

Practice note on leases with consumers

1 Introduction

- 1.1 This is a practice note to accompany SAPOA's draft standard leases where the transaction is governed by the Consumer Protection Act, 2008. The draft agreements and this practice note should not be used where the lessee is a juristic person, with asset or annual turnover values that exceed R2 million.
- 1.2 **This practice note is not intended to be legal advice and it does not exhaustively cover all aspects of commercial leases. Please ensure that you obtain legal advice for your specific circumstances. This practice note is only a guideline by SAPOA.**
- 1.3 **All leases are different in nature due to the fact that parties and their respective needs differ. Accordingly, this document is only to be used as a guideline and should not merely be copied with the expectation that it will serve each party's individual circumstances.**
- 1.4 This Practice Note is designed to be read together with the basic draft commercial leases for consumer tenants.
- 1.5 The terms landlord or lessor may be used interchangeably in the leases but nothing hinges on using one term or the other – it is more a question of preference. When you refer to the landlord you should use tenant as the counter-party and similarly with lessor and lessee.
- 1.6 Landlords, who let their property in the ordinary continual course of business, to consumers must ensure that the lease and the services delivered to the tenant are in line with the requirements of the Consumer Protection Act (**CPA**).
- 1.7 A consumer tenant is:
- (1) any individual (sole trader) regardless of their turnover or asset value:
 - (2) a juristic person including a company, close corporation, trust, association or partnership whose assets or annual turnover value R 2 million¹ or less; and
 - (3) a franchisee, regardless of the turnover value, who is letting premises in terms of their franchise agreement.
- 1.8 The standard form lease has been drafted to avoid provisions which would be unfair or prohibited under the CPA. Care is needed to avoid the inclusion of provisions which would be unfair in terms of the CPA. These include terms that are excessively one-sided in favour of the Landlord. For example if only the Landlord may terminate the lease or have rights on breach of the lease, this may be unfair. A term in a Lease which avoids a Landlord's obligations in the CPA or takes away any consumer rights is not allowed.
- 1.9 Landlord obligations and tenant rights under the CPA differ depending on whether the tenant is an individual (sole trader); juristic person, consumer or a franchisee:
- (1) The individual tenant is protected in a fixed term agreement. There are limitations on when a landlord can cancel the lease and on the penalties that can be charged (see section 2 below).

¹ The asset or turnover value is assessed at the time of the transaction based on the previous year's financial statements. Only the turnover of the direct entity is considered. For example, a company that has no assets or turnover, owned by a large group of companies will still be a 'consumer'.

- (2) The lease (other than with a franchisee) must comply with the plain language requirements of the CPA and must include an itemised breakdown of the costs the tenant will incur under the lease.
- 1.10 Commercial leases, industrial leases and retail leases are similar when it comes to the essential components of the lease, but there are significant differences such as the inclusion of trading hours, marketing funds, and continuous trading clauses for a retail lease. Also it is more common to base or supplement rent by using a percentage of the retail tenant's turnover than it is in a commercial or industrial lease. Therefore separate drafts of a retail lease and a commercial/industrial lease agreement are provided.
- 1.11 Users of these draft leases should understand the meaning of certain basic concepts such as:
 - (1) **Single Net Lease** – the tenant/lessee is responsible for paying property taxes as well as base rent;
 - (2) **Double Net Lease** –tenant/lessee is responsible for paying property taxes and building insurance in addition to the base rent and it is then expected that the landlord/lessor will be solely responsible for the costs and expenses incurred in relation to structural maintenance and general upkeep of the building or common areas;
 - (3) **Triple Net Lease** – a type of lease relationship where the tenant/lessee agrees to pay the two "Nets" in addition to the base rental meaning property taxes, building insurance and maintenance.
- 1.12 The Triple Net Lease is a hybrid form that is the most common in the South African commercial/industrial and retail rental market as it has become common-place for landlords to transfer as many of the obligations associated with the leased premises to the tenant as possible.

2 Duration of a lease

- 2.1 All parties' needs differ and therefore there is no right or wrong lease period.
- 2.2 If parties commit to a fixed term lease period, the parties are usually expected to be bound for the full duration of the lease period. Accordingly most leases only cater for a right to terminate the lease in the event of an unremedied breach by the Tenant/Lessee. More recently the right to cancel the lease has sometimes become reciprocal. Under the CPA it will be unfair for a landlord to grant itself a right of cancellation without granting the same right to the consumer tenant.
- 2.3 Under the CPA a fixed-term agreement with an **individual** consumer tenant is limited to a maximum period of 24 months unless:
 - (1) There is a demonstrable financial benefit to the consumer.
 - (2) This is allowed in regulations for a specific type of agreement, consumer, sector or industry or if an industry code provides for a longer period.
- 2.4 Early termination of a lease with an individual consumer
 - (1) In terms of the CPA an individual may cancel a fixed-term agreement by giving the landlord 20 business days' written notice.

- (2) The supplier may only cancel the agreement 20 business days after giving the tenant written notice of a material failure by the tenant to comply with the agreement, unless the consumer corrects the breach within that time.
 - (3) If the agreement is cancelled before the expiry date the landlord may charge a reasonable early cancellation fee and the tenant remains liable for any amounts that remain owing to the landlord up to the date of cancellation. It is important to bear these possible amounts in mind when determining an appropriate deposit. It is advised to increase the amount of the security deposit when dealing with a tenant to mitigate this risk.
 - (4) The landlord must also credit the tenant with any amount that remains the property of the consumer as of the date of cancellation.
- 2.5 The landlord must also notify a tenant in writing not more than 80 business days, nor less than 40 business days (about four to two months) before the expiry date of the lease regarding the imminent expiry date. The notice must include any material changes that will apply if the agreement is renewed or if it continues beyond the expiry date, on a month-to-month basis (e.g. an increased rent or renewal).
- 2.6 When the fixed-term expires the lease will automatically continue on a month-to-month basis incorporating any changes that the landlord has notified to the tenant unless the tenant expressly directs the landlord to terminate the agreement on the expiry date or agrees to a renewal of the agreement for a further fixed term.
- 2.7 Parties need to be mindful of the difference between short and long term leases:
- (1) Short-term leases are leases (including their renewal periods) that are less than 10 years. These leases may also be notarially executed and registered and endorsed against the title deed of the property.
 - (2) Long-term leases are those leases which are 10 years or more in duration. This includes leases that have an initial period of less than 10 years but by virtue of the renewal periods are in excess of 10 years. These leases, if notarially executed and registered and endorsed against the title deed of the property, are considered immovable property in terms of section 102 of the *Deeds Registries Act No. 47 of 1937* which in turn means that a tenant may register a mortgage bond over the lease in favour of a creditor. It also was the tenant's rights are protected against all third parties including a purchaser of the property

3 Rental

- 3.1 The manner of charging rental is a matter of business preference. Some landlords prefer knowing what they will receive every month whilst others are more comfortable with a more risky approach where they 'share' in the fortunes of the tenant/lessee by charging a percentage of turnover if the tenant is leasing retail premises from the landlord.
- 3.2 In South Africa, most landlords for retail premises have taken a combined approach by charging a minimum base rental or turnover, whichever is the most.
- 3.3 Rental is payment for the occupation and possession of the leased premises but great care should be taken to ensure that the amount covers all ancillary charges relating to the property if a landlord decides to embark on a single or double net lease, as described above.

- 3.4 Escalation of rent usually takes place in equal percentages over the lease period but in some instances, based on commercial considerations, the parties agree to a lower escalation rate for the first few years to ensure the tenant will be able to build and grow its business and then escalate it more aggressively for the remaining lease term. This is also a way of making a fixed-term agreement with a financially beneficial to them and justify a longer duration than two years.
- 3.5 On renewal, the parties can either opt for a renegotiation, a rent review process by independent experts or to continue with the previously agreed annual escalations. If there is no certainty renewal is unenforceable.
- 3.6 Under the CPA the consumer must be informed of the total costs involved in the lease of the premises and what other costs might be incurred and how they will be determined.

4 Operating Costs

- 4.1 There is no fixed list of what comprises operating costs. Landlords need to decide what costs are part of the basic rent and what operating costs to charge separately.
- 4.2 The draft leases include a broad list. It will also depend on whether it is a single, double and triple net lease. Most landlords want to pass as much of the direct costs associated with the leased premises on to the tenant/lessee, but if that is the case, the landlord has an obligation to tell the Tenant/Lessee what they will be paying for.
- 4.3 The landlord is usually responsible for everything happening on the outside of the leased premises and the tenant for the internal aspects. But in multi-tenant buildings and office parks it becomes a lot more complex. Most landlords use a triple net lease position where the total cost associated with the property is apportioned between the Tenants.

5 Operating hours

- 5.1 In a retail lease the landlord should require specific trading/operating hours for the shop. This means that the landlord can require that all tenants keep their shops open for the same hours. The landlord may also require that the tenant keep the lights on for a period after the leased premises have been closed for business. The retail lease agreement may also provide for temporary closure of the leased premises in circumstances where, for example, the premises are being remodelled or the shop fronts are being changed.

6 Marketing fund

- 6.1 In a retail lease, the landlord may require tenants to contribute a monthly amount to a marketing fund to promote business in the shopping centre. The contribution is usually paid with the rent and will comprise a percentage of the tenant's turnover. The landlord must charge this amount as a separate item.
- 6.2 The landlord must also ensure that the fund is actually used for the commercial interests of the shopping centre / retail tenants by marketing of the centre as a whole for the benefit of the benefit of the tenants.
- 6.3 The landlord may also choose to establish a merchants association that must be joined by all tenants in the shopping centre to represent the interests of the tenants.

7 Damage or destruction of the Leased Premises

- 7.1 The 'damage or destruction' clause, over the years, has become rather complicated and convoluted.

- 7.2 The basic principle is that the landlord bears the risk in relation to damage to the buildings and loss of rental income and for that risk it should obtain and keep in place adequate insurance.
- 7.3 The tenant has the risk of not having a place of business from where it can operate, plus loss of movables, revenue and the like – for this the tenant must have his or her own appropriate business interruption insurance.
- 7.4 The version used in these drafts is quite generous from a landlord perspective but it is easily understandable and does not depend on complicated formulas of usability being employed. It can be used for a CPA covered lease.
- 7.5 Provision can be made for reduction/apportionment of rent where the premises are partially damaged but can still be used to a limited extent by the tenant. And provision must be made for the tenant not to pay rental for the period when the leased premises remain unusable.

8 Costs and commission

- 8.1 The costs and commission clause is a very basic clause and usually the landlord is liable for payment of commission. If the tenant is to pay, they must be informed of this cost upfront.
- 8.2 If there is no separate commission agreement or mandate in place, the landlord, alternatively the party who gave an express mandate, will have to pay commission at the rate publicised in the Government Gazette from time to time. It should preferably be addressed in a separate written mandate.

9 Limitation of liability

Please see the guidance note on disclaimers and exclusion or limitation of liability, and how they must be explicitly drawn to the consumer tenants' attention. The landlord may not exclude liability for their own or their agent's gross negligence. Also landlords may not contract out of harm caused by defective goods supplied as part of the leasing service.

10 Disputes

- 10.1 The draft lease contains a simple dispute resolution and arbitration clause.
- 10.2 The draft lease is intended for use in normal situations where parties may much rather wish to resolve the disputes between themselves, alternatively with the assistance of court.
- 10.3 A consumer tenant will also be able to take any dispute to the National Consumer Commission or any commercial property ombud established.

11 Marketing the property

- 11.1 The landlord or the agent must not directly or indirectly mislead the tenant regarding any material fact in relation to the premises. This includes failure to correct an apparent misunderstanding by the tenant. For example the landlord must not represent that a building is approved for a particular business activity when in fact it is not or fail to correct a misunderstanding by a tenant that the premises are approved for a particular business.
- 11.2 A landlord (or their agent) may not falsely claim that any land or other immovable property:
- (1) has characteristics that it does not have;

- (2) may lawfully be used, or is capable of being used, for a purpose that is in fact unlawful or a purpose that is not practical; or
 - (3) has or is close to any facilities, amenities or natural features that it does not have, or that are not available or close to it.
- 11.3 Any other conditions of use that are applicable to the property must be disclosed fully to the tenant.
- 11.4 The CPA also imposes a positive duty on a landlord to disclose to the tenant any risk or danger in the facility that is of an unusual character or nature, of which the tenant could not reasonably be expected to contemplate and that could result in serious injury or death. Any such hazards should be drawn to the tenant's attending in writing.
- 11.5 If a consumer tenant is required to comply with Body Corporate rules or the terms of the landlord's insurance policy, for example, they should be provided with a copy of the document so that they understand their obligations.

12 Security and the CPA

- 12.1 The CPA does not require a deposit to be kept in an interest bearing account for the benefit of the tenant. But the deposit remains the tenant's property until lawfully used by the landlord. It is best to be specific about the circumstances in which the deposit can be used by the landlord to offset expenses incurred.
- 12.2 The landlord's hypothec (the right to retain the tenant's property until overdue rent is paid) is not affected by the CPA.
- 12.3 A landlord may not grant access to the leased premises to a third party wanting to reclaim goods supplied to the tenant. Self-help of this nature is prohibited by the CPA.
- 12.4 A suretyship provided by a third party is not a transaction that falls under the CPA. Despite this, take care to avoid overly complicated and lengthy suretyship agreements. Due to the personal and onerous nature of the obligations imposed in a suretyship, the surety must be able to understand what they are agreeing to.