Time to defenestrate the five year term

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In 2013 the Small Business Commissioner of New South Wales published a Review of the Retail Leases Act.

One of the important issues flagged in the Review questions whether the minimum five year term is still required.

The question is important because the minimum five year term sucks a lot of oxygen out of the management greenhouse.

I am not sure what informed the decision to legislate for a minimum five year term in the first place, but the thinking seems to have been that tenants sometimes make a significant investment in fit out, and therefore need to be assured of an adequate term in order to recoup the value of their investment.

Pausing here, it is evident that a cucumber could grasp this concept without the need for legislation. Put another way, no amount of legislation could conserve the interests of a tenant who was not across this issue.

The minimum term legislation works like this. Section 16(1) says that the minimum term of a retail shop lease is five years. Under section 16(3), the minimum five year term can be avoided if a solicitor not acting for the landlord gives the tenant a certificate stating that the solicitor has explained to the tenant the effect of giving the certificate is that the term can be less than five years.

In practice, this produces the following routine. The landlord and tenant agree to a three year term. The tenant says “Great. Where do I sign?” The landlord says “no, you might have agreed to three years, but you have to accept a five year term, unless you get a certificate from a lawyer, telling you what you have just agreed. Otherwise, you could end up with a term we have not agreed”.

When you explain this process to a bureaucrat, he looks like a dog with two tails.

I am not understanding why the parties cannot simply agree on a three year term, and be done with it.

Shocking it may seem, but this is how it rolls in Queensland. There is no minimum term requirement in Queensland, and the sky has not fallen in. In fact, according to a report by Savills released in November 2013, retail sales growth in Queensland for the year ending June 2013 was double the national average. And the NSW Review itself observes that the average length of term in New South Wales is similar to the average length of term in Queensland, despite the legislation.

Findings like these make you wonder what the legislation actually does, apart from get in the road.

You would think that parties to a commercial contract should be free to come to an agreement of their choosing, without having that agreement modified by legislation, unless there was evidence to suggest that one contracting party was being consistently expropriated by the other. So far as I am aware, there is no such evidence. If it exists, the Queenslanders aren’t too worried about it.

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For centre owners, the static around section 16(3) certificates is a major irritant. The real problem with the minimum five year term is the risk of short-term occupancies being enlarged into five-year terms by inadvertence or misunderstanding of the legal voodoo surrounding section 6A of the Act.

I have been frequently critical of section 6A. It has the effect of enlarging short term leases into five year terms as a result of oversight or inadvertence. This can be disastrous for landlords planning redevelopment.

In cases like that, the landlord needs to manage the relevant tenancies on a short-term basis. The last thing the landlord wants to find is that a tenant has fallen through the cracks, and somehow obtained a windfall five year term.

Misunderstanding is a real risk, because no one really understands how s6A works in the first place.

Accordingly, landlords tend to be vigilant, and in some cases overly cautious, about managing holding-over tenancies. Because so much is at stake, landlords would rather end these arrangements and evict the tenant, than risk a deemed five year term arising. And for a tenant who is otherwise happily trading under a short-term occupancy arrangement, this outcome can be exactly what the tenant does not want.

Without the minimum five year term, short-term occupancies could continue indefinitely, while it suited both the landlord and tenant. Why would you want to mess with that?

If they did not have the five-year risk hanging over their heads, money spent by landlords in obtaining legal advice about managing and evicting short-term tenants could be spent on more direct investment for the benefit of the centre as a whole.

And so yes, the minimum five-year term should be defenestrated. Like so much of the retail legislation, it increases the cost and complexity of centre management, and provides no benefit to tenants. And for tenants who are happy on short-term arrangements, it is a curse.

Unfortunately, most States and Territories have followed New South Wales into the five year wilderness. And each jurisdiction has enacted its own idiosyncratic version of this stupidity.

Prize for the most idiotic legislation (in a crowded field) goes to South Australia. The only way the crow-eaters can avoid a five year term is by obtaining what is grandly called a “Certified Exclusionary Clause.”

What is apparent is that none of these States or Territories have really thought about the effect of the legislation. Like New South Wales, they have adopted the quantity-over-quality approach. They keep dancing at shadows, and knocking over the furniture in the process.

It can only be hoped that the NSW Review will lead to repeal of sections 6A and 16, and that the other jurisdictions will remain true to type, and follow suit.