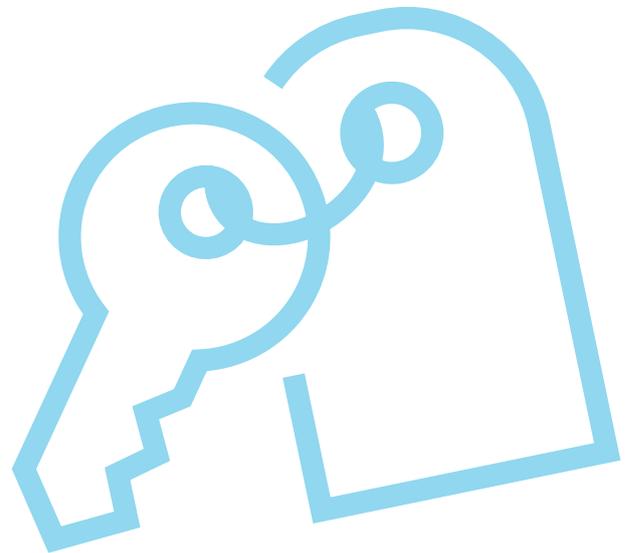




Leasing business premises

A commercial and practical guide

4th edition



Small Business
Development Corporation

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Foreword

The right business premises lease is crucial for success.

The Small Business Development Corporation's specialist commercial tenancy service offers guidance, awareness and education on the *Commercial Tenancy (Retail Shops) Agreements Act 1985* and all aspects of lease negotiations and operation.

Each year the Small Business Development Corporation deals with many thousands of small business commercial tenancy queries.

The large number of enquiries illustrates the importance and concern small businesses place on leasing business premises.

In addition to the legislative and other legal aspects of leasing business premises, an equally integral part is the commercial and practical side of making the decision to lease business premises. A need exists for guidance, based on practical experience, in this very important area.

To alert and assist clients, the Small Business Development Corporation has updated and expanded its educational material to include this plain language commercial and practical guide to leasing business premises.

This guide highlights concisely many of the matters to be considered before entering into agreements for leasing business premises.

As many small business tenants enter into leases for relatively long periods of time to enable the building of business goodwill, it is important that small business operators are well enough informed to negotiate leases which are commercially viable and meet their business needs.

This guide is recommended to help to avoid some of the many pitfalls associated with leasing business premises and to provide guidance in choosing the right lease to operate a successful business.

Introduction

This publication seeks to improve awareness of issues that must be considered when leasing business premises.

The nature of leasing involves a magnitude of issues that must be considered in relation to each specific situation. This publication can only be a guide. Before any obligations are undertaken, legal and financial advice should be sought.

1. What is a lease?

A lease is a legally binding contract in which the landlord allows the tenant to occupy premises on certain terms and conditions agreed to by both parties.

A lease identifies the tenant, the landlord, the premises, the terms and conditions, as well as the rights, obligations and liabilities of both parties. This includes the rent and outgoings to be paid and their periodic adjustment.

2. Why is a lease so important to your business?

A lease can be vital to the profitability of a business and is usually central to the goodwill, value and future sale of the business.

Occupancy costs are one of the main business overheads.

There are a multitude of issues that must be considered and agreed to between the parties.

Business failure may result if the lease is unsuitable to the tenant.

A lease is often complex and difficult to understand, but it is essential that you completely understand your lease before signing or making any commitments.

Failing to understand may cause you to breach your lease or lose important rights you have. This may prove costly and lead to the failure of your business.

3. What are my key objectives?

Before the decision to lease premises is made, it is important to firstly consider your key business objectives.

The main objective is to develop a profitable business. Everything must be focused on this objective.

A profitable business will then allow other objectives such as independence and freedom of lifestyle to be achieved.

Some common key objectives are that the premises will:

- allow a business to expand and grow
- have a lease that will easily be able to be assigned (ie transferred on sale of the business) to provide a return on capital in the medium or long term
- sustain a business with a designated income.

What to watch out for

- While objectives must be commercially sound, it is important that you do not limit yourself to one or two objectives, but seek to accommodate as many as possible.

Actions to take

- Clearly identify and write down your objectives. Ensure the premises will meet those objectives.
- Review objectives from time to time as circumstances and awareness change.

4. Should I have a lease?

Leasing premises may not be the answer in all cases and there may be other options that need to be considered in light of your key objectives. For example, it may be preferable to buy premises outright or to operate the business from home at least in the initial stages. Available capital and your tax position will also be relevant here.

What to watch out for

- Ensure that the leasing of premises will improve the bottom line results of your business and that a real growth in business will occur.
- Where there are other reasons for leasing premises, such as the business has now overtaken your home life. Ensure that the set up costs and rent and outgoings can be covered by the business and required profit made.

Actions to take

- Clearly demonstrate that leasing of premises is required. In particular, ensure the lease of the premises on the terms and conditions offered is acceptable to you by applying the points raised in this guide.



5. Strategic and practical considerations

The following are some of the key strategic and practical matters that must be taken into account when considering leasing premises:

a) Time constraints

Many people seeking to enter into a lease are under time constraints for a number of reasons (for example, the obligation to complete the purchase of a business by the settlement date). This often limits the options available and interferes with the ability to make correct decisions.

Leasing generally involves the following stages:

- considering leasing requirements and issues
- inspection and research of premises
- obtaining preliminary documentation
- applying for and obtaining finance
- obtaining advice
- negotiating conditions
- preparation of final documentation
- fit-out of premises.

These matters could take anywhere from several weeks to many months to finalise.

What to watch out for

- Don't allow yourself to be forced to make decisions or to agree to enter into a lease by a certain time.
- Don't sign any documents which may place obligations on you, occupy the leased premises or pay any deposit monies until full legal and financial advice has been obtained and it is clearly ascertained that the above matters can be dealt with in the required time frame.

Actions to take

- To avoid problems because of time constraints, adequate time should be allocated to allow each of the above stages to be dealt with properly.

b) Business needs

The type of business will determine what type of premises and facilities will be required. For example:

- The premises for a restaurant will require a kitchen and cool room. The tenant should ensure the lease provides for this.
- The premises for a takeaway and delivery pizza shop will require parking facilities.
- The premises for a gift shop should be in a location with a high level of pedestrian traffic, such as a shopping centre.
- Some businesses, such as jewellery shops, will have greater security needs.



What to watch out for

- The future directions of your type of business requires consideration. A business which does not consider business trends in leasing could find itself at a competitive disadvantage. For example, it could be argued that with the increasing use of communications technology, a secretarial service could be operated more profitably from home.
- The type of customers and their requirements will also be a factor in assessing the suitability of the premises. For example, if the business is a child minding service, then the premises will require adequate fencing and other security measures.
- Some features of the premises may need to reflect the tenant's physical limitations. Take, for example, a business which requires a storage room. If the tenant is not physically strong, the storage room will need to be conveniently located.

Actions to take

- Research your type of business and ascertain the features that premises should have. Talking to other people in the same business and inspecting premises where similar businesses are conducted will help your research.
- If the premises do not meet the requirements for that type of business, then you should consider:
 - The costs involved in meeting those requirements.
 - Whether you can afford the cost of meeting those requirements.
 - Whether the landlord will allow the premises to be altered to meet those requirements.
 - Whether the landlord will pay for the premises to be altered to meet the business requirements.



c) Demographics

Demography is the study of human populations and their size, growth distribution, characteristics and change.

Demographic indicators include population size, growth rate, distribution, age, gender, marital status, occupation, income, education, race\ethnicity, birth rate and death rate.

Demographic indicators can play a crucial role in understanding past trends and preparing for future developments.

Manufacturers, wholesalers and retailers use population data to segment and target the markets for their specific goods and services.

Consideration of population data is a useful aid when evaluating the viability of a location for a business.

What to watch out for

- To access the information you need from government bodies, you will have to be specific about what you require.
 - For example, if you wish to start a young children's clothes shop some relevant indicators would be: How many children aged between two and six years of age live in the target area? What is the average age and employment status of the population? What is their average income and what are the predominant occupations?
- Population data should not be confused with demand. Data for the demand for goods or services does not exist. Do not expect that all of the market will buy your goods or use your services. Population data is only an indication and should be considered together with all other factors.

Actions to take

- Identify your target market and its characteristics.
- Research population data. This data can be found in sources prepared by the Australian Bureau of Statistics and the WA Department of Planning.
- Identify areas of existing population concentrations of your likely customers and research whether or not this may change.
- Gather further specific local information from the local shire and business and community groups in the area.

d) Location

For many businesses, location can be crucial to successful operation.

Location must be considered both specifically and generally.

Some specific location considerations would be:

- Where in the shopping centre would this type of business do well?
- How visible is this location?
- Are there any competitors in this shopping centre? Are they well established, are there likely to be any others and where will you be located in relation to your competitors?
- Is there a good traffic flow of customers and how accessible is this location for customers?
- How easily can customers get in and out of this shopping centre and is parking readily available?
- How accessible is this location for deliveries and how close are you to your suppliers?
- How well is this location situated to utilise the services being provided by the landlord and paid for by the tenant?
- Are there any obstructions to the flow of pedestrian traffic to the shop? Which entry point are customers likely to use?
- What is the condition of the roads around the location?
- Is there a major anchor tenant, such as a major chain store, which will attract customers and is that major tenant likely to stay?
- How are other businesses in this shopping area performing and are they profitable?
- What facilities are provided for in this location?





d) Location (continued)

Some general considerations would be:

- What type of area would suit this kind of business? For example, an upmarket clothing shop would be best located in a high income area or in an exclusive shopping precinct.
- What type of climate suits this business?
- What is your preferred geographical location?
- How far is the business from your home?
- What type of surroundings are necessary to attract customers? For example, a fashion boutique would be suited to a busy area with amenities such as cafés and theatres to attract young people.

What to watch out for

- Future events and trends that may affect the desirability of a location. For example, plans to allow light industrial activity in a restaurant area.
- Past recent events, such as nearby tenants recently vacating or a shopping centre being rearranged.
- The impact of other nearby businesses. For example, a clothes shop would not be ideally placed near a fish shop which may emit smells that deter customers.
- Other external factors such as the type of persons frequenting the area.
- Is the location one that employees can easily get to and will the location be acceptable to current and future staff?

Actions to take

- Identify and make a checklist of all your specific and general requirements for the location.
- Personally inspect the location at several different times and gather as much information as possible. Ensure the location is going to work for your business.
- Discuss the location with people in the same type of business and people operating businesses in the same shopping centre or area.
- Gather information to ascertain suitability of locations from the Australian Bureau of Statistics, the WA Department of Planning, and private consulting firms.
- Research, investigate and compare a number of locations.
- Use your checklist to compare and score the different premises you are considering.



e) Tenancy mix

It is desirable in any group of shops that the mix of tenants is well balanced. The aim is to offer a wide range of products and services to attract customers to the location and enable the participating businesses to trade without having to compete with similar businesses.

What to watch out for

- Many large and small shopping centres rely on large anchor tenants. Often, a major business, such as a national chain store, will attract many customers to an area and benefit other nearby businesses.

If the major business ceases to trade in that area, this will affect many surrounding businesses. Great care should be taken if you are seeking to rely on large nearby businesses for trade.

The likelihood of a major business moving should be investigated.

- Sometimes a business may decide to expand and sell products it does not normally sell, which could have a dramatic effect on surrounding businesses.

The capability of surrounding businesses expanding their range of products and services needs to be ascertained and if a threat exists, then exclusivity should be obtained as a term of the lease.

However, it does not necessarily follow that a similar business will impact adversely on trade – sometimes the reverse may be true. For example, coffee strips often attract more trade because of the lifestyle and venue attraction.

- You should ensure that in any group of shops where a certain tenancy mix is represented by the landlord or agent, this is actually the case. This is a major consideration in new shopping centres.

In some situations a landlord may own only one property and not have any control over surrounding businesses (for example, shopping strips).

- In strata title complexes, a landlord may own all the properties, but then sell them over a period of time. This results in the complex being owned by a number of unrelated landlords.

The new landlords may not be bound to any exclusivity provision or be concerned about tenancy mix, which could result in new competitors being introduced.

This problem can be dealt with by lease terms which oblige the original landlord to have a term in the contract of sale requiring the purchaser, and any future purchasers, to continue the exclusivity provisions of the lease.

Actions to take

- Ascertain the businesses that are, or may in the future, be operating in or near your market area; the type of products and services they sell or provide; and whether or not the tenancy mix will suit your business, especially in shopping centres.
- Ensure that the existing businesses do not have so many competitors that they are, or are likely to become, non-viable.

- Ascertain whether or not your competitors will have exclusivity for their products and services.
- Ascertain whether the market is able to absorb further competition.
- Request that your lease gives you exclusivity to operate your type of business and sell your products and services. This should protect you from future competitors who may destroy or adversely affect your business.

f) Regulatory authorities

Planning, health, fire, council and other governmental regulatory bodies oversee, regulate and control the conduct of businesses through legislation and regulations.

Governmental regulation will, in many instances, determine whether a business can be conducted from a certain location and on what conditions.

In most cases, licences from the appropriate authority will need to be obtained to run a business.

Many businesses will need to comply with regulations specific to that business.

If you have signed a lease then you are bound to pay the rent and outgoings and perform all of your other obligations. The fact that you are unable to get the required approval, permit or licence does not release you from your obligations under the lease unless the lease provides so.

In most leases the landlord is not obliged to meet the costs of complying with licence and other regulatory requirements whether structural or otherwise.

What to watch out for

- Just because a licence has been granted or a regulation has been complied with previously, this may not necessarily be the current position. You should ensure that all required approvals, licences and permits are able to be transferred to you and renewed in the future.
- Compliance needs to be for the period of the running of your business, in particular the period of your lease.
- A change in zoning may cause a different mix of business in your location which may in turn adversely affect your business.
- A change in the roads in your location (for example road blockage or change of direction) may have an effect on flow of customer traffic to your business.

Actions to take

- Identify which licences, permits and approvals are required to run the business from the premises to be leased and that you are able to obtain them.
- Make enquiries at all regulatory authorities (including planning, council, occupational safety, health and fire) in relation to the requirements to run your business from the leased premises.
- Make enquiries at the Business Information Centre at the Small Business Development Corporation, which can help you with your business licence requirements.
- Arrange for and check local government, public health and fire safety inspections and reports covering compliance of the building and premises.
- If you decide to proceed, ensure you obtain all the necessary licences, approvals and permits.
- Identify existing zoning and other planning restrictions in relation to the premises to be leased and any future proposals.
For example, investigate the possibility of future road widening, road blocking, change of traffic direction or any other related matters.



g) Building and condition

The building or property to be leased will need to be in a condition which enables you to successfully and profitably operate your business.

Generally, there is no warranty from the landlord that the premises are fit for the intended purpose and the tenant takes the premises as they find them.

There is no obligation on the landlord to fix the building which you lease unless the lease specifically provides so.

However, if the premises are part of a shopping centre covered by the *Commercial Tenancy (Retail Shops) Agreements Act 1985*, there may be some obligations on the landlord.

Once you have signed the lease you are required to pay rent and outgoings and comply with all your other obligations under the lease, irrespective of the suitability of the premises for your business.

What to watch out for

- A building may be inspected at a certain time of the year and appear to be suitable. However, with a change in season, it may become unsuitable. For example, in the winter it may be subject to flooding or in summer it may be too hot and the airconditioning system inadequate.
- There may be hidden defects such as a weakening of the building structure due to termites.
- Making a building suitable for your business may involve alterations to the premises.
For most leases the tenant is required, at the end of the lease, to reinstate the premises to the condition they were in at the beginning of the lease. This may be expensive and should be taken into account when making a decision on the suitability of the premises.

Actions to take

- Have a builder check the condition of the building and give a detailed report on what structural repairs and other repairs are required to enable you to operate your business. An investigation of the building should include the state and condition of all plant and equipment, for example, airconditioning plant, fire sprinklers. If the building is in an unacceptable condition, ask the landlord to remedy any defects as a condition of the lease prior to entering into the lease.
- Ensure there is an adequate ongoing property management service by the landlord that attends to building services such as lights, airconditioning, cleaning, security and fire services.
- Consider the appearance of the building for its likely impact on the customers you are hoping to attract. Do the premises present the type of image that you want for your business? If it is an ugly building it may keep customers away.
- Check that the building suits your business in relation to size and layout. Consider characteristics such as ventilation, adequate internal lighting and climatic conditions and whether it can deal with any expansion or change in the business. Be careful not to rent premises which are too large as you will have to carry the extra cost of the unproductive space.
- Calculate whether the cost to you of any repairs and alterations to render the building suitable makes the leasing of the property un-feasible.

h) Fitout

In many cases, premises will need fixtures, fittings and services in order to enable the tenant to operate the business.

Some of the fitout items to be considered are:

- shopfront
- lighting
- airconditioning
- floor coverings
- power points
- windows
- security
- fixtures
- water supply and waste
- electrical fittings and submeters
- painted walls
- plastered walls
- telephone
- signage
- smoke detectors and fire control systems.

Who is to bear the cost of these items will be determined by negotiation and agreement between the tenant and the landlord.

What to watch out for

- The fitout costs may be a major cost item which should be recovered from the business.
- Fitout costs should not leave you with insufficient funds to operate your business.
- For those fitout items that are at your cost, make sure you negotiate as much as possible that these items are your property and can be removed by you when the lease comes to an end.
- Make sure you properly estimate fitout requirements. A common problem is the underestimating or overestimating of the space required.

Leasing more space than is required for the business will generally result in higher rent and outgoing charges, which will directly affect the profitability of your business.

Actions to take

- Inspect the premises and ascertain your fitout requirements and whether these can be achieved in the premises.
- If necessary, employ a consulting specialist to assist in the design, layout and fitout for your business.
- Check whether any statutory requirements and conditions exist in relation to the fitout. For example, *Occupational Safety and Health Regulations 1996* (see Page 9, Section 5 (f) Regulatory Authorities).
- Negotiate with the landlord who will attend to each item and at whose cost.
- Ascertain and resolve all fitout matters prior to entering into the lease.

i) Future events and trends

In deciding whether to lease premises, forthcoming events and likely trends should be taken into account. Some relevant matters are whether:

- In the near future, any new shopping centres will open nearby.
 - The shopping centre is old and in need of redeveloping and refurbishing. Is this likely to take place during the term of the lease and how will this affect the business? For example, if the shopping centre is redeveloped or refurbished this may necessitate a relocation or a disruption to business trade.
 - The shopping centre or premises is likely to be sold and, therefore, subject to a change in policy. This may mean that the premises or shopping centre will be required for other purposes and the lease will not be renewed.
- The local council is planning to build major cultural facilities, government agencies, libraries and tourism and information centres to stimulate economic recovery where your business is located. Alternately, this could happen elsewhere and draw customers away.
 - Public transport facilities are going to be relocated (eg. moving the bus depot away from the area). Are there going to be any road closures or other changes in roads? Is a major employer in the area moving out or downsizing their staff?
 - The government is going to amend tenancy legislation which could affect your rights under your lease.

In some cases it may be prudent to wait to take advantage of changes to the law. In other cases it may be impractical to do so.

What to watch out for

- Do not assume that information about future events and trends will be disclosed – you will need to make your own enquiries.
- Satisfy yourself that the premises will be able to cope with future changes to your business, which may include a change to the layout and fitout of the premises.
- When developing your business plan make sure that the business is sustainable over the full term of the lease. The life cycle of the product or service may be less than the lease term which may lead to business failure.
- Assess whether an event, like a major new retail project in the area, will result in an increase in council rates and land taxes.
- Assess any likely technological changes, such as online shopping, and what effect these may have on your business. Will the premises and the terms of the lease have the flexibility to deal with those changes?

Actions to take

- To ascertain future events and likely trends make enquiries with:
 - State planning, council, health, roads and all other relevant government agencies.
 - Other tenants in the area, the landlord and the agent.
 - Local business associations and local business advisers.

In addition, research local community newspapers and publications at the local library.

- Obtain whatever social and economic impact statements are available from the council and the WA Department of Planning.
- Assess, realistically, the likely effect of future events and trends.
- Ensure the lease contains terms that satisfactorily deal with future events or trends which may affect your business.

j) Prevailing conditions

In making a decision to rent premises for operating a business, it is prudent to consider the prevailing political, government, economic and social conditions.

Essentially you should seek to determine whether now is a good time to be leasing property for the purpose of running a business.

Some conditions to take into account are:

- The prevailing interest rates, exchange rates, international traveller trends and commercial prices and their impact on your business.
- Whether the government and council are open to assisting small business in that area. For example, in relation to zoning and health regulations.
- What the community's and nearby retailers' views are on that specific shopping centre and your type of business. (For example, there may be groups lobbying to redirect custom away).
- What the present government's position is in relation to charges which may be passed on to the tenant by the landlord.
- Whether the management of the shopping centre is sympathetic to the concerns of retailers.
- Whether the management is driven by a 'hands on' management team or by a property trust or landlord seeking a high return for its investors.
- The state of the economy. If it is in an unstable state, a long term lease may cause financial hardship or business failure in the future.
- Whether the current market for your business in the location under consideration is strong.

What to watch out for

- Be careful not to place too much emphasis on a single factor.
- Be careful not to rely solely on prevailing conditions and take into account likely future events, trends and developments (see page 12, Section 5(i) Future events and trends).
- Do not re-mould the current situation to suit your objectives.
- Be aware of biased information and seek information from a variety of sources.

Actions to take

- Obtain copies of current economic, social and legislative policies from Federal, State and Local Governments in relation to your location and type of business.
- Obtain local demographic data from the Australian Bureau of Statistics including their data in the Basic Community Profile.
- Spend time in the area of the premises to ascertain the social profile levels and the activity of potential customers.
- Explore local advertising and promotional opportunities in the community.
- Prepare a marketing plan.

k) Relationships

The success of any leasing arrangement is greatly enhanced if there is full cooperation between landlords and tenants. You should ensure that the landlord is someone with whom you will be able to have a good working relationship in the context of your lease.

A well negotiated lease will help you foster a good relationship with your landlord.

Actions to take

- Ask other tenants of the landlord their opinion of the landlord.
- Ascertain the financial standing of the landlord and whether this is likely to change by searching the bankruptcy office and Australian Securities and Investments Commission.
- Find out whether the landlord is in dispute with any tenants including any court or State Administrative Tribunal (SAT) proceedings.



6. Benchmarking to establish lease viability

Benchmarking is the process of measuring and comparing the performance and practices of a person or business in the same or similar trade in order to identify best practice.

Benchmarking is a useful tool to ensure that credible goals, objectives and directions are set and in deciding whether or not to lease certain premises.

Benchmarking can also be used to ascertain the occupancy costs (rent and outgoings) of a similar type of business, in order to achieve an acceptable profit.

What to watch out for

- Benchmarking can be used as a reliable guide, but it is not a foolproof method.
- There may be a number of different opinions as to what the benchmark should be so you may need to compare these different views.
- The currency of the benchmark figures should also be considered. Outdated figures may not be useful.
- A large enough sample of businesses needs to be used to construct the benchmark figures in order to have some accuracy.
- Some benchmark figures may relate to the position Australia-wide. Accordingly, these need to be considered taking into account local variations.

Actions to take

The following benchmark procedure can be used to help determine the viability of premises to lease and in particular, whether the costs associated with your proposed lease are within the norms for your industry.

1. Assess the sales levels at established industry mark-ups that a business is likely to achieve, projected over the period of the lease (vital, and can be a difficult assessment).
2. Take the commencing rent plus variable outgoings and compare with industry standards (rate per square metre per annum). Some sources of information are licensed valuers, leasing agents, retail and business associations, other tenants operating similar businesses and public and university libraries. Ensure that you gather information from a wide variety of sources to ensure an acceptable level of reliability.
3. Calculate the sum of the annual rent plus variable outgoings as a percentage of the anticipated annual sales level. When calculating your leasing costs, you will need to take into account the goods and services tax liability that you may be able to claim from the Australian Taxation Office as an input tax credit.
4. Compare the percentage from point 3 above with established Australian benchmarks. A business adviser or accountant can help with this comparison.
5. Calculate the set-up cost of the fitout for the shop and determine whether it can be spread out over the term of the lease.
6. If the lease has a redevelopment clause make sure that the requirements of point 5 are satisfied.
7. As the rent and outgoings will vary over the lease period, it is vital to do a total occupancy cost table projected over at least five years with probable rent and any other occupancy cost increases to clearly ascertain whether the leasing proposition is viable.



7. Negotiation

Negotiation is a process whereby the landlord and tenant come to an agreement on the terms of their lease.

Negotiation is an important part of the leasing process. Theoretically, everything is capable of being negotiated.

A lease may be presented as standard, but this does not mean it cannot be changed by negotiation.

A lease is able to be negotiated in many cases with terms and conditions to suit tenants and landlords.

Usually there is more room to negotiate than most potential tenants think.

What to watch out for

- Generally, leases are prepared by the landlord's solicitor so it is to be expected that the conditions in the document will be acceptable to the landlord but not necessarily acceptable to you. Seek to vary the lease to make it acceptable to your requirements.
- The extent to which a landlord will be willing to negotiate will depend on a number of bargaining factors, some of which are:
 - the demand for the premises
 - your desirability as a tenant which may include your ability to meet your leasing obligations and your potential to attract clients and other tenants to the location
 - the landlord's financial position
 - the future intentions of the landlord in relation to the premises.
- It is to your advantage to prepare a case as to why the landlord needs you as a tenant and the benefits for the landlord. For example, your tenancy will cause an increase in customers which will benefit the landlord's other tenants. Furthermore, your lease, especially if it is long term, will add significantly to the capital value of the building.
- Do not expect that the landlord will agree to all your requirements, but ensure you do not go below your bottom line. Be prepared to walk away if the landlord will not at least meet your bottom line.

Actions to take

- Before you can be in a position to negotiate, you need to learn and understand about leasing premises and familiarise yourself with all the issues involved in leasing premises.
- Read this guide thoroughly and the other reading and research referred to in this guide under Further Assistance.
- The terms of your lease are critical to the success of your business and it is essential that you spend time and effort to get it right from the start. Carefully consider and identify your leasing requirements and those needed to make your business a success.
- The following are some items you will need to consider and ascertain your needs:
 1. period of lease
 2. options to renew
 3. rent
 4. operating expenses
 5. rent review
 6. assignment
 7. redevelopment and relocation clauses (for further information see the Small Business Development Corporation's publication *How to negotiate your way to a better retail lease*)
 8. early termination
 9. permitted use
 10. competition and exclusivity
 11. tenancy mix
 12. further cost items (legal costs, fitout)
 13. condition of premises and structural repairs
 14. repair and maintenance
 15. option to purchase/first right of refusal
 16. responsibility of tenants and agents
 17. fixtures and chattels
 18. defaulting under lease
 19. insurance obligations
 20. availability of services and facilities
 21. sinking funds
 22. access
 23. hours of business
 24. common areas
 25. carpark requirements
 26. destruction clauses
 27. landlord obligations
 28. size of premises
 29. redecoration
 30. promotional funds
 31. signage
 32. security bond
- To assist you in your negotiations, it is useful to break up your requirements into:
 - Those you must have and cannot proceed without.
 - Those that are desirable, will affect your business overall and are worth fighting for.
 - Those that do not overly affect your business and you are willing to compromise on.
 - Those that do not affect your business.
- Establish a bottom line of requirements that represent the minimum you will accept before leasing the premises that meet your business needs.
- You are in a position to negotiate once your needs have been understood and identified. Depending on how comfortable you are with the complexities of leasing you may need to be represented during negotiations.
- Negotiations are normally through an agent acting for the landlord. Initially it is worthwhile discussing your requirements on an informal basis to ascertain the position of the landlord and whether it is worth proceeding to more formal written negotiations.
- It is generally accepted that both parties will seek to get the best lease they can, so do not be afraid of bargaining.
- All negotiations should be on the basis that they are subject to and conditional on the approval of your solicitor and financial adviser.



8. Leasing minimum standards and best practice

The Commonwealth and all states and territories have agreed on eight key benchmark principles to provide minimum standards for retail tenancy laws.

The eight key principles deal with the following areas:

- disclosure
- ratchet clauses
- relocation costs
- rent reviews
- outgoing (auditing and reporting)
- lease assignment
- access to turnover figures
- dispute resolution procedures.

Outlined below are the core lease requirements that are considered to achieve leasing best practice.

These best practice requirements incorporate the eight key benchmark principles to provide minimum standards for retail tenancy laws, setting in place a safety net of protections for retail tenants as agreed on by the Commonwealth and all states and territories.

Leasing best practice

Disclosure

Many tenancy problems are caused because important information is not disclosed.

Before entering into a lease, a full disclosure statement should be obtained. This should include:

- the lease period and options to renew
- the rent and rent review procedures
- who is to provide the shop fitout
- outgoing and other costs, eg. legal fees
- insurance obligations
- complete details of the building in which the premises are located
- tenancy mix
- exclusivity provisions
- redevelopment and relocation plans
- number of premises currently leased
- number of premises unoccupied
- what is to be provided by the landlord
- all details and representations given by the landlord or the landlord's representatives during negotiations.

Full disclosure will help prevent otherwise unforeseen circumstances that may have severe consequences for the business.

All the provisions of the disclosure should be included in the final lease terms (where these have been agreed).



Term of lease

The term of the lease is important. Depending on the circumstances, a long lease may not be suitable. For example, the future success of a newly started business may be uncertain. It may be preferable to have a shorter term with an option or options to renew the lease.

In considering the term and options of a lease, the time required to recover the setup costs and realize on the goodwill of the business must be considered. There should be sufficient time left in the lease to make the sale of the business attractive to prospective purchasers, which means leaving enough time in the term and options of the lease to recover costs and make the required return on investment.

Rent reviews

The rent is generally subject to a review during the term and at renewal of a lease.

Both parties should be able to initiate a rent review.

The business must be able to afford proposed rent increases. Rents should not escalate to unsupportable levels. Reviews based on market rent must allow for rent reductions as well as increases.

For a rent review based on market rent, there should be a cheap and effective way to resolve a dispute if there is a disagreement between the parties.

In the case of a rent review dispute, information should be made available to an independent expert to allow a fair determination of market rent.

Relocation costs

Leases often contain clauses which allow a tenant to be relocated (eg where there is a redevelopment or refurbishment). Where this is so, the tenant should be adequately compensated and should be no worse off as a result of the relocation.

Tenancy mix

Circumstances may arise where more than one tenant sells the same type of goods, eg. in a shopping centre. For the viability and success of any business, exclusivity for operating that type of business and selling particular types of goods needs to be carefully considered before entering into the lease (see Page 8 for more on Tenancy Mix).

Outgoings

The landlord's outgoings (also called operating expenses) which the landlord passes on to the tenant to pay are a major business expense and each specific outgoing needs to be carefully considered as to its acceptability before entering into the lease.

Costs such as structural repairs and capital items should be at the landlord's expense.

Any increases in outgoings over the term of the lease need to be taken into account when assessing the lease.

Outgoings should be limited to those from which the leased premises receives a benefit. The lease should also provide for the tenant to have access to invoices and receipts so all outgoing payments can be checked.

Lease assignment

In order to sell and realise on the goodwill of a business, a tenant will generally require the consent of the landlord to an assignment of a lease.

The lease should provide that consent to the assignment will not be unreasonably withheld by the landlord.

Access to turnover figures

Some leases require the tenant to provide turnover figures. Turnover figures should only be supplied in limited circumstances and only where the tenant has agreed.



End of a lease

When a lease term has come to an end and all options to renew the lease (if any) are used up, the tenant does not have the right to remain in the premises.

Once a lease has come to an end, the tenant may be required to vacate the leased premises or enter into a new lease with different terms which could include a higher rent.

To help the tenant prepare for the future, a lease should require the landlord to advise the tenant in writing (eg. 12 months before the lease expires) whether the lease will be renewed and on what conditions, including the term and rent.

Exercise of option

Where a lease provides for an option to renew, most leases state that the option for renewal is to be exercised within a specified time frame and in writing.

It is critical to ensure that if the tenant wishes to exercise the option, that it is exercised correctly and within the agreed timeline otherwise all rights to renewal will be lost. The tenant may be required to vacate the leased premises or enter into a new lease with different conditions, which could include a higher rent.

It is prudent to diarise when an option to renew must be exercised and include early reminders leading up to that date.

Suitability of use

Generally, there is no warranty as to the suitability of the premises for a particular business or for the condition of the premises.

A tenant should ensure that the business can be operated from the premises to be leased. The zoning and use should be checked with the relevant planning authority and local council.

Where the leased premises are a strata lot, enquiries should be made with the strata company and the strata plan checked for restrictions on use.

(see Page 9, Section 5(f) Regulatory authorities and also Page 10, Section 5(g) Building and condition.)

Repairs and maintenance

Repairs and maintenance can be a large expense. The responsibility for repairs and maintenance can sometimes lead to disputes, especially where it is unclear whether the cost is for repair or the replacement of a capital item.

In order to avoid disputes, it is useful to specify certain items as being the landlord's obligation, eg. roof and air-conditioning repairs.

Other costs

Before entering into a lease, the prospective tenant should consider all the other leasing costs that may be incurred including legal fees, insurance costs, fitout costs and other establishment costs.

Dispute resolution procedures

The lease should outline procedures to deal with disputes between the landlord and the tenant.

Ideally, a landlord and tenant and/or their representatives should discuss any areas of disagreement and find a workable solution that is satisfactory to both parties.

The Commercial Tenancy (Retail Shops) Agreements Act 1985 contains a dispute resolution procedure for leases regulated by the Act.

In most cases, a retail tenancy dispute will be considered first by the Small Business Commissioner. If the matter cannot be resolved through the Small Business Commissioner, the matter may be referred to the State Administrative Tribunal (SAT) for determination.

For other commercial leases, referral to a mediator, including through the Small Business Commissioner could be less costly than the court system.

The Small Business Commissioner provides a range of services in helping the parties resolve their dispute. This includes providing information, advice and guidance together with bringing the parties together for the purpose of resolving the dispute informally, and more formal impartial alternative dispute resolution.

Alternative dispute resolution can:

- Resolve disputes quickly, allowing you to get back to business sooner.
- Get workable business solutions.
- Have greater control over the outcome and feel more satisfied with the result.
- Save on legal costs and time spent preparing for court.

What to watch out for

- Minimum standards will change over time. It is important to keep informed of developments.
- Each lease situation will be different. However, a best practice approach ensures you are on the right track.
- The best practice points outlined above are only some of the many matters that need to be considered when entering into a commercial lease.

Actions to take

- Adopt a best practice approach as outlined above when negotiating the terms of your lease to ensure a secure foundation for your business.
- Be sensitive to your own specific requirements in negotiating a lease.



9. Specific bargaining items

In negotiating your lease there are bargaining items that you can seek from the landlord to help you get started. Some of these are:

- an initial rent free period or a reduced rent period
- favourable rent reviews (infrequent and restrained)
- specific outgoing charges to be excluded for the term of the lease or an initial period
- landlord's contribution towards fitout
- an extended fitout period before the lease commences;
- specific items to be repaired by the landlord prior to lease commencing
- landlord to pay the legal costs of drawing up the lease.

What to watch out for

- Do not rely on verbal concessions. All concessions obtained should be included in, and form part of, the lease.
- The concessions that may be obtained for the initial period should be considered in the context of the term of the lease and all other conditions.

The business must be able to run profitably once the concessions have expired or are used up.

If the landlord easily grants concessions, this could mean there are problems with the premises and the landlord is having difficulty securing tenants. Therefore, the landlord may be amenable to negotiating a lease which is even more favourable to you.

Actions to take

- Ascertain whether you are able to seek concessions from the landlord (see Page 16, Section 7 Negotiation).
- Identify those items which are of value to you, and that the landlord is able to provide, and seek those items from the landlord.

10. Commercial Tenancy (Retail Shops) Agreements Act 1985

Many commercial tenancies in Western Australia are regulated by the *Commercial Tenancy (Retail Shops) Agreements Act 1985*. Knowledge of this Act is essential.

Under the Act, a landlord should give to the tenant:

- a disclosure statement
- a proposed lease
- a tenant guide (attached to the lease)
- an operating expenses budget.

Leasing disputes for leases covered by the Act are, in most cases, first considered by the Small Business Commissioner. If the matter cannot be resolved through the Small Business Commissioner, the matter may be referred to the State Administrative Tribunal (SAT) for determination. In some areas, the Act will override the terms of the lease.

What to watch out for

- Be aware that some leases contain clauses which conflict with the Act and this can mislead some people. If this occurs, the Act will override the terms of the lease.
- The Act can only go so far in protecting tenants and proper advice is still needed.

Actions to take

- Get to know your rights and obligations under the *Commercial Tenancy (Retail Shops) Agreements Act 1985*.
- The following Small Business Development Corporation books explain the Act in an easy to read format:
 - *Common questions about the Commercial Tenancy Act for leases entered into on or after 1 January 2013*
 - *Common questions about the Commercial Tenancy Act for leases entered into on or after 1 July 1999 but before 1 January 2013*
 - *Common questions about the Commercial Tenancy Act for leases entered into before 1 July 1999*
- If you are unsure of your position under the Act, seek advice from your solicitor or the Small Business Development Corporation.
- Watch out for future changes to the Act which may affect any new lease you may be considering entering into.

11. The importance of advice

Leasing of premises is a complicated and specialised area with many traps for the inexperienced and unwary.

There are continual changes in trends and the legislation that regulates commercial tenancy arrangements.

Many business owners do not have an adequate knowledge of leases or are unaware of the need for commercial and legal advice. This is especially the case with people entering into business for the first time.

A lease and its clauses may appear to be simple, standard and acceptable on the surface but this, in many instances, may not be the case.

With the appropriate advice, any problems the lease could cause you and your business will be brought to your attention, including clauses that could result in substantial additional expense.

The cost in time and money in obtaining advice to negotiate and obtain an acceptable lease for your business is likely to be many times less than what a poorly negotiated lease would eventually cost you.

Once the appropriate advice has been obtained, the tenant is in a position to make informed decisions and negotiate more acceptable leasing terms.

Note that the party that initiates the proposal as to term, rent, rent review etc. tends to have an advantage in the negotiations.

What to watch out for

- Often prospective business tenants, especially those new to business, will receive advice from well intending relatives or friends who have had a lease or have some exposure in leasing premises. These people are a useful source of information, but proper professional advice is still needed.
- A lease may be presented as standard and therefore acceptable. It must be stressed that lease terms acceptable to one tenant may not be acceptable to another.

Leases presented as standard often contain many conditions which prove costly and materially damaging to the tenant's business.

Each situation is different and advice should be obtained in all instances.

- Obtaining advice does not mean you do not need to read or understand your lease. On the contrary, the reason for obtaining advice is to inform and assist you in understanding the proposed lease.

You need to be involved in the process so that your advisers are aware of your business and other needs.

Once you have received advice you can make informed decisions as to whether to proceed.

Actions to take

- Legal and commercial advice should be obtained before:
 - making any commitments to buy, lease, take on an assignment or incur any other obligations
 - signing an offer to lease or any other lease related document
 - payment of any deposit or other monies
 - occupying the leased premises.
- In addition to legal and financial advice, you should also seek business and property advice in order to ensure the lease is sound on business and property principles.



12. Further assistance

In addition to your solicitor and accountant, further assistance in relation to leasing premises is available from a wide variety of sources.

The Small Business Development Corporation (SBDC) has a specialist Commercial Tenancy Advisory Service to assist landlords and tenants with commercial lease problems and queries. For questions on leasing business premises call 133 140.

The SBDC has four online publications which can be of assistance:

- *How to negotiate your way to a better retail lease*
- *Common questions about the Commercial Tenancy Act for leases entered into on or after 1 January 2013*
- *Common questions about the Commercial Tenancy Act for leases entered into on or after 1 July 1999 but before 1 January 2013*
- *Common questions about the Commercial Tenancy Act for leases entered into before 1 July 1999*

These books are available from smallbusiness.wa.gov.au.

The SBDC 's Business Information Centre is the first place you should contact to get your business successfully under way. You can also research your business or industry with our comprehensive range of reference materials available online or by visiting our Business Information Centre in the Perth CBD.

Other sources of assistance are available from:

- Business Local service providers, a Statewide network of advisers who can help you develop, manage and expand your business. To find your nearest provider visit smallbusiness.wa.gov.au/businesslocal
- Member business associations such as the WA Retailers Association and the Chamber of Commerce and Industry.
- TAFEs and universities run a variety of small business courses and units.
- Banks and other financial institutions.
- Local business associations.
- Other tenants operating similar businesses or in the same shopping centre.



What to watch out for

- Seek assistance as soon as you decide to look for premises to lease.
Early assistance will save you much time and effort in considering unsuitable premises and stop you being forced into a rushed decision.
- Leasing involves consideration of many practical, legal, financial and commercial issues. Do not assume that one source of assistance will meet all your leasing assistance needs.

Actions to take

- Seek assistance from as many sources as possible. Any assistance obtained should be considered according to the adviser's level of expertise and the limited area of their experiences. For example, do not treat advice from an accountant as legal advice.



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