

SMALL BUSINESS INFO KIT

1. BEFORE SIGNING A COMMERCIAL OR RETAIL LEASE



A lease is a contract that you probably can't end early

Entering into a lease is a serious financial commitment. The duty to pay rent regularly is a key term of a leasing contract. Over the period of the lease, monthly rent can add up to hundreds of thousands of dollars. When you sign a lease you are agreeing to pay the rent for the whole term of the contract. If the rent is \$320 per week for three years, you have agreed to pay the landlord nearly \$50,000 regardless of how your business goes.

Paying the rent late can mean the landlord is able to take possession of the building and lock you out (without written notice) yet still claim rent until another tenant is found. Getting a new tenant can take some months in a difficult commercial environment, and you may be required to pay for a rent-free period in a new lease.

When you think about how much money you are agreeing to pay the landlord, it's clear that a lease is a serious financial commitment. Consulting a solicitor before entering a lease may save you a great deal of time, money and anxiety in the long term. A solicitor can look over the lease and give you advice about what the contract requires of both parties. It's extremely important that you check your lease thoroughly, that you understand it and can comply with all of its terms.

Planning to succeed

There are a lot of costs to doing business that can interfere with your ability to pay rent. Before signing a lease, think about how much time and money is required to make the business succeed. Make sure your business has sound financial backing. Prepare a realistic business plan or employ someone who can advise you on whether the business is a good investment.

The landlord does not have to reduce your rent if the business is not doing well. The landlord also does not have to let you out of the lease if you are losing money, having family problems, or are in poor health. Sometimes even with the best financial advice, unexpected events happen. If you cannot pay your rent, or are struggling to pay on time, it is important that you contact the landlord early and try to negotiate a deal. If you are unable to do this yourself, you should seek advice and assistance from the Office of the NSW Small Business Commissioner. Email: we.assist@smallbusiness.nsw.gov.au Phone: **1300 795 534**

Check with the local council

It's important to check with the local council before you sign a lease to see if written consent is needed for the type of business that you plan to run.

If you are planning to do a fit-out or any other building work, you should also check with the council's 'duty planner' to see whether you will need to lodge an application for development consent. You should not rely on your landlord's understanding of council regulations, as zoning and planning rules may have changed. If you go ahead and start building work without approval, the council may stop you from trading, order you to close the business and stop the works.

If you need council approval to do building work, think about the amount of time it will take to get the development approval and the work done. During this preparation time there can be a lot of costs and no money coming in. You may be able to negotiate with the landlord for a rent-free period at the start of the lease. You should also think about what you will do if there are problems or delays, because your duty to pay rent may start before the work is finished and before you can begin trading.

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- The duty to pay rent regularly is a key term of a leasing contract.
- Consulting a solicitor before entering a lease may save you a great deal of time, money and anxiety in the long term.
- Prepare a realistic business plan or employ someone who can advise you on whether the business is a good investment.
- It's important to check with the local council before you sign a lease to see if written consent is needed for the type of business that you plan to run.

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Get advice about the terms of the lease

It's important to realise that once the lease begins both parties are committed to the terms and conditions of the leasing contract (for specific information about when a *retail* lease starts, see 'Additional Rules for Retail Leases'). For this reason, it's important to make sure you negotiate carefully, ensure the lease states what was agreed, and that you can comply with the terms of the lease **before** signing it or entering into possession of the building.



Be sure that you understand if you have to pay for **outgoings**, and **repairs and maintenance of the premises**, including any fixtures and fittings (for more information see 'Repairs and Damage' in the 'Retail Tenant's Guide').

Consider how each section of the lease may affect your business in view of the investment you are making and the rest can be negotiated. If the lease has a **relocation** or **demolition clause**, strike a deal with the expectation the landlord will decide to end the lease early.

At the end of the lease

Before starting the lease, work out whether the amount it costs to start the business allows you to make a profit during the first term of the lease. This timeframe is important because the landlord does not have to give you a new lease at the end of the first term. It will be almost impossible to sell a business without a lease. If there is still a debt after the first term, you may not have the opportunity to make up this loss.

When first negotiating for a lease, consider asking for an option for a new lease. This helps protect your investment by giving you something to sell and hopefully get a return for the time and money it took to build up the business. For more information about exercising an option, see 'If the lease has an option' in the 'Retail Tenant's Guide'.

At the end of the lease, if the landlord agrees to offer you a new lease it may be at a significantly higher rent. If the premises are in a shopping centre, it's also likely that you will be required to do additional fit-out works.

You and the landlord may trust each other at the start of the lease, but the situation may change during the term of the lease. The premises may be sold to a new landlord, for instance, who has different plans for the building. Other things may happen that damage the relationship and make it hard to negotiate a new lease together.

To prevent disputes

Keep detailed notes of every conversation and meeting you have with the landlord or agent from the start of negotiations until you move out. Make a note of who was present, the time and date, the location, what was discussed and most importantly, what was agreed. This will help you if something goes wrong. You will have a way of proving why certain decisions were made and the intention of the parties at the time. Re-creating a historical record some time later is far less accurate and reliable.

Ask the landlord or agent important questions and record their answers. The following are some examples:

- Who was the last tenant in this shop and why did they end the lease?
- Did their business succeed or fail? *Even if you hear that the previous tenant failed because they had poor business skills, it may be worth checking for yourself.*
- If you are thinking of renting a shop in a shopping centre, ask about shops that have failed in the past two years.
- If the shop has a large flow of traffic, work out if these people are your potential customers. *Will you have a flood of customers when they are on their way to and from work, but few customers throughout the day? Consider what time of day the customers are likely to stop.*

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- Be sure that you understand if you have to pay for **outgoings**, and **repairs and maintenance of the premises**.
- When first negotiating for a lease, consider asking for an option for a new lease.
- Keep detailed notes of every conversation and meeting you have with the landlord or agent from the start of negotiations until you move out.

It's risky to rely solely on the agent or landlord to give you important information. You should visit the area at different times during the day to see what the environment is like, seek expert advice and do your own research.

Is your lease a commercial lease or a retail lease?

If the type of business is going to be one of the retail businesses listed in Schedule 1 of the *Retail Leases Act 1994* (the Act) then it will apply to your lease. A retail lease has more rules about how the lease works. Your type of business may not be one of the listed businesses, but may still come under the Act if it's located in a shopping centre. You may need to seek advice if you're unsure about what kind of lease you will have.



ADDITIONAL RULES FOR RETAIL LEASES

A retail lease starts when the lease is signed, the tenant starts to pay rent or when they take possession of the shop – whichever comes first.

1. Retail leases should be at least 5 years

If you want to sign a retail lease that is for less than five years, the law requires you to provide a **Section 16** certificate to the landlord. Only a lawyer or licensed conveyancer can sign this document for you. If you do not give this document to the landlord, you may find you are committed to a five-year lease, even if you do not want to be. *Note that a Section 16 certificate only applies to a retail lease, and not a commercial lease.*

2. Fit-out

The tenant usually pays some or all of the costs of installing shop fixtures and fittings (known as 'the fit-out'). The fit-out can be a large expense and the tenant is likely to bear the cost of removing the fit-out at the end of the lease unless they have a written agreement that says it can stay.

Installing a fit-out can take some time to complete. During this time, while the shop is not trading, make sure you can afford the rent, or negotiate for a rent-free period with the landlord.

Shopping centres usually have building standards for shop fit-outs. The landlord (or leasing agent) must provide you with their standards so you can work out whether you can afford the fit-out.

In a shopping centre, landlords often pass on the cost of preparing the shop for the fit-out. These are known as landlord's works. The Lessor's (landlord's) Disclosure Statement informs a tenant of the costs of landlord's works or how they are calculated. The landlord must give you this information in writing before the lease starts.

3. Disclosure of information

At least seven days before the retail lease begins the landlord must give the tenant a Lessor's Disclosure Statement. This statement has important information about the shop and the lease. Carefully consider it as part of the legally binding agreement between the parties.

Read the Lessor's Disclosure Statement carefully. Check that it includes all of the agreements you reached during negotiations and any promises made to you. Tell the landlord immediately if you

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- You should visit the area at different times during the day to see what the environment is like, seek expert advice and do your own research.
- If you want to sign a retail lease that is for less than five years, the law requires you to provide a **Section 16** certificate to the landlord.
- The fit-out can be a large expense and the tenant is likely to bear the cost of removing the fit-out at the end of the lease unless they have a written agreement that says it can stay.

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don't understand or don't agree with the statement. If you need to, ask the landlord for a new corrected disclosure statement.

4. Lessee's (tenant's) Disclosure Statement

Within seven days of receiving the landlord's disclosure statement, the tenant must give the landlord a Lessee's (tenant's) Disclosure Statement, or ask for an extension to provide this document.

Make sure you note in this disclosure statement all commitments made by the landlord or the landlord's agent. If you do not make a note of important promises, it is much harder to hold the landlord to the promise in the future. Be sure to write in the statement anything the landlord (or agent) has said in the lease negotiations (for more information about what should be noted, refer to 'Knowing the facts up front' in the 'Retail Tenant's Guide').

5. Rent increases

Check what your lease says about rent increases and how your rent will increase throughout the term of the lease. There are several rules about how this can happen:

- Generally rent can only increase once every 12 months;
- There cannot be two methods for calculating rent changes at any one time, giving one party the right to choose which applies (i.e. it can't be five percent or the consumer price index, whichever is higher);
- The lease can't say that the rent is not to go down when one method is used (i.e. it can't say, 'review to current market rent but only to the extent that it does not decrease').

If the lease says that rent goes up by the rate of inflation every year, but the landlord does not give the tenant notice that the rent has increased, the landlord is probably still entitled to the increase when they do ask for it. Under the lease agreement, the tenant knows rent increases by the rate of inflation and has agreed to pay the increase by signing the lease.

If a large amount of rent or outgoings have accumulated before you are asked to pay for them, you can probably negotiate a payment plan. If you are in this situation, call the Office of the NSW Small Business Commissioner if you need help or advice.

6. Outgoings

Outgoings are expenses relating to the shop that the tenant has agreed to pay in addition to the rent. A tenant is given notification of the outgoings in the lease contract and the Lessor's Disclosure statement. The *Retail Leases Act* states that outgoings must be:

- directly and reasonably related to the shop; and
- attributable to the operation, maintenance or repair of the building or shopping centre in which the retail shop is located.

Outgoings are another major cost for the tenant. You need to understand these costs before signing a lease and make sure you can afford them.

The landlord must give you estimates of the expenses before the end of the financial year and audited statements within three months of the end of the financial year. Some statements do not have to be audited if there are limited outgoings and you're given a copy of the statements, assessments or receipts.

If you are not getting your estimates or statements, write to the landlord and ask for them. If the landlord does not provide them 10 business days after you requested them, you can stop paying outgoings until you receive the documents. Once the landlord does provide them, you need to pay the withheld outgoings within 28 days. This process of notice, withholding and repayment also applies when tenants need to ensure a landlord provides marketing plans and statements.

7. Lease preparation fees

Under the Act, the tenant does not have to pay the landlord's cost of entering the lease. This includes lease preparation costs and mortgagee consent fees. If the landlord asks for these fees, write to them and refer to sections 14 and 24A of the Act. One exception is that after the tenant's disclosure statement has been returned to the landlord the tenant may be required to pay for the changes they request.

The tenant may be required to pay for the registration of the lease. Registering a lease with a lease term of more than three years (including any option period) protects the interests of both the tenant and the landlord.

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- **Read the Lessor's Disclosure Statement carefully.**
- **Be sure to write in the statement anything the landlord (or agent) has said in the lease negotiations.**
- **Check what your lease says about rent increases and how your rent will increase throughout the term of the lease.**
- **Outgoings are another major cost for the tenant. You need to understand these costs before signing a lease and make sure you can afford them.**

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8. Security

The landlord (or landlord's agent) may ask you for some form of security when negotiating the lease. This security may be:

- a cash bond;
- a bank guarantee, which is a promise by your bank to pay the landlord an amount up to an agreed limit if you break the terms of the lease;
- a third-party guarantee, which is a promise by an individual to pay the landlord if you break the terms of the lease.

A cash bond is not intended to be used by the tenant as an alternative to paying rent on time. Even with a bond, if the rent is behind the landlord may have the right to terminate the lease, lock a tenant out of the premises, keep the bond or bank guarantee and still sue for damages.

The Act requires all cash bonds received for a retail lease to be deposited into the NSW Retail Bond Scheme within 20 days of receipt. If a bond is not lodged, the landlord may receive a substantial fine.

Note that the Act does not require cash bonds for commercial leases to be in the Scheme. However, if the parties to a commercial lease agree, they may use the Scheme to hold their bond.

A bank guarantee is issued by a bank and the paper form of that guarantee is held by the landlord. If the landlord makes a claim and draws the guarantee, the bank pays the money whether or not the tenant agrees, or even has notice payment is being made. If you give the landlord a bank guarantee as security, you should get an agreement in writing that the landlord will release the guarantee by a certain time after you have left the shop. Without an agreement, tenants have experienced difficulty getting the money held against their bank guarantee released.

9. Lodging or claiming a bond

To lodge a bond, you must complete (an original) **Retail Bond Lodgement Form** signed by both parties (the landlord or agent and the tenant). Each form has a unique barcode for ease of tracking the funds. An online request form is available on the website of the Office of the NSW Small Business Commissioner at: www.smallbusiness.nsw.gov.au

Forms can also be requested by emailing or phoning the Office.
Email: we.assist@smallbusiness.nsw.gov.au
Phone: **1300 795 534**

After the form is completed and signed, a cheque for the bond payable to the **Office of the NSW Small Business Commissioner** must be attached and sent to the address printed on the top left of the form. The tenant and landlord (or managing agent) should receive notification (**Advice of the Bond Lodgement**) and the bond number within approximately two weeks.

The **claim form** can be downloaded from the Office's website at: www.smallbusiness.nsw.gov.au

If only one party signs a claim form, the other party is notified that there is a claim on the bond. If the other party does not dispute the claim on the bond, the money is paid after 14 days. If there is a dispute, the money is held until the dispute is resolved.

Important Note: *When you move out of the leased premises, lodge a **change of address form** with the post office so you will be notified when a claim for the bond is made by the landlord/agent.*

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- **To lodge a bond, you must complete (an original) Retail Bond Lodgement Form signed by both parties (the landlord or agent and the tenant).**
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RETAIL TENANT'S GUIDE

Make sure you read the separate **Retail Tenant's Guide**. The Guide summarises the important sections of the law that apply to a *retail* lease. A copy of the Guide, as well as other useful information, can be found at: www.smallbusiness.nsw.gov.au. The Lessor/Lessee Disclosure Statements can also be downloaded from the website.

The Office of the NSW Small Business Commissioner has a Dispute Resolution Unit, which includes the former Retail Tenancy Unit. They can answer questions, as well as provide strategic or procedural advice and information about leasing concerns, the *Retail Leases Act*, and other issues relating to your business. This service is available to tenants, landlords, agents, solicitors, accountants and all other interested parties in the retail leasing industry and small business sector.

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