

Information Sheet

Options and Renewals

What is an option to renew a lease?

A retail premises lease will ordinarily provide for a particular period of occupancy. Tenants wanting to continue their business beyond the initial term of the lease should negotiate with the landlord to ensure there is an ‘option to renew’ provision (commonly just called an “option”) contained in the initial lease or lease agreement. The option to renew the lease for a further term should be realistic and clearly described.

Examples of leases with options could be:

- A 5 year lease with two further options, each of 5 years (often described as a “5+5+5”)
- A 3 year lease with four further options, each of 3 years (often described as a “3+3+3+3+3”)

An option to renew gives the tenant the right to continue the tenancy for the option period agreed in the lease. Options to renew may be preferable to one lease of many years because they provide the tenant with a means for discontinuing the lease at the end of a specified period. For example, under a lease of 3 years with two options of 3 years each, the tenant can choose to end the lease after 3 or 6 years. However, under a single lease of 9 years, the tenant is committed to the full term of 9 years.

Section 27 of the *Retail Leases Act 2003* (the Act) specifies that, where a lease contains an option exercisable by the tenant to renew the lease for a further term, the lease must state:

- the date after which the option is no longer exercisable; and
- how the option is to be exercised; and
- the terms and conditions on which the lease is renewable under the option; and
- how the rent payable during the term for which the lease is renewed is to be determined.

What notices are required of the landlord when the tenant has an option to renew?

When the lease contains an option for the tenant to renew the lease for a further term, the Act specifies that the landlord must give a notice to the tenant *notifying* the tenant of the date after which the option is no longer exercisable, as specified in the lease. The notice is primarily a reminder and a prompt for the tenant to make a decision as to whether or not to continue the lease. Section 28 of the Act specifies the relevant time requirements for this notice.

Section 28(1) of the Act provides that this notice must be given at least 6 months, but no more than 12 months, before the date after which the option is no longer exercisable.

However, if the tenant exercises the option *before* the tenant receives the notice from the landlord, the landlord is not required to provide the notice.

For example, a particular lease may specify that the tenant must exercise their option no later than 3 months prior to the expiry of the lease. In this case, the lease expires on 30 December 2013. As the last date to exercise the option is 30 September 2013 (being 3 months prior to the expiry date), the landlord would have to have given the notice at any time between the dates of 30 September 2012 and 30 March 2013, effectively giving the tenant *at least* 6 months (but no more than 12 months) to consider whether to exercise the option. Note, if the tenant exercises the option on 30 September 2012, and the landlord had not yet given the notice, the landlord is not required to give the notice.

If the landlord does not give the notice in the time specified by section 28(1) of the Act, the date after which the option is no longer exercisable is given an extension of 6 months after the landlord does eventually give the notice to the tenant. Where the extended date is *after* the expiry date in the lease, the lease continues until that date on the same terms and conditions as applied immediately before the expiry date.

However, if the tenant does not wish for the lease to be extended beyond the end date specified in the lease, the tenant can give the landlord a written notice terminating the lease at any time (providing the lease is not terminated any earlier than the end date specified in the lease). See section 28(2) and (3) of the Act.

Regardless of any extension according to the Act, once the option is eventually exercised by the tenant, the new term will commence *the day after the expiry date of the previous lease* (see section 28(4)).

When is an option not exercisable?

Even if a lease contains an option to renew, it may not always be exercisable by the tenant (section 27(2) of the Act). The option may not be exercisable if:

- the tenant has not remedied any default under the lease about which the landlord has given the tenant written notice; or
- the tenant has persistently defaulted under the lease and the landlord has given the tenant written notice of the defaults.

Disclosure on renewal

The landlord must provide a disclosure statement to the tenant not less than 21 days before the end of the initial term, or not more than 14 days after the parties have agreed to renew when there is no option (section 26).

What notices are required of the landlord when there are *no options to renew*?

When the lease does not contain any options to renew the lease for a further term, the Act specifies that the landlord must give a written notice to the tenant outlining the landlord's intentions. Section 64 specifies that the notice must either:

- offer the tenant a renewal of the lease (on the terms specified in the notice); or
- inform the tenant that the landlord does not propose to offer the tenant a renewal of the lease.

The time period by which the landlord must provide the notice is at least 6 months, but no more than 12 months, before the lease expiry date.

If the landlord fails to give the notice in the time specified, the lease is extended by 6 months after the date on which the landlord eventually gives the notice to the tenant.

For example, if a lease expires on 30 December 2012, the landlord must give the notice at any time between the dates of 30 December 2011 and 30 June 2012. If the landlord fails to give the notice between these dates, and eventually gives the notice to the tenant on 30 September 2012, the lease is extended by 6 months from that date, and will expire on 30 March 2013, on the same terms and conditions as applied immediately before the expiry date.

However, if the tenant *does not* wish for the lease to be extended beyond the lease end date (because of the landlord's failure to provide the notice), the tenant may give the landlord a written notice terminating the lease at any time (but no earlier than the lease end date specified in the lease).

Does my landlord have to renew my lease?

The landlord will only have to renew a lease if the lease contains an option to renew, and the tenant has validly exercised the option.

Where a lease contains *no options*, the landlord is not obliged to renew the lease, even if the tenant has developed substantial goodwill in the premises. This is made clear in section 79(b) of the Act which specifies that failing to renew the lease *does not* amount to unconscionable conduct.

The landlord is, however, required to provide the tenant with notice of the landlord's intentions as to whether the landlord wishes to renew the lease or not.

Where a tenant has been in continuous possession of the premises for more than 1 year but under 5 years, the tenant may be able to continue to lease the premises for up to 5 years, *if* the tenant has not obtained a certificate waiving the right to a lease of 5 years (as per section 21 of the Act – please refer to Information Sheet on the 5 Year Waiver).

The tenant may still try to negotiate a further term with the landlord, even if the landlord had initially stated that a further term would not be offered, however, the tenant has no legal entitlement to a further term.

Does the rent increase when I exercise my option?

For new retail premises leases, the rent will initially be set by negotiation. However, once the lease commences, the rent will be determined by the rent review provisions and specifications in the lease. Throughout the lease the rent may be increased, if the lease provides for it, by a fixed percentage or amount (e.g. 4% per annum), or by a certain figure determined by the consumer price index (CPI). These increases will often take place annually. However, when a tenant exercises their option, the lease will often provide for a *market review* of the rent.

Conducting a market review to assess the market value of the premises usually takes into consideration a range of factors (e.g. location of the premises, size of the premises, condition of the premises, etc), and may take place by negotiation between landlord and tenant, or in the case that the landlord and tenant cannot agree, by the

appointment of an independent specialist retail valuer by the Small Business Commission to assess the market rent.

Tenants should note that a landlord's only obligation regarding options is to provide notice 6 months prior to the date after which the option can no longer be exercised. Tenants should be aware that they may not know the proposed rent prior to exercising an option under a lease. In such circumstances it is advisable for the tenant to approach the landlord prior to the last date for exercise of the option to clarify the proposed rent for the next term of the lease.

What if I exercise my option and then change my mind?

Sometimes a tenant will exercise an option under the lease and then, due to a change of circumstances, decide that he/she no longer wants to continue with the lease. This situation can cause problems as the tenant has committed to the further term and the landlord has been of the belief that a tenant would be in place for the next option period. Although the tenant may try to negotiate a solution with the landlord, the landlord may insist that the tenant continue with the lease.

How to resolve a dispute

The Victorian Small Business Commission (VSBC) offers a dispute resolution service to assist parties to resolve business disputes. A dispute can be referred to the VSBC by submitting an application which summarises the issues and the parties involved.

The Commission appoints an officer to consider the application, contact the parties and, through preliminary assistance, seeks to resolve the dispute. There is no cost to the parties for this service. If the dispute cannot be resolved at this stage, the parties are invited to attend mediation. Mediation involves a meeting between the parties in dispute and an independent mediator who will attempt to assist the parties to reach an agreement about the dispute. When all parties agree to mediation, the Commission appoints a mediator and arranges the date, time and venue. The mediation can be in regional Victoria if it is more convenient for the parties. Mediation costs only \$195 per party per session and usually takes 3-4 hours.

The mediation is confidential; however, any settlement agreement may be taken to the Victorian Civil and Administrative Tribunal (VCAT) or an appropriate Court for enforcement, if necessary.

Each party pays their own costs at VCAT. However, where a party refuses to take part in mediation, VCAT has the power to order that party to pay the costs of the other party.

Further information including the cost of mediation can be found on the VSBC's website at www.vsbcc.vic.gov.au

Further Information

Contact the Victorian Small Business Commission

Call 13 VSBC (13 8722)

TTY (03) 9651 7596

Or visit: www.vsbcc.vic.gov.au

