TURNOVER RENT AND REPORTING TURNOVER TO LANDLORDS

Pharmacy Guidelines
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DISCLAIMER

The information contained in this publication is general in nature and may not deal with all aspects of the law which are relevant to your specific situation. Therefore, you may wish to seek independent professional advice to ensure all factors relevant to your circumstances have been properly considered. This publication reflects the law as at 4 June 2012. The Pharmacy Guild of Australia does not provide any warranty or guarantee as to the accuracy, reliability, currency or completeness of the information contained within this publication and does not accept any legal liability arising from or in connection with your use of or reliance on the information contained herein.

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These Guidelines have been developed to provide members with an overview of the legal framework governing leasing arrangements for pharmacy premises and to identify some of the commercial issues which members should be aware of when dealing with landlords.

In particular, these Guidelines focus on two related issues of particular concern to members:

- calculation of rent by reference to the turnover or profits of a pharmacy business; and
- supply of turnover figures to landlords by pharmacy owners.

The first part of the Guidelines sets out the legal framework which governs leasing arrangements for pharmacy premises. Because of the unique position of community pharmacy in Australia, the law in a number of States and Territories affords protection to pharmacy businesses which is not available to other retail businesses.

The second part of the Guidelines identifies commercial issues which can arise in leasing arrangements and offers some practical suggestions for members in dealing with their landlords. In particular, this part of the Guidelines focuses on the reporting of turnover figures to landlords.

Pharmacy owners are under a legal obligation to comply with the valid terms and conditions of existing lease arrangements. For this reason, these Guidelines will be of most assistance in relation to:

- the negotiation of a new lease;
- the renewal of an existing lease;
- the exercise of an option under an existing lease; and
- market rent review under an existing lease.

These Guidelines are intended to inform and assist members. However, they are necessarily generic and are not intended to provide specific advice on individual arrangements. You should always exercise your own judgment and seek independent legal advice in relation to your commercial arrangements.
The revenue components of a pharmacy business can be described under three major categories:

**Prescription Medicines**

The largest category is prescription medicines. It accounts for 55% to 80% of the total business depending on the size and location of the pharmacy and its proximity to doctors. Government policy has a major bearing on profitability and in recent times this category has been the target of Government savings. These policy changes will continue to have an effect on revenue and profitability over the next five years. Profitability on the 25% of prescriptions which are not subsidised by government through the PBS is also under pressure due to intense competition amongst pharmacies.

**Scheduled Non-Prescription Medicines**

The second largest category is scheduled medicines, which includes products that are only available from a pharmacy because of the potency and safety profile of the medicine. This category accounts for 10% to 15% of the business. This group includes analgesics and cold and flu medicines. Over recent years there has been intense price competition generated by the large discount chains. Discount chains have targeted scheduled non-prescription medicines and market prices have moved to match competitors. The largest seller in this category is cold and flu medications and market prices have moved to match competitors. The largest seller in this category, cold and flu medications, has recently seen strict sales conditions placed on products containing pseudoephedrine and there has been a 20%+ fall in cold and flu sales.

Overall, turnover for scheduled non-prescription medicines has increased by approximately 6%, however the profit line has remained flat. This category, which is the only category where pharmacists have broader control over pricing, product range and profitability, remains a small part of the pharmacy business.
General Retail

The last category covers all remaining products including vitamins and supplements, health and beauty, and cosmetics and fragrances. Recent years have also seen pharmacy move aggressively into the weight management category, meaning that pharmacy is increasingly being viewed as a weight management destination. The ‘grey’ market for fragrances, which pharmacy dominated over recent years, has slowed dramatically due to new market entrants and other competition. The vitamins and supplement market has seen strong growth. Overall for this category, there has been a 6.5% growth rate and a similar growth in profit line.

The Pharmacy Channel

The pharmacy channel is the largest single retail channel in Australia with in excess of 5000 outlets, located in all forms of retail property with a high percentage under rental lease. It is The Pharmacy Guild of Australia’s position that the pharmacy channel should be a stand-alone Sales Group Category, in the same way that other unique retail operations are recognised by the Shopping Centre Council of Australia (SCCA) guidelines, for example the jewellery channel.

When negotiating leasing arrangements, Guild members should satisfy themselves that any comparative occupancy cost measures provided or referenced by the landlord or his or her agent directly reflect pharmacy only benchmarks.

Understanding the Landlord’s Perspective

Since September 2006, the SCCA has endorsed the SCCA Sales Reporting Guidelines (SCCA Guidelines). The SCCA Guidelines define a number of activities undertaken by landlords, centre managers and leasing executives focussed on the reporting of lessee sales and the production of Sales Productivity Measures and Sales Group Category Reporting.

Since the introduction of the SCCA Guidelines, the pharmacy industry has experienced its most prolific growth in occupancy costs (rentals).

Sales Group Category

In the SCCA Guidelines, community pharmacies are included under the General Retail sales group category. This category also includes other retail channels such as giftware, cosmetics, discount variety stores, florist shops, pet shops, toy stores and miscellaneous retail outlets.

The Pharmacy Guild of Australia considers that this categorisation does not provide a satisfactory classification of community pharmacy (being Australia’s single largest retail channel) and should be changed.

Sales Productivity Measures

The SCCA Guidelines also set out a number of Sales Productivity Measures, which are used by the property industry to produce industry benchmarks for occupancy costs. These benchmarks are used in property industry publications and reports to drive favourable promotion of the value of retail investments (both new and existing), mainly through the reporting of rental growth and returns for shareholders.

One Sales Productivity Measure that has particular impact for community pharmacy is the treatment of GST. A standard property industry practice involves collating sales and occupancy costs that include GST in lessee sales reporting and then excluding GST in the occupancy charges of rent and outgoings etc.

This treatment of GST results in occupancy cost measures which reflect a better than actual outcome in favour of the property industry. Over past years, the property industry’s practice of applying inflated occupancy cost measures to various sales reporting methods has resulting in inaccurate rental results.
Sound commercial leasing arrangements are essential for pharmacy owners. Not only are occupancy costs, including rent, a significant cost but relocating to an alternative premises can be very costly and disruptive.

Pharmacy owners have a limited ability to pass on fixed underlying costs such as rent because prices in the industry are largely regulated, in particular for dispensed items under the Pharmaceutical Benefits Scheme. The requirement to obtain approval from the Department of Health and Ageing to supply Pharmaceutical Benefits at pharmacy premises, location rules and State and Territory registration of premises, including mandatory standards for pharmacy premises, can make relocating premises difficult.

The Pharmacy Guild of Australia is committed to informing members about their legal rights and obligations in relation to lease arrangements.

Turnover Rent

“Turnover rent” is rent calculated in whole or part by reference to the turnover or profits of a business; the amount of rent varies depending on the sales results of the business. In effect, this type of rent gives the landlord a financial interest in the business.

A long standing policy underpinning pharmacy regulation in Australia is that ownership of community pharmacies should remain in the hands of pharmacists. Giving a landlord a financial interest in a pharmacy through a turnover rent provision runs counter to this policy.

For this reason, pharmacy specific legislation in all Australian States prohibits or restricts turnover rent for pharmacy premises:

- in Queensland, Victoria and New South Wales pharmacy legislation renders turnover rent provisions void;
- in Western Australia and Tasmania, turnover rent provisions breach the ownership restrictions in the pharmacy legislation; and
- in South Australia, turnover rent provisions breach restrictions in the pharmacy legislation on who can provide pharmacy services.

Including a turnover rent provision in a lease agreement for a pharmacy premises can result in significant consequences for both the landlord and the pharmacy owner, including financial penalties for the landlord. In some cases, a pharmacy owner’s ability to continue to carry out a pharmacy business at the premises may also be at risk.

It is therefore important that members are aware of the prohibitions and restrictions on turnover rent when negotiating a new lease, renewing a lease, exercising an option under a lease or participating in a rent review process under an existing lease.

There are currently no restrictions on turnover rent in the Northern Territory and the Australian Capital Territory. Nevertheless, pharmacy owners in the Territories do have a legal right to negotiate rent arrangements with their landlord. Pharmacy owners, just like other retail shop owners, can seek to have a rent clause where rent is calculated on a basis other than turnover.
Reporting Turnover Figures

Although turnover rent is prohibited or restricted in all Australian States, in some jurisdictions a landlord is not prevented from requiring a pharmacy owner to supply turnover figures (for example, monthly sales results). As a consequence, landlords may attempt to include a clause in a lease which requires pharmacy owners to provide turnover figures even when their lease does not include a turnover rent provision.

Landlords typically use standard form leases which are not specific to pharmacy premises. These standard form leases will often include turnover rent provisions and provisions requiring the supply of turnover figures. In leases for pharmacy premises, the turnover rent provision may well be excluded because of legal restrictions on turnover rent. However, the provisions requiring the supply of turnover figures often remain part of the lease. This provides an opportunity for landlords to refer to turnover figures when calculating rent.

Members should think carefully before agreeing to supply turnover figures to their landlords. In most cases, agreeing to supply turnover figures will not be in the best interests of the pharmacy owner.

Importantly, some Australian States and Territories DO restrict the information a landlord can require:

- in Western Australia, South Australia and Tasmania, turnover figures can only be required if the lease agreement provides for turnover rent. As pharmacy legislation in these States prohibits turnover rent, landlords are not legally entitled to require turnover figures and cannot insist on a provision in a lease which requires the supply of turnover figures;
- in the Australian Capital Territory there is a similar restriction for leases in shopping centres; and
- in New South Wales and Victoria, pharmacy legislation renders void a provision in a lease agreement which gives the landlord access to the books of account for a pharmacy business unless it is for the purpose of determining whether or not the tenant is complying with the terms of the lease.
Protecting Your Interests

To ensure that your lease agreement complies with the relevant legislative requirements and that turnover figures are not used inappropriately to calculate rent, you should be aware of the following:

- **You CAN negotiate your lease agreement with your landlord.**
  In most cases, landlords will use standard form leases. However, you can agree with your landlord that certain provisions (such as provisions relating to turnover rent and turnover figures) do not apply to your lease. At law you are entitled to insist that the landlord or his/her agent engage in meaningful negotiation on the terms of the lease, including any requirement that the turnover figures be supplied.

- **Turnover rent provisions should NOT be included in lease agreements for pharmacy premises in any Australian State.**
  Although turnover rent is not prohibited in the Northern Territory or the Australian Capital Territory, you can agree with your landlord not to calculate rent by reference to turnover.

- **Unless you are under a legal obligation to do so, you DO NOT have to supply turnover figures to your landlord.**
  You will have a legal obligation to supply turnover figures if, for example, you agreed to do so under a lease agreement. If a landlord requests turnover figures and it is not a requirement under the lease to supply those figures, you are entitled to refuse the request. In Western Australia, South Australia and Tasmania you are entitled to refuse even if there is such a requirement in the lease.

- **When negotiating your lease, carefully consider whether or not to agree to provide turnover figures in the absence of a turnover rent provision.**
  Agreeing to such a term will not normally be in your interest as a pharmacy owner as it provides an opportunity for the landlord to refer to turnover figures when calculating rent in circumstances where turnover rent may be prohibited. Remember, in Western Australia, South Australia, Tasmania and the Australian Capital Territory a landlord cannot require turnover figures if there is no turnover rent provision.

Do

- Read the disclosure statement and proposed lease agreement carefully before signing.
- Advise the landlord that, as a pharmacist, you are unable to accept a turnover rent provision.
- Think very carefully before agreeing to provide turnover figures to the landlord, bearing in mind the risk that these figures could be used to calculate rent even if your lease does not include a turnover rent provision.
- Seek legal advice if you are concerned about any provision in a lease agreement.

Don’t

- Assume that you have to agree to every provision in a standard form lease agreement.
- Agree to a turnover rent provision if such provisions are prohibited or restricted under pharmacy legislation.
- Consider that you must provide turnover figures to your landlord if you are not required to do so under the law.
Reporting Turnover and the Impact on Rent

Although few pharmacies have leases that contain a turnover rent provision, it is common for leases to require pharmacy owners to report monthly sales results to the landlord. This is particularly common practice for pharmacies located in shopping centres with a gross lettable area of 10,000 square metres or more.

Landlords often justify provisions requiring the supply of turnover figures in leases where rent is not calculated by reference to turnover on the basis that turnover figures are needed to establish the effectiveness of centre marketing, for portfolio analysis or to report to shareholders. However, this information can also be used by landlords to establish parameters to drive rents and result in higher rents for pharmacy premises.

In the pharmacy industry there is also inconsistency in the way that turnover is reported to landlords. Pharmacy revenue is made up of three major categories:

1. Prescription medicines
2. Scheduled non-prescription medicines; and
3. General retail.

Discrepancies in the way that pharmacy owners report their sales in these categories results in inaccurate indicators which can be used by landlords to establish a case for higher rents when new leases are negotiated, existing leases are renewed or as part of a rent review process.

Given the unique role of community pharmacy, pharmacy businesses are in a different position to many other retail businesses. This is reflected, for example, in the restrictions on turnover rent in all Australian States. With this in mind, if members do decide to provide turnover figures to their landlord, they should consider the most appropriate way to report turnover.
One option is to agree with your landlord that you will only report turnover based on sales in the general retail and scheduled non-prescription medicine categories (i.e. excluding sales of prescription medicines). In most (if not all) cases this will require an amendment to standard form leases to accommodate pharmacy specific provisions, including an appropriate definition of what “turnover” or “gross sales” mean.

If you have an existing lease that validly requires the provision of turnover figures, you must comply with the terms of that lease. However, you and your landlord could agree to a variation of the lease to accommodate changes in the way turnover is reported.

**Common Terminology**

It is important to have an understanding of some of the common terms and formula that are used in the property industry when you are preparing to discuss rental issues with your landlord or representative.

Some common terms are explained below.

<table>
<thead>
<tr>
<th>Common terms</th>
<th>Definition</th>
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<tbody>
<tr>
<td>Moving Annual Turnover (MAT)</td>
<td>Sales for a twelve-month period calculated on a monthly basis. ( MAT = ) Last 12 months sales including the most current available month minus the corresponding month from the previous year.</td>
</tr>
<tr>
<td>Gross Lettable Area Retail (GLAR)</td>
<td>A measure of the amount of retail space within a shopping centre, commercial building or strip centre available for lease.</td>
</tr>
<tr>
<td>Occupancy Cost Ratio</td>
<td>Occupancy costs for the premises divided by the Moving Annual Turnover as a percentage. Costs include rent, outgoings, etc.</td>
</tr>
<tr>
<td>Turnover/Sales Per Square Metre</td>
<td>Sales divided by the total number of square metres of rentable area. May apply to individual stores, groups of stores or the total centre. Gross Lettable Area Retail divided by Moving Annual Turnover. ( (GLAR/MAT) = $/sqm )</td>
</tr>
<tr>
<td>Mini Major</td>
<td>All tenants greater than 400sqm not defined as Major, Other Retail or Non Retail. Some pharmacies in shopping centres have a GLAR over 400sqm and hence need to be treated as a Mini Major and not a Speciality Retailer for the purposes of rental and shop fit requirements.</td>
</tr>
</tbody>
</table>

1In Western Australia, South Australia and Tasmania, turnover figures cannot be required if there is no turnover rent provision.
The Centre Manager
ABC Shopping Mall
Address [insert]
Address [insert]

Attention: [insert centre manager name]

RE: Lease to ABC Mall Pharmacy
Shop No. 123 ABC Shopping Mall, Suburb, State
Guidelines for the Reporting of Sales for Leases – The Pharmacy Guild of Australia

Dear [insert],

We refer to the abovementioned lease.

As you know, pharmacy in Australia is subject to a specific legal and regulatory framework. As a consequence, the issues facing pharmacies in leasing arrangements are different from those of other retail businesses.

Further information in relation to these issues is set out in Guidelines recently established by the Pharmacy Guild of Australia. We attach a copy of these Guidelines for your reference in the context of our discussions regarding the abovementioned lease.

Yours truly,

ABC Pharmacy

Insert name
Director/Lessee ABC Pharmacy P/L [example]
In fact for all your Retail Lease and Landlord issues LEASE1 are the industry experts here to help you profit and initial advice to you is FREE.

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