases of tenants of more than 1000 square meters.
- This requirement although not contentious, is subject to the person completing the disclosure statement, ensuring that that the expiry dates of such tenants are absolutely accurate and could lead to a claim for misleading and deceptive conduct.
- Under new section 24, the floor plan to be provided must, in addition to showing the tenancy mix as previously, now also show common area trading, kiosks and major tenants.
- The old assurance by the landlord that the centre “is an ongoing entity and changes will take place from time to time”, is no longer relevant in the new statement. The landlord must answer yes or no as to whether he assures the tenant that the current tenant mix will not be altered by the introduction of a competitor.
- To comply with this, landlords may have to undertake some extensive research on each category in a centre, to ascertain the impact an additional tenant will have on the category.
- Details of customer traffic flow are still required in the new statement with a schedule to be attached showing this. As this is a schedule we may have to show traffic flow for a number of years.
- It may also require lessors to ensure that the equipment used to measure traffic flows, are carefully tested and monitored for accuracy and if there are inaccuracies, that the lessor has used its best endeavours to ensure that the equipment has been properly tested.

- If the centre adheres to the Casual Mall Leasing Code of practice as determined by the Shopping Centre Council. A copy of the casual mall policy must now be included with the disclosure statement.
- Section 27 of the new disclosure statement has a new requirement to disclose details of any current legal proceedings in relation to the lawful use of the premises or building/centre.
- However, there is no definition of either the term “lawful use” or current legal proceedings.”
- It seems that to comply with this section, the landlord or agent will have to provide a list of any proceedings that is ongoing between the landlord and any tenant in say that centre or complex.
- In NSW where this clause originates, interpretation was that it applies where there is a legal proceeding, say in the granting of DA approval for the centre.
- Besides affecting the confidentiality of discussions between landlord and tenant, disputes may include claims for arrear rent or spurious disputes by a tenant. The disclosure of such information to a new or existing tenant may affect the future relationship between the landlord and the tenant.
- We now have a section 28 that must be completed, dealing with any oral or written representations made by such landlord or agent during negotiations.
- Section 31 requires an acknowledgement by the tenant. In the other two states we previously had a lessee’s disclosure statement which was not applicable in Victoria. This new acknowledgement confirms and acknowledges that the tenant received the disclosure statement.

- It also comes with a warning and a checklist for all tenants who should consider 9 key questions before signing the document namely:
 - Does the planning authority allow your proposed use for the premises under planning law?
 - Is the security of your occupancy affected by
 - ❖ Mortgage charges or encumbrances granted by the landlord?
 - ❖ Rights and obligations under a head lease?
 - Do the premises comply with building and safety regulations? Is the premises affected by outstanding notices by any authority?
 - Could your trading be affected by disturbances or changes to the building/centre?
 - Does the landlord require you to refurbish the premises regularly or at the end of the lease?
 - Can the landlord end the lease early even if you comply with the lease?
 - Are all the existing structures, fixtures, plant and equipment in good working order?
 - Are you required to make good the premises at the end of the lease?
 - Is the tenancy mix of the shopping centre (if applicable) likely to change during the term of the lease?

- Failure by the landlord or his agent to have answers to all these questions, may give the tenant second thoughts about entering into the lease and as such he must be prepared.
- If applicable, the following attachments must be included with the disclosure statement
 - Plan of premises
 - Head Lease or Crown Lease
 - Any additional attachments
- If the premises are in a retail shopping centre, the following additional attachments must be included if applicable
 - Floor Plan
 - Customer traffic flow statistics
 - Casual Mall licensing policy
 - Any additional attachments

CHECKING THE DISCLOSURE STATEMENT AFTER THE DEAL HAS BEEN NEGOTIATED

Quite often the migrant retailer is required to check the Disclosure Statement after the deal has been concluded.

The details as contained in the statement continue to be considered factual throughout the term of the lease and throughout the term of any renewal pursuant to options contained in the original lease. If any of the representations are misleading, the tenant may recover damages.

It can't be emphasised enough that you insist on all details and representations given to you by the landlord or his

representative during the negotiation phase, be included in the Disclosure Statement.

In particular check all the correspondence carefully. Quite often concessions obtained early in the lease negotiations are not carried forward to later letters.

Also be aware that concessions won from the same landlord in other lease negotiations should be transferred to the current lease. Insist that they be included in the new disclosure statement and also carried forward to the lease.

If you are having the lease checked by your solicitor or consultant, ask him to check to ensure that the provisions of the disclosure statement have been carried forward to the final lease terms.

CHAPTER 15

ADMINISTERING THE FIT OUT OF THE PREMISES

A proper administrative process needs to be followed in the fitting out of the premises. Do not simply leave this to your fit out contractor.

If you are going into a new centre or to the redeveloped area of an existing centre, ensure that you sign a proper fit-out agreement with your contractor, clearly spelling out your fit-out contractor's rights and obligations.

Ensure that your agreement is not in conflict with those of the main builders. If your contractor breaks the site rules, the whole site could go out on strike and you could be faced with a heavy damages bill.

Ensure that any obligations imposed in the agreement to lease or lease document which you signed are stated exactly the same in the fit out agreement.

Be certain that the fit out contractor is covered with the required contractor's insurance and public liability insurance.

All parties must be clear on the date the store will be handed over to your shopfitter, the date of practical completion, and the date your lease commences.

Be careful not to be caught up in a situation whereby the lease commencement date is specified to be the date of practical completion of the centre. Should your fit out take the usual 4 weeks to complete, this may mean as mentioned above, that your first rent review may be much sooner than you anticipated. ie after 11 months trading and not one year later as planned.

If you have negotiated an incentive deal with the landlord who may have contributed to your fit-out, always make absolutely certain you are aware of which fittings will remain the property of the landlord and which you will be entitled to remove.

The taxation implications of this type of incentive are very complicated. You should first discuss this with your tax adviser before proceeding.

Ensure that all lease incentive payments negotiated with landlords are received on due dates and passed on to the fit out contractor.

THESE ARE THE CLAUSES THAT SHOULD BE INCLUDED IN CONTRACTS OR ORDERS AWARDED TO FIT OUT CONTRACTORS

Example of Legal Document

In accepting an order from the retailer, a fit out contractor must acknowledge and confirm the following conditions pertaining to the contract:

- That I understand and have received confirmation from the retailer as to the date the fit out is to be completed. I further acknowledge that time is of the essence in the completion of the contract and that we have at our disposal sufficient resources and manpower to complete the fit out on time
- That the price contained in the agreement is a fixed price and any variations will only be payable with the prior agreement of the retailer before undertaking such additional works.
- That I have read the tenancy design and fit out guide and do not believe that there are any provisions or conditions in the guide that I can not meet. In any event I will comply with such except where there is a conflict.
- I will undertake to use only new material or as agreed with the retailer.
- That I have examined the drawings and specifications and confirm that the proposed fit out will meet these specifications and designs and will not require any further modification or variation.
- That I have sufficient contractor's insurance (not less than \$20million in public liability to meet the requirements of the agreement to lease.

- That I have read and understood the site conditions that apply during my fit out and that I will undertake to comply with these provisions. Any claims arising out of a breach of such conditions will be for the account of the fit out contractor without any recourse to the retailer.
- The works will be carried out during normal working hours unless the landlord in its discretion allows access at other times.
- In the event of any disputes, I undertake to abide by the decision of an architect appointed by the Institute of Architects.
- That I am satisfied that the lessor has completed all its works as contracted for in their agreement to lease prior to fit out.
- That I have obtained all the necessary permits, consents and approvals required under law, before the retailers works are carried out.
- That I am satisfied as to the charges to be made to the Retailer regarding category 1 works. I will undertake to either agree such costs or proceed with and assist the retailer to arbitration by a quantity surveyor in term of the retail leases act.
- I will undertake to keep the premises tidy and clean and on completion of the works to remove from the site all waste and debris wrappings and residual materials which result from the retailers works.
- That I will rectify all damage to the premises or the land or any part of them directly or indirectly as a result of carrying out the retailers works.
- I will further undertake to indemnify the Retailer from any claims arising out of delays caused by any or incidental to the execution of the retailer's works.

- Any designs and intellectual rights regarding the fit out will at all times remain the property of the retailer.

Signed _____ Date _____

TAKING OVER OF THE STORE FROM THE LANDLORD READY FOR FITTING OUT

CONDITIONS FOR HAND OVER OF PREMISES

You should ensure that there is a clause in the disclosure statement or confirmation by the lessor, that the retailer will only agree to take possession of the premises from the lessor as being complete and ready for fit out provided that at least:

- a. All lessors' works have been completed
- b. The premises are handed over with a smooth floor in broom swept condition and with plasterboard ceilings and walls
- c. There is a supply of water and waste to a point and there is a basin and tap that conforms with the design criteria
- d. The sprinkler system including the sprinkler heads are fully installed in line with the design criteria
- e. There is an electrical board with standard power in line with design criteria
- f. The air conditioning system and air conditioning registers have been installed to suit the design criteria and that the

quality of air conditioning provides comfort, even when the lighting exceeds 50 watts per square metre of floor area.

- g. The premises are water sealed and weatherproof.

ANALYSIS OF RESPONSIBILITY FOR SPRINKLERS, EMERGENCY LIGHTING, FIRE DOORS, FIRE HYDRANTS AND FIRE REELS AND HOSES IN THE TENANCY AND CENTRE

- Landlords, particularly of large shopping centres, are currently under extreme pressure from state governments and state emergency services, to ensure that the emergency services and fire equipment within their centres comply with set standards.
- In states like New South Wales, the Council regulations stipulate that the shopping centres provide the councils with satisfactory Maintenance Essential Services Certificates on a 6 monthly basis. These certificates must relate to the centre as a whole and must encompass all tenancies.
- In Victoria, under regulation standard AS :2293, a compliance audit needs to be conducted every 6 months of the emergency and exit lighting which also includes any lighting within the store.
- Such testing is required to be documented to check that the lighting illuminates and that the battery backup operates correctly and successfully powers the emergency and exit lighting for 90 minutes. A logbook to this effect must be kept on the premises.
- Many major landlords have emergency systems compliance audits in the shopping centres that they manage. As a result, the landlords have letters requesting the retailer to comply by

either undertaking this rectification themselves or to contact their agents who will charge for the service.

- Following the recent bush fires in Victoria, this issue is likely to become a major issue between landlord and tenants.
- Most of the state emergency requirements clearly provide that the owner of the property has the ultimate responsibility for ensuring that fire fighting equipment is installed and properly maintained and there are severe penalties for not complying.
- In addition, with spiralling insurance costs, landlords have been pressured by risk management departments from their insurers, to check that emergency services are properly audited and maintained.
- Many landlords have begun formal compliance audits and retailers in their centres have been sent letters requesting them to conform to the retailer's responsibility.
- This has raised the issue of responsibility for emergency services as required under the lease.
- Most of the shopping centres run a building intelligence program that monitors emergency and exit lighting within the centre. Westfield have a specific outgoings charge to cover this.
- AMP include in their outgoings, a charge entitled "stand by equipment" which presupposes that they have equipment in all centres like back up generators that will cut in if electricity fails and will thus provide emergency lighting.
- ❖ Migrant retailers must familiarise themselves with the Australian standards covering emergency services referred to above and should have a designated person at their disposal to advise them on this.

- ❖ The retailer must include in his lease offers the requirement of a special condition to be included in the lease (not just in the agreement to lease) which spells out the lessors and lessees responsibility in dealing with emergency lighting, fire doors, fire hydrants, sprinklers and fire hoses etc.

CHAPTER 16

ADMINISTERING TURN KEY PROJECTS

More and more larger retailers are using a method known as “turn key” projects to finance the enormous cost of fitting out the store. This means that the landlord undertakes to fit out the premises up to a certain amount, in exchange for an additional rental, so that the retailer receives a minimum interest loan and pays it back monthly by way of rental.

The amount paid back is the same each year and is not subject to rental increases as would be the normal rental for the premises.

The assets, up to the amount of the turn key amount, are retained by the lessor as an asset on which it can claim depreciation over the period of the lease.

The tax implications can be beneficial to both parties, but this is subject to advice from the tax adviser of either party and this needs to be carefully discussed by all parties before embarking on such a course of action.

Remember for tax purposes, the landlord is required to charge an amount for interest even if such amount is only a nominal amount.

The retailer can claim the extra rent as a tax deduction and the landlord achieves what he wants, namely getting the loan back by way of a tax deduction as depreciation or a lease incentive (in some cases).

Note that this additional rent does not form part of any formula in the lease for purposes of calculating rent.

The only way to control leases with this type of financing, is by restricting the lease schedule to show the normal rent as base rent and the turnkey rent as special rent. This will allow the monitoring of percentage rent calculations accordingly.

In most states there is unlikely to be stamp duty payable on this additional rent.

Note that GST is payable on both rentals

Given the problems in the current economic climate which makes obtaining finance from banks to pay for fit outs difficult, this technique of negotiating rental deals has become quite popular.

CHAPTER 17

OPTION RENEWALS AND EXERCISING YOUR OPTION UNDER THE TERMS OF THE LEASE

Not many major landlords are prepared to offer tenants an option in their leases. However, smaller landlords trying to secure a good tenant for a long period are prepared to offer options in leases.

If you have secured a lease with an option, there is a distinct process you need to go through, in order to exercise such an option

Your management schedule will alert you to the date by which you have to exercise your option.

Remember that an option in a lease is a right that the tenant has and not the landlord.

The tenant alone can decide whether he will exercise the option or not.

Until the tenant formally exercises the option, the landlord may be uncertain whether the tenant will continue in occupation or whether he will have to go out and find a new tenant, maybe even at a reduced rental.

Providing you ensure that you do not miss the deadline date, you could use the opportunity to improve conditions in the lease by

requesting the landlord to vary certain conditions as part of the option exercising process.

You can find that taking advantage of the landlord's vulnerability at this stage can often result in variations to clauses in the lease which are currently to the tenant's disadvantage.

The ability of the tenant to take advantage of this situation will often be determined upon how you have negotiated the original option terms of the lease:-

If you are able to negotiate options to renew the lease make sure that they are not restrictive.

Never accept a clause that grants an option stating that the landlord could cancel this option if he wishes to redevelop or refurbish that part of the centre.

To be on the safe side, you should always retain the right to exercise your option to take up premises in an alternate site in the centre if there is to be a redevelopment of the centre involving your store.

Avoid clauses in leases where the landlord demands "due and punctual performance" of all of the terms and conditions of the lease throughout the term as a pre-condition to the exercise of an option.

Be sure to have your solicitor water down such a clause to enable you to exercise this option, provided you are not in breach of the lease "at the time of the notice exercising the option or at the expiration of the term of the lease".

If you do exercise the option for a further term, the retailer ***must under no circumstances*** write a conditional exercise of the option

This is an example of letter you do not write

“In terms of clause 4 of the lease, we hereby exercise our option for a further term of 3 years providing we can arrive at a lower rental than at present”

This is a conditional exercise of the option and if the landlord so desires he may argue that you have not exercised your option

This is an example of letter that you *do* write

“In terms of clause 4 of the lease, we hereby exercise our option for a further term of 3 years.

Then a day or so later you will write the following letter to the landlord

“As you are aware we have exercised our option for a further term of 3 years. However we are unhappy with our present rental and before we proceed to market value as per the lease, we would like to meet with you to discuss a possible lower rental”

CHAPTER 18

RIGHT TO RECEIVE COMPENSATION FROM A LANDLORD IN A SHOPPING CENTRE IF YOUR TRADING ACTIVITY IS DISRUPTED BY THE ACTIONS OF THE LANDLORD

Quite often the retailer may be advised by the store manager that the landlord has commenced a redevelopment of the centre and that the car park servicing your store, has been closed. Alternatively the landlord could have put up hoardings and as a result customers can no longer see the store. What do we do now?

Given the large amounts of refurbishment and redevelopments that have taken place in shopping centres throughout Australia, and the disruption that such redevelopments have caused to tenants, one of the most powerful protection tools available to tenants, is contained in all the **State Retail Acts**.

The Act gives the tenant the right to receive compensation if the landlord behaves in a way that disrupts the tenants business. The wording in most State Acts is similar

LET US LOOK AT THESE COMPENSATION PROVISIONS MORE CLOSELY

The lessor “is liable to pay” to the lessee reasonable compensation for loss or damage suffered by the lessee when the landlord, or a person acting under the landlord’s authority:-

- relocates the lessee’s business to other premises during the term of the lease or any renewal of it or substantially restricts the lessee’s access to the leased shop or takes any action (other than action under a lawful requirement) that substantially restricts or alters access by customers to the leased shop or the flow of customers to the shop or causes significant disruption to the lessee’s trading in the leased shop.
- Does not take all reasonable steps to prevent or stop significant disruption within the lessor’s control.
- Does not fix as soon as possible any breakdown of plant or equipment under the lessor’s care and maintenance or any defect in the retail shopping centre or leased building containing the leased shop, other than a defect due to a condition that would have been apparent to the lessee when the lessee entered into the lease.
- Neglects to clean, maintain, or repaint the retail shopping centre or leased building containing the leased shop or the part of the centre or building that under the lease is the lessor’s responsibility.
- Causes the lessee to vacate the leased shop before the end of the lease or renewal of it because the extension, refurbishment or demolition of the retail shopping centre or leased building containing the leased shop.
- ✓ **Section 43(2) of the Queensland Act** further provides that the lessor is liable to pay the lessee reasonable compensation for loss or damage suffered by the lessee

because:

the lessee entered into the lease or a renewal of it, on the basis of a false and misleading statement or representation made by the lessor or any person acting under the lessors authority or

- ✓ the leased shop was not available to the lessee for trading on the specified date in the disclosure statement because of the default of the lessor or anyone acting under the lessors authority

The amount of compensation payable under the above situations will be decided by way of the dispute process and any provision in a lease is void if it tries to limit the amount of compensation payable under this section

If the retailer believes that any of the above situations have occurred, he should immediately notify the lessor of his intentions to take action under the Act.

The amount of the damages will be determined later. The amount to be claimed is “the gross profit that would have been earned on any fall in sales compared to the same period in the previous year as a result of any of the situations outlined above”.

CHAPTER 19

LEASE IMPLICATIONS OF UPSIZING THE PREMISES

More and more speciality retailers, in an attempt to compete with the large power stores are up-sizing their premises. This often is done by either taking over the store next door when the lease on that store expires or building and adding it onto the existing premises.

This action to up-size could affect the lease on your existing store and tenants who embark on this course of action should take into account the following:-

- When breaking down walls etc always re-measure the total size of the premises. Often the new size of the combined store is not the sum of the two store sizes as provided in the original individual leases
- Rentals per square metre for larger stores are often lower than for specialty stores.

Thus, if you have extended your store, it is critical that you re-negotiate your rental on the combined premises. Do not simply add the rental paid on the new store to your existing store to arrive at the total rent payable. Remember larger stores pay a smaller rental per square metre.

Ensure that the city council is aware of the consolidated status of the new store and you are assessed for rates and taxes accordingly.

It is critical that you get the original lease to be varied so that rental adjustments and terminations on both stores are synchronised to a common date.

Usually the up-sizing of a store will entail the investment of a substantially increased amount of stock. This may also entail that you need a store room facility in the centre to carry reserve stock holdings.

Try to negotiate such a storeroom by way of a licence agreement simultaneously with the new lease to be contiguous with the new lease and ending on the same date. Usually such store room facility should be on a rental only basis with no outgoings payable on such area

Be careful that the increased size does not take you over the 1000 square metre rule as this could then take your lease outside the protection of the Act

CHAPTER 20

RELIEF AGAINST FORFEITURE OF THE LEASE WHERE A LANDLORD LOCKS OUT A RETAILER

Whilst some states have some form of relief from forfeiture if the landlord locks a tenant out, the State of Victoria has some special provisions which the tenant should be aware of as follows:

- The Victorian Administration Tribunal that hears all retail disputes, in that state, is the only body that can hear a claim by a retailer against a landlord for relief from forfeiture in the event of a lockout from the retail premises
- Even though the landlord may have grounds for locking out the retailer, the retailer, provided that he promises to correct whatever caused the lockout, may under this section of the act, seek relief.
- In addition, since section 92 provides that each party must pay its own costs, the landlord **may not** recover legal costs from the retailer. Thus a landlord may win but actually lose.

This is a very useful defence for a retailer who is being threatened with a lockout.

CHAPTER 21

SOME ADDITIONAL TERMS AND CONSIDERATIONS THAT COULD BE INCLUDED IN LEASE OFFERS

Quite often the parties think that they have agreed on the commercial terms of the lease and later when the retailer receives the landlord's standard documents and conditions, he may find them totally unacceptable.

To overcome this, retailers are advised to put the following special conditions in their lease offers.

Kiosks

- No Kiosk (other than existing Kiosks) will be permitted within 10 meters of our lease line which will affect the view of our store or impair ingress or egress from our store”

Method of Payment of Rent

- The payment of rent and outgoings will be by electronic transfer and not by direct debit

Opening Promotion Levy

- If the tenancy is to be in new shopping centre and a once off opening promotion levy is to be charged, this levy shall be payable 14 days before the commencement of trading from the store.

- In addition, the landlord will provide details within 3 months of opening on how such opening promotion contributions have been spent.

Consulting Fees

- The retailer will not be responsible for the payment of any consulting, plan approval or engineering costs in respect of the fit out.

CPI Rent Increases

- If rent increases are to be calculated on the basis of CPI plus a fixed percentage, which is permitted in all states except Victoria, it is important to secure a provision in the lease that ensures that should CPI be negative and that rent will fall accordingly on the anniversary date of the lease.
- In difficult retail trading times as at present, it is not unusual to see wording in leases for the CPI to be “no greater than 4% and not less than 1%.

Tenancies in Strip Centres

- If the retailer is opening a store in a strip centre which may be subject to flooding from storms, the lease offer must provide that the lease contains a condition requiring the landlord to ensure that on hand-over of the premises to the tenant, the premises are water and weather sealed.

Insurance

The following provisions should also be included in the lease offer:

- Public Liability Insurance will be taken out to an amount of \$20m and in addition the retailer will only maintain an industrial special risks policy
- The company's insurance policies are to be in the name of the retailer only but the lessor's interest will be noted in the policy

Fit Out Contributions

- If an incentive deal has been negotiated with the landlord who may have contributed to your fit-out, make sure that there is a provision in the lease that such fittings making up the contribution, will remain the property of the landlord for the term of the lease, but the retailer may or may not remove at the end of the lease term.
- In the case of a fit out contribution which includes a pay back provision, you need to be certain that there is a provision in the lease that in the event of an assignment of the lease to an assignee acceptable to the lessee, no repayment of the fit out contribution will be required if the assignee is prepared to accept this contingent liability.

Cost of Hoardings during Fit Out

- All costs of hoardings during the store fit out will be payable by the lessor.

Painting and Restoration during the lease term

- Painting and restoring of the premises during the lease term and option periods will occur as and when by mutual consent

Quality of Air Conditioning to be provided

- You should request a provision in the lease to ensure that: “The lessor shall provide air conditioning to the premises of a quality so as to provide comfort conditions even when the lighting heat intensity exceeds 50 watts per square metre of the floor area of the demised premises including other heat producing equipment within the premises”. This is in accordance with the Australian standard.

Fire Walls, Sprinklers and Emergency Lighting

We require a provision in the lease or confirmation from the landlord that irrespective of these costs being included in the definition of outgoings in the lease, the landlord covenants and will ensure the following:

- That the landlord conducts a six monthly inspection of the fire walls and that these are tagged to this effect
- That the landlord conducts a 3 monthly inspection to ensure that the pressure is correct to the sprinklers in your tenancy and that they will work in the event of an emergency
- That all fire hydrants hoses and reels within the common area of the centre are also checked at least every 3 months to see than the equipment has not been vandalised and that it will work in an emergency.

Change of Signs and Colour

You need to make sure that that the lease contains a provision that no permission will be required from the landlord in the event of a total change of corporate colour or image change of the entire network

Restoration of Shop front during lease term

- You require a provision in the lease that this will only be done if mutually agreed by both parties.
- You must ensure that clauses dealing with repainting and restoration are not at fixed intervals but activated as and when necessary, as mutually agreed.

Services

- In the event of electricity or gas being provided to the premises by the lessor to the premises, (as compared to buying electricity from an independent provider), this will be charged at the same tariff rate as paid by the landlord or at the best available rate. In addition the retailer will be able to acquire such services from its own providers.

Relocation

You require the following wording in the lease offer:

- The alternative premises offered to the tenant will be in no worse a position in the centre that what he currently enjoys.
- The rental will be the same rental as the current lease adjusted to take into account the commercial value of the new premises at the time of relocation (as agreed by the parties or in the absence of agreement as determined by a valuer appointed by the Small Business Commissioner as in the case of Victoria).
- The lessor will, in addition, agree to waive the making good and decommissioning costs of the existing premises and pay for any surrender of lease legal costs.

Market Reviews in Victoria

- If your premises are in Victoria and there is to be a market review on the exercise of the option in the lease, make sure

that there is a provision in the lease for the market review to be completed first before you have to exercise your option. Other states have the timetable the right way around.

Lease Term:

- Should the date of commencement of trading be delayed as a result of the late handover of the premises prior to fit out, then the commencement date and the termination date must be adjusted accordingly.

Storeroom:

- In the event of a storeroom being supplied as part of the deal, you must request a licence agreement be supplied for the storeroom to run concurrently with the lease and to terminate at the same time as the lease at a nominal rental of say \$1.

Unlike the main lease, no outgoings should be payable in respect of the storeroom premises.

New Shopping Centres:

If you are going into a shopping centre that is still in the process of being built and will only be completed after you have commenced trading, you need to have a provision that you will only pay a gross rental limited to a percentage of sales until such time that the centre is complete. The centre shall be deemed to be completed when all the following have occurred:

- ❖ All majors are trading
- ❖ Car Parking is 100% complete
- ❖ 95% of the specialty areas are trading or mall is substantially complete

Term of the lease

Whilst the term of the lease is a minimum of 5 years, it is important to understand from a retail point of view the months that this covers.

Many shopping centres that are built or refurbished, usually plan to open say in October, in anticipation of Xmas trading. If your lease is to run for 5 years from 1 October to 30 September, 5 years on do not be afraid to ask the lessor to have the termination date as 31 January, thus making the lease 5 years and 3 months. This will allow you to trade through Xmas before deciding whether to renew your lease or not.

Classification of your store

The classification of your store is very important, as the rental structure, future rental increases and even the percentage rent payable is determined by the classification.

Thus, for example, you will pay much more per square metre for a store that is classified as gift wares than for one that is classified as home wares.

Make sure that your classification is the one that best suits your business.

CHAPTER 22

SOME ADDITIONAL ADVICE DEALING WITH A LANDLORD IN AN ECONOMIC DOWNTURN

For those retailers who are about to renegotiate their leases, the following leasing tips will help secure a lease that sees you through the recession and will stand you in good stead for the next 5 years

- If your lease expires in 2011, ask for the first two years of the new lease term to be fixed at the agreed level, with the first increase to be at the start of year 3.
- Do not be afraid to ask for a substantial rental reduction at the start of the new lease. Landlords will be reluctant to lose tenants who pay their rent regularly.
- To overcome any landlord objections, insert a market review at the end of year 3 of the lease. This will allow the rental to be restored to market rent if the economy has recovered by that time.
- Many retailers have a storage area within the store that is not used for display. Do not be afraid to split the store area so that you will have a 10m² store room and a 140m² display area. This makes your rental payable for display calculated at current rentals while the rent for the storage area is calculated at storage rates e.g. \$200 per square metre with no outgoings for this area. Your overall rental cost for the 2 areas will be reduced.

- Instead of entering into a new lease, ask for the current lease to be varied for a further 2 years at the same or reduced rental, thus avoiding the necessity of a refurbishment of the store. You will be saving working capital which is difficult to obtain in the current climate.
- Request that the landlord increase his contribution to the promotion fund to attract more traffic flow to the centre.
- Use the opportunity to vary your permitted use to include other usages for the store.
- Take the opportunity to again request for an option to be inserted in the lease that will assist you, should you want to sell the store in the medium term.

CHAPTER 23

PURCHASING A NEW STORE AND TAKING OVER AN ASSIGNMENT OF THE LEASE FROM THE EXISTING TENANT OR ASSIGNING YOUR LEASE TO A NEW OPERATOR

When a retailer takes over a store from another tenant or the retailer plans to sell a store to another retailer, his or her understanding of the lease implications, is essential.

WHAT WILL A BUYER BE LOOKING AT IN THE LEASE WHEN CARRYING OUT A DUE DILLIGENCE ON THE PURCHASE OF YOUR STORE?

In arriving at the final selling price, it would be prudent for a potential buyer to carry out a proper due diligence on the lease, underpinning the purchase of the store. There may well be a number of provisions contained in the lease that may have to be taken into account in the final purchase price. These include:

- Does the lease provide for a refit of the premises at the end of the current lease term?
- If it does, the purchaser may have to spend \$100000 to \$1500000 of his own funds within a short while of taking over the store. This may mean that an appropriate sum of money may have to be deducted from the purchase price.

- Given the flat retail conditions in some centres, the store may have been enjoying a marketing or rental abatement of say \$2500 per month being credited to the monthly statement. This will mean that the rental paid as per the profit and loss presented will be understated (Often these rental abatements will cease on assignment.).
- Such credits should be added back and deducted from the profit of the business.
- Many leases provide for the painting of the premises every 3 years. This may well cost up to \$5000 for each painting.
- If the date for painting has not yet been reached before the takeover, a sum equivalent to the above should be taken into account in the purchase price.
- If you are buying a store in a rising rental market, and the lease calls for a market review, which is to take place after the new buyer has taken over, the purchaser may well have to ask for an independent valuer's opinion of what this may well be as a possible substantial, as any increase in the market rental will affect the future profitability of the business and should be taken into account when determining the profitability on which the return on investment will be calculated.
- Leases often provide for several months rental payment into the centre's promotion fund on the assignment of the lease. Who is to pay this assignment fee needs to be negotiated by the parties.
- In addition, some leases provide that on assignment of the lease, there is to be an automatic market review. Again you should ensure that you obtain an independent valuer's opinion of what this is likely to be and should be taken into account in determining the profitability of the business.

- It is important to ascertain the age of the lease. If the lease is old and currently in the second option period, you may well be stuck with all the old provisions of the various state Acts. This could be disadvantageous to the new buyer.
- It may well be a negotiating point for the buyer to rather negotiate a new lease than live with a “bad old lease”
- If the business is in an old centre that is likely to be refurbished or upgraded shortly, there may well be certain outgoings like building maintenance, or air conditioning being upgraded, or a new centre owner substantially increasing management costs. This could cause an increase in future outgoings costs. You need to take this into account in assessing the real future occupancy costs of the store.
- All leases provide for a make good provision at the end of the lease. If the store has been restructured to suit the needs of the current occupier, it may well create a substantial cost to put the store back to its original condition.
- Always request if there are photos of the store at the date of hand over. Comparing old and current photos will allow the purchaser to ascertain what the potential liability will be for making good at the end of the lease.
- New legislation in some states requires the person assigning the lease to provide a new disclosure statement on the centre. Make sure that you ask for this, as it will give you details of any future developments of the centre.
- If there is an exclusivity provision in the lease as to the number of similar businesses that may operate in a centre, make sure that this exclusivity continues on an assignment of the lease.

CHAPTER 24

WHAT CONSTITUTES RETAIL PREMISES SO THEY FALL UNDER THE PROTECTION OF THE RETAIL LEASES ACT IN VICTORIA?

This is a complicated section, due mainly to the wording of the Retail leases Act, therefore much interpretation is involved. Each lease has to be assessed individually. As this is a complex area, a consulting specialist in the field is often your best course of action.

The small business commissioner in Victoria issued the following guidelines on what constitutes retail premises and must be read in conjunction with section 4 of the Act.

The criteria for determining whether the premises are “retail premises” are set out in section 4 of the Act. The premises will be “retail premises” if the premises, or part of the premises, under the terms of the lease, are to be used wholly or predominately for the sale or hire of goods by retail or the retail provision of services (section 4(1)(a)).

Further, section 4(1)(b) provides that the Minister may determine that a specified business or specified kind of business is “retail” for the purposes of section 4

Note, the word “lease” which is used in section 4(1) is defined in section 3 of the Act as meaning a lease, sub lease, agreement for lease or sub lease whether or not in writing.

Guiding principles to determine “retail premises”

The Act does not define “retail”. Therefore an interpretation of the term must rely on its ordinary meaning. Therefore in order to determine whether the premises are “retail” each lease must be assessed individually, having regard to the nature and provisions of the lease, including the actual or intended use of the premises under the terms of the lease, and the actual circumstances in this respect.

The following guidelines derived from leading decisions of the Tribunal and courts are provided to assist in assessing whether the premises are “retail” premises.

If the lease expressly or impliedly prohibits retail use of the premises, there is an assumption that the premises are not retail. An example of an implied covenant prohibiting retail use of the premises, is a covenant requiring the tenant to comply with planning requirements and lawful use of the premises. For example, the local law and/or planning laws may prohibit the premises from being used as retail - that is, the premises may be located in an “industrial” zone.

How the premises are “used, or are to be used”

In the absence of an express or implied prohibition, the way the premises are used, or are to be used, under the terms of the lease, must be taken into account.

Actual usage may, in some circumstances, assist in the interpretation of the terms of the lease in this respect, but cannot contradict them. From the language of section 11(2) of the Act, it would appear that the way the premises are used or are to be used, is assessed at the time the lease is entered into. For some leases, there may be no actual use at the time the lease is entered into.

For example, when an agreement for lease is signed for the purpose of erecting a building on the premises, the commencement date of the lease is the date the works are completed and the premises are ready for trade. In these situations, the use is assessed according to the express or implied terms of the lease (this may be found in the “permitted use” clause).

However, if it is unclear from the permitted use clause whether a retail use is permitted, and the landlord and tenant are in dispute as to whether the premises are to be used for retail purposes of a particular kind or kinds, the Tribunal or a court (as the case may be) is likely to explore what the intentions of the landlord and tenant were, when they entered into the lease, to the extent that this intention can be determined objectively, that is, that the parties cannot give evidence as to their subjective intention.

Sale to the “ultimate consumer”

The provision of goods or services generally involves a sale to an “ultimate consumer”. This is the ordinary meaning of “retail” consistent with definitions found in various authoritative dictionaries. These dictionary definitions indicate that it is implicit in the concept of “sale” that goods are sold at a price, which involves the payment of money. The position is similar with respect to the meaning of “hire” (ie “hire” does not mean merely “lend”, gratuitously, as “sale” does not involve “giving” in the usual sense).

The ultimate consumer is generally a member of the public, however the ultimate consumer can also be a class of persons. For example, a retail shop selling books and information products that are only sold to members of a certain professional association would still involve a sale to the “ultimate consumer”.

In respect of the kind of sales made to the ultimate consumer, many, if not most are for household or personal use. However the meaning of “retail” is not limited to these situations and may include large commercial transactions, providing they are made to the “ultimate consumer”.

It should not be overlooked that the definition of “retail” in the Act also includes the hire of goods and, additionally, includes the retail provision of services and therefore the “ultimate consumer” test is also to be applied to these classes of retail, as indicated by previous Tribunal and court decisions.

These decisions do, however, indicate that the retail provision of services may take place in circumstances where, for example, professional services are provided for an intermediary where the “ultimate consumer” pays for those professional services and the nature and content of the “product” of those services is not changed in any substantial way by the intermediary. An example is the professional advice of a patent attorney which is provided to a firm of solicitors on behalf of their client where the advice of the patent attorney is passed on to the solicitors’ client.

Sales in small quantities may be retail

If the premises are used for the sale of goods in small quantities to the “ultimate consumer”, this may be indicative of the sale being “retail”. However, the quantity of goods sold is not necessarily a decisive factor.

Retail excludes wholesale

The concept of “retail” excludes sales by wholesale. Wholesale sales are the converse to sales to the “ultimate consumer” discussed above, as commonly wholesale sales are to retailers, industrial, institutional and commercial users. These recipients acquire the goods for the purpose of resale to others who will be the ultimate consumer, of a retail sale.

Also, premises where wholesale sales are carried out, such as factories or warehouses, are generally not premises where the public are invited, and are not places where retail sales are expected to be made to the ultimate consumer. Note however that factory outlets, or seconds shops, in factories or warehouses are likely to be exceptions as they involve retail sales.

Example:

A hardware shop selling nuts and bolts to the general public would be “retail premises”, whereas a warehouse selling nuts and bolts to hardware shops would not.

Similarly, industrial premises where nuts and bolts are manufactured, and sold to distributors, who then sell their products to wholesalers, would not be “retail”.

What are “occupancy costs”? – The \$1million rule

If the lease exceeds \$1 million in rental it may be excluded from the provisions of the Act

The term “occupancy costs” is defined in section 4(3) as being the total of:

- the rent (excluding turnover rent)
- outgoings of a prescribed kind

- other costs of a prescribed kind

All are payable under the lease. Outgoings of a prescribed kind and other costs are set out in regulation 7 of the Regulations (see paragraph 9.4 below).

Lease incentives included as “rent”?

Rent reductions, abatements, or other lease incentives provided for under a separate deed to the lease may not be considered effective to reduce the amount of rent payable under the lease for the purpose of calculating “occupancy costs” as the deed may be considered an anti-avoidance mechanism, and runs the risk of being made void if disputed under sections 94(2) and (3) of the Act.

What are “prescribed” outgoings and costs?

Regulation 7 of the Retail Leases Regulations 2003 prescribes the kind of outgoings and other costs for the purposes of sections 4(3)(b) and (c). The prescribed outgoings are as follows:

- amenity facilities, including gardening and landscaping, public address and music systems
- building or retail shopping centre management services, including temperature control insurance, pest control and ventilation
- communication facilities, including telephones and post boxes
- customer facilities, including car parking, lifts, escalators, and child minding
- hygiene services, including cleaning, garbage collection and disposal, sewerage and waste disposal

- information services, including customer traffic flow and other building intelligence information, information directories and signage
- rates, taxes, levies, premiums, charges and fees, including municipal council rates and charges, sewerage and drainage rates and charges, administration costs, audit fees and management fees
- repairs and maintenance services
- security services, including emergency systems and fire protection equipment
- utility services, including electricity, gas, oil, water and energy management systems

The prescribed other costs are as follows:

Advertising and promotional services, including marketing fund contributions.

These outgoings and costs have been prescribed for the purpose only to calculate the “occupancy costs”. Therefore, outgoings which fall outside of these categories will not be included in the calculation of “occupancy costs”; however they can be recovered from the tenant, provided they do not otherwise offend the Act.

This means that there may be leases that have a total liability for costs in excess of \$1,000,000 per annum which still come within the application of the Act. That is, the total liability for costs is made up of a component of prescribed occupancy costs which is less than \$1,000,000, and a component of other non-prescribed costs which, in addition to the total of prescribed occupancy costs, exceeds \$1,000,000. Time occupancy cost is calculated: It appears from section 11(2) of the Act that the total occupancy cost is to be calculated at the time the lease is entered into. However,

when leases are entered into, some of the actual costs are unknown. Actual costs may become known only at a later point during the first term of the lease. The question this raises is whether the total occupancy cost should be calculated on the actual costs, or the estimated costs.

In cases where the occupancy cost borders on the \$1,000,000 threshold, it would be unreasonable for the parties to wait until all actual costs are ascertained before it is known whether the lease is subject to the Act or not. This would also create a burdensome administrative task of refunding or back-charging the fees that are prohibited from being recovered under the Act.

In the circumstances, it appears that practical necessity dictates that an estimate of costs at the commencement will be sufficient. Of course, the estimated costs should be reasonable, and where ascertainable, have regard to last year's actual costs.

The commercial premises exception

Leases of commercial premises take many forms, for example, professional suites, head administration offices, and call centres. Some commercial premises will fall into the definition of "retail" by virtue of the way the premises are used, as opposed to the lease's permitted use, which is often termed "office"

On the other hand, some leases will involve a use of the premises merely for office purposes where no retailing is involved. These may include leases of premises to management or administration companies that provide a service to a retailer or other intermediary (as opposed to the ultimate consumer). Therefore for example, the "head office" premises to a fashion retailer, or the office of the master franchisor may not be retail. However this may differ where the office is an essential component of the retail business,

particularly where customer orders or enquiries are handled from that office. In this instance, the office may be considered “retail”.

The Minister’s Determination

A lease of premises where the retail provision of services occurs would, in the first instance, be a “retail premises” to the extent that the criteria in section 4(1)(a) are satisfied. However, the Minister has made a Determination limiting the application of the Act to these “commercial leases”.

The Determination, made for the purposes of section 4(2)(f) and published in the Victorian Government Gazette No. s 75 (30 April 2003) provides as follows:

PREMISES NOT CONSTITUTING RETAIL PREMISES

This determination is made under Section 5(1)(c) of the Retail Leases Act 2003. This determination does not apply to:

Premises that under the terms of the lease relating to the premises or part are used, or are to be used, wholly or predominantly for the sale or hire of goods by retail; *or* retail premises located in a retail shopping centre.

Acting under Section 5 (1)(c) of the Retail Leases Act 2003, determine that the following kind of premises are premises to which Section 4(2)(f) applies:

Premises that are located entirely within a building which, under the terms of the lease relating to the premises, or part of the premises, are used, or are to be used, wholly or predominantly for the retail provision of services, other than premises located

entirely on any one or more of the first three storeys in a building, excluding any basement levels.

This determination came into effect on 1 May 2003.

This Determination excludes premises or part of the premises in a building used wholly or predominately for the retail provision of services, other than those located on any one of the first three storeys of the building. In calculating the first three storeys of the building, the basement levels are not included.

The Determination does not affect the application of the Act to any premises in the building used wholly or predominately for the retail sale of goods. The Determination also does not affect any premises in a retail shopping centre which are used wholly or predominately for the retail provision of services (and for the retail provision of goods for that matter). These types of premises are still “retail premises” within the meaning of the Act, providing that the criteria in section 4(1) are otherwise.

PRACTICAL TIPS FOR CALCULATING STORIES

The third storey of the building may not necessarily be the third floor of the building. That is, if there is a “ground floor”, this would be counted as the first storey. Similarly, what is called the “basement” level in the building’s directory or elevator may not be a basement in the ordinary sense of the word. “Basement” is ordinarily taken to mean the car park level or the storage level, which is usually uninhabitable. But in some office buildings, the “basement level” is occupied by tenants, commonly by food court tenants, travel and real estate agents, beauty salons, newsagencies, etc. So how are the storeys to be calculated? It is intended that the use of the term “excluding any basement levels” is for the purpose only of calculating the three stories. It is irrelevant that

there may be retail premises located on a “basement” level. Retail premises located on the basement levels will still come within the Act. Therefore to assist in determining the first storey (which then allows the calculation of the remaining 2 stories) the first floor above the storey which is categorised as “basement” should be established. In most cases, this will be the “ground” floor, or if there is no ground floor, the “first” floor. A simple way to determine this is to have regard to the way the stories are described in the building’s tenant directory or elevator.

Some examples:

The directory describes a medical suite as being located on “Floor 3”. The floors of the building are “Basement”, “Floor 1”, “Floor 2”, and “Floor 3”. In this example, the relevant three stories of the building, excluding the basement levels, are “Floor 1”, “Floor 2”, and “Floor 3”. As the medical suite is located within the first three stories of the building, the Act will apply to the medical suite premises and any other retail premises in the building.

The directory describes a hairdresser as being located on the “Basement”. The floors of the building are “Basement”, “Floor 1”, “Floor 2”, and “Floor 3”. In this example, the hairdresser is located on a basement level. Accordingly, it is not necessary to determine the relevant three stories of the building. The Act will apply to the hairdresser’s premises and any other retail premises in the building.

The directory describes an accountant’s practice as being located on “Floor 2”. The floors of the building are “Basement 2”, “Basement 1”, “Ground 1”, “Ground 2”, “Floor 1”, and “Floor 2”. In this example, the relevant three stories of the building, excluding the basement levels, are “Ground 1”, “Ground 2”, and “Floor 1”. As the accountant’s practice is located above the first

three stories of the building, the Act will not apply to the accountant's premises

The directory describes the car park (which involves a paying service) as being located on "Basement 1 – 3". The floors of the building are "Basement 3", "Basement 2", "Basement 1", "Ground", "Floor 1", and "Floor 2". In this example, the car park is located on the basement levels. Accordingly, it is not necessary to determine the relevant three story's of the building. The Act will apply to the car park premises and any other retail premises in the building.

The directory describes an architect's firm as being located on the "Mezzanine". The floors of the building are "Basement", "Ground", "Mezzanine" and "Floor 1". In this example, the relevant three storeys of the building, excluding the basement levels, are "Ground", "Mezzanine" and "Floor 1". As the architect's firm is located within the first three storeys of the building, the Act will apply to the architect's premises.

The directory describes a law practice as being located on "Floors 2 and 3". The floors of the building are "Basement", "Ground", "Floor 1", "Floor 2", "Floor 3" and "Floors 4-10". In this example, the relevant three storeys of the building, excluding the basement, are "Ground", "Floor 1" and "Floor 2". As the law practice is not located entirely on one or more of the first three storeys of the building, the Act will not apply to the law practice.

It is clear that each building must be considered in isolation, and a common sense approach employed in each instance.

Definition of "retail premises" – changes from the previous Acts

Franchises

Provided that the contractual arrangement that the franchisee holds with the franchisor is a lease or sublease, and all the criteria in section 4(1) are satisfied (see paragraph 6, above) and none of the exemptions in section 4(2) apply (see paragraph 8, above), the premises will be “retail premises”. This is in contrast to the 1986 Act and the 1998 Act which excluded franchisees from the application of those Acts if the tenant operated under a name or mark identifying, commonly associated with or controlled by the landlord.

Carrying on a business

It is not a requirement for the application of the Retail Leases Act 2003 that the tenant is carrying on a “business” of retailing in order for the premises to be considered “retail” pursuant to section 4(1) of the Act. The only requirement under the Act in this respect is that the tenant is permitted to use the premises for retailing “under the terms of the lease” (see section 4(1)). This is in contrast to the 1986 Act and the 1998 Act which required the tenant to be “carrying on of a business involving” retailing. Therefore tenants who operate not-for-profit organisations (for example, op-shops) are now clearly included in the application of the Act.

Part of premises

The definition of “retail premises” in the Act now contains the additional words “or a part of premises” which seemingly widens the scope of premises included in the application of the Act.

Although it is not free from doubt, it would appear that the effect of the addition of these words was intended to be limited to accommodating mixed retail and residential use of premises as contemplated by section 95 of the Act (which makes provision for

maintenance in good repair of the residential area where the Residential Tenancies Act 1997 does not apply). An interpretation of these provisions, which applied the “wholly or predominantly” test in section 4(1) with respect to part only of the premises, would produce a far broader application of the Act – beyond what would generally be regarded as retail premises – than Parliament would be likely to have intended. For example, this interpretation of the Act would capture leases where the premises are used almost exclusively for wholesale, industrial, manufacturing or office uses but which also contain a small retail outlet occupying a very small part of the premises where sales to the public are undertaken.

In borderline cases, it may be unclear whether the premises are used wholly or predominately for wholesale, manufacturing, or industrial purposes or whether the premises are used wholly or predominately for the retail sale of goods. Consider for example, a dairy manufacturing premises that contains a manufacturing part and a retail sales part, both of equal area. In this case, it is unclear what the premises are used for, wholly or predominately. It would therefore be advisable to at least treat the retail part as a “retail premises”. This can be done by drawing up two leases, one for the “retail premises” and the other for the manufacturing area. In the alternative, one “retail premises” lease can be drawn up that covers the whole of the premises - this will be easier to administer than having two leases for the premises. When “retail premises” determined: As discussed above, section 11(2) of the Retail Leases Act 2003, in effect, provides that the time for determining whether the premises are “retail” is at the time the lease is entered into or renewed (see sections 7 and 9 for definition of “entered into” and “renewed” respectively). This is in contrast to the 1986 Act and the 1998 Act which did not contain such a provision. Under these Acts, the applicability of the Act could be affected

throughout the term of the lease and therefore could cease to apply or begin to apply at any time during the lease term.

Because of the effect of section 11(2), if the Act applies to the lease when entered into or renewed, and subsequently there is a change in circumstances during the term of the lease that affects the applicability of the Act, the lease will remain subject to the Act. Similarly, where the Act does not apply when the lease is entered into, the lease will not become subject to the Act if there is a change in circumstances affecting its applicability. Therefore the status of the applicability of the Act is determined at the outset and does not change during the term of the lease. Examples of the circumstances that may change include an increase (or decrease) in the total occupancy cost, or the tenant becoming (or ceasing to be) a listed company.

As such, the only opportunity for the status of the applicability of the Act to change is upon renewal of the lease. For example, a lease is entered into with a public company tenant for five years with a five year option for renewal. At the time the lease was entered into, the Act did not apply. In year 3, the lease is assigned to a non-public company. There is no variation to the terms of the lease and therefore the assignment does not amount to a new lease (section 8 of the Act). For the remaining two years of the initial term, the Act will not apply. However, upon the lease renewal (because the renewal of a lease is regarded as the granting of a new lease), the applicability of the Act changes and the Act may then apply to the lease for the five year option term. The same would apply if the lease term were extended by agreement. This results in a surrender and termination of the existing lease and the grant of a new lease for the remainder of the then extended term.

Thus it is essential when entering into a lease for a tenancy in say a CBD building selling goods and services and you want the protection of the Retail Tenancy Act, that you pick one of the first 3 floors of that building

CHAPTER 25

WHO IS RESPONSIBLE FOR PAYING THE LEGAL COSTS IN PREPARING A LEASE AND THE STAMP DUTY ON SUCH LEASES?

The law relating to who is responsible for paying the legal costs of preparing a lease and the stamp duty on such leases payable to the state government, varies from state to state. This can be a substantial cost to a new retailer as he may have to pay his own legal costs as well as the legal costs of the landlord and these costs need to be taken into account in your decision to enter into the lease.

New South Wales

A tenant is not liable to pay for lease preparation costs except any amendments to the lease that are requested or negotiated.

Also it is worth noting that a tenant cannot be compelled to use the lawyer nominated by the landlord.

No stamp duty is payable on leases.

Victoria

The landlord cannot charge the tenant for legal costs and other expenses relating to the negotiation, preparation and execution of the lease nor for the costs of obtaining the mortgagees consent nor the landlord's requirement to comply with the Act.

This does not preclude the landlord recovering the legal costs in respect of an assignment of the lease including the investigation of the proposed assignee.

No stamp duty is payable on leases.

Queensland

The landlord cannot charge the tenant the legal costs for preparing, renewing or extending a lease.

The landlord can, however, charge the tenant for the registration of the lease, survey fees associated with the registration of the lease, obtaining mortgagees consent, the costs of an actual variation to an ongoing lease and the landlord's consent to a sublease or licence.

No stamp duty is payable on leases.

Australian Capital Territory

Each party must bear its own legal costs. However, if the tenant wishes to have the lease registered, he must pay for registration costs of the lease and the costs of obtaining the mortgagee's consent.

Also, it is worth noting that a tenant cannot be compelled to use the lawyer nominated by the landlord.

No stamp duty is payable in the ACT

It is recommended that all leases be registered if you are opening a store in the ACT.

Northern Territory

A tenant is liable for reasonable legal expenses incurred by the landlord. He must, however, be provided with an account showing how the amount has been calculated which must also be shown in the disclosure statement.

A landlord can still recover legal costs from the tenant where the prospective tenant enters into negotiations and then withdraws.

Again it is also worth noting that a tenant cannot be compelled to use the lawyer nominated by the landlord.

Stamp duty is not payable.

South Australia

The tenant is required to pay one half of the landlord's legal costs unless he withdraws from the negotiations. If he withdraws he may be required to pay the full amount.

The tenant also has to pay mortgagees consent fees.

The tenant is not required to pay anything unless he receives a detailed account of how the charge is made up.

No stamp duty is payable.

West Australia

The act is silent on this issue and will have to be negotiated between the parties. It is recommended that each party pays its own legal fees.

No stamp duty is payable.

Tasmania

A tenant is not liable to pay for lease preparation costs except any amendments to the lease that are requested or negotiated.

A landlord can still recover legal costs from the tenant where the prospective tenant enters into negotiations and then withdraws

Mortgagees fees are payable.

Again, it is also worth noting that a tenant cannot be compelled to use the lawyer nominated by the landlord.

No stamp duty is payable.

CHAPTER 26

CHECKLIST OF TENANTS RIGHTS UNDER THE RETAIL LEASES ACTS AND OTHER PROTECTION UNDER THE VARIOUS STATE ACTS

As indicated earlier, the retail tenancy acts in the various states and territories give the tenant rights and protection from landlords. They also stop landlords from requesting certain clauses in leases that are unreasonable. Finally they also try to create a level playing field during the negotiation process.

Whilst this chapter is not meant to be a legal lesson, it is crucial for the tenant to have this information in his arsenal when negotiating a lease with a landlord. Some points may have been included earlier but they are worth repeating. The checklist is again broken up by state as the law is different in each state. We will be looking at the three major states of Victoria, New South Wales and Queensland.

VICTORIA

- There is no specific list of premises that are considered to be retail and thus fall under the act. If you are to use the premises predominantly for the sale or hire of retail goods, the lease is to be for more than one year, you are not a subsidiary of a public company listed on a world stock exchange and the total occupancy cost does not exceed \$1m you fall under the act.
- The landlord is responsible for the repair of the premises, provided that such damage has not been caused by the

negligence of the tenant. The landlord may not recover the cost of such repair though the outgoings schedule.

- The landlord has an obligation to make statistical information about the performance of a centre available to the tenant.
- A copy of the proposed lease and a copy of the information brochure must be given to the tenant before negotiations commence.
- A disclosure statement and a copy of the final lease is required at least 7 days before the lease is entered into. If you do not receive a disclosure statement, the tenant, after giving notice to the landlord may withhold rent.
- If the premises are not available for handover on the date specified in the disclosure statement, the tenant is not liable to pay rent.
- The landlord must give a copy of the signed lease back to the tenant within 28 days after receiving a copy of the lease from the tenant.
- If the lease is to be for less than 5 years, the tenant must request the small business commissioner to certify a shorter term.
- A tenant in a shopping centre is not responsible to pay for outgoings relating to capital costs, depreciation, sinking funds for capital works, interest on landlords borrowings, rent under a head lease and rent for other property and land tax.
- The tenant does not have to provide his turnover unless the lease contains a percentage rent clause.
- Goods and Services tax must be deducted from sales provided by landlord to tenant in respect of percentage rent sales.

- A provision in a lease is void if it prevents the rent falling in the case of a market review of rent.
- A tenant is not required to pay “key money” for entering into a lease.
- If the lease contains an option, the landlord must notify the tenant the date after which the option is no longer exercisable at least 6 months and not more than 12 months before that date.
- If the landlord does not give the notice required, the option remains exercisable until 6 months after the landlord gives the required notice. The lease will then continue under the holding over provisions of the lease.
- A clause in a lease is void if it prevents the tenant from joining a tenants association.
- The Shop Trading Reform Act makes lease provisions void if they require to trade on Sundays. Undue influence or pressure to trade on Sundays may amount to unconscionable conduct.
- Any party to a lease can initiate a dispute. All retail tenancy disputes are handled initially by the Small Business Commissioner’s office by way of mediation. Costs of mediation are shared in proportions agreed by the parties or if they cannot agree equally. If mediation as certified by the Commissioner has failed, then it may be referred to the Victorian Civil and Administration Tribunal (VCAT).
- Tenants cannot be held liable to indemnify landlords beyond the liability they would have had at Common Law.
- If the tenant is required to pay a security bond, it must be held in a separate account and the landlord must account to the tenant for interest earned but keeps it and it forms part of the overall security which is refundable at the end of the lease.

- The landlord cannot reasonably refuse a bank guarantee in place of a security deposit.
- A provision in a lease requiring the tenant to undertake any promotion or advertising of the tenants business is void. However, the tenant may still be required to pay an amount into a marketing fund, together with other tenants, to promote the centre.
- The tenant is entitled to receive from the landlord a marketing plan one month before the start of each accounting year.
- In the case of an opening promotion contribution, details of the proposed expenditure must be made available to the tenant, one month before the promotion.
- A landlord and a tenant must not engage in unconscionable conduct. The act sets out a list of what is considered unconscionable conduct.
- It is not unconscionable conduct, if the landlord institutes a dispute, fails to enter into a lease or renew a lease, not agree to have an independent valuation of a current market review.
- A tenant has 6 years to issue a claim with VCAT for loss or damage sustained by a landlord for unconscionable conduct.
- If the leased premises or the building in which they are located is damaged, the tenant does not have to pay rent or outgoings. If repairs are impracticable to the building, the tenant or the landlord may terminate the lease.
- If the landlord has to carry out works in the building that affects the tenants business, 60 days notice in writing to the tenant is required. If the premises have to be demolished the act in section 56 sets out a detailed formula as to how the tenant is to be compensated.

- If the tenant is to be relocated to a new tenancy, again the act sets out the conditions under which such relocation is to take place.
- A lease cannot be terminated simply because the tenant has not achieved a certain level of sales.
- The act also has a ban on a restriction on trade if a tenant also trades in premises outside the centre.
- A lease provision is void if it limits the tenant's rights to engage persons doing work on the premises, other than specifying limits of competence and complying with any award affecting the shopping centre.
- A provision in a lease is void if it requires the premises to be refurbished unless it indicates the nature, extent and timing of the refurbishment or refitting.
- If the lease contains a right for the tenant to use part of the premises as a residential area and the residential Tenancies Act does not apply to the lease, the landlord must ensure that the residential area is maintained in good repair.

NEW SOUTH WALES

- If the store is over 1000m² it does not fall under the Act. Public Companies under this size do fall under the Act.
- Leases for under 6 months in duration do not fall under the Act. The use of this technique to retain a tenant whilst the centre is under construction, must be watched by a retailer as it gives the tenant no protection for compensation during this construction phase. If you have to take out such a lease, insist that it be for 6 months and 1 day.
- Premises that form part of the office tower of a shopping centre do not fall under the act.

- There is no obligation to pay rent unless the landlord has completed the fit out and tenant is entitled to take possession of the premises.
- The creation of a sinking fund for future repairs and maintenance, unlike in Victoria, is permitted in New South Wales.
- Land Tax is permitted to be charged to tenants in the state. However, this is based on a single ownership basis which is more favourable to a tenant. However, there has been a move to stop land tax being charged to tenants under the act in that state.
- If there is a market review in a lease, this must be completed 3 to 6 months prior to the date the option is to be exercised.
- In the case of promotion and advertising charges for a centre made on the tenant by the landlord, the landlord must provide a marketing plan, a list of expenditure and an account for unspent contributions.
- A copy of the lease and a retail tenancy guide must be provided to the tenant when negotiations commence, otherwise a fine is imposed on the landlord.
- If the tenant does not receive a disclosure statement at least 7 days before the lease is entered into, a fine is also imposed. The same applies to a renewal.
- The tenant is not liable for fit out costs, services, equipment, refurbishment or refitting which are not disclosed in the disclosure statement.
- A lease can be terminated by the tenant within 6 months of the lease being entered into, if the landlord fails to provide a disclosure statement, or such statement is incomplete, or materially false or misleading.

- A copy of the lease is to be given to the tenant within 1 month of registration of the lease, subject to the time it takes to obtain mortgagees or head lessors consent.
- The tenant has no liability to pay for any fit out costs, equipment, refurbishment, refitting which are not disclosed in the disclosure statement.
- Also the tenant is not liable to pay for fit out works that is more than the agreed maximum amount.
- If the landlord is required to do some fit out, the tenant is not obliged to commence paying rent or outgoings until the work is substantially complete.
- A provision in a lease requiring the tenant to undertake any promotion or advertising of the tenants business is void. However, the tenant may still be required to pay an amount into a marketing fund together with other tenants to promote the centre.
- A lease cannot be terminated simply because the tenant has not achieved a certain level of sales.
- The act also has a ban on a restriction on trade if a tenant also trades in premises outside the centre.
- Rental increases of CPI plus a percentage are allowed in New South Wales but not in Victoria.
- A provision in a lease which prevents the rent falling on a market review is void.
- If the parties cannot agree on the market rent, then the act allows the retailer to apply to the tribunal to set the market rent.

- If the tenant must be relocated in a shopping centre, he is entitled to payment by the landlord of the reasonable costs of relocation.
- A landlord can only withhold consent for the assignment of the lease if the assignee proposes to change the usage or the assignee has financial and retail skills inferior to the assignor or has not complied with the lease.
- Key money cannot be requested for consent.
- Goods and Services tax must be deducted from sales provided by landlord to tenant in respect of percentage rent sales.
- A guarantor is no longer liable on the lease, if the person assigning the lease, that will be an ongoing business, has handed over a copy of the disclosure statement to the assignee.
- A clause in a lease is void if it prevents the tenant from joining a tenants association.
- If the tenant is required to pay a security bond, it must be lodged with the Rental Bond Board within 20 days after receipt of the bond. Both the landlord and tenant must sign any application to pay out money from this account.
- The landlord cannot reasonably refuse a bank guarantee in place of a security deposit.
- The landlord must provide the tenant with a statement every 6 months of the expenditure from any promotion or advertising fund. If not provided, the tenant can withhold any contributions to the fund until received. Any unspent money must be carried forward to future expenditure.
- If the leased premises or the building in which they are located is damaged, the tenant does not have to pay rent or outgoings. If repairs are impracticable to the building, the tenant or the landlord may terminate the lease.

- If the landlord has to carry out works in the building that affects the tenants business, 90 days notice in writing to the tenant is required. Section 34 sets out the formula for compensation to be paid.
- If the premises have to be demolished the act in section 35 sets out a detailed formula as to how the tenant is to be compensated. Familiarise yourself with these provisions.
- A lease provision is void if it limits the tenant's rights to engage persons doing work on the premises other than specifying limits of competence and complying with any award affecting the shopping centre.
- A refurbishment requirement is void unless it sets out in general terms, the nature, extent and timing of the refurbishment.
- Where the tenancy is part of a strata subdivision, the act extends some of the provisions applicable to body corporates and centre managers. Some of the bylaws of a body corporate may also apply to the lease. Tenants are advised always to ask for a copy of the body corporate bylaws to ascertain if there are any liabilities which may be passed on to the tenant, particularly major repair and maintenance and body corporate fees.

QUEENSLAND

- If the store is over 1000m² and leased to a public company, it does not fall under the Act.
- Stores over 10,000m² leased to any person or company also do not fall under the act.
- The act also does not apply to franchised service stations governed by the Petroleum Retail Marketing Franchise Act.

- Leases for under 6 months are exempted from most of the provisions of the Act.
- A lease can be terminated by the tenant within 6 months of the lease been entered into, if the landlord fails to provide a disclosure statement, or such statement is incomplete, or materially false or misleading.
- Within 30 days after signing the lease the landlord must supply the tenant with a certified copy of the lease. If not the landlord can be fined.
- Unlike the other states where 5 years is the minimum lease period that must be offered to the tenant, Queensland has no minimum period for the lease.
- In the event of a specialist valuer being used to determine the market rent for the premises, each party must pay for half the valuer's fee.
- Land Tax is not recoverable from tenants if they fall under the Act.
- A landlord can charge a tenant for the supply of electricity to the premises based on charges under the Electricity Act in that state. Tenants should always request that the rate for electricity should be at the same rate as paid by the landlord or the best rate.
- Where the tenant supplies the landlord with sales figures for percentage rent purposes, the landlord may not disclose such figures other than as provided in the Act.
- Unlike Victoria, that allows for only one form of rental increase, Queensland permits rental increases to be CPI plus a percentage. A cap on the CPI is permitted under the Act. For example CPI shall be not more than 4% or less than 2%.

- If the lease has a market review of rent clause and the parties cannot arrive at a figure, it must be undertaken by a specialist valuer in a manner as set out in the Act.
- If a new migrant is buying a business from an existing retailer and the lease has an option for a further term and which provides for a market rent review on the exercise of such option, the tenant, in order to facilitate the sale, may request in writing, for an early determination of such market review. Such notice must be not more than 6 months or less than 3 months from the date on which the option is to be exercised.
- Whilst sinking funds are permitted for major repairs and maintenance, such annual sinking fund payment must not exceed 5% of total estimated outgoings and the balance in the sinking fund may not at any time exceed \$100,000.
- Payment of Key Money to secure a tenancy is prohibited.
- Rent in advance is limited to one months rent.
- If a tenant suffers damage as a result of actions by the landlord which disrupt trade or limit access to the premises, the act sets out how compensation is to be paid even if the tenant is in a holding over period after the expiry of the lease term.
- A landlord may not impose additional restrictions on an assignment of the lease.
- An existing tenant and the guarantor are automatically released from the lease if on assignment, a disclosure statement has been provided to the assignee, and providing such statement is not defective.
- If the lease contains an option, the landlord must notify the tenant the date after which the option is no longer exercisable at least 6 months and not more than 12 months before that date.

- If the landlord does not give the notice required, the option remains exercisable until 6 months after the landlord gives the required notice. The lease will then continue under the holding over provisions of the lease.
- A clause in a lease is void if it prevents the tenant from joining a tenants association.
- A provision in a lease which tries to force a tenant to trade outside the core trading hours is void. In addition tenants who do not open are not liable to pay the extra outgoings caused by the tenants that do.
- Disputes about the lease are settled firstly through mediation and if the dispute is not settled after 4 months it is referred to the tribunal where each party pays its own legal costs.
- Unlike in Victoria, the lease can provide that a tenant may have to indemnify a landlord for any damage suffered by the landlord as a result of the tenant's actions.
- Unless you have more than 6 stores in Australia you may be requested to present a financial advice and legal advice report to the landlord. Your consultant will be able to help you in completing these reports.

CHAPTER 27

SELLING THE BUSINESS AND USING YOUR RETAIL LEASE TO MAXIMUM ADVANTAGE

Before leaving a business always make yourself aware of the range of techniques available to you that could boost the financial viability of your business to a new buyer.

As the lease is often the single item that may under-pin the value of the business, we need to examine the lease and ask ourselves the following questions

- Do I have a solid retail lease and does it maximize its value in the business?
- What will the buyer of a business be looking at when conducting the proper due diligence on an existing lease?
- If the retail store is located on real estate owned by the store owner, how can we improve the value of the real estate by using my lease?
- Can I use the conditions of the lease to create a better tax effective dissolution of a partnership?

GETTING THE LEASE IN ORDER WITH A VIEW TO A SALE OF THE RETAIL BUSINESS

As indicated earlier, just as you need to have a good lease going into a business, so you need to ensure that you have a good lease going out of the business. The buyer's solicitor will be looking at a number of key items in the lease in order to determine this.

These are as follows:

- It should have at least 5 years to run to end of the current lease term
- If possible have an option for on or two additional lease terms. Such options should be totally unrestricted in their ability to be exercised.
- If your lease has only a short time to go, no buyer trying to assess the potential of the business would be willing to pay for goodwill knowing that within a short period he may no longer have a lease.
- Ensure that any market review clauses have no "ratchet clauses which only allows rental to rise following such review.
- Ensure that clauses dealing with repainting and restoration are not at fixed intervals but as and when necessary as mutually agreed.
- Ensure that no immediate fit out of the business is required on assignment, as this will be taken into account by a potential buyer in assessing the purchase price for the retail business.
- Ensure that if the store is situated in a regional shopping centre that the total gross rent, comprising base rent, variable outgoings, statutory charges and marketing contribution does not exceed the benchmark for that category. This could be obtained from the URBISJHB annual reports.

ALSO ASK YOURSELF THE FOLLOWING QUESTIONS

- Have the premises been surveyed and is there a survey certificate attached to the lease? Since rent and outgoings are measured on a rate per square metre, it is vital that the area as shown in the lease is correct.
- Is there a cap on the “making good provision” in the lease or will the buyer be faced with a costly removal expense for say partitions and counters as well as the cost of putting back the premises to its original state? A photo of the premises at the date of hand over would be useful.
- In Victoria, ensure that if there is to be market review on the exercise of the option in the lease, that there is a provision for the market review to be completed first before you have to exercise your option.

INITIATING AN EARLY LEASE NEGOTIATION

If you are contemplating a sale of the business and you have only 2 years to go on the lease with no further option, it is imperative that you initiate negotiations with your landlord for a new lease as soon as possible. The longer you leave it the more difficult it will be to achieve the desired outcome.

The recent amendments to the retail tenancy legislation in some states, set out the legal position regarding early lease negotiation and should be used as a technique for the sale of the business where there is say one year to run plus a 5 year option in your lease.

If the lease requires a market review on the exercise of the option, it can be done early and such market review used as the rental for the start of the option period.

Thus opening negotiations with a landlord to initiate a new lease with the view to retirement planning, should not be a fear on the part of the retailer, but rather an opportunity to reset the level of occupancy cost for a number of years to come.

GLOSSARY OF TERMS

Consumer Price Index (CPI)	The increase in the cost of living as measured against a fixed basket of goods over time within a Capital City. Often used as a benchmark for a Rent Review.
Gross Lettable Area (GLA)	Industrial property is measured by GLA. It is the entire area of a building measured from the outside walls.
Gross Rent	Rent payable including all outgoings except utilities, such as water use, electricity and telephones. Outgoings are paid by the owner.
GST	GST is a services tax currently charged in Australia at 10% of the value of applicable transactions.
Anchor Tenant	The major or prime tenant in a shopping centre or building
Land Tax	A tax payable by the Owner applied annually on the value of the property.
Lease	The document detailing all the terms agreed between the Lessor and Lessee.
Lease Terms	Lease terms are the major points agreed between Lessee and Owner such as the Net Rent, length of lease, Option to renew, etc.
Lessee	The party named on the Lease liable for the rent and any other obligations under the Lease. Also known as the tenant
Lessor	The party offering the property for lease. Usually the owner of the property but in some cases a Lessee themselves offering the property under a Sub-lease. Also known as the landlord
Market Review	A rent review based on the comparable rents in the market for similar properties at the time of review.
Covenant	A written agreement put into leases stipulating performance of certain acts
Net Rent	Rent payable excluding Outgoings and GST.
Option	The right for a Lessee to renew the lease and remain in the premises after the original or previous lease expires. If your lease allows an option to renew make sure you know exactly when and how the tenant can exercise such option.
Outgoings	Outgoings are typically paid by the Lessee and can include council rates, water rates, Strata Levies, insurances, Land Tax and management fees.

Escalation Clause	A clause in a lease which provides for the rent to be increased by either a fixed periodic increase, tied to the consumer price index, market review
Rate per Square Metre (/sqm)	To compare properties equally a Rate per Square Metre is often quoted. A 100sqm office for rent at \$40,000 per annum would have a Rate per Square Metre of \$400/sqm.
Rent Review	A review of the rent usually applied annually during a Lease. Often in the form of a fixed percentage increase or applied at the prevailing CPI at the time of the review.
Stamp Duty	Stamp duty is a tax payable on the total value of a lease, property purchase, lease transfer, or lease assignment.
First Right of Refusal	A clause in a lease, giving a tenant the first opportunity to buy the property at the same price as the landlord has expressed his willingness to accept
Sub-lease	A lease between an existing Lessee and a Sub-lessee. The Sub-lease is usually restricted by the terms of the Head Lease.
Sub-lessee	The party leasing the property from the existing Lessee.
Guarantor	One who makes a guaranty or promises to pay a tenants obligations under the lease if the tenant does not do so
Gross Lettable Area – Retail (GLAR)	Retail property is measured by GLAR.
Outgoings	Outgoings in a Retail Lease are often comprehensive and can include council rates, water rates, Strata Levies, waste disposal, security, insurances, Land Tax, management fees. Any outgoings payable by the Lessee are detailed on a Disclosure Statement before a Retail Lease is signed.
Percentage or Turnover Rent	A percentage share of Lessee turnover paid as Net Rent in a Retail Shopping Centre.
Promotional Levies	A percentage of Net Rent payable by a Lessee toward promotion of a Retail Shopping Centre.
Retail Lease	A lease governed by the Retail Leases Act.
Retail Leases Act	The Act governing the substance and form of all Retail Leases.
Retail Shopping Centre	A collection of retail tenancies as defined by the Retail Leases Act.

Share of Outgoings	A Share of Outgoings is paid by the Lessee in proportion to the Net Lettable Area of their tenancy compared to the Gross Lettable Area of the Retail Shopping Centre.
Market Rent	The rental income the property would command on the open market, indicated by rents that landlords were willing to accept and tenants were willing to pay in recent lease transactions for comparable space
Normal wear and tear	The deterioration or loss in value caused by the tenants normal and reasonable use. In many leases the tenant is not responsible for normal wear and tear
Percentage rent	This is a provision in a retail lease which provides for a landlord being paid a percentage of the tenant's retail sales as a component of rent. This is normally calculated by applying an agreed percentage to the gross sales and deducting the base rent payable
Rent Commencement Date	This is the date on which the tenant commences to pay rent. It may not be the same as the lease commencement date as the tenant may often be granted a month or two rent free as part of the negotiation process
Security Deposit	This is a deposit of money by a tenant to a landlord to secure performance of a lease. The deposit can also take the form of a bank guarantee
Strip Centre	Any shopping area generally with common parking, comprising a row of stores but smaller than a neighbourhood centre anchored by a supermarket
Permitted Use	This clause in a lease determines what type of business the tenant can operate from the premises. Such permitted use does not give the tenant an exclusive right to operate a particular type of business in a shopping centre
Common areas	The common areas of a retail shopping centre are areas in or near the centre for the public or the tenants of the centre. They include stairways, escalators, elevators, malls and walkways, parking areas, toilets and restrooms, gardens and fountains, car parks ,community and leisure

	facilities. They do not include any areas that are leased to tenants or adjacent vacant land lot used for the shopping area
Key Money	This is an amount to be paid or a benefit to be conferred to secure for the tenant the granting, renewing, extending or assigning the lease. A landlord is prohibited by law from seeking or accepting payment of key money

Australia

The Immigrant's Guide to Retail

Retail is a real challenge in Australia.

With migration to Australia, the opening of retail businesses by these new arrivals has been one of the driving factors in the growth of Australian retail sector

This book is designed to assist and inform a migrant who wants to make a success of a retail business in Australia. It covers the following aspects of retail business:

- ✓ The advantages and disadvantages of buying a franchise and how to avoid the many pitfalls that franchisees need to be aware of, in order to be successful. You will have to spend a great deal of money buying a franchise, so it is better to be safe than sorry.
- ✓ The dos and don'ts of entering into a lease in a shopping centre and how to deal with landlords, so as to ensure that you have firm lease.
- ✓ It also deals with your selling of the business at the best price.

This is the first of three volumes about retail business in Australia. The other volumes in the series will include: *Managing a Retail Business and Retiring from a Business and Handing Over to Your Heirs and Successors.*

Hymie is a certified practicing accountant (FCPA) with many years financial and management experience, and has run his own consulting company, specialising in the retail and property industry.

In his role as business consultant, Hymie Zawatzky has assisted new immigrants with the basic requirements of running a small retail business in Australia. Also, large companies work with him before setting up their retail franchise structures. He, therefore, has a thorough understanding of the problems and pitfalls facing the uninitiated wanting to go into retail business. He has used his vast knowledge and experience in this area of business in order to write this series.

He is the author of the books: *Australia the immigrants guide and Retail Australia – Understanding the Finances of your Business*, both of which have sold in Australia and Internationally.

If you have an interest in the retail sector you will thoroughly enjoy and benefit from reading Hymie's new offering.

ISBN: 978-0-9871340-1-1

