

## Lease agreements in a volatile economic climate

As many retailers are looking to go digital and shrink their physical presence, lease agreements need to be fair and reasonable to protect both tenant and landlord in a volatile economic climate

By Nabeela Edris 17 May 2019



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While the lion's share of South Africa's retail revenue is still earned via traditional bricks-and-mortar outlets online retail has become a mainstream shopping trend and passed the R14-billion revenue mark last year, accounting for 1.4% of total retail earnings.

This is according to a study by World Wide Worx, which found that this figure represents 25% growth over 2017, which surpassed expectations, as predictions held that online retail growth would slow down to below 20% by 2018.

This robust growth has mainly been driven by digital transformation, which has seen large investments in online retail, aggressive marketing, and the rapid uptake of new shopping channels, such as mobile.

The move to digital, coupled with an increasingly tough trading environment for traditional retailers, has forced organisations to rethink their business models, and has seen many trimming their physical presence explains Muhammad Ziyaad Gattoo, Director in the Real Estate practice at Cliffe Dekker Hofmeyr (CDH).

### Tough trading

The trading environment for South African companies has been especially difficult over the past decade, with South African Revenue Service data showing the country has lost 83,000 firms in the financial and business services sector during this period. Several factors drove this decline, including the financial crisis of 2007/8, an increase in administrative and regulatory burdens, and the high cost of crime for businesses in SA, among others.

In addition, the South African consumer has increasingly come under pressure, with annual consumer price

inflation at 4.1% in February 2019, up from 4% in January, putting a squeeze on retail spend.

While these factors are pushing businesses towards decreasing their physical footprint, in favour of a big online presence, landlords can suffer economic loss when an organisation decides to change its business model and pull out of its lease agreement, says Gattoo.

## **Prepare for possibilities**

“It is a commercial reality that, from time to time, circumstances demand for a change in business strategy. This just serves as a reminder to landlords to equip themselves for such possibilities, thus ensuring profitability,” he says.

At the same time, he adds, the main principles behind a lease agreement must remain fairness and reasonableness, so that tenants are also given a fair deal. In short, the rights and responsibilities of both parties in a lease agreement must be taken into consideration – while small retailers need to be protected the effect of centres losing tenants due to economic factors can have a negative effect on the industry.

## **Reasonable terms and clauses**

When entering into lease agreements, landlords must ensure any term which may fall within the categories mentioned in Sections 48 to 51 of the Consumer Protection Act are not drafted on any unreasonable term and are explained to the tenant, with the tenant signing a declaration that such terms were brought to their attention, the consequences explained and understood.

Gattoo says that ideally, lease agreements should include an early termination/escape clause, as early termination causes a disruption that comes with costs.

Furthermore, Gattoo notes that a breach clause should be included and carefully drafted. It should only be invoked in circumstances where there has been a breach of the fundamental terms and conditions of the lease.

Lastly, he encourages parties to sign a Triple Net Lease (also known as the NNN lease), which refers to an agreement where a tenant pays all the real estate taxes, building insurance and maintenance, as well as the normal costs of a lease agreement. In this case, the tenant invests more into the property they are occupying, meaning that the tenant has more to lose than an ordinary tenant.

## **ABOUT THE AUTHOR**

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