



Without a good lease your hospitality business will fail

There are many reasons why a small hospitality business, like a bar, restaurant or tavern, will fail. I have often heard statistics thrown around that 50% of small businesses fail in the 1st year and 95% in the first 5 years. I am not sure how accurate those statements are. But the fact is it can be tough out there for a new business and many do fail in the first couple of years for a variety of reasons including having a poor lease and paying too much rent, not enough capital, starting business for the wrong reasons, poor management, lack of planning, wrong location or even external influences that disrupt the business.

One reason we commonly hear as solicitors is the business is struggling or has failed because the rent was too much or the lease terms were not fair. But these are usually factors that can be determined prior to entering into a lease with the right advice.

The largest expense for any hospitality venue is usually the wages and the cost of selling the goods. With wages being the single biggest expense for any hospitality venue we are now seeing some venues choosing not to open on certain days, such as Sundays and public holidays when penalty rates are high.

The next largest expense will often be the rent. Therefore, it is critical that the rent is sustainable for the success of the business, i.e. you need to be sure that you can achieve the level of turnover required in order to satisfy the payment of rent and other expenses.

The ATO released the following benchmarks in 2014 for pubs, taverns and bars across Australia:

Benchmark ratio	Annual turnover range		
Income tax return	\$100,000 – \$750,000	\$750,000 – \$2,500,000	More than \$2,500,000
Labour/turnover	13% – 20%	18% – 24%	17% – 23%
Rent/turnover	9% – 13%	7% – 10%	6% – 9%

However, it is not just the rent that you need to get right. There can be many clauses within a lease that can directly impact on the success of your business and the overall value of the business. The following are just some of the key issues to consider when reviewing a lease for a hospitality venue.

1. **Term:** It is important to have a lease long enough so you can have enough time to build the business and then still have sufficient time on the lease that will be attractive to a



purchaser of your business. If a lease is only 5 years, then if it takes you 2 to 3 years to establish the business there will be very little left to sell.

2. **Bank Guarantee:** Often a landlord will ask for a bank guarantee, lease deposit and/or personal guarantee. These all need to be carefully considered for asset protect and the impact it may have on your cash flow or access to funds if you are tying up funds in a bank guarantee when the business may need this money. However, most Landlords will insist on a bank guarantee.
3. **Who owns the liquor licence?** Is a question that we often get asked. When a liquor licence is granted it is approved for the Licensee, the holder of the licence. However, most hospitality leases will have a retention clause where the liquor licence reverts to the Landlord at nil cost. Again, this needs to be considered, as significant expenses have been incurred by the tenant in acquiring the liquor licence.
4. **Redevelopment:** Redevelopment clauses allow the Landlord to develop the premises during the term of the lease. However, a bank may not consider the lease length if there is a development clause in it. Similarly, if the clause has a sunset date when it may be instigated a bank may only recognise the length of the lease up until that sunset date. If a landlord insists on a redevelop clause then it is important to try and negotiate compensation for the tenants exit.
5. **Rent review:** The rent is usually reviewed annually often by CPI or it might be fixed term. There is also often a market rent review at the end of the term. All these things are very important to consider. A rental amount at the commencement can very easily accumulate to a level that is unachievable.
6. **Painting & Repairs:** How often do you need to repaint or redecorate the premises and what is required with these works? Often hospitality leases require this to occur at least once every 3 to 5 years. But it can mean significant costs, therefore you need to carefully consider what is required and if you have some flexibility with style and colour choices or is this entirely at the discretion of the Landlord.
7. **Expiration of lease:** What happens at the end of the lease with the fitout? If the premises needs to be returned to a vacant premises with the fitout removed then this can incur considerable costs for the outgoing tenant. A tenant may want to endeavour to negotiate that the Landlord must purchase the fit out from the tenant.

These are just some of the important terms that you need to get right when negotiating a lease and we strongly advise that you seek legal assistance with such negotiations and in finalising any lease. Furthermore, you should also get financial advice from your accountant or advice from an agent in relation to the appropriate market rent for a particular premises and other commercial terms.

If you find you are already in an undesirable lease and the rent is unsustainable or the lease conditions are unreasonable then don't continue down the path to failure. Try to negotiate with your Landlord what is not working. In the end a Landlord needs a tenant. We are finding that some Landlords appreciate the tough times that their tenants are facing and at times some



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have been willing to work with their “good tenants”. In fact, we have been able to negotiate new rental arrangements and better terms of a lease for some of our clients, despite not being in a legal position to do so. It is better to try and address the issue and ask the question instead of letting things get to an unrecoverable level.

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