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## **Background**

In the first article I wrote in this series, I covered the importance of leases. I stated that landlords generally, treat their leases with respect. And tenants (and many of their advisors) do not.

This is one reason, why leases and tenancy law is skewed in favour of the landlord. The other reasons are “cultural” and a failure by politicians (legislators) to legislate.

Both landlords and tenants fail to “structure” leases properly to attain a “balance” in conflicting interests. Tenants do not demand reasonable “security of tenure” offering their capital up by investing considerable sums of money on fitout (including intangible capital i.e. intellectual capital) without security of tenure. And landlords do not structure leases over the life-time of a property properly, even the major A-REITs.

## **Why structure a lease, what is meant by structuring a lease/leases?**

One of the most important considerations from both a landlord and tenants perspective is to have properly structured leases.

“Structuring” a lease, covers the overall broad terms and conditions of the agreement. Is the lease being entered into only a 3-year term with 5% increases? Is it 5 plus 5 years or a 3 plus 3 year lease with 3.5% increments (including the options) or are there market reviews on exercising the option or is it a 10 plus 10 year lease term or 5 plus 5 plus 5 plus 5 years, etc? Are there mid-term reviews to current market rent?

A property structured lease with a business paying the “current market rent” in relation to the business opportunity, with a “return” relevant and appropriate for each party’s investment adds “value” to the business. Conversely the opposite applies, however it never ceases to amaze me how little consideration business proprietors and business valuers pay to these simple yet important considerations eg. how can one supermarket or convenience store be worth a multiple of 10 weeks turnover or another type of business 4 times net income, regardless of the sales, their margins, the net income (when only considering turnover), security of tenure, the structure of the lease, their location, the competition, the value of the intangibles, the value of the fixtures and fittings or their condition, etc!

Equally, the above paragraphs transfer into the “value” of the landlords asset/assets, except for other reasons and not for one lease, but a “bundle of leases” i.e. the leases being valued or the underlying value of the shopping centre. Businesses with no reason d’etre (reason for being) i.e. no value, no profitability can easily transfer to vacancies!

## **The conflict in interests between the landlord and tenant’s investments**

Within all this is a conflict in interests, between what a landlord needs for tenure and security of tenure and that of the tenants. While landlord leases (and their financiers) need security of tenure sometimes landlords need vacant possession (or would save themselves significantly in having to pay out compensation for breach of quiet use and enjoyment, if they “structured” their leases properly), to renovate, refurbish, maintain to ensure their investments do not become obsolete; hence the need for a balance of properly structured leases.

## **Customary practice**

It is customary practice for major shopping centre landlord to offer flat 5 year leases. This is where the behaviour emanated from and the copycat smaller centres followed. There is insufficient tenure to amortise<sup>1</sup> fixtures and fittings, plant and equipment, let alone allow for “start-up” and “close-down” of a business.

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<sup>1</sup> To depreciate and to earn a return

Assuming automatic right of renewal at “current market rent” is a completely flawed assumption; it has been and is used to “jack-up” rents and extract more capital, by way of asset transfer via disproportionate “rent”. i.e. corporate theft.

This “modus operandi” has worked for the “industry” for 15 to 20 years +. This structural rigidity is built into this asset class i.e. a long-term asset class, with predictable outcomes for all the stakeholders.

### **Conclusion**

Other terms and conditions aside that make up a lease, properly structured leases and businesses paying current market rent adds genuine “value” to the value of leases, which is also in the interests of all the stakeholders.

Structuring a lease in conjunction with the lifetime of a business and the other shopping centre leases allows one to properly amortise investment costs and earn an appropriate return. This adds genuine “value” to the bundle of leases that make up the “value” of the property.

In my next articles I will cover various aspects to do with leases i.e. other essential terms.

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