SHOPPING CENTRE

COUNCIL OF AUSTRALIA

Productivity Commission Inquiry into the Market for Retail Tenancy Leases in Australia

A submission by
the Shopping Centre Council of Australia
July 2007

CONTENTS

EXECUTIVE SUMMARY

This submission is made by the Shopping Centre Council of Australia which represents owners and managers of shopping centres. Our members own 455 shopping centres around Australia which contain around 62% of the lettable floorspace of Australian shopping centres.

Our members, in turn, represent more than 9 million Australians with investments in retail property through their superannuation and life insurance policies or direct investments in property trusts (or real estate investment trusts) and other property investment vehicles.

Shopping centres comprise around 38% of retail space and generate 40% of retail sales. The bulk of the retail tenancy market exists outside shopping centres in a range of other retail property formats.

Our submission demonstrates:

- The market for retail tenancy leases in Australia is competitive. As a result it works efficiently and there is no evidence of significant market failure that requires correction.
- Claims that shopping centres are monopolies are nonsense. They represent less than half the market and have diverse owners who compete vigorously with each other (and with other retail property formats) for retailers and customers.
- There is no evidence of entrenched market power or of systemic unfair or unconscionable conduct by shopping centre owners or managers.
- The major determinant of rents is the prevailing competitive balance of supply and demand between sellers and buyers of retail space.
- Substantial amounts of new retail space come on stream each year, both inside and outside shopping centres, and this exerts a moderating influence on rental growth.
- Shopping centres require sales (or turnover) figures from retailers for the same reason that retailers do – to guide major expenditure and investment decisions.
- Shopping centre owners and managers understand that a successful shopping centre depends on the business success of the tenants who comprise the centre.
- The regulation of the retail tenancy market is already excessive and fragmented across the states and territories.
- Only a very small number of retail tenancy disputes (both in numerical terms and as a proportion of retail leases) occur each year and these are usually successfully resolved by low-cost, easily-accessible dispute resolution mechanisms.
- The vast majority of retail leases are renewed and there is no justification for imposing continuing rights of occupation when a lease has expired which would undermine long accepted principles of property ownership.

We have also made the following recommendations in this submission:

- The Federal Government, through the Council of Australian Governments (COAG), should encourage State and Territory Governments to standardise retail tenancy documentation around the minimum necessary level of detail, including the lessor's disclosure statement, the lessee's disclosure statement and the assignor's disclosure statement.
- If this standardisation is achieved, COAG should then pursue harmonised state and territory retail tenancy legislation.
- A system of national regulation of retail tenancies should only be considered if such regulation is *in place of* not *in addition to* the present system of state and territory regulation. We believe the only practical way in which national uniform regulation could be achieved is if the States and Territories agreed to surrender their powers to the Federal Government.
- If the necessary political agreement could be achieved, the drafting of a Commonwealth Bill, to be negotiated with the States and Territories, in consultation with relevant stakeholders, would also present an opportunity to critically scrutinise existing regulation with a view to removing any unnecessary regulation.
- To improve the transparency of the retail tenancy market there should be mandatory registration of leases in those States which presently do not require registration (Victoria, South Australia, Tasmania and Western Australia) to ensure details of rents and other lease conditions are publicly available to inform retailers during lease negotiations.

Ultimately, however, it must be recognised that retail tenants are in business and must take responsibility for the business decisions they make. There is no shortage of information and advice available to retail tenants (most of it free of charge); nor is there any shortage of laws in place to protect retail tenants. While there will be occasions when a retail landlord does the wrong thing, this is not commonplace and there are plenty of remedies available to tenants when it does occur. With the best will in the world, governments and landlords cannot be held responsible for every bad business decision taken by a retailer.

INTRODUCTION

The shopping centre industry in Australia is now 50 years old, with the first modern shopping centre opening to the public in Brisbane on 30 May 1957. Since then the number of shopping centres in Australia has grown to 1,231[1].

Perhaps the best illustration of the growth and success of the shopping centre industry over the last 50 years can be gained by looking at that first shopping centre, at Chermside in Brisbane, which opened with 25 retailers. Now, 50 years later, that centre (now called Westfield Chermside) is home to 391 retailers (including two department stores, two discount department stores, three supermarkets and an entertainment and leisure precinct, including a cinema). The shopping centre model has proved a great incubator for retailing in Australia.

Shopping centres are less than half of the retail tenancy market

Nevertheless, as impressive as the growth of the shopping centre industry has been in Australia and contrary to widespread belief, shopping centres do not dominate the retail landscape. In considering the market for retail tenancy leases in Australia, it must be stressed that the bulk of this market exists outside shopping centres in a range of other retail property formats, including high streets and strip shops, bulky goods and homemaker centres, and retail outlet centres (factory outlet centres). These non-shopping centre locations still comprise the majority of retail space and generate the majority of retail sales.

Nor, despite their prominence, do regional shopping centres[2] (i.e. the large shopping centres) dominate the shopping centre industry in Australia. Neighbourhood shopping centres comprise the largest number of shopping centres and constitute the greatest amount of shopping centre lettable space.

Given that only around 35% of retail shops are located in shopping centres, it follows that the majority of retail leases are located outside shopping centres. The fact that the vast bulk of retail leases are unrelated to shopping centres often seems to be overlooked in discussions of retail tenancy. *The Australian Financial Review*, for example, on 26 June 2007 headlined a story relating to this current inquiry by the Productivity Commission: "*Shopping centre review embraced*."

[1] Figures supplied by MapInfo Dimasi, 2005-06.

[2] Regional shopping centres (or department store-based shopping centres) are defined as shopping centres which contain at least one department store. A sub-regional (or discount department store-based) shopping centre is one anchored by at least one discount department store; and a neighbourhood (or supermarket-based) shopping centre is one anchored by at least one supermarket. This reflects the fact that shopping centre classifications in Australia are generally based on the type of 'anchor tenant'.

The success of shopping centres

Shopping centres have grown rapidly in Australia because they have been meeting market needs. Shopping centres offer a range of benefits for consumers, retailers and the community generally. They satisfy consumer demand for convenient shopping opportunities easily accessible by car and public transport. They provide ample, convenient and usually free car parking. They provide comfortable, undercover and air conditioned shopping. They offer a wide range of choice relevant to consumers' needs in a 'one stop' shopping experience. They provide a competitive retail offer, including discounted prices. They combine shopping with a leisure and entertainment experience and increasingly fulfil the role of a community gathering place. In an increasingly insecure world, they also provide a generally safe and secure environment for shoppers.

While much is rightly made of the role shopping centres now play as community meeting places, or as the new 'village square', their economic role in the community is often overlooked. Shopping centres are major generators of jobs, both directly and via the retailers who find a home in the centres, and they are usually the main generator of local government rates in their local government community. In 2001 it was calculated that the shopping centre industry made a direct contribution to GDP of 2.8% (compared, at that time, to 2.9% for agriculture, forestry and fishing and 2.2% for electricity, gas and water.)[3]

Most importantly, shopping centre owners in Australia have continued to innovate, constantly 'reinventing' the shopping centre format, in a manner which is the envy of other countries. These innovations include the introduction into shopping centres of supermarkets, discount department stores, fresh food, entertainment and leisure precincts, centre courts for community activities, concierge facilities and upmarket restaurants. In addition, working co-operatively with local and state governments, shopping centres have incorporated public facilities as part of their developments and redevelopments, including bus and transport interchanges, libraries, child care, community facilities and other improvements to the public domain.

The key success of the shopping centre is to attract large numbers of shoppers to the centre and deliver them to the doors of the retailers who comprise the centre[4]. It is estimated that in 1999-2000 there were 1.82 billion shopper visits to regional and sub-regional shopping centres or 35 million visits a week. Given Australia's then population of 19.2 million, this equated to everyone visiting a shopping centre about twice a week on average[5]. This estimation did not include visits to the far more numerous neighbourhood shopping centres.

Well managed shopping centres also appeal to retailers. The customer traffic volumes they generate create high trading potential for retailers and relatively high turnovers are achieved. Not surprisingly, this leads to considerable competition among retailers to

[3] Jebb Holland Dimasi *Shopping Centres in Australia Vital Statistics* April 2001
[4] We outline in *Term of Reference 1* the key drivers of success.
[5] Jebb Holland Dimasi *Shopping Centres in Australia Vital Statistics* April 2001.

locate in shopping centres. In consequence rents in shopping centres are correspondingly high, reflecting the demand for space, the high cost of land zoned for commercial and retail purposes and the high cost of construction and maintenance. This is balanced by retailers in shopping centres generally being more profitable, based on the much higher turnovers achieved.

Support for retailers

There is another reason why retailers seek to locate in shopping centres. It is generally accepted that the rate of failure of small retail businesses ("speciality shops") in shopping centres is much lower than for those outside shopping centres. This is not surprising. Much greater consideration is given to the selection of retailers in shopping centres, particularly to their previous retailing or business experience, and whether they are a 'good fit' for the centre. Centre owners also have some discretion to refuse assignments of leases and one of the grounds on which they can do so is insufficient business experience. The centre's promotions and advertising fund can be used to promote retail categories that may be doing it tough. There is also much greater control over the 'tenancy mix' of the centre and although this does not protect existing retailers from new competitors, they are not subjected to the lottery of the shopping strip or the high street where there is no control at all over the tenancy mix of retailers.

Most importantly, retailers in larger shopping centres have support mechanisms which are generally not available outside such shopping centres. When a retailer gets into trading difficulties, the first response of the shopping centre is not to replace them with a new tenant. Some centre owners have sophisticated 'retailer relations' advisory services where struggling retailers are given practical advice on how they might trade out of their difficulties. Shopping centre owners regularly provide short-term incentives (such as rent reductions or promotion allowances) to help struggling retailers through difficult periods and owners are sometimes prepared to renegotiate leases for retailers in short-term trading difficulties. Significant amounts of money are spent by shopping centre owners each year in direct assistance to the retailers in their centres.

It is obviously in the interests of shopping centre owners and retailers that vacancy rates in shopping centres are kept as low as possible. An increase in vacancy rates means a reduction in the efficient use of the retail space investment; a reduction in rental income to the owner/investor; a decrease in the variety of the shopping experience being offered by the centre; and inevitably leads to a decline in customer traffic in the centre. As any visitor to a shopping centre will know, it is not an impressive shopping experience if a substantial number of the shops in the centre are empty.

Highly regulated retail tenancy market

The retail tenancy market operates according to a body of legislated rules. These include rules as to what constitutes acceptable behaviour by owners and managers in transactions with tenants. Where a tenant claims an owner or manager has breached one of

these rules there is adequate redress by easily-accessible and low-cost mediation and, as a last resort, legal proceedings.

This body of legislated rules is only one part of the significant assistance and protection provided by governments to retail tenants. It is difficult to think of another area of business-to-business relationships where governments have intervened so substantially in order to protect small businesses or where they spend so much taxpayers' money on providing advice and support.

As a result of this intervention the market for retail tenancy leases in Australia is now heavily regulated. We are unaware of any other country in the world with such a highly regulated retail tenancy market. In all States and Territories there is very detailed and prescriptive legislation regulating all aspects of the retail tenancy relationship, beginning even before a tenant signs a lease. It also seeks to resolve retail tenancy disputes by easily-accessible and cost-efficient mediation.

This is in contrast to other countries with which Australia generally likes to compare itself. New Zealand, for example, does not have retail tenancy legislation. The only regulation of leases is contained in the *Property Law Act* which applies to all property classes, not just to retail property. There is no retail tenancy legislation in the United States of America (USA). Even in the United Kingdom (UK), where the *Landlord and Tenant Act 1954* applies to all commercial property, there is no specific retail tenancy legislation to protect retail tenants.

Unfortunately the existence of this detailed regulation has led to a 'protectionist' mentality on the part of many retailers in Australia. Unlike retailers in countries such as the USA and New Zealand, the response of many retailers and retailer associations in Australia to the inevitable risks and uncertainties of retailing is to call for even more government intervention and regulation. As the Department of Industry, Science and Tourism noted, in its submission to the Reid Inquiry in 1997: "An examination of the issues raised by small business to the inquiry and its many predecessors, and the particular circumstances of problems raised with the Government, does not necessarily support the case for legislative amendment. Many of the problems can be actioned under existing Federal or State law while others are consequent of certain characteristics of small business that cannot be effectively addressed by legislation." Despite this common sense advice the Reid Inquiry led to even more retail tenancy regulation[6].

Few retail tenancy disputes

Retail tenancy disputes, although they sometimes receive media prominence, are actually few in number and, when considered as a proportion of the number of retail leases on foot, are very small. We detail later (*Term of Reference 4*) that, each year, fewer than 2,000 retail tenancy disputes occur in Australia which require referral to mechanisms established to settle such disputes. This represents

[6] See "Other Issues" section of submission.

around 1% of all retail leases[7]. The vast majority of these disputes are satisfactorily resolved by mediation.

Fewer than half of these retail tenancy disputes occur in shopping centres. This demonstrates the absurdity of the claim by the Reid Inquiry[8]: "The idea there is a war going on in shopping centres around Australia, between retail tenants and property owners and managers, conveys accurately the tenor of evidence given to the Fair Trading inquiry on retail tenancy issues." Unfortunately, however, this is an industry where anecdote, not evidence, quite often informs public policy.

Australia's export achievement

The shopping centre industry has not only expanded significantly in Australia. Australian shopping centre owners and managers are now exporting their capital, knowledge and management expertise to other parts of the world, including the USA, New Zealand, the UK, Europe and Asia. Two Australian companies are now in the 'top 10' owners of shopping centres in the United States and other Australian companies are also significant owners of shopping centres in the USA. Regrettably this phenomenal export achievement, which makes a significant contribution to Australia's balance of payments, remains largely unacknowledged by governments in Australia.

Despite the USA being regarded as the 'home' of the modern shopping centre industry, Australian companies have been praised in America for the management expertise and innovations they are bringing to the industry in that country. An international study[9] has shown that Australian regional shopping centres, for example, are recognised as generating substantially higher sales per square metre than those in the United States and Canada. While there are a number of factors that explain this difference, one of those factors was: "Australian regionals offer a much broader range of merchandise than their US counterparts and play a much more central role in the day-to-day shopping needs of households."

Shopping Centre Council of Australia

This submission is made by the Shopping Centre Council of Australia Ltd (SCCA) which represents owners and managers of shopping centres in Australia. Our members are: AMP Capital Investors, Centro Properties Group, Colonial First State Property, DB RREEF Funds Management, GPT Group, Jen Retail Properties, Jones Lang LaSalle, Lend Lease Retail, Macquarie CountryWide Trust, McConaghy Group, McConaghy Properties, Mirvac, Multiplex, Perron Group, Precision

---

[7] There are no official statistics of the number of retail leases in Australia. Section 25 of the Victorian Retail Leases Act, however, requires landlords to notify the Small Business Commissioner when a retail lease is signed. In the last few years this number has stabilised at just over 14,000 each year. Assuming an average lease term of 5 years this suggests there around 70,000 retail leases in Victoria. Some of these are commercial leases 'caught' by the Retail Leases Act. Taking this into account, and extrapolating this figure nationally, suggests there are around 180,000 – 200,000 retail leases in Australia.

[8] House of Representatives Standing Committee on Industry, Science and Resources, *Finding a Balance: Towards Fair Trading in Australia*, 1997

[9] Urbis JHD *Retail Perspectives* February 2007. This is discussed in more detail in Term of Reference 5.

Group, QIC, Savills, Stockland, Westfield Group and the Yu Feng Group. Some of our members, while endorsing this submission, will also be making individual submissions to this Inquiry.

Shopping centre owners are in reality managers of the investments made in retail property by more than nine million Australians through their superannuation funds and life insurance policies or through direct investments in listed property trusts (real estate investment trusts), property syndicates and other property investment vehicles. Regulation that reduces the returns to owners of shopping centres directly impacts on the retirement savings and retirement incomes of these Australians.

SCCA's members own 455 shopping centres in Australia, including all types of shopping centres (regional, sub-regional, neighbourhood and city centres), in both metropolitan and regional Australia, and these centres contain around 62% of the total gross lettable area retail (GLAR) of all Australian shopping centres. In addition our 'reach' throughout the industry is even greater through our two independent shopping centre management members (Jones Lang LaSalle and Savills). More information about the SCCA can be obtained from our website at: www.scca.org.au.

This submission addresses, in turn, each of the seven terms of reference outlined in the Treasurer's reference to the Productivity Commission on 19 June 2007. Where applicable we have also addressed the questions raised by the Productivity Commission in its Issues Paper of 29 June 2007 under the relevant term of reference.

1. TERM OF REFERENCE 1.

The structure and functioning of the retail tenancy market in Australia, including the role of retail tenancies as a source of income for landlords, investors and tenants and the relationships with the broader market for commercial tenancies.

1.1 Structure of the retail tenancy market

As noted earlier, the bulk of the retail tenancy market exists outside shopping centres in a range of other retail property formats, including high streets and strip shops, food courts, arcades, bulky goods and homemaker centres, and retail (or factory) outlet centres. These non-shopping centre locations comprise 62% of retail space and generate 60% of retail sales[10].

By contrast, shopping centres comprise only 38% of total retail space; make up only 19% of all retail locations and around 35% of all retail shops; and generate 40% of total retail sales in Australia.[11]

There are an estimated 1,231[12] shopping centres in Australia comprising:

- 65 regional shopping centres, containing 4,940,000 square metres (sqm) of lettable area, and generating $25,038 million in retail sales;
- 257 sub-regional centres, containing 6,810,500 sqm of lettable area and generating $30,249 million in retail sales;
- 803 neighbourhood shopping centres, containing 5,220,000 sqm of gross lettable area and generating $26,565 million in retail sales; and
- 106 CBD shopping centres, containing 1,007,000 million sqm of lettable area and generating $4,647 million in retail sales.

Despite their public prominence, regional shopping centres do not dominate the shopping centre industry in Australia. Neighbourhood shopping centres (or supermarket-based shopping centres) actually comprise the largest number of shopping centres (69 per cent of the total); contain 30% of the shopping centre retail floorspace; and generate 12.3% of all retail sales. Sub-regional shopping centres comprise 21% of all shopping centres; contain 40% of all shopping centre retail space; and generate 14% of all retail sales. Regional shopping centres comprise only 6% of all shopping centres; contain

[10] Derived from material supplied by Urbis and MapInfo Dimasi.

[11] Derived from material supplied by Urbis and MapInfo Dimasi.

[12] These are figures calculated by MapInfo Dimasi for 2005/06. The equivalent figures calculated by Urbis are: 1,102 (regional 63; sub-regional 268; neighbourhood 759; and CBD 12). The differences are mainly due to differing classifications, particularly of city centres. The lack of a standard method of defining and categorising shopping centres is currently being addressed by the SCCA. In this submission, when we use shopping centre data, we will footnote whether it is from Urbis or MapInfo Dimasi.

28% of shopping centre retail space and generate around 12% of all retail sales[13].

1.1.1 Shopping centre ownership and management

The ownership of shopping centres in Australia is widely held. According to the Property Council of Australia, which publishes the Directory of Shopping Centres in Australia[14], there are:

- 16 different owners (some are in co-ownership) of Australia's regional shopping centres;
- at least 100 different owners of sub-regional shopping centres; and
- at least 500 different owners of neighbourhood shopping centres.

Over 450 owners own only one shopping centre and 85 owners own only two shopping centres[15]. It is clear that there is considerable diversity of ownership and control across the shopping centre industry (and, as noted above, shopping centres account for less than 40% of retail floorspace). Smaller centres are owned by a range of entities ranging from institutional investors to proprietary companies and individuals, while most owners of the larger regional shopping centres are major institutions such as superannuation funds and property trusts. These owners are in fact managers of the investments made in retail property by more than nine million Australians through their superannuation funds and life insurance policies and through direct investments in property trusts (or Real Estate Investment Trusts, REITS) and other property investment vehicles.

All these shopping centre owners compete fiercely with each other and with other retail property formats for retailers and for customers. They also take different approaches to the management and leasing of their shopping centres. Some are managed internally or by related (or stapled) entities while other owners engage real estate agencies such as Jones Lang LaSalle and Savills to manage their centres.

While there is a diversity of specialty tenants and 'mini-majors'[16] in the Australian retail market, there is a limited number of 'anchor tenants' for larger shopping centres due to the limited size of the consumer market. There are only two major chains of department stores and only three major chains in the hands of only two owners of discount department stores. This has been made more difficult by the fact that over the last decade both of these department store chains have, at various times, been struggling for profitability and the present economic environment for discount department stores is challenging. By definition, regional and sub-regional shopping centres cannot be developed without securing either a department store or a discount department store, respectively, as an anchor tenant. This of

[13] MapInfo Dimasi, 2005-06
[14] Property Council of Australia, *Directory of Shopping Centres in Australia*, 2007
[15] Urbis, *Concentration of Ownership*, 2005
[16] This is defined in the SCCA Sales Reporting Guidelines as any tenant occupying more than 400 sqm which is not defined as 'major', 'other retail' or 'non-retail'.

course increases the bargaining power of these tenants in negotiations with shopping centre owners.

This market structure does not exhibit any obvious barriers to entry. Indeed, concerns about excessive development of retail space are raised from time to time by retail businesses in the face of retail property investments. That said, the structure of the market is continually evolving and different sectors wax and wane. Barriers to entry constitute an important diagnostic tool for evaluating the competitiveness or otherwise of any market. Provided that barriers to entry are absent or low and that there is either actual or potential contestability in the markets concerned, then competitive market outcomes are likely to ensue. This is not to suggest that markets cannot exhibit segmentation into 'prime' and 'sub-prime' elements - they do, both in retail outlets and other markets – but it should be recognised that competitive tensions between segments exert market discipline on both.

1.2 Functioning of the retail tenancy market

The SCCA considers that the retail tenancy market is currently functioning as efficiently as possible given the weight of prescriptive regulation that is imposed on the industry.

In the shopping centre market, success depends on being able to attract large numbers of shoppers to the centre and deliver them to the doors of the retailers who comprise the centre. This is achieved through:

- the customer 'pulling power' of the major anchor tenants (such as department stores, discount department stores and supermarkets);
- carefully managing the overall tenancy mix to offer a wide range of attractive, relevant and contemporary retail shops, restaurants and entertainment;
- the strategic siting of the shopping centre in relation to population and transport networks;
- providing convenient parking;
- developing an attractive and inviting ambience; and
- promoting the centre to customers through advertising, special events and other attractions.

Shopping centres, in order to maintain their success, are involved in what one senior shopping centre executive has described as the "relentless pursuit of relevance."[17] As detailed later in this section, this can require (in the interests of all parties - owners, tenants and customers) constant adjustments to the centre's 'tenancy mix'. Occasionally a new lease may not be offered because the retailer's offering is no longer meeting customer preferences and is dragging down the performance of other retailers. Good retailers don't oppose measures to update the tenancy mix. They want to be part of a successful shopping centre so that they can benefit from the

[17] *The Relentless Pursuit of Relevance: A Discussion with Kenneth Wong*, International Council of Shopping Centers Research Review Vol. 14, No. 2, 2007

synergies created by equally good retailers, working with centre management, to maximise the centre's customer pulling power and sales performance.

As noted previously, Australian shopping centres have been very successful. It was estimated in 1999-2000[18] that there were 35 million visits a week to Australian regional and sub-regional shopping centres, which translates to two visits a week by each person. (This does not include visits to the far more numerous neighbourhood shopping centres.) Customer traffic volumes of this order create high trading potential for retailers and relatively high turnovers can be achieved.

Not surprisingly this leads to considerable competition among retailers to locate in shopping centres. In consequence, rents in shopping centres are also correspondingly high, reflecting the demand for space, the high cost of land zoned for commercial and retail purposes and the high cost of construction and upkeep. This is balanced by retailers in shopping centres generally achieving much higher sales turnover.

As detailed later in this submission (under term of reference 5), retail tenancy rents in Australia are the product of market forces. They are the result of a good faith negotiation between a willing seller (of retail space) and a willing buyer (of retail space). The outcome of that negotiation is determined by the forces of supply (of retail space) and demand (for retail space). As a result, sometimes rents go up; sometimes they go down; and sometimes they stay the same.

In times of local oversupply of retail space - for example, after the opening of new shopping centres or the expansion of existing ones – there is significant downward pressure as landlords seek to retain their tenants in the face of competition from the new landlord seeking to attract retailers to lease the new space. Indeed as suburban shopping centres constantly expand, and as new centres are constructed, it is a significant task for landlords to fully lease centres. Between 1991-92 and 2005-06 the amount of floorspace in shopping centres nearly doubled – from 9.2 million sqm to 17.3 million sqm.

There is also the constant expansion of other forms of retailing, such as strip retailing, CBD retailing, and retail outlet centres which are also competing with shopping centres for tenants. Retail floorspace, other than shopping centres, grew from 23.6 million sqm in 1991/92 to 27.5 million sqm in 2005/06 (out of a total 44.8 million sqm of retail floorspace in Australia in 2005/06)[19].

This constant increase in the supply of retail space for lease, and the intense competition between individual shopping centres for tenants and the competition between shopping centres and other retail formats for tenants, has delivered significant bargaining strength to retail tenants in recent years.

Of course, it is not only the supply side of the equation that affects retail rents. Developments on the demand side, such as the level of

[18] Jebb Holland Dimasi, previously cited.
[19] Figures supplied by Mapinfo Dimasi, Australia: Growth in Floor Space, June 2007.

retail sales also have an impact. During retail downturns there is downward pressure on rents as centre owners try to avoid empty shops. In these circumstances, retailers seeking to renew their leases can often demand lower rent or obtain incentives such as rent holidays or lessor contributions to fit out costs.

The operation of these factors has generally meant that, over time, the growth of rents has generally been in line with the growth of retailers' turnover, something the SCCA believes is a sign of an efficiently operating retail tenancy market.

We also demonstrate later in the submission that the great majority of retail tenants in shopping centres who wish to renew their lease, and who have observed the terms and conditions of their lease and whose retail offer is still relevant to the customers of that shopping centre, do obtain a new lease.

There are also a range of government bodies to help resolve disputes in the retail tenancy market promptly and inexpensively. The SCCA considers that the relatively low number of retail tenancy disputes is further evidence that the retail tenancy market is operating well. We set out later in this submission the retail tenancy complaint and dispute figures in each jurisdiction. Fewer than 2,000 formal retail tenancy disputes occur in Australia each year – which is less than 1% of all retail leases – and the vast majority of these are successfully mediated. This is a very low figure, given that a retail lease operates 7 days a week, 52 weeks a year, usually for 5 years.

1.2.1 Highly regulated retail tenancy market

We are unaware of any other country in the world which has such a highly regulated retail tenancy market. Indeed in many countries such as New Zealand and the United States, there is no specific regulation of retail tenancies.

In all Australian States and Territories (except Tasmania which has a mandatory code of conduct, made by regulation), there is very detailed and prescriptive legislation regulating all aspects of the retail tenancy relationship, beginning even before a tenant signs a lease. We do not believe this level of regulation is proportionate to the problems it is seeking to address. The current regulation can have a 'stifling' effect on the industry and certainly imposes significant costs on the retail tenancy market which must ultimately be borne by retail customers.

When considering the retail tenancy market, therefore, it is important to understand that it operates according to a legislated body of rules as to what constitutes acceptable behaviour by owners and managers in transactions with tenants. Where a tenant claims an owner or manager has breached one of the rules there is adequate redress by easily accessible and low cost mediation and, as a last resort, legal proceedings.

In a shopping centre context, retail tenancy legislation regulates, among other things:

- compulsory disclosure of information to prospective tenants prior to signing a lease (and penalties for lessors who fail to disclose or give misleading information);

- prohibition on payment of 'key money'[20] and rent 'ratchet clauses'[21];
- procedural requirements for rent reviews;
- minimum terms for leases;
- definition of expenses allowed to be charged as outgoings and a requirement for an audited statement of outgoings to be given to tenants;
- control of advertising and marketing funds;
- protections for tenants in assignments, relocations and demolition;
- compensation to tenants for disturbances and damaged premises;
- notice to be given of renewal or termination of a lease;
- fitouts;
- misleading, deceptive and unconscionable conduct;
- determination of trading hours;
- rights of tenants to form tenant associations in shopping centres;
- control of security deposits; and
- dispute resolution mechanisms.

(A useful summary of the comparative provisions of State and Territory retail tenancy legislation is contained in Minter Ellison Lawyer's *Retail tenancy legislation compendium* 7 August 2006, which is available at: www.minterellison.com.)

These various State and Territory Acts of Parliament are also reviewed on a very regular basis, probably far more regularly than any other legislation. Over the last decade there have been 13 separate reviews (in some States there have been several reviews in that time) and these reviews have either led to new legislation (the Australian Capital Territory in 2002 and the Northern Territory in 2003) or amendments of existing legislation. Each amendment of existing legislation leads to increased regulation. In Victoria, for example, when retail tenancy legislation was first introduced in 1986, the relevant Act numbered 26 sections and 37 pages. In 1998 when a new Act was passed it numbered 52 sections and 57 pages. The current Act, passed in 2003, and the subject of major amendment in 2005, now numbers 123 sections and 138 pages. This is nearly a five-fold increase in the volume of regulation in 20 years.

The NSW Independent Pricing and Regulatory Tribunal (IPART) recognised this 'regulatory creep' in its recent 'red tape' inquiry report and recommended that the NSW Government consider

[20] Key money is either money or a benefit sought by a landlord to grant, renew, extend or assign the lease but does not include paying a cash bond or giving a guarantee.
[21] A ratchet clause is any provision in a lease that precludes or prevents a reduction of rent or limits the extent to which rent may be reduced.

whether less prescriptive alternative mechanisms are available to regulate retail leases and ensure that the regulation is proportionate to the market failure it is seeking to address[22].

As noted previously, this is in contrast to other countries with which Australia generally likes to compare itself. New Zealand, for example, does not have retail tenancy legislation. The only regulation of retail leases is contained in the *Property Law Act* which applies to all property classes, not just to retail property. There is no retail tenancy legislation in the United States of America (USA). Even in the United Kingdom (UK), where the *Landlord and Tenant Act 1954* applies to all commercial property, there is no specific retail tenancy legislation to protect retail tenants.

1.3 Relationship between the market for retail tenancies and the broader market for commercial tenancies

The major difference between the operation of the retail tenancy market in a shopping centre and the commercial tenancy market (offices, industrial, hotels) is the importance of 'tenancy mix'.

In an office tower or an industrial development area, it does not matter much to the landlord or the tenant what sort of 'mix' of tenants occupy various tenancies within the development. If, for example, all the tenants in an office tower undertake exactly the same sort of business, it has little impact on the viability of the office tower or its tenants. By contrast, the same situation in a shopping centre (or in a shopping strip), would destroy the centre's (or the shopping strip's) viability and the viability of the individual retailers within it.

The "relentless pursuit of relevance", referred to earlier, recognises that all shopping centres, and all other retail formats, are in constant competition for customers. "Those customers, be they retailers or shoppers, are ever more confident, mobile, willing to try new things. We have to attract their attention, make it worth their time to give us a try and exceed their expectations or they won't come back. There are just too many alternatives available to them."[23]

If a shopping centre is to survive it cannot have 10 butchers and no bakery, 15 shoe shops and no clothing retailers, or five home wares stores but no music store. It also cannot be full of retailers whose retail offer is no longer appealing to customers. The location of retailers within the shopping centre is also critical to a centre's success.

All of these things comprise what is known as 'tenancy mix' and without a good tenancy mix a shopping centre and its retailers will not survive, let alone thrive. As well as attracting customers, a good tenancy mix is also the reason why retailers choose to locate in a shopping centre rather than a street location – because they know that in a shopping centre there will be higher customer traffic and a greater variety of neighbouring tenants.

---

[22] *Investigation into the burden of regulation in NSW and improving regulatory efficiency*, IPART Final Report, October 2006, p.243.
[23] Kenneth Wong, previously cited, p.1.

Therefore, in the interests of all parties (owners, tenants and customers), a shopping centre owner must have the flexibility to adjust the centre's tenancy mix when required (consistent with the terms of the lease) to ensure the centre remains attractive to customers over time. Tenancy mix is a fact of life in a shopping centre and retailers who choose to take out a lease in a shopping centre rather than, say, a shopping strip, must accept it as such.

Occasionally tough decisions have to be made. Sometimes a new lease may not be offered because the retailer's offering is no longer meeting customer preferences or because the retailer is not keeping up with the centre's performance (and therefore dragging down the performance of other retailers). Sometimes a retailer will be offered a lease in alternative premises in the centre which work better for the retailer and centre. The tenancy mix of a shopping centre needs to be constantly monitored and adjusted where necessary to keep the centre's retail offer to customers fresh, relevant and enticing.

Good retailers don't oppose measures to update the tenancy mix (although they may not say so publicly). They want to be part of a successful shopping centre so that they can benefit from the synergies created by equally good retailers working with centre management to maximise the customer pulling power and sales performance of the centre. The last thing a good retailer wants is to be locked in alongside a mediocre or underperforming retailer.

Another key difference between the tenancy markets is that in around half the states and territories, the retail tenancy market is heavily regulated while the commercial tenancy market is not[24]. This means that retail tenancy is subject to compliance costs that commercial tenancies are not. These extra costs are inevitably incorporated in the cost of the tenancy and therefore in consumer prices. This puts retail property at a significant disadvantage to other commercial property.

[24] In some states and territories, commercial tenancies are regulated under retail tenancy legislation. Much of this regulation (for example, most of the disclosure statement) is not relevant to commercial tenancies. This has been recognised in some states, such as Victoria, and steps have been taken to remove some commercial tenancies from coverage of the *Retail Leases Act*.

2. TERM OF REFERENCE 2.

Any competition, regulatory and access constraints on the economically efficient operation of the market.

2.1 Competition among retail property formats

The claim is sometimes made that shopping centres are protected from competition by the operation of planning schemes and that retailers do not have a choice of whether or not to locate in a shopping centre (and accept its lease terms) or do not have a choice about *which* shopping centre they locate in (and accept its lease terms). We address the issue of the operation of planning schemes later in this section. The claim that retailers do not have a choice of location, however, is simply not supported by the facts. For example:

- only around one third of shops are in shopping centres;
- only 40% of retail sales occur in shopping centres;
- many suburban centres and regional towns have two or more shopping centres competing with each other, and with other retail formats, for tenants;
- the catchment areas of shopping centres overlap considerably and also overlap with over retail property formats;
- unlike more concentrated industries, such as grocery retailing, there are 10 or more large shopping centre owners in Australia, at least 10 medium size owners, and hundreds of smaller owners, all of whom are competing against each other for retailers and shoppers;
- retailers can, and do, move out of shopping centres, or move to different shopping centres, if they regard the terms of a new lease as being too onerous.

Generally what retailers mean when they say they have no choice but to be in a certain shopping centre, or certain type of shopping centre, is that they want the benefits of the high turnover, high foot traffic and retail prominence that comes from these locations but they resent the associated high rents that come from the competition with other retailers for these same advantages – even though, in net terms, they recognise that they will be better off.

One of the advantages of leasehold, over freehold, is that it gives retailers mobility in location. Admittedly moving locations may not be cost free – fitouts, for example, may not be completely amortised by the time of the move – but the retailer is not anchored to the location by having made a substantial capital outlay for the freehold of the shop.

From time to time publicity is given to retailers who decide to move out of a shopping centre, to an alternative location. Generally these retailers decide to accept the lower turnover and lower pedestrian traffic in return for the associated lower occupancy costs.

2.2 Regulatory Constraints

At the outset it must be recognised that shopping centres and the retailers within them are essentially a distribution channel between producers of goods and services at one end and consumers at the other. Although some of the costs imposed on a distribution channel will fall on retailers or on shopping centre owners the majority of costs are ultimately passed on in retail prices and will therefore fall largely on consumers.

Regulations which artificially direct which costs must be borne by which party in the retail distribution channel cannot change their ultimate imposition on consumers and may serve only to increase the overall costs of a particular retail channel. Therefore it is very important that there is an efficiency gain from any regulation to offsets its costs.

State and Territory retail lease legislation regulates almost every aspect of the retail tenancy relationship and as such imposes significant constraints on the efficient operation of the retail tenancy market. The level of intrusion in the market ranges from requiring landlords to renew leases; to dictating how rent is reviewed; to prohibiting landlords from directly passing on some tenancy costs to tenants. In Victoria and the Northern Territory, legislation bans certain methods of rent review that are common in other states. In other states, shopping centre owners are prohibited from directly passing on to tenants their proportion of the cost of land tax or the costs associated with the preparation of the lease. By contrast, the SCCA is unaware of any legislative restrictions on the costs which retail tenants can pass on to their customers.

Both landlords and tenants are, of course, subject to the forces of supply and demand in relation to their capacity to pass on costs in rents (rent setting is discussed in more detail under *Term of Reference 5* of this submission) or in customer prices. Nevertheless all of these rules and restrictions impose costs on the shopping centre distribution channel that are not imposed on other retail distribution channels (such as internet shopping) and are ultimately borne by consumers in the retail prices they pay.

In some areas of Australia, such as Perth, additional constraints are imposed by trading hours regulation which prohibits certain categories of shops (mainly larger shops) in certain locations - and therefore most major shopping centres in those locations - from trading on Sundays and on all or some public holidays. The social and economic benefits that might justify these restrictions have not been identified.

Shopping centre owners and managers are also subject to real estate agent regulation which varies from state to state and imposes significant extra costs on the industry. This is despite the fact that the 'consumers' being protected by this regulation are generally large companies which do not need, or want, this legislative protection.

As noted previously, most of the owners of large shopping centres are major institutions such as superannuation funds and property trusts who manage the investments of more than nine million Australians. Regulation that reduces the returns to owners of

shopping centres therefore adversely impacts on the retirement savings and retirement incomes of these millions of Australians.

2.3 Costs imposed by regulation

Costs imposed on the retail tenancy market by retail tenancy regulation include:

- the cost to shopping centre owners and managers of providing ongoing training to their centre management and leasing staff to ensure they comply with the eight different sets of retail tenancy regulation around the country plus the unconscionable conduct provisions of the *Trade Practices Act*. For national companies operating in a number of states, the cost of compliance training is obviously considerable;
- the cost to shopping centre owners and managers of providing all the required disclosure documentation to prospective tenants within the required time frame;
- the cost to shopping centres of preparing and auditing outgoings statements;
- the cost to shopping centres of preparing and distributing marketing and promotions statements;
- the administrative cost of meeting procedural requirements for rent reviews, rent renewals and lease terminations;
- the delays and cost to shopping centres of complying with relocation and demolition requirements when redeveloping a shopping centre;
- the costs such as land tax or lease preparation costs that shopping centres owners are prohibited from passing directly on to tenants;
- the ongoing cost to taxpayers of the government bureaucracies established in each state and territory to administer retail tenancy regulation;
- the ongoing cost to taxpayers of information publications for retail tenants at the Commonwealth level and in each state and territory; and
- the ongoing cost to taxpayers of the retail tenancy dispute resolution mechanisms.

Of course, a proportion of these costs would be incurred anyway without retail tenancy regulation. Shopping centre owners and managers would still want to provide training for their leasing staff for example and would still have to pay for the preparation of leases but the administrative complexity and therefore compliance costs would undoubtedly be much less.

As previously noted, the majority of these costs are ultimately borne by consumers but if the costs continue to increase to the point where the returns to retail property investors are well below the returns from other property investments (or indeed from other investments generally) then retail property will become less attractive to investors and retail property investment will decline. This would, of course,

reduce the supply of retail property and therefore, assuming the demand for retail space remained the same, result in increased rents for retail property.

Unfortunately it has been our experience that the costs imposed by retail tenancy regulation receive little consideration by governments. Although most governments require the preparation of some form of Regulatory Impact Statement (RIS) to assess the costs and the benefits of proposed new regulations, it has been our experience in the regular reviews of retail tenancy legislation, including national competition policy reviews, that these cost assessments are perfunctory at best. Little real attempt is made to properly consider what new costs are being imposed on the retail tenancy market (both property owners and tenants and ultimately consumers as well) by the latest expansion of retail tenancy regulation, or whether the goals could be achieved by less intrusive means.

In the time available for this inquiry we have not been able to commission a study of the quantitative costs on the retail tenancy market of complying with state and territory retail tenancy regulation. However, in order to provide some indication of the sort of costs that can be imposed (on landlords and tenants), two particular retail tenancy provisions, in Victoria and in NSW, are examined below.

Case Study 1 - Section 25, *Victorian Retail Leases Act*

In 2003, a provision was introduced in the Victorian *Retail Leases Act* (section 25) which requires, after a lease is signed, that certain details are to be notified to the Small Business Commissioner. These details are: the address of the premises; the landlord's name and address; the tenant's name and address; and the date the lease was signed or renewed. It should be noted that details such as rent and other lease conditions do not have to be notified.

The justification for this regulation was a belief that such information would be necessary if the Commissioner needed to communicate directly with tenants and landlords. Thus the Act also requires (section 84) the Commissioner "for the purposes only of the Commissioner performing his or her functions under [the *Retail Leases Act*] to create and maintain a register of the information provided under section 25."

In the four years the Act has been in operation the Commissioner has had no reason to use this information in performing his functions and apparently has no plans to do so. Even if the Commissioner wanted to communicate directly with landlords and tenants, it is doubtful the information in the register would enable him to do so. The Commissioner has commented that "concerns about currency [of the information] serve to restrict use of the lease register".[25]

This is because retail is a dynamic industry and leases are regularly surrendered and assigned. When either occurs, the information previously notified to the Commissioner becomes useless. Also, and despite a penalty for non-compliance, there is no guarantee the register is complete since the Commissioner does not have the resources to monitor compliance. Small landlords and agents, for example, are sometimes not as well informed as they should be of all their requirements under the *Retail Leases Act* and many may be unaware of their obligations under section 25.

In other words, landlords are complying with this requirement for no public policy reason and at a significant cost.

[25] Annual Report of the Victorian Small Business Commissioner 2004-05, p.11.

The number of lease notifications under section 25 is now running at more than 14,000 each year. Assuming each notification costs a landlord, conservatively, $50 (either by way of a charge by the solicitor handling the preparation of the lease or an internal administrative cost) then this unnecessary regulation is costing Victorian landlords over $700,000 each year. This estimate of $50 a lease is undoubtedly conservative and it is more likely the actual cost burden for landlords is at least $1 million a year.

This regulation is not only a cost burden to Victorian landlords. There is obviously a significant administrative cost to the Small Business Commissioner's Office – and therefore to the Victorian taxpayer - in receiving and registering the details of around 1,200 retail leases each month and in maintaining a register, the utility of which is very doubtful.

This is an example of unnecessary regulation which is a cost to landlords but there are also examples of regulation which are a cost to tenants. The case study below refers to the new system for security deposits introduced by the NSW Government in amendments to the NSW *Retail Leases Act*, which began operation in January 2006.

Case Study 2 - Part 2A NSW *Retail Leases Act*

Retail property landlords in NSW who enter into a new lease can no longer hold cash security bonds on behalf of tenants but, instead, must lodge those security bonds with the Rental Bond Board. Cash security bonds which were already held by retail property landlords under existing leases have now also been required to be transferred, together with the interest earned on those bonds, to the Rental Bond Board.

The Government justified these new arrangements on the grounds that there were too many instances where landlords had unreasonably refused to repay security bonds at the end of a lease. No attempt was made to quantify the extent of this problem.

It also promoted the new scheme as an administrative blessing for landlords who would now "save time and money" by no longer having to manage an individual bond account for each tenant. It is difficult to see, however, how forcing landlords to go through the new procedures for lodging security bonds is less of an administrative burden for them than opening a bank account on behalf of a tenant.

Not surprisingly, many major landlords have looked at the administrative complexity of the new scheme, and the possible long delay and additional expense in gaining access to the bond in the event of non-performance of lease obligations, and have decided they will no longer accept cash security bonds. Instead they now require prospective tenants to provide a bank guarantee.

Bank guarantees, because of their administrative convenience, were already becoming more popular than cash as security for a lease and the new administrative scheme has undoubtedly accelerated their use.

One of the consequences of regulating security bonds in this way, therefore, is that fewer and fewer tenants are now able to use cash as security under their leases. This means it is now the tenant who has to spend the "time and money" in arranging the necessary lease security, rather than the landlord. This is a commonsense response to regulation.

There are even more substantial costs for tenants under the new arrangements, however. The amount of interest paid by the Rental Bond Board on security bonds is virtually negligible and certainly significantly less than the bank interest (minus fees) they were previously paid when these were held in bank accounts arranged by the landlord. Even taking into account the bank fees for a tenant who now has to arrange a bank guarantee, at the end of the lease such a tenant will still be financially better off than a tenant who had the same amount of money tied up in a cash deposit under the new rental bond scheme.

The justification for this new regulation was to protect tenants against unscrupulous landlords who refused, without good reason, to release the security bond at the end of the lease or were tardy in doing so. But the cost of the new scheme (in terms of interest foregone on the security bond or the administrative cost of arranging a bank guarantee) is now being carried by *all* retail tenants, including the vast majority who were never at risk of losing their deposits.

Even if we assume, generously, that 10% of tenants are now better off – in the sense that their security deposits are now more secure – all tenants are now worse off because of lost interest or the higher cost of arranging lease security.

2.4 Access Constraints

Certainly, the planning system imposes constraints on the supply of land for retail tenancy but to no greater extent than it does in relation to the supply of land for any other commercial purpose. Planning laws dictate where retail development can and cannot occur, just as they dictate where office, industrial, or residential development can occur. This is done in the public interest to ensure sustainable urban development. You cannot build a shopping centre anywhere you want anymore than you can build an office block or a factory, or indeed a house, anywhere you want.

It has been longstanding policy in Australia (and in the United Kingdom, for example) to concentrate commercial and retail activities (ie. major trip generating activities) in designated urban centres served by public transport. All Australian Planning and Transport Ministers have committed to the centres policies approach through the *National Charter of Integrated Land Use and Transport Planning,* which "seeks to ensure that the bulk of goods and services are located at hubs and linked effectively by an efficient transport system" which "allows for the optimisation of investment decisions and better use to be made of existing infrastructure and services".

These "centres policies" seek to ensure sustainable urban development by reducing unnecessary car use and traffic congestion and optimising the investment of taxpayers' funds in public infrastructure such as public transport. Centres policies also give confidence to governments in terms of their own investment decision-making. Retail developments that are permitted outside these designated centres inevitably generate their own demand for road and transport infrastructure and, in a constant climate of scarce public resources, this will inevitably be at the expense of continuing public investment in designated urban centres. Such out-of-centre developments are therefore discouraged because of their significant community and environmental cost.

At the State level, planning policies have been introduced across the country to encourage development in centres and restrict out-of-centre developments. These include the Melbourne 2030 strategy, Adelaide's Metropolitan Planning Strategy, Western Australia's Metropolitan Centres Policy, and, in NSW, the *Integrating Land Use and Transport* and *The Right Place for Business and Services* and draft State Environmental planning policies.

These policies however do not restrict the amount of retail floor space per se. Perth is an exception. In Perth, the expansion of shopping centres is constrained by Government-imposed limits on

the amount of retail space permitted in certain types of centres in certain locations. The SCCA and its members have consistently argued for the lifting of these limits.

Commonsense would also suggest that local and state governments have little reason to discourage or block the development of additional retail floorspace given the boost to local economies, jobs and rate/tax revenue that that extra floorspace can deliver.

Nor do centres policies impose limits on shopping strips that are not imposed on shopping centres. Indeed, by seeking to support CBDs and suburban centres, centres policies arguably impose greater planning constraints on shopping centre development than on retail strip development.

Of course, the alternative to the Australian and UK approach would be the planning free-for-all that has occurred in many parts of the United States. As a result of this 'laissez-faire' approach to the location of retail development, the United States not surprisingly has more retail space per person than Australia – both outside and inside shopping centres. In shopping centres, there is around 1.8 sqm per capita in the US compared to 0.8 sqm per capita in Australia. Total retail space in the US is 3.7 sqm per capita compared to 2.1 sqm per capita in Australia. Not surprisingly, with a much greater supply of leasing space, rents will be lower – both inside and outside shopping centres.

Nevertheless the amount of leasing space in shopping centres has grown substantially. Floorspace in shopping centres nearly doubled between 1991-92 (9.2 million sqm) and 2005-06 (17.3 million sqm). This has resulted in an increase in shopping centre floorspace per head of population from 0.53 sqm in 1991-92 to 0.84 sqm in 2005-06 while total floorspace per head increased from 1.88 sqm to 2.18 sqm over the same period.

With the exception of areas such as Perth, planning laws impose no greater constraints on the retail tenancy market than they impose on any other tenancy market and they certainly do not advantage one segment of the market (shopping centres) over other retail formats.

The development of new or expanded shopping centres, or additional retail floorspace more generally, is ultimately a function of retail demand.

3. TERM OF REFERENCE 3

The extent of any information asymmetry between landlords and retail tenants and the impacts on business operation.

It is useful to consider the information that is available to landlords and tenants, and which impacts on their business operations, in three stages:

- pre-lease (information available to landlord and tenant when each is deciding whether to commit to a lease);
- during the period of the lease (what continuing information is needed by a tenant and landlord while the retail business is operating); and
- at the end of the lease (what information is needed by both parties when considering whether to offer or whether to accept a new lease and on what terms).

3.1 PRE-LEASE DISCLOSURES

3.1.1 Information required under retail tenancy legislation

There is a responsibility on all retail tenants to read the information provided to them and to seek advice before signing a lease. There is a wealth of information and advice available to retail tenants, usually free of charge, from government agencies. In many cases, the landlord is required to provide this information to prospective tenants.

The disclosure of information by a landlord to a prospective tenant, and by the prospective tenant to the landlord, is highly prescribed in retail tenancy legislation in all States and Territories. In most States and Territories the landlord is required to supply the prospective tenant with:

- a letter of offer;
- a copy of the proposed lease (often 30-40 pages in length);
- a copy of the official Retail Tenants Guide (in those States and Territories where governments produce them);
- a copy of the 'Lessor's Disclosure Statement' (completed by the lessor);
- a copy of the 'Lessee's Disclosure Statement' (to be completed by the lessee);
- details of the fitout requirements for speciality shops (in the case of larger shopping centres);
- other documentation (such as acceptance forms, centre rules, bank periodical payment requests, privacy policy form etc.)

The landlord is required to supply the prospective tenant with a 'Lessor's Disclosure Statement' within a set period prior to the commencement of the lease (usually not less than 7 days) and penalties can apply if this is not done. There are also serious consequences for a lessor if the disclosure statement is not supplied to a tenant at all or if information contained in the disclosure statement is incomplete or is materially false or misleading. Section 11 of the NSW *Retail Leases Act*, for example, provides grounds on which the lessee can terminate the lease if the disclosure statement is incomplete or contains information that was materially false or misleading.

These prescribed disclosure statements in each State and Territory have been exhaustively examined during each review of retail tenancy legislation and have grown in length with each review. The pro forma NSW Lessor's Disclosure Statement, for example, is now 6 pages in length but when populated by the lessor can be twice that length. This statement contains (in the case of shopping centres) 40 separate items of information that must be supplied. Seventeen of these questions are specific to shopping centre tenancies. The Lessee's Disclosure Statement, by contrast, is only one page in length and contains only six items of information. Copies of the NSW Lessor's and Lessee's Disclosure Statements and the NSW Retail Tenants Guide are **attached**.

The SCCA supports full disclosure of all relevant information required by a tenant in order to make an informed decision whether or not to sign a lease. The challenge is to design a disclosure statement that fulfils this purpose while not being too complex for landlords (particularly small landlords) to prepare and too lengthy and intimidating for a tenant to read.

It must also be recognised that a disclosure statement cannot predict every business eventuality that may occur. While it is designed to help the tenant make an informed decision, it is not a guarantee that a tenant's business plan will succeed.

There is already concern about the growing complexity of the documentation required to be given to a prospective tenant, which can now be so overwhelming that some tenants are not bothering to read it all. The Victorian Government, for example, has announced a review of its disclosure statement as part of its red tape reduction program with the intention of making the statement clearer in intent and less complex.

The SCCA has indicated its willingness to participate in this review and considers the review has the potential to devise a 'model disclosure statement', agreed by all relevant parties, which could then be adopted, *without variation*, by all other State and Territory Governments. The achievement of a standardised disclosure statement operating around Australia, would be a major achievement and of great administrative benefit to national retailers and national retail property owners. (We elaborate on this matter under *Term of Reference 4*.)

3.1.2 Queensland requirement for financial and legal advice reports

The Queensland *Retail Shop Leases Act* also requires prospective tenants who are not "major lessees" (i.e. those with less than five shops nationally) to provide a 'financial advice report' and a 'legal advice report'. These are reports provided by a qualified accountant and a lawyer, respectively, certifying that they have provided the tenant with advice about the tenant's financial and legal rights and obligations under the lease. The reports also require these professionals to advise the tenant to seek further professional advice on a range of specific financial and legal matters if necessary. (The range of specific matters on which they are required to report is set out in sections 7 and 8 of the *Retail Shop Leases Regulation 2006*.)

Other States have considered these Queensland provisions but, so far, none has decided to impose these additional obligations on prospective lessees. The reluctance of other States to do so has generally been due to concerns about the bulk of material already provided to lessees as well as a general feeling that 'you can lead a horse to water but. . .' This is a pity since for every lessee who treats this requirement as just another hurdle put in their way, there could be another who decides not to proceed with the lease because they realise their business plan is deficient.

3.1.3 Other information available to lessees

Many State and Territory Governments, as well as the Australian Government, also allocate significant resources to providing educational and training advice to small businesses, including small retailers, on how to more effectively run their businesses. This ranges from general information on operating a business through to specific information on retail leasing.

The Victorian Government, for example, has established an Office of the Small Business Commissioner which is dedicated to "promoting a competitive and fair operating environment for small business." In addition, through the Office of Small Business, the Victorian Government provides a range of educational material, information and counselling services, including a 'shop front' providing a vast array of educational publications for small businesses. Most other States provide similar services to small businesses and much of this material is specifically directed to providing advice to small retailers. The WA Small Business Development Corporation, for instance, has a wide range of specific publications available for this purpose.

Similarly the Australian Competition and Consumer Commission (ACCC) publishes a range of material specifically for small business, including guides to unconscionable conduct and collective bargaining as well as holding information forums for retailers.

Similarly State and Territory retail tenancy officials are very proactive in the advice they give to retailers on retail tenancy matters. In Queensland, for example, Retail Shop Leases Registry staff in 2006-07 contacted 4,000 clients during an awareness and education campaign throughout Queensland. Educational material, including a 'Retail Leasing Guidelines' booklet, was disseminated at trade fairs,

conferences, seminars, door-to-door contact with retailers and through advertising.

3.1.4 Ultimate responsibility rests with the tenant

Ultimately, however, it must be recognised that retail tenants are in business and must take responsibility for the business decisions they make. There is no shortage of information and advice available to retail tenants (most of it free of charge or at nominal cost). Nor is there any shortage of laws in place to protect retail tenants. Of course there will be occasions when a retail landlord does the wrong thing but this is not commonplace and there are plenty of remedies available to tenants when it does occur. With the best will in the world, however, landlords and governments cannot be held responsible for every bad business decision taken by a retailer.

3.2 DURING THE LEASE

Retail tenancy legislation also requires the disclosure of a range of information during the term of the lease. This includes, for example:

- provision of the executed lease;
- procedures for obtaining a lease with a minimum term of less than five years;
- information required to be provided to enable market rent reviews;
- details of the administration of outgoings;
- information to be given to tenants in the event of alterations and refurbishments of the shopping centre;
- information on relocations and demolitions;
- details of advertising and promotions fund revenue and expenditure; and
- disclosures required to be given to an assignee in the event of assignment of a lease (i.e. sale of business).

In almost all cases this imposes obligations on landlords to provide information to tenants. Such obligations have been thoroughly examined during successive retail tenancy legislation reviews and have been frequently expanded. We are unaware of any deficiencies in this area. Indeed in a recent review of the NSW *Retail Leases Act* it was agreed by all parties to eliminate a requirement to make available to tenants information relating to expenditure on outgoings during the financial year because it was seen to be unnecessary. (It must be said that this was a rare example of regulation being removed during such reviews.)

3.2.1 Provision of sales information to landlords

The most important information required to be given to landlords by tenants (at least in major shopping centres) during the lease are retailers' monthly sales (or turnover) figures. (There is a popular misconception that retailers are required to 'open their books' to their landlords. This is not correct. Tenants are only required to report their sales figures.)

This requirement has been a matter of considerable discussion during retail tenancy reviews but in the end all State and Territory Governments have accepted that this turnover information is vital for shopping centre owners and also vital for the retailers in shopping centres. Indeed, as outlined later in this section, retailer associations in two States have successfully sought to have centre turnover information included in the lessor's disclosure statement.

It is useful to consider why such information is necessary, since this is an issue likely to be raised before the Productivity Commission.

First, turnover information is necessary for proper market share analysis - to determine the overall financial performance of a shopping centre and the strengths and weaknesses of the centre's retail offer according to various retail categories. This information is critical for decisions on expansions and refurbishments of the centre – to establish the strength of the centre's market share and if it is losing sales to a competitor. Shopping centres usually require major refurbishments, involving substantial amounts of capital, every 10 years or so. To return to the example of Westfield Chermside, referred to in the Introduction, since Westfield purchased the centre in 1996 it has had two refurbishments and a total of around $450 million has been invested by Westfield in these redevelopments.

Decisions on refurbishments and expansions are always major risks and to embark on these projects without proper market share analysis would be a case of 'flying blind'. To expect shopping centre companies to undertake such major capital expenditures without knowledge of the turnover of particular centres would be like expecting, say, David Jones to make similar decisions about its chain of department stores without knowing the turnover of individual stores or of individual products. Turnover is needed, in turn, to inform shopping centre investors' expectations about the rates of return on investment.

Second, turnover information is necessary to ensure a centre has a successful tenancy mix strategy to enable it to adapt to a constantly changing market place. Without turnover information it would not be possible to monitor the retail performance of individual shops and categories. Over time the tenancy mix strategy would become largely 'hit and miss' and ultimately detrimental to the customers' needs; to retailer turnover levels; and to the centre's retail profitability.

Third, turnover information is vital to most effectively target shopping centre marketing and promotional strategies to ensure a centre gets maximum value for its marketing and promotional expenditure. A typical regional shopping centre will spend between $1 million and $2 million a year on marketing, funded jointly by contributions from centre retailers and the centre owner. A detailed assessment of turnover information enables the centre to direct its marketing funds to where they are needed most; to evaluate the success of marketing strategies; and, particularly, to boost those categories of retail experiencing difficult trading periods.

Fourth, turnover information is vital to industry researchers to, among other things, compare the relative performance of shopping centres. For example, the independent magazine *Shopping Centre*

News publishes each year comparative performance tables based on turnover for shopping centres, which are important for investors, retailers and owners. Retailers use the tables to decide in which centres they will seek premises. The magazine relies on this information to compile its comparative lists (what it calls 'Big Guns', 'Middle Guns' and 'Little Guns') and this would not be possible if turnover figures were not disclosed. Leading retail research firms, such as Urbis and MapInfo Dimasi, rely on turnover figures to prepare important industry data, including the annual Urbis Retail Averages, which are used by both owners and retailers for benchmarking purposes.

Fifth, turnover information is vital to individual retailers for benchmarking purposes. It enables the retailer to compare the performance of their store to the trend of that particular retail category and to the trend of all speciality shops in that centre. This can alert them to the need for corrective action. Major chain retailers now regularly request this information to enable them to benchmark the performance of their stores in various centres against the performance of other stores in the same category so they can make better business decisions. Major landlords now, as a matter of course, make this information available to retailers who request it, provided it can be aggregated so that it does not identify the sales performance of individual retailers.

It has been claimed by some retailer groups that the disclosure of turnover information can be used to determine rents. This completely misunderstands how retail rents are determined. (We go into this matter in considerable detail in *Term of Reference 5*.) It suggests that landlords are able to set rents according to whatever the tenant can afford. This is not the case. Even if landlords were to take turnover into account in rent negotiations, the ultimate outcome of that negotiation depends on the supply of, and the demand for, retail floor space and this often favours the tenant rather than the landlord. Moreover, there are many factors other than turnover that will determine a retailer's capacity to pay rent about which the landlord will not have information. Although a useful indicator of ongoing performance, turnover alone would not be a suitable basis for setting or revising rents.

It should also be pointed out that many tenants actually draw attention to their turnover figures when negotiating rents or seeking rental concessions from the landlord. This disclosure of turnover figures by tenants helps the landlord assess whether this is truly the case or whether the tenant is simply seeking a tactical advantage in negotiations. If it is not a misuse of turnover figures in these circumstances, why is it a misuse for figures to be referred to when a tenant is trading profitably? Also, as noted above, turnover information is now routinely requested by national and state chain retailers.

There is an obvious disconnect between the position of those retailer associations which are pressing for turnover information not to be disclosed and the position of many of their members who are using turnover figures supplied by the landlord to better inform their business decisions. In a recent review of the *Retail Shop Leases Act*

in Queensland the relevant retailer associations did not seek to have the declaration of turnover information prohibited. On the contrary, those retailer associations argued that the sales performance of the shopping centre (moving annual turnover), where it is collected, should be included on the lessor's disclosure statement so that this information is readily available to prospective tenants. This was agreed by SCCA and is now a requirement in Queensland. This was copied in a subsequent review of the NSW *Retail Leases Act* and, in fact, a more detailed breakdown of centre turnover information (according to food, non-food and services) is now required to be included on the lessor's disclosure statement in that State. Obviously this information could not be provided to prospective tenants if sales information were not collected.

3.3 END OF LEASE INFORMATION

Retail tenancy regulation also stipulates the information that must be supplied to the tenant nearing the end of a lease.

In most States and Territories, the lessor is obliged between 6 and 12 months before the expiry of the lease to inform the lessee of their intentions in relation to renewal of the lease (see, for example, section 64 of the Victorian *Retail Leases Act* and section 44 of the NSW *Retail Leases Act*). If the lessor proposes to offer the lessee a renewal, this notification must contain advice about the terms of the new lease, including the rent. If the lessor does not propose to offer a new lease, this advice must also be given to the tenant. The legislation also imposes consequences on a lessor if this notification is not given during the specified time period. The purpose of these 'end of lease notification' provisions is to ensure that there is sufficient time for a lessor and a lessee to negotiate the terms and conditions of the new lease and also, if those negotiations cannot be resolved, to ensure that the lessee has sufficient time to make alternative arrangements for their business.

In addition, where a new lease is being proposed, retail tenancy legislation requires that a new disclosure statement, or a written statement updating the information contained in the earlier disclosure statement, must be given to the tenant.

3.3.1 Information asymmetry

It is sometimes argued that there is an imbalance in the information available to landlords and tenants when renegotiating a lease. The landlord, the argument goes, has access to the tenant's turnover information and can assess how well the tenant is performing but the tenant does not have access to information about comparable rents being paid by other tenants in the shopping centre. This is said to give the landlord an unfair advantage in lease renegotiations. The Baird Committee[26], for example, argued: "in major shopping centres, there is a lack of transparency with regard to the cost of floor space rent. That is the seller (landlord) has knowledge – the buyer (prospective tenant) has none. Prospective tenants are therefore prevented from making informed decisions in assessing the 'market rent' as it applies to particular areas of retail space."

[26] Joint Select Committee on the Retail Sector, *Fair Market or Market Failure*, 1999

We would dispute the claim that the tenant has no knowledge of prevailing rents and certainly that is not the case in those States that require registration of leases. The majority of tenants in the larger shopping centres are national or state chain retailers or major franchisors. These retailers are vastly experienced in lease negotiations and many have their own property departments with responsibility for lease negotiations. They are very well informed on prevailing market rents.

However, all tenants, including the small independent retailers, have a responsibility to research their proposed locations in the same way that they research the viability of their proposed retail business. Rents are obviously a key element in any business plan.

There is now an entire industry of 'tenant advisers', which has mainly developed over the last few years, especially to provide advice to tenants on lease negotiations. In many cases these tenant advisers also represent tenants in these negotiations. We are aware of 30 such tenant advisers operating in Queensland, 17 retail advisers who operate in NSW and the ACT and seven in South Australia. This is not a definitive list and we have not surveyed the other States. This industry is also one of the fastest growing and many of these tenant advisers are former leasing executives for shopping centre companies.

3.3.2 Mandatory registration of leases

If there is a perceived imbalance in the information available to the parties in lease negotiations there is a simple solution which does not involve significant additional costs. In two States (NSW and Queensland), and in both Territories, registration of leases is already required[27]. (It should be noted that the mandatory notification of lease details in Victoria, referred to in case study 1 under *Term of Reference 2*, does not require the notification of details such as rent or lease conditions. In any event this information is not made public.) When a lease is registered, it is available for inspection for the payment of a small search fee (for example, $10.50 per lease in NSW). Indeed the availability of lease data in these two States and two Territories is used by this new industry of commercial tenant advisers to assist tenants to negotiate their leases.

One such firm, Leasing Information Services (www.leaseinfo.com), advertises "current retail leasing data Australia-wide for shopping centres, retail strips and bulky goods" demonstrating that lease data is obviously available even in those States that do not require the registration of leases. Information can be accessed from this firm's website for fees ranging from $600 (for single centres) to $5,000 (for corporate use). The firm's advertisements state that it can provide:

- *"Lease Reports: Benchmark retail leasing information in seconds, by centre, landlord, shop, usage, area, rent or expiry. Leases can also be*

[27] We have referred to this as mandatory registration of leases although technically it is not mandatory. Registration is driven in NSW by provisions of the *Real Property Act*, and in other States and Territories by its equivalent, not by retail tenancy legislation, and there are legal advantages for a lessee to do so. While it is not compulsory for a lessee to register a lease, in practice it is unusual for a lessee not do so.

purchased online. Information is sourced directly from the relevant State Land Titles Office."

- *"Custom Lease Reports: Order a full rental assessment including location profile, customer demographics, competitor's benchmarks and lease terms for any centre in our database for $300 + GST."*

During the review of retail tenancies in Victoria in 2001-2002 the SCCA proposed the registration of leases in that State as a means of addressing this so-called information imbalance. Our recommendation was not adopted. Last year we were contacted by the Western Australian Government and asked our views on the registration of leases in that State. (Western Australia has an optional system of registration.) We advised the WA Government that we had no objection to mandatory registration. We understand the WA Government is still considering the issue. It is our strong view that if an information imbalance is perceived to exist then the best means of addressing it would be for all State and Territory Governments to require the registration of leases.

Most of the other States already have a provision for optional registration of leases so the additional administrative costs of compulsory registration would be largely covered by the registration fee and the search charges. While registration is an additional cost to retailers - $90 in NSW and $145.90 in Queensland - these costs are not substantial. There would also, presumably, be no objection to these additional costs from retailer associations, since these associations have argued that there should be a more level playing field when it comes to the information available to both parties during lease negotiations.

3.3.3 Lease confidentiality clauses

The Senate Economics References Committee inquiring into *"the effectiveness of the Trade Practices Act in protecting small business"*[28] in 2004 considered so-called 'secrecy clauses' in leases. While acknowledging that there may be circumstances where it is in the interests of both parties to keep the details of the lease secret, the Committee argued this should be the exception rather than the rule. The Committee noted that a tenant should be free to discuss the terms of their tenancy if they wished to do so. The Committee recommended "that the Commonwealth Government negotiate with the State and Territory governments with a view to introducing measures which would prohibit retail lease provisions compelling tenants to keep their tenancy terms and conditions secret".

The Committee, although acknowledging there were circumstances in which tenants may wish to keep lease details confidential, seems to have proceeded on the assumption that retail tenants are generally happy to have such details made public and it is only landlords who are preventing this occurring. This was a naïve assumption. In our experience the majority of tenants, particularly chain retailers and franchisors, regard the details of the rent they pay in various

[28] Report of the Senate Economics References Committee, *Inquiry into the Effectiveness of the Trade Practices Act 1974 in Protecting Small Business,* tabled in the Senate on 1 March 2004.

locations as confidential commercial information and they have no wish for this information to be in the hands of their competitors.

The Australian Government did not accept this recommendation[29]. It argued: "It is a fundamental principle of the law of contract that parties are free to negotiate the terms of the contract, including a lease. Prohibiting secrecy clauses would violate this principle of contract law. Furthermore, if retail tenancy arrangements need regulating, it is a matter for State and Territory governments, rather than the Commonwealth Government." We understand the Australian Government has referred this issue to State and Territory Governments but no Government has acted on this recommendation.

It should be noted, however, that section 11(2a) of the WA *Commercial Tenancy (Retail Shops) Agreements Act,* already provides: "A provision in a retail shop lease purporting to preclude the tenant from voluntarily disclosing the rent under the lease is void." This section has been in the Act for many years, since well before the Senate Committee made its recommendation. The SCCA has no objection to similar clauses being inserted in other state and territory retail tenancy legislation.

3.3.4 Suggestion by Chairman of the ACCC, Mr Graeme Samuel

Recently the Chairman of the ACCC, Mr Graeme Samuel, put forward the suggestion that landlords consider publishing retail tenancy information on their websites[30]. Mr Samuel said:

"One of the major complaints the ACCC hears from retail tenants is that they object to providing their turnover information details to landlords. We must remember that in some cases this information can be useful to a shopping centre when assessing possible future development and the tenancy structure that in turn assists with the success of the centre.

Second, we often hear that tenants are unhappy at not being able to discover the rents paid by neighbouring traders. This is not always strictly true, as NSW, Queensland and the ACT have compulsory retail leasing registers, and it can be as simple as searching these publicly available registers. Other states also make some limited information available.

Where details are not readily searchable, landlords such as shopping centres might want to consider publishing rental information on their websites, where the tenant concerned gives their consent.

It is my understanding that landlords generally do not oppose disclosing such terms and conditions, and that this could become a voluntary process on the part of individual landlords or indeed in the case of shopping centres, an industry-wide code.

Such a code would in fact go a long way to avoiding further need for regulation in this sector."

We doubt Mr Samuel's suggestion would be as effective as our recommendation that the remaining States (Victoria, Tasmania,

[29] *Australian Government Response to the Senate Inquiry into the Effectiveness of the Trade Practices Act 1974 in Protecting Small Business, Statement by the Treasurer, the Hon Peter Costello MP, 23 June 2006.*

[30] *ACCC News Release 3 July 2007. This is an extract from Mr Samuel's address to the COSBOA National Small Business Summit.*

South Australia and Western Australia) should also introduce mandatory registration of leases.

First, Mr Samuel concedes that information about rents and other lease terms is not an issue in NSW, Queensland and the ACT (and he could have added the Northern Territory) where registration of leases is already the practice.

Second, a voluntary code of conduct or voluntary action by landlords to disclose this information, because it is voluntary, is unlikely to provide complete coverage and those landlords that do agree to disclose may change their minds if major competitors do not do likewise.

Third, Mr Samuel concedes, under his proposal, that retailers would have the right to object to the publication of their own rent and lease details. As noted earlier, our experience is that major retailers, in particular, object strongly to the publication of such details and it is most unlikely, for this reason, that the coverage of individual shopping centres would be as extensive as under mandatory registration of leases.

Fourth, for nearly half the States in Australia, Mr Samuel's proposal would be superfluous. The States and Territories that currently provide for registration of leases would still do so. Voluntary disclosure in these States and Territories therefore would mean providing information that is already publicly available.

Mr Samuel conceded in his address that registration of leases, where it occurs, provides an opportunity for retailers to ascertain details of market rents. The SCCA agrees with him and we recommend that the practice be extended to all other States.

4. TERM OF REFERENCE 4.

Scope for reform of retail tenancy regulation to improve economic performance, including:

- ***differences in retail tenancy regulation between States and Territories, and the scope for nationally agreed regulations and approaches; and***
- ***the extent and adequacy of dispute resolution systems for landlords and retail tenants, including differences in dispute resolution frameworks between the States and Territories.***

4.1 DIFFERENCES IN RETAIL TENANCY REGULATION

Retail tenancy legislation in Australia developed on a state-by-state basis, beginning in Queensland in 1984, followed by WA in 1985, Victoria in 1986, NSW in 1994, South Australia in 1995, the ACT in 2001 and the Northern Territory in 2003. Tasmania adopted a code of practice (made under its Fair Trading Act) in 1998.

The main retail tenancy legislation that now applies in each State is as follows:

- Queensland *Retail Shop Leases Act 1994*;
- WA *Commercial Tenancy (Retail Shops) Agreements Act 1985*;
- Victoria *Retail Leases Act 2003*;
- NSW *Retail Leases Act 1994*;
- SA *Retail and Commercial Leases Act* 1995;
- Tasmania *Fair Trading (Code of Practice for Retail Tenancies) Regulation 1998;*
- ACT *Leases (Commercial and Retail) Act 2001*;
- NT *Business Tenancies (Fair Dealings) Act 2003*.

Although to some extent States have 'borrowed' from each other when legislating (most notably the South Australia legislation in 1995 reflected provisions of the previous year's NSW *Retail Leases Act* and the Northern Territory *Business Tenancies Act* in 2004 largely adopted the NSW *Retail Leases Act*), much of this initial harmony has been undone as a result of the subsequent frequent reviews of each State's legislation. It has been rare for State Governments to pay much consideration to the need for harmonisation with other jurisdictions when reviewing their retail tenancy legislation.

4.1.2 Constant reviews of retail tenancy regulation

There is a constant round of state/territory retail tenancy reviews which adds to the volume and complexity of regulation, has increased differences between states, and has often imposed

unnecessary regulation. Since the Reid Report[31] in 1997 there have been 13 successive retail tenancy reviews around Australia: in Victoria, Queensland, NSW, WA, ACT, Northern Territory, Victoria, (again), Tasmania, WA (again), NSW(again), Queensland (again), NSW (again), and Victoria (this time a drafting review). These review have led to the following pieces of legislation:

- Victorian *Retail Tenancies Reform Act* in 1998;
- Amendments to *Trade Practices Act*, introducing section 51AC, in 1998;
- Amendments to *NSW Retail Leases Act*, in 1998;
- Amendments to Qld *Retail Shop Leases Act*, in 1999;
- Amendments to WA *Commercial Tenancies (Retail Shops) Agreements Act* in 1999;
- ACT *Leases (Commercial and Retail) Act*, in 2002;
- Victorian *Retail Leases Act* in 2003;
- Northern Territory *Business Tenancies (Fair Dealings) Act* in 2004;
- Amendments to *NSW Retail Leases Act* in 2006;
- Amendments to *Queensland Retail Shop Leases Act* in 2006; and
- Amendments to Victorian *Retail Leases Act* in 2005.

(Legislation arising from the most recent WA review is still awaited but the WA Government has recently advised stakeholders that it intends to introduce a Bill in early 2008.)

4.1.3 Scope for nationally agreed regulations and approaches

Only in recent years have there been deliberate moves to achieve harmonisation of State and Territory legislation. This began in 2003 when the Victorian Government passed a new *Retail Leases Act*, following a two-year review of retail tenancies legislation, and adopted many provisions of the NSW *Retail Leases Act* (although, frustratingly, it still insisted on a number of drafting differences.) This was continued in Queensland in 2005 when the SCCA and the National Retail Association (NRA) and the Queensland Retail Traders and Shopkeepers Association (QRTSA), with the encouragement of the Queensland Government, agreed to bring many elements of the *Retail Shop Leases Act* into line with the NSW and Victorian *Retail Leases Acts*. Given these developments, and given the similarities between the NT *Business Tenancies (Fair Dealings) Act* and the NSW *Retail Leases Act* and some remaining similarities between the SA *Retail and Commercial Leases Act* and the NSW *Retail Leases Act*, the task of harmonising the provisions of all State and Territory retail tenancy legislation is not as daunting as it may seem at first.

Despite these encouraging developments in Victoria and Queensland in recent years, however, we have significant doubts that the political

[31] House of Representatives Standing Committee on Industry, Science and Resources, *Finding a Balance: Towards Fair Trading in Australia* 1997

will exists among the States and Territories to achieve completely harmonised retail tenancy legislation. In addition to the usual reluctance of state/territory governments to cede any legislative powers by adopting uniform laws, many retailer associations are state-based associations and have little interest in harmonised legislation. These associations also believe they are better placed to pressure their State Government to achieve favourable legislative amendments and they fear this ability will be circumscribed if the freedom of State Governments to legislate is restricted by national uniformity. Other retailer associations also believe the present system is to their advantage since it allows them to 'win' an advantage in one state and then use that to convince other State governments to grant a similar advantage.

4.1.4 A national retail tenancy regulation system

From time to time there have been calls for a national system of retail tenancy regulation. Most recently, in 2002, the ACCC called a meeting of relevant parties to explore the possibility of a national code of retail tenancies made under Part IVB of the *Trade Practices Act*. There was little enthusiasm for this approach once it became clear that the ACCC did not envisage such a code replacing the existing system of state and territory regulation but rather as an addition to that regulation.

Several Australian Government inquiries have recommended a national system of retail tenancy regulation. The Reid Report in 1997[32] recommended a uniform retail tenancy code, a recommendation which was not accepted by the Australian Government or favoured by State and Territory Governments. This recommendation was repeated in 1999 by the Baird Report[33]. It must be said that neither of these reports gave much consideration to how such a uniform national code would be achieved and how it would operate in practice given the existence of State retail tenancy legislation. Indeed the Australian Government, in its official response to the Baird Report, noted it had deliberately not adopted the Reid Report's recommendation for a national code and, in doing so, retail tenants "have also been spared the additional burden of compliance that would have been delivered by an additional layer of regulation."

SCCA supports a system of national regulation of retail tenancies but with an important proviso: only if such regulation is *in place of* not *in addition to* the present system of State and Territory regulation. For this reason we would not support a uniform code of practice, as recommended by the Reid Inquiry, unless the States agreed to repeal their legislation. We doubt this would be satisfactory to retailer associations[34]. We also doubt that the States and Territories could be convinced to repeal their existing legislation. A national code is therefore more likely to create an additional layer of regulation, not a uniform system. If so it is also likely to lead to

[32] Previously cited.

[33] Joint Select Committee on the Retail Sector, *Fair Market or Market Failure*, 1999

[34] The National Retail Association, in its submission in September 2003 to the Senate Inquiry into 'the effectiveness of the Trade Practices Act in protecting small business', stated it "would not support any industry code that derailed state-based tenancy legislation."

'jurisdiction shopping' and legal disputes over inconsistencies between the national code and state/territory legislation.

Similarly we doubt whether the Federal Government has the constitutional power to effectively legislate in this area to the exclusion of the States. Although the High Court decision in relation to Work Choices[35] would seem to pave the way for the Federal Government to again use the corporations power to legislate in this area, we estimate the number of unincorporated bodies involved in the retail tenancy market to be substantially high. In such circumstances, again, there would be little incentive for the States to repeal their legislation (and, indeed, strong arguments for them to retain the legislation). Once again, we would be more likely to find ourselves with another layer of regulation being added.

4.1.5 Uniform state and territory legislation

There are probably only two effective ways in which uniformity of retail tenancy legislation among the States and Territories can be achieved. These are:

- first, if the States and Territories agreed to bring their legislation into conformity with each other;
- second, if the States and Territories surrendered their powers in this area to the Federal Government.

The *first approach* is not a Herculean task since, as we have previously noted, some tentative steps have already been made in this direction in Victoria, Queensland and the Northern Territory. Similarly the SCCA and the Australian Retailers Association have recently negotiated a national voluntary code of conduct on casual mall licensing, which is currently before the ACCC for authorisation. It would, however, be a task that would require putting aside petty state jealousies in the interests of the nation. We would also be concerned if it resulted in the States and Territories simply adopting the most 'tenant friendly' provisions in each State rather than applying critical analysis to each provision where retail tenancy legislation differs.

Even if the States and Territories agreed upon, and ultimately achieved, uniform retail tenancy legislation, there would have to be continuing political will to ensure that this uniformity was maintained. The constant rounds of State reviews of retail tenancy legislation, which have seen States amend legislation without any regard for the need for harmonisation, would have to end.

We have in the last few years seen an example of this disregard for the need for uniformity with the drawdown of the unconscionable conduct provisions of the *Trade Practices Act* into retail tenancy legislation. This saw Victoria draw down the provisions in a different way to NSW, Queensland and the Northern Territory. Western Australia, when it drew down these provisions last year, followed the Victorian model, not the majority model. The result is that the law relating to unconscionable conduct is different in those two States to

[35] New South Wales v Commonwealth of Australia; Western Australia v Commonwealth of Australia [2006] HCA 52 (14 November 2006).

the other three, and possibly different to the law under the *Trade Practices Act*. We doubt the ability of the States and Territories to resist pressure from state-based retailer associations to pursue individual legislative solutions within their jurisdictions.

For this reason we consider that the *second approach* is the only practical and effective way in which a national, uniform system of regulation could be achieved. This would require the States and Territories to agree to surrender their powers in this area to the Australian Government. This is the approach that resulted in a uniform corporations law around Australia. If a national system of retail tenancy regulation is to be achieved we believe the Australian Government would need to be the driver, probably through the Council Of Australian Governments (COAG) process. A Commonwealth Bill would need to be drafted which would form the basis for negotiations with the States and Territories, in consultation with relevant retailer associations and retail property owners' associations, including the SCCA and the Property Council of Australia.

This would also be an excellent opportunity to critically scrutinise the existing legislation to remove unnecessary regulation. As we have noted in an earlier section (*Term of Reference 2*), much of the regulation now being applied to the retail tenancy market has had the effect of imposing costs on landlords and tenants, without any benefit for those it is supposed to protect.

If the second approach were deemed to be too radical or too ambitious we suggest the first approach could be tackled in stages. We suggest below a possible first step towards ultimately achieving a single Commonwealth Act of Parliament regulating retail tenancies.

4.1.6 Uniform retail tenancy documentation

One of the most frustrating and costly aspects of the present disparate systems of retail tenancy regulation is the lack of common documentation requirements. National retailers and national retail property owners have to contend with eight different lessor and lessee disclosure statements, different forms in relation to assignments and so on. This is an area where those operating in more than one State incur significant compliance costs. We mentioned earlier (in *Term of Reference 3*) that the Victorian Government, in consultation with relevant parties, has commenced a review of the disclosure statement in Victoria. We believe this has the potential to become a model disclosure statement which could then be adopted, *without amendment*, by all other States and Territories. If this could be achieved the next step could be to tackle other required documentation, such as the assignor's disclosure statement. In order to gain the necessary political will we suggest that this initiative probably needs to be driven by COAG.

If this exercise proved successful it would be a useful first step in achieving harmonisation of legislative provisions. If it proves impossible to gain agreement on national retail tenancy documentation, then there is little point in trying to proceed further.

4.2 EXTENT AND ADEQUACY OF DISPUTE RESOLUTION SYSTEMS

Each State and Territory has established low-cost, easily-accessible dispute resolution systems under their retail tenancy legislation. Mediation is generally required prior to proceedings being instituted before the relevant retail tenancy tribunal. In some States these tribunals are composed of people with practical experience in the retail tenancy industry, with an independent chairperson, while in other States, tribunal members are able to draw on advisers with practical industry experience.

The dispute resolution provisions in each State and Territory are summarised below:

- In NSW, the *Retail Leases Act* provides that parties may refer a retail tenancy dispute to the Registrar of Retail Tenancy Disputes for mediation. If mediation is unsuccessful a claim may be lodged with the Retail Leases Division of the Administrative Decisions Tribunal (ADT). The ADT also has the power to consider unconscionable conduct applications under the provisions of the *Retail Leases Act* drawing down the provisions of section 51AC of the *Trade Practices Act* (TPA).
- In Victoria, the parties may refer a dispute to the Small Business Commissioner for mediation. If mediation fails, proceedings can commence before the Victorian Civil and Administrative Tribunal (VCAT). VCAT also has the power to consider unconscionable conduct applications under the provisions of the *Retail Leases Act* drawing down the provisions of section 51AC of the TPA.
- In Queensland, parties to a dispute may refer a dispute to the Retail Shop Leases Registry for mediation. If mediation fails the mediator can refer the dispute to the Retail Shop Leases Tribunal. The tribunal has the power to consider unconscionable conduct applications under the provisions of the *Retail Shop Leases Act* drawing down the provisions of section 51AC of the TPA.
- In South Australia, parties may refer a dispute to the Commissioner for Consumer Affairs for mediation using an independent mediation scheme administered by the Commissioner. If mediation fails the matter can be referred to the Civil (Consumer and Business) Division of the Magistrates Court or, for claims over a certain amount, to the District Court. South Australia has not drawn down section 51AC but the Magistrates Court (and the District Court) have jurisdiction in equity to determine a matter pursuant to Part IVA of the TPA.
- In Western Australia, parties may refer a dispute to the State Administrative Tribunal (SAT) which can arrange mediation and, if not resolved, the dispute can be heard by SAT. The SAT has the power to hear unconscionable conduct matters under the draw down of section 51AC of the TPA into the *Commercial Tenancy (Retail Shops) Agreements Act*.
- In Tasmania, parties are obliged to negotiate a resolution to a dispute. If this fails either party can ask the Office of Consumer Affairs to attempt to negotiate a solution. If unresolved it can be

referred to the Retail Tenancies Code of Practice Monitoring Committee. If still unresolved either party can refer the dispute to a court. Tasmania does not have specific retail tenancy legislation and so has not drawn down the unconscionable conduct provisions of the TPA, although of course, the TPA itself applies in Tasmania.

- In the ACT disputes are dealt with by preliminary hearings, mediation and court hearings in the Magistrates Court. The Act also provides for the use of alternative dispute resolution, including mediation. The ACT has not drawn down the unconscionable conduct provisions of the TPA but it does have specific unconscionable conduct provisions in its own legislation.
- In the Northern Territory parties to a dispute may apply to the Commissioner of Business Tenancies who calls a conciliation conference. If conciliation fails the dispute can be referred to the courts. The Northern Territory has drawn down the unconscionable conduct provisions of the TPA.

It is the experience of our members who operate in these jurisdictions that the dispute resolution processes operate reasonably effectively. In most States disputes can fairly speedily be referred for mediation and the success rate of mediation tends to be quite high (around 80%). While the quality of mediation can vary, it is generally of good quality.

4.2.1 Number of retail tenancy disputes

We have set out below the number of retail tenancy disputes that have occurred in each State and Territory in the most recent year for which statistics are available. These dispute figures show three things:

- most retail tenancy disputes (around 90%) occur in NSW and Victoria but, as a proportion of retail leases on foot, even these are relatively few in number;
- very few retail tenancy disputes (less than 200 a year) occur in the rest of Australia (outside NSW and Victoria) requiring referral to the formal dispute-settlement mechanisms provided for in States and Territory retail tenancy legislation; and
- the success rate for mediation of retail tenancy disputes is very high, with success rates of around 80% in NSW, 75%-80% in Victoria and 90% in Queensland.

In South Australia, the Annual Report of the Commissioner for Consumer Affairs does not publish the number of retail tenancy disputes it is asked to mediate each year. The Commissioner informally advised SCCA recently, however, that there were "not many."

In Western Australia, the Annual Report of the State Administrative Tribunal (SAT) for 2005-06 records 1,516 applications under the *Commercial Tenancy (Retail Shops) Agreements Act*. Of these, however, 1,467 were applications seeking approval of lease clauses which the SAT notes "are administrative in nature". Only 49 applications related to matters in dispute.

In Tasmania, according to the Tasmanian Government, only one retail tenancy dispute required mediation in 2006-07. There have been very few retail tenancy disputes which have required mediation in the nine years in which the code has been in existence.

In Queensland, in 2006-07, there were only 115 formal disputes which required mediation under the Act. Of these, 91% were successfully mediated and only 19 disputes required arbitration by the Retail Shop Leases Tribunal.

In the Northern Territory, only two disputes occurred in each of the first two years of operation of the Act and only one dispute occurred last year (2006-07).

In the ACT, 42 retail tenancy matters were lodged with the magistrates Court although this figure also includes rent determinations.

4.2.2 NSW and Victoria

Only two States – NSW and Victoria - publish detailed figures of retail tenancy disputes and these figures are examined below.

In NSW, 824 disputes were referred for mediation in 2005-06. To put this in perspective, this means only around 1%[36] of retail leases resulted in a dispute which has to be referred for mediation. This is a remarkable statistic given that a retail lease operates 7 days a week, 52 weeks a year, usually for 5 years. In any other field of human relationships, this would be regarded as an excellent record. Imagine if it could be said of Australia's 7 million married couples that only 1% had one serious complaint a year about their partner!

Also a very high proportion of these disputes are successfully resolved at mediation. Of these 824 disputes, 496 (60%) were what the NSW Retail Tenancy Unit describe as 'informal mediations' – 426 (86% of the 496) were settled at this stage and 70 (14% of the 496) went forward for 'formal mediation. Of the total 328 disputes which went to 'formal mediation', 39 (12%) were settled prior to mediation; 111 (34%) were settled at mediation; and 81 (25%) were settled after mediation. In other words, nearly 80% of all disputes were settled by mediation and of those that went to formal mediation, 70 per cent were satisfactorily resolved by mediation.

Of these 328 disputes requiring formal mediation, 150 (46%) occurred in strip shops while 178 (54%) occurred in shopping centres.

Only 97 disputes could not be settled by mediation and had to be referred to the Administrative Decisions Tribunal (ADT) for arbitration. If we examine statistics of retail tenancy disputes before the ADT over the same period, 2005-06,[37] a total of 184 applications were filed during the year and 156 were disposed of during the year. Of the 156 matters disposed of, 107 (69%) were either withdrawn or discontinued or dismissed without hearing; 14 (9%) were dismissed after hearing; 7 (5%) were settled with orders made; and 24 (15%)

[36] See footnote 7 in the Introduction. The SCCA estimates there are around 80,00 retail leases in NSW.
[37] Annual Report of the NSW Administrative Decisions Tribunal 2005-06 p.47

resulted in orders made by the ADT. There were 4 other disputes in which the ADT had no jurisdiction or which were transferred to the Supreme Court.

These figures reinforce the fact that very few retail tenancy disputes require arbitration by the ADT and these represent a very small proportion of the total number of retail tenancy disputes. When considered with the statistics of retail tenancy mediation, it is clear that the dispute-settlement processes in NSW are operating very efficiently.

In Victoria, according to the latest annual report of the Small Business Commissioner (SBC), the office handled 797 retail tenancy disputes in 2005-06, although this figure appears to include matters relating to the appointment of specialist retail valuers which are not necessarily retail tenancy disputes. This represents only 1.1% of all retail leases in the State[38]. In other words, only 11 leases in every 1,000 results in a dispute being referred to the SBC. It should be noted that of these 797 matters, 253 (32%) were referred by landlords.

The annual report also notes that just over 80% of the disputes that were referred for formal mediation were satisfactorily resolved by mediation. It also notes that only 120 (15%) of these disputes originated in shopping centres and 30% of these shopping centre-related matters were referred by landlords.

It should also be noted that the mediation services provided by the SBC are very low cost and each party pays only $95 for mediation. According to a survey conducted for the SBC by an independent consultant, 81% of those who have used the SBC's services rated them as 'very good' or 'good'.

The SBC has also supplied dispute resolution figures for the first four years in which the office has been operating (May 2003–June 2007). There were a total of 2,962 retail tenancy disputes or, on average, 680 a year (ignoring May-June 2003). A total of 75.3% were successfully mediated.

Of these disputes only 14.2% involved shopping centres and in nearly 30% of the shopping centre disputes the shopping centre owner or manager was the applicant. The figures show there is a higher rate of successful mediation (81.1%) where the shopping centre is the respondent compared to when the shopping centre is the applicant (66.9%).

As in NSW, it is clear that the dispute-settlement processes for retail tenancy disputes are operating very efficiently.

4.2.3 Unconscionable conduct complaints

In addition to the extensive State and Territory regulation of the retail tenancy market outlined earlier, the Australian Government in 1998 also began directly regulating this market.

[38] See footnote 7 in the Introduction.

Section 51AC was included in the *Trade Practices Act*, following the Reid Inquiry, and became operative in July 1998. The Australian Government said section 51AC would "provide a new avenue for small and specialist retailers to pursue remedies against unconscionable conduct in the retail tenancy relationship."[39] Since then four States (Queensland, NSW, Victoria, Western Australia) and the Northern Territory have incorporated similar provisions in their retail tenancy legislation. This was made possible by the passing of the *Trade Practices Amendment (Operation of State and Territory Laws) Act 2001.*

Since July 1998 the ACCC has launched very few actions for breaches of section 51AC and some of these have been franchisor-franchisee disputes. Only one action related to a shopping centre and this matter was satisfactorily settled by agreement between the ACCC and the landlord. (In fact, this matter had already been settled by agreement between the landlord and tenant before the ACCC intervened.) The ACCC has also launched a case against a shopping centre under section 51AA since the behaviour complained of occurred prior to July 1998. The relatively small number of prosecutions is despite the ACCC acknowledging that it had received a ministerial direction and special funding to mount unconscionable conduct test cases.[40]

The small number of cases launched by the ACCC must also be put into the context of complaints received by the ACCC. In September 2002 the ACCC released[41] figures for complaints in 2001 and 2002.[42] In 2001 the number of complaints numbered 162 and in 2002 it was 161. This suggests that the number of complaints, three years after the law began, was static and not increasing. These, of course, were 'complaints' and are not in themselves evidence that such conduct occurred.

Recently, in evidence before the Senate Estimates Committee, the ACCC revealed that the number of unconscionable conduct complaints lodged with it in 2006-07 was around 150[43]. Not all of these would have been retail tenancy complaints – it is likely some would relate to franchising – but even if we assume that they were all retail lease complaints this represents less than 0.1% of all retail leases[44]. In other words, less than one lease in every 1,000 results in a complaint of unconscionable conduct - and a complaint, of course, is not evidence that such conduct has actually occurred. This is a remarkably low figure, remembering again that a retail lease is on foot seven days a week, 52 weeks a year, usually for five years.

---

[39] Hon Peter Reith, Minister for Workplace Relations and Small Business, House of Representatives, 30 September 1997.
[40] ACCC media release 9 July 1999.
[41] This information was contained in correspondence from the ACCC to the SCCA and other parties dated 10 September 2002.
[42] It only released figures for the first eight months of 2002. We have extrapolated this figure to cover the entire year by assuming the number of monthly complaints in the last 4 months of that year was the same as in the first 8 months.
[43] Brian Cassidy, Chief Executive Officer of the ACCC, in a hearing of the Senate Estimates Committee on 30 May 2007. Mr Cassidy said the ACCC had received 126 complaints in the first 10 months of 2006-07. We extrapolated this figure by assuming the same volume of monthly complaints over the remaining two months of 2006-07.
[44] See footnote 7 in the Introduction.

This must also be considered against the background of the ACCC, as part of its functions, conducting extensive publicity and education campaigns to make retailers, in particular, aware of the provisions of section 51AC. These campaigns have included publishing a joint information bulletin with the Australian Retailers Association and holding its Competing Fairly Forum (which had a major emphasis on unconscionable conduct) throughout regional Australia.

We must admit, in the light of these figures, to being frustrated that the ACCC is not publicly and prominently proclaiming the success of section 51AC in curbing unconscionable behaviour in the retail tenancy market. These figures suggest that not only are the number of complaints the ACCC receives a tiny fraction of the number of leases on foot, but the annual number of complaints it receives is also declining slightly. Instead the Chairman of the ACCC, Mr Samuel, recently threatened landlords with a tougher line on legal actions in this area.[45]

Mr Samuel appears to have accepted arguments by small business organisations that the success or otherwise of section 51AC must be judged on the basis of the number of 'scalps' hanging from the ACCC's belt. The true success of a law is surely its success in changing behaviour so that 'scalps' are not necessary. Major shopping centre owners and managers now spend significant resources on education and compliance courses for their staff in order to ensure that their leasing and management staff, in particular, are aware of their legal and ethical obligations in dealing with tenants. No shopping centre owner wants to be accused of acting unconscionably towards its tenants.

It is true that the incidence of complaints of unconscionable conduct also has to include complaints lodged with tribunals established under retail tenancy legislation in those States where section 51AC has been drawn down. (It should be noted, however, that it is likely that there will be some overlap with those complaints lodged with the ACCC since presumably the ACCC would advise complainants to first exhaust the other avenues available to them.)

If we examine applications to the NSW ADT relating to unconscionable conduct, however, we find that these are still not numerous. The picture is confused by a tendency of many applicants to 'tick all boxes' when lodging retail tenancy dispute claims – thus 65 of the 184 applications (35%) filed involve both ordinary retail tenancy claims and unconscionable conduct claims. Those alleging only unconscionable conduct, however, numbered only 4 (2.2%). Even if we assumed that half of those that ticked all boxes alleged an element of unconscionable conduct, this would still mean that only 0.05% of NSW leases result in a claim – not evidence, but a claim - of unconscionable conduct.

Judging from the very low level of complaints of unconscionable conduct this relatively new law (together with the ongoing prescription of rules of behaviour laid down in retail tenancy legislation) has been remarkably successful in changing the culture which may have previously operated in some sections of the retail

[45] Address to COSBOA National Small Business Summit in Sydney, 3 July 2007.

tenancy industry. This has been acknowledged by Stephen Spring, a former retailer and prominent retail tenant adviser in NSW, who is also an adviser to the Council of Small Business Associations and the Franchise Council of Australia. Mr Spring wrote recently: "*For those who were retailing just over a decade ago, today's disclosure statements, plain English leases, access to demographics, specialist retail advisers, retail benchmarks and information, mediation, tribunals and a cultural shift in general are a far cry from the bad old days and a godsend to today's retailers to know better. . . Like any system, it has its flaws, but it's a far cry from a free for all from years gone by."*[46]

[46] Stephen Spring, *Inside Retailing* online 30 April 2007.

TERM OF REFERENCE 5.

The appropriateness and transparency of the key factors that are taken into account in determining retail tenancy rents.

5.1 FACTORS IN RENT DETERMINATION

5.1.1 Independent studies show moderate rents on renewal.

The SCCA has previously commissioned two independent studies of lease renewals to accompany submissions to retail tenancy reviews. The first study was in Victoria by Jebb Holland Dimasi[47] of 17 Victorian shopping centres and represented around 70% of retail tenancies in regional and sub-regional shopping centres. Of the leases renewed in these centres in 2000 the average rents charged under the new lease were only 3.5% higher than the rent charged under the previous lease. In 29% of lease renewals (or nearly 3 leases in every 10), the rent under the new lease was less than the rent under the old lease. The report concluded: "On average, in a competitive market, rents were renewed at close to the old rent."

The second study was by JHD Advisors[48] of 18 shopping centres in Western Australia, representing around 40% of retail tenancies in regional, sub-regional and neighbourhood shopping centres. This study found the average rent on renewal was only 2.2% higher than the rent under the old lease. It also found that in 22% of lease renewals the new rent was less than the old rent and in 6% of renewals the new rent was the same as the old rent. The report noted that this "does not support a view that landlords are charging excessive rents when leases expire."

5.1.2 Rents are the product of market forces

These outcomes are not surprising since retail tenancy rents are the product of market forces. They are the result of a good faith negotiation between a willing seller (of retail space) and a willing buyer (of retail space). The outcome of that negotiation is determined by the forces of supply (of retail space) and demand (for retail space). Developments on both the supply side and the demand side of this equation have an impact on rents. We consider below the impact of changes in the supply and demand for retail space on market rents.

5.1.3 Competition among landlords to fill expanding retail space

In times of local oversupply of retail space - for example, after the opening of new shopping centres, or the opening of other new retail property formats, or after redevelopments and extensions of existing shopping centres – there is significant downward pressure on rents as landlords seek to retain retail tenants in the face of competition from other landlords seeking to attract retailers to lease the new space. An example of this was the opening of the new Westfield

[47] *Retail Tenancies Legislation – Data Report,* April 2001, Jebb Holland Dimasi
[48] *Western Australian Retail Tenancies Review, Industry Structure and Lease Renewal Patterns,* December 2002 JHD Advisors

Bondi Junction in Sydney in 2004. This had a significant impact on surrounding retail areas such as Oxford Street and Double Bay which had some of the highest retail rents in the country. Retail landlords in those areas, faced with rising vacancies, had to respond by substantially cutting rents to retain tenants and replace departing tenants. This will in turn place pressure on rents at Westfield Bondi Junction as leases come up for renewal in that centre.

The independent study in 2002 in Western Australia (referred to above) found significant competition among shopping centres to attract retailers to fill space as shopping centres were redeveloped and expanded. The report found that the amount of retail floor space in all shopping centres in WA increased from 1.031 million sqm in 1991-92 to 1.366 million sqm in 2000-01. This is an increase of 335,000 sqm in 9 years or an average increase of 37,000 sqm every year. This is the equivalent of landlords having to find an additional 370 speciality tenants each year, while at the same time holding on to their existing tenants. This is not an easy task. As the JHD Report noted: "In fact, as suburban shopping centres constantly expand, and as new centres are being constructed, it is a significant task for landlords to fully lease centres."

These figures relate only to increases in shopping centre retail floor space. At the same time there has been a constant expansion of other forms of retailing, such as CBD retailing, strip retailing, retail outlet centres and bulky goods retailing, and these are also competing with shopping centres for tenants. The JHD Report shows that floor space in these other retail property formats increased by 255,000 sqm over this same 9-year period or an average increase of 28,300 sqm a year. This is the equivalent of finding an additional 280 speciality retail tenants a year. In other words, taking into account all new retail space, WA landlords over this 9-year period had to find the equivalent of 630 new speciality retailers *every year* to lease the new retail space created.

Western Australia is not unusual in having a constantly growing supply of shopping centre floor space. The study by Jebb Holland Dimasi in Victoria in 2001 (also referred to above) found the amount of retail floor space in shopping centres in Victoria increased from 1.838 million sqm in 1991-1992 to 2.356 million sqm in 1999-2000. This increase of 28% in 8 years, or an average of 3.2% a year, is the equivalent of building an additional medium-sized regional shopping centre in Victoria every year. In other words it is the equivalent of finding an additional 375 specialty retail tenants every year. As the report noted: "It is no easy task to find tenants every year for 375 new shops."

Once again this relates only to shopping centre floor space. Over the same period the amount of retail space outside shopping centres (excluding freestanding supermarkets) increased by 627,000 sqm or by 11%. This is the equivalent of finding an additional 780 retail tenants *each year*. In other words, over this 8-year period, the equivalent of more than 1,100 speciality shops became available *each year*. Again this gives some indication of the difficult task facing retail property owners in finding new tenants while still holding on to existing tenants.

5.1.4 Competition between landlords gives bargaining strength to tenants

This constant increase in the supply of retail space for lease, intense competition for tenants between individual shopping centres and between shopping centres and other retail property formats, has delivered significant bargaining strength to retail tenants. In these circumstances it is not surprising that the JHD Report shows occupancy cost ratios (i.e. rent and centre outgoings as a percentage of turnover) in WA shopping centres over the same period – although they varied substantially from year to year and in some years they fell – had not increased substantially. The JHD Report noted: "As regional and sub-regional centres, in particular, expand, new additional specialty floor space is normally added to the centre. New space is frequently leased at lower rentals than existing space in keeping with market forces which determine sustainable rental levels. . . .The small changes in average rent levels confirms the view that it is a significant task to fully occupy managed shopping centres in Western Australia."

Similarly the Jebb Holland Dimasi study of Victorian shopping centres[49] found that over the period of the study occupancy cost ratios for speciality retailers in regional shopping centres had declined from 15.2% in 1995-96 to 14.2% in 1999-2000; those in sub-regional centres had fallen from 12.8% to 11.9% and those in neighbourhood centres had fallen from 10.7% to 10.1%.

Table 1: Specialty Shop Occupancy Cost Ratios, Victorian Shopping Centres[50]

	95/96 %	96/97 %	97/98 %	98/99 %	99/00 %
Regional Shopping Centres	15.2	15.5	14.6	14.5	14.2
Sub-Regional Centres	12.8	13.1	12.5	12.1	11.9
Neighbourhood Centres	10.7	10.4	10.3	10.4	10.1

The authors noted: "Again, the rate of expansion of regional shopping centres over this period has been a factor in this situation with extensive new areas of retail space requiring to be leased as centres have expanded. Similarly in sub-regional centres occupancy costs are 11.9%, a proportion of turnover which has declined from 12.8% in 1996 as new centres have been constructed and existing centres extended. Similar patterns have applied in supermarket based centres."

[49] Previously cited, pp 37-38.
[50] Ibid.

5.1.5 Growth in shopping centre floorspace over the last six years

This rate of increase in shopping centre retail floorspace has continued over the last six years. Between 2000 and 2006, the total amount of floorspace in regional, sub-regional and neighbourhood shopping centres increased by 3,407,000 sqm, or an average increase of 568,000 sqm each year[51]. The amount of floorspace in regional shopping centres increased by 381,000 sqm over this period; the amount of floorspace in sub-regional shopping centres increased by 1,613,000 sqm; and the amount of floorspace in neighbourhood shopping centres increased by 1,413,000 sqm.

This is the equivalent of adding 5,680 speciality retail tenants to Australian shopping centres *each year* for the last six years. And this does not take into account the retail space which was added outside shopping centres in strips centres, retail outlet centres, city centres, high streets and bulky goods centres. Once again this gives an idea of the leasing challenge facing shopping centre owners as they seek to entice tenants for this new space as well as holding on to their existing tenants.

5.1.6 Has the supply of retail floorspace dried up?

Is there any reason to believe this continual expansion of retail space has come to an end? It is unlikely. If we consider shopping centres alone, most of the major owners have either announced significant redevelopment programs and/or have major redevelopments under way around Australia.

A recent report by Savills[52] has calculated that in the first quarter of 2007 a total of 1,109,000 sqm of retail space was under construction around Australia. Around 340,000 sqm of this space was being built in NSW and 330,000 sqm in Victoria.

This is the equivalent of more than 3,000 speciality stores being added to existing supply in each of those States and around 11,000 speciality stores being added around Australia. Once again it will be a significant challenge for retail property owners to find tenants for these shops.

5.1.7 Retail sales growth also impacts on rents

It is not only the supply side of the equation that impacts on retail rents. Developments on the demand side also have an impact.

In times of downturns in the retail industry - for example, as landlords confront the spectre of empty shops in their shopping centre and other retailers threaten to close their shops – there is downward pressure on rents. Retailers seeking to renew their leases are often in a position to demand lower rents or obtain incentives such as rent holidays or lessor contributions to fitout costs thereby lowering the effective rent.

---

[51] *Shopping Centres in Australia Vital Statistics* April 2001 Jebb Holland Dimasi; *Australian Shopping Centre Industry Information Update* March 2007 Urbis JHD.
[52] Savills Quarter Time – National Retail Q1/07.

During the downturn in retail sales in 2001, research by the Australian Retailers Association, although it was never made public, revealed that rents were also declining. In a letter to the *Australian Financial Review* on 7 June 2001, the then Chief Executive Officer of the ARA, Phil Naylor, noted that the ARA's own research showed "there are leasing deals being done in major shopping centres . . . that confirm rents are declining." It is not only the ARA that was aware of this fact. "*Rents come down all over the shop*" and "*Rent rise forecasts drop to zero in a hard retail climate*" are headlines from stories in *The Sydney Morning Herald* just a few months after Mr Naylor's comments.

Similarly, when retail sales are booming, retailers are more optimistic and look to open additional stores or to franchise their stores while other fledgling retailers seek to enter the market for the first time. This increases the demand for retail space and helps to bid up rents. The consistently strong growth in retail sales over the last five years has obviously led to upward pressures on market rents.

5.1.8 Vacancy rates in shopping centres

Despite the continuous growth in available space for lease in shopping centres over the last ten years, outlined above, this has been outstripped by the growth in demand for retail space. This has led to a compression of vacancy rates in all categories of shopping centres. This is shown in the following table (Table 2) which measures average vacancy rates across three centre types from a sample of shopping centres.

Table 2: Vacancy Rates in Shopping Centres[53]

Year	Total Centres	Regional Centres	Sub-Regional Centres	Neighbourhood Centres
1996	3.7%	2.6%	3.4%	7.6%
1997	4.3%	4.4%	2.8%	10.6%
1998	1.5%	1.2%	1.5%	3.7%
1999	2.0%	1.6%	2.0%	3.3%
2000	1.4%	0.8%	1.6%	3.6%
2001	1.8%	0.8%	2.2%	4.4%
2002	2.6%	1.5%	3.0%	7.0%
2003	2.3%	1.7%	2.3%	4.9%
2004	1.5%	0.5%	2.1%	3.3%
2005	1.0%	0.4%	1.4%	2.7%
2006	1.2%	0.9%	1.0%	3.1%

Not surprisingly, average vacancy rates vary from year to year, mainly reflecting the immediate impact of additional space coming on stream following redevelopments and the opening of new centres. However the average vacancy rate, for all shopping centres, has fallen from 3.7% in 1996 to 1.2% in 2006. In regional shopping centres and sub-regional shopping centres vacancy rates are now only around one-third of the rates they were 10 years ago and in neighbourhood centres they are less than half the rate they were 10

[53] Table supplied by Urbis July 2007. This is based on a sample of shopping centres.

years ago. This reflects the continuing growth in popularity of shopping centres by retailers attracted by the relatively high turnover, high pedestrian traffic rates and the other advantages of shopping centres. Despite the substantial growth in shopping centre floorspace over this time, an increasing proportion of retailers is seeking to locate in shopping centres.

5.1.9 Rents and occupancy costs over time

Despite this additional takeup in shopping centre floorspace the growth in rents in shopping centres has generally been in line with the growth of retailers' turnover. This has meant that average occupancy cost ratios, although varying from year to year, have generally been fairly stable. This can be seen from the following table (Table 3). The full table, from which this is derived, is Table 4.[54] The table below is inclusive of the marketing levy and includes GST.

Table 3: Occupancy Cost Ratios in Shopping Centres 2001-06

	00/01 %	01/02 %	02/03 %	03/04 %	04/05 %	05/06 %
Regional Shopping Centres						
All	16.0	16.1	16.1	15.6	15.9	16.2
Top 10	16.8	16.9	16.8	16.3	16.7	16.9
Sub-Regionals						
All	12.4	12.2	12.2	11.9	11.9	12.1
Double DDS[55]	13.9	13.6	13.4	13.0	12.9	12.8
Single DDS	11.7	11.5	11.4	11.3	11.2	11.7
Neighbourhoods						
All	11.0	10.9	11.0	11.4	11.3	11.8
Double supermarket	10.5	10.8	10.5	11.5	11.8	12.0
Single supermarket	11.1	10.8	11.2	11.3	11.1	11.6

Over the six years since the introduction of the GST, occupancy cost ratios have moved within a fairly narrow band. For regional shopping centres, the ratio is only fractionally higher (0.2 percentage points) in 2005-06 than it was five years earlier; for sub-regional centres it is fractionally lower (0.3 percentage points); and for neighbourhood centres it is less than one percentage point (0.8) higher. (It should be noted that a proportion of total occupancy costs – government taxes and statutory charges – are outside the control of the landlord.)

[54] Tables 3 and 4 need to be interpreted with some caution as there have been three distinct breaks in the series and this is shown by the shading in Table 4. The first occurred between 1999-00 and 2000-01 with the transition from the Wholesale Sales Tax to the GST. The second occurred between 2003-04 and 2004-05 with new uniform reporting guidelines adopted by the SCCA. The data has been recalculated to enable a comparative analysis but Urbis suggests it should be interpreted with caution.
[55] DDS – Discount Department Store.

TABLE 4 OCCUPANCY COST RATIOS, Source: Urbis Retail Averages

Occupancy Costs of Retail Specialty Shops

Including Marketing Levy	Financial Year									INCLUDING GST
Centre Type	96/97	97/98	98/99	99/00	00/01	01/02	02/03	03/04	04/05	05/06
Regional Centres										
All Regional Centres	-	14.9%	14.9%	14.4%	16.0%	16.1%	16.1%	15.6%	15.9%	16.2%
Top 10 Regional Centres	-	15.2%	15.3%	15.0%	16.8%	16.9%	16.8%	16.3%	16.7%	16.9%
Other Regional Centres	-	-	-	-	-	-	-	15.3%	15.6%	15.8%
DDS Based Centres										
All DDS Based Centres	-	12.1%	12.0%	11.8%	12.4%	12.2%	12.2%	11.9%	11.9%	12.1%
Double DDS Based Centres	-	13.0%	13.4%	12.9%	13.9%	13.6%	13.4%	13.0%	12.9%	12.8%
Single DDS Based Centres	-	-	11.1%	11.1%	11.7%	11.5%	11.4%	11.3%	11.2%	11.7%
Supermarket Centres										
All Supermarket Centres	-	10.7%	11.4%	10.9%	11.0%	10.9%	11.0%	11.4%	11.3%	11.8%
Double Supermarket Centres	-	-	-	10.6%	10.5%	10.8%	10.5%	11.5%	11.8%	12.0%
Single Supermarket Centres	-	-	-	10.7%	11.1%	10.8%	11.2%	11.3%	11.1%	11.6%

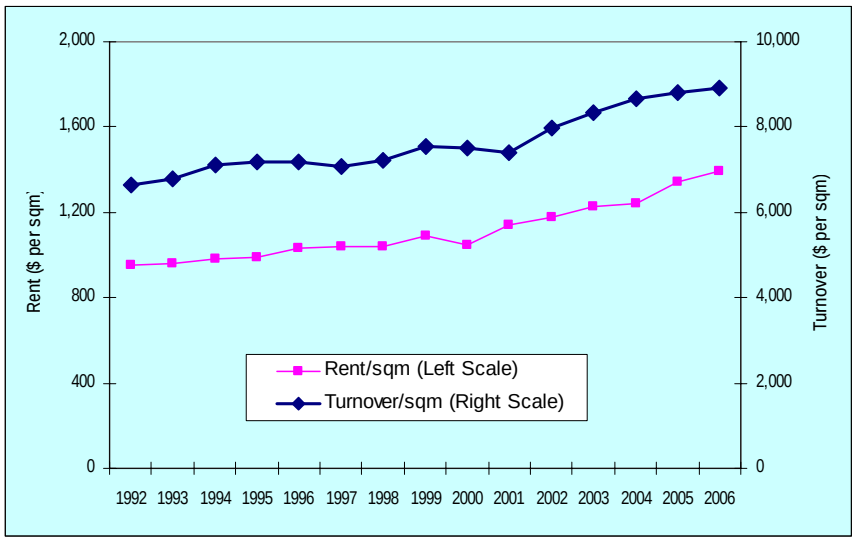
Occupancy Costs of Retail Specialty Shops

Excluding Marketing Levy										INCLUDING GST
Centre Type	96/97	97/98	98/99	99/00	00/01	01/02	02/03	03/04	04/05	05/06
Regional Centres										
All Regional Centres	14.7%	14.6%	14.4%	13.9%	15.4%	15.6%	15.5%	15.1%	15.2%	15.6%
Top 10 Regional Centres	15.3%	14.7%	14.8%	14.6%	16.2%	16.4%	16.2%	15.8%	16.1%	16.4%
Other Regional Centres	-	-	-	-	-	-	-	14.8%	14.9%	15.3%
DDS Based Centres										
All DDS Based Centres	11.9%	11.7%	11.6%	11.4%	12.0%	11.8%	11.8%	11.5%	11.5%	11.7%
Double DDS Based Centres	13.0%	12.6%	13.0%	12.6%	13.3%	13.1%	12.8%	12.5%	12.4%	12.4%
Single DDS Based Centres	-	-	10.8%	10.7%	11.3%	11.1%	11.0%	10.9%	10.8%	11.3%
Supermarket Centres										
All Supermarket Centres	10.5%	10.2%	10.7%	10.3%	10.4%	10.3%	10.6%	11.0%	10.9%	11.4%
Double Supermarket Centres	-	-	-	10.3%	10.1%	10.1%	10.1%	11.1%	11.4%	11.6%
Single Supermarket Centres	-	-	-	10.3%	10.6%	10.4%	10.9%	10.9%	10.7%	11.3%

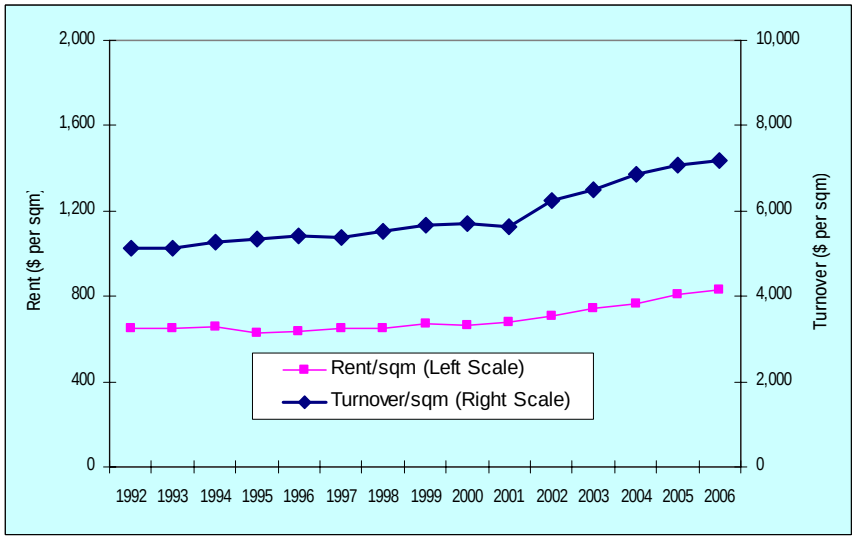
In other words, while average rents have obviously increased over the last five year years, they have not increased faster than sales over the same period, except for neighbourhood shopping centres where rents have increased only moderately faster than sales. There is no evidence, at a time when retail sales have been rising steadily, that landlords have been able to demand excessive rent increases.

This is also illustrated in the following graphs which track rent and turnover growth between 1992 and 2006 for both regional and sub-regional shopping centres. For regional shopping centres (Graph 1) the rate of growth in rents has largely 'tracked' the growth in turnover while for sub-regional shopping centres (Graph 2) the rate of growth in turnover has outstripped the growth in rents.

Graph 1: Rent and Turnover Growth – Regional Centres[56]



Graph 2: Rent and Turnover Growth – Sub-Regional Centres[57]



[56] Graph supplied by Mapinfo Dimasi, July 2007
[57] Graph supplied by Mapinfo Dimasi, July 2007

5.1.10 Geographical disparities in rents

The forces of supply of, and demand for, retail space can also lead to significant geographical disparities in rent, both between metropolitan and non-metropolitan areas, and within metropolitan areas. In some geographical areas, retailers compete very strongly with each other for positions in shopping centres (and in other retail property formats) because these areas are considered prime retail locations. In other areas, which are not such prime locations, the competition by retailers for tenancies is not as strong. In 'blue ribbon' suburbs, for example, where household disposable income is high, rents for retail property, including in shopping centres, tend to be higher than they are in suburbs where household disposable income is lower. In 'blue ribbon' areas, of course, it is not only retailers competing for space that helps drive up rents, the cost of land in these areas is generally higher which obviously also affects rent levels.

These market realities for retail space have close parallels in property markets generally. 'Location, location, location' manifests itself in various ways in various markets but all translate into a degree of market segmentation across a spectrum from 'prime space' to 'cheap and cheerful' space. No amount of regulation can really change these market realities, although they may (differentially) add to costs faced by landlords, tenants and ultimately consumers.

5.1.11 Stability of tenants in shopping centres

Some retailer associations have argued that shopping centre owners have been able to sustain significant rent increases in shopping centres by 'churning' their tenants (i.e. by replacing those tenants who can't or won't pay higher rents on lease renewal by those retailers keen to find tenancies in these centres). Quite apart from the commonsense objection to this argument that no shopping centre would deliberately seek to have a continual series of closures and empty shops, this argument assumes that there is always a ready supply of retailers willing to pay rents 'on hope' i.e. who are prepared to ignore their business plans and projections when negotiating initial rents in shopping centres.

The table below (Table 5) demonstrates that this has not been the case. This table shows, in any given year, the proportion of retailers who were in the same centre the previous year. This demonstrates that, in most years, 85% or more of the retailers in shopping centres were also in the centre the previous year. The stability rate in regional shopping centres has generally been higher each year than in the other categories of shopping centres.

Table 5: Stability of Tenants in Shopping Centres[58]

From Year	To Year	All Centres	Regional Centres	Sub-Regional Centres	Supermarket Centres
1996	1997	88.8%	89.6%	88.9%	85.3%
1997	1998	90.0%	91.0%	88.4%	83.4%
1998	1999	89.3%	91.2%	87.1%	85.3%
1999	2000	82.2%	85.6%	80.8%	69.3%
2000	2001	87.4%	88.4%	88.5%	81.6%
2001	2002	85.9%	87.1%	85.0%	85.3%
2002	2003	88.0%	88.4%	88.1%	87.8%
2003	2004	86.5%	89.7%	85.5%	81.7%

As the studies in the next section (*Term of Reference 6*) show, there are always tenants who decide not to renew a lease for reasons that have nothing to do with rents or lease conditions. When this is taken into account the table above shows that the turnover of tenants in shopping centres is remarkably low.

5.1.12 Very high rents on renewal

From time to time publicity is given to claims by tenants that rents on renewal have increased by very large amounts (sometimes in excess of 20%) and no doubt the Productivity Commission will receive examples of this in submissions from retailers. As the earlier data on the growth in occupancy cost ratios shows, however, these are unusual situations and there are generally good reasons why such rent increases have been sought. Most often it is because the tenant had previously been on a very favourable rent, well below prevailing market rents, a situation that the tenant knew was not going to continue.

This also occurs in the case of underperforming shopping centres which have recently been acquired by a new owner, often an institutional owner, who then spends a considerable amount of capital redeveloping and renovating the centre. Often the tenants in such centres have paid the same rent for a long period of time and annual sales growth has been minimal, reflecting the lack of capital spent on the centre and the absence of intensive management.

Even though in such cases rents are significantly increased on renewal, as the owner seeks a return on the additional capital invested in the centre, retailers' sales also increase as customers return to the rejuvenated centre. As a result the retailers' occupancy cost ratios (their rent and outgoings as a proportion of sales) tend to stay around the same level and, in some cases, decline. These situations are a 'win, win' situation for the owner and the retailer.

[58] Table supplied by Urbis. This data is only available until 2003. Prior to then the Retail Averages were calculated by Urbis based on tenant lists supplied by companies. After that date a new method of collection was adopted, in order to reduce administrative costs, and tenant lists were no longer supplied.

When retailers seek publicity for increased rents on renewal the other side of the story is rarely given. There was an example of this when the Discussion Paper of the Victorian Review of Retail Tenancies Legislation was released. It cited the example of a menswear retailer at a shopping centre in regional Victoria as an example of "significant rental increases arising from new leases" and claimed the rent had jumped from $53,337 to $101,588 on renewal. The SCCA was able to investigate this incident, because the centre was owned by one of our members and was managed by another. The facts turned out to be very different to those portrayed in the Discussion Paper and this was subsequently acknowledged by the Victorian Government.

The menswear tenant, occupying a tenancy with a frontage to the centre court, had commenced on a very favourable rent of $51,600 pa. Even with annual rent reviews this had only increased to $53,337 pa by the time the lease expired. This equated to $196 per sqm and, at that time, the average gross rent in the centre was around $500 per sqm, with centre court tenancies attracting even higher rents because of their prime position. The agent proposed a new rent of $101,588 for a new lease (which equated to $378 per sqm) which, given the premium location and the fact the previous rent was well below market, was considered very reasonable.

This was rejected by the tenant and the agent proposed a revised rent of $94,815 (or $350 per sqm) but this was again rejected by the tenant. At this stage the agent tested the market and received an offer of $105,000 from a toy retailer. This prompted a revised offer from the menswear retailer of $65,000.

After further negotiations the agent informed the menswear retailer that it proposed to accept the other offer but that it wanted to keep the menswear retailer in the centre. The agent suggested the menswear retailer investigate a more affordable site it had identified. After negotiations directly with the owner, the menswear retailer accepted the alternative site on an agreed rent of $53,337 (equivalent to $232 per sqm). The owner also granted a generous fitout allowance of $75,000 for the new site. The menswear retailer argued during negotiations over the new site that it expected its sales to fall by 10-15% in the new site. Although we obviously could not be given details of the retailer's sales figures the owner of the centre advised us that these fears had not materialised.

The outcome of these negotiations, far from being an example of a 'greedy' landlord, is an example of a sensible commercial negotiation in a retail tenancy market that is working efficiently. The landlord received a rent much closer to market rent for the site and the tenant was able to continue to trade in the centre and to still pay a rent below market rent.

5.2 OTHER ISSUES IN RENT DETERMINATION

5.2.1 Collective bargaining by small retailers

Last year the *Trade Practices Act* was amended to adopt new procedures for collective bargaining by small businesses with big business. These new procedures began operation on 1 January 2007. The ACCC has since embarked on a major advertising and education

campaign to ensure small businesses are aware of the new procedures.

The *Trade Practices Act* has always permitted collective bargaining but only after the ACCC gave authorisation after being satisfied that the public benefit would outweigh the harm constituted by any lessening of competition that would result. Small business organisations argued before the Dawson Inquiry[59] that the procedures for gaining authorisation were too slow and too costly. The Dawson Inquiry recommended new procedures to speed up the process and this recommendation has led to the new 'notification' provisions in the Act which enable small businesses to begin to collectively bargain one month after notifying the ACCC, unless the ACCC determines this is contrary to the public interest. The fee for notification has been reduced to $1,000 compared to $7,500 under the authorisation procedures.

Federal Government Ministers and the ACCC have both nominated shopping centres as an example of where they believe small businesses should take advantage of the new collective bargaining procedures. The SCCA did not oppose this change of procedure, although we have serious doubts that the ACCC can adequately assess the public benefit of such arrangements in just one month.[60]

5.2.2 Australian regional centres generate higher sales per square metre

As noted in an earlier section, a study by Michael Baker, former head of research for the International Council of Shopping Centers (ICSC), published by Urbis[61], found Australian regional shopping centres are 36% more productive than their US counterparts and 28% more productive than equivalent centres in Canada. Measured in US dollars, adjusted to standardise purchasing power parity among the three countries, Australian regional centres averaged sales of $5,845 per sqm; US centres averaged $4,284 and Canadian centres averaged $4,553.

The study identified three major factors to explain this discrepancy. The first is "the sheer weight of competition in the US market place", mainly deriving from the significant gap in retail space per capita between the USA (3.8 sqm) and Australia (2.1 sqm). The second is the discrepancy in store sizes. The much larger speciality store sizes in the US, compared to Australia, "are far more spacious for the shopper to move around in but cannot generate the same productivity as small shops selling comparable merchandise."

The third factor is "Australian regional centres offer a broader range of merchandise than their US counterparts and play a more central role in the day-to-day shopping needs of households." This stems from the fact that such centres in the USA usually do not include supermarkets or discount department stores. In addition, these

[59] *Review of the Competition Provisions of the Trade Practices Act* January 2003. See Section 7.
[60] The Dawson Inquiry recommended a period of only 14 days and the Government has said it will review the 28 day period after the first year of operation to see whether it should be reduced to 14 days.
[61] Urbis JHD *Retail Perspectives* February 2007.

centres have over time lost a range of merchandise categories, such as sporting goods, toys, consumer electronics, to big box retailers in non-regional centre locations. “Thus, while US centres have become more specialised and targeted, Australian centres still cover the merchandising waterfront and can legitimately claim to be one-stop shops for many households. This confers on them a destination appeal that US centres can’t mimic.”

5.2.3 The real occupancy costs of franchising

The Franchise Council of Australia (FCA) – which represents franchisors, not franchisees - has been a particular critic of late of shopping centre rents. There is a considerable element of self-interest on the part of franchisors in this criticism. While franchising has been a welcome development in Australian retailing, enabling many to enter retailing who might never have been able to do so, it does have one major downside for retailers. Because franchisees pay a franchise fee to their franchisors, usually based on a particular percentage of turnover, the real occupancy costs of franchised businesses is substantially higher than those of other retailers.

As an example, say an independent retailer in a shopping centre is paying an occupancy cost of 15%. That is, their rent and their proportion of centre outgoings, in this example, are 15% of their turnover. Consider now a franchisee, who is a competitor to this independent retailer, whose occupancy cost ratio is of the same order, i.e. 15%. In addition to that occupancy cost, however, this franchisee may be paying a franchise fee to their franchisor of 10% of turnover. This retailer’s real occupancy cost is therefore 25%. Therefore, all other things being equal, this franchisee has to achieve a significant *additional* sales volume (in this case, 66.5% more) in order to be in the same position as the independent retailer. While it is likely that the franchisee will have a lower cost base than the independent retailer, provided of course that he has a strong and reputable franchisor who is delivering the necessary support, it will still be a considerable sales struggle for the franchisee just to end up in the same position as the independent retailer. This will particularly be the case if the franchisee paid a substantial amount to purchase the franchise in the first place. It is reported that some franchisees have paid multiples of 400% to 500% of the average entry price for a successful franchise.

The FCA’s attitude to this dilemma appears to be to argue that landlords should reduce rents. In other words, its attitude seems to be that investors in retail property (primarily people saving for or living out their retirement) should accept a lesser return from their investment in order to subsidise franchisors’ business models and profits.

While the FCA is very voluble on the subject of rents and rent increases, arguing for additional regulation, it remains remarkably silent on the subject of the level of franchise fees and whether there is a need for regulation of these fees. It is also a strong opponent of legislation regulating the franchise-franchisee relationship, relying instead on a code of practice, which provides franchisees with nowhere near the same level of protection as lessees receive under retail tenancy legislation.

There is another dilemma confronting franchising. One of the most frequent topics of discussion among franchisors at the present time is the difficulty of finding good franchisees. It seems inevitable, therefore, than many of those who are now buying or establishing franchises, including retail franchises, will have difficulties in operating them profitably, particularly given the flaw in the franchising model noted above. Inevitably this will lead to claims by some franchisees that they went out of business because the rent was too high, rather than recognition that many of these did not have the skills or abilities to be entering retailing in the first place.

It is also the case that the explosion in franchising has been a major factor in bidding up the levels of rents, particularly in regional shopping centres. In order to establish the franchise, franchisors knew there were certain shopping centres and certain retail locations in which they had to have a presence if their business model was to be successful. They were prepared to pay very high rents to secure that presence. In doing so, of course, they were bidding up market rents.

If the franchise is successful, however, and the brand becomes very popular with customers, these franchisors then find they become highly prized tenants in shopping centres and other locations and are actively pursued by shopping centre landlords. This means the bargaining power has now swung substantially in favour of the franchisor and they are able to successfully play one landlord off against another in lease negotiations.

5.2.4 Rents for major tenants compared to speciality tenants

From time to time public attention is drawn to the rents paid by major tenants in shopping centres compared to rents paid by speciality tenants. Although these major tenants pay very substantial amounts of rent in absolute dollar terms, when that rent is calculated on a per square metre basis it is often less than the rent paid by speciality stores on a similar per square metre basis.

Department stores, discount department stores and supermarkets occupy very large amounts of space in shopping centres. Take the example, once again, of Westfield Chermside (referred to in the *Introduction*). The two department stores in this centre each occupy more than 15,000 sqm; the two discount department stores occupy 7,791 sqm and 6,721 sqm, respectively; the three supermarkets each occupy around 4,000 sqm. The speciality retail shops in the centre, however, average around 100 sqm.

It is not surprising that the rent paid by these major retailers, when expressed in dollars per square metre, is less than that paid by speciality retailers. Incidentally this is not only true of shopping centres. Major tenants occupying large space in office buildings are able to negotiate a lower rent per square metre than small tenants in the same building. These sorts of 'economies of scale' are very common in business anywhere.

There is no law, however, that says department stores, discount department stores or supermarkets must locate in shopping centres. Many of these retail formats operate from free-standing stores outside shopping centres. Indeed, without a pre-commitment from a

major retailer to lease space, investors contemplating new shopping centres would find such projects too risky to undertake. (Again, such pre-commitments from prospective tenants for large proposed buildings are not unique to the retail property sector).

For this reason these major retailers are usually referred to as 'anchor tenants'. In order to gain commitments from these 'anchor tenants' to lease space in shopping centres, rather than opening a store elsewhere, shopping centre owners or developers have to offer a rent that is competitive to the costs or rents the anchor tenant would face in establishing in alternative locations. This is always a long and protracted negotiation between the owner and the anchor tenant. (In recent months, for example, we have seen one of the two department store chains announce they were closing stores in two major shopping centres in Sydney because they would not pay the rent the owner sought for a new lease.)

The most important point, however, is that these major retailers are the main draw cards in shopping centres and the speciality retailers profit from the pedestrian traffic they generate. That is why so many speciality retailers seek space in shopping centres rather than in, say, strip locations. Once again there is no law forcing speciality retailers to do so. Specialty retailers seek locations in shopping centres because, among other things, they want to take advantage of the customer pulling power of the major retailers. The statistical evidence indicates the superiority of such locations in terms of turnover achieved – both gross and net of rent and other occupancy costs.

Most retailers understand this economic fact. A recent article by an adviser to small retailers, for *Inside Retailing* online[62], makes the same point: "*There is a very good reason that Woolworths [per square metre] rent is lower. It's pulling power. The number one determinant in supermarket shopping market share is location. Woolworths can (and does) self develop mini-centres in local areas or stand alone supermarkets at very low cost. Landlords actually have to price rent to lure them into their centres as – unlike many speciality retailers like butchers – Woolworths pulls foot traffic to wherever it locates. The other retailers around Woolworths pay for the right to exploit the foot traffic generated by the retail 'anchors' like Woolworths. The rent is higher for this very reason and – just like Woolworths – any retailer has the choice to locate somewhere else where the rent is cheaper."*

Obviously landlords would love to charge the same rent per square metre for the anchors as they do for speciality retailers but, if they did, they would not have any anchor tenants and the specialities would have far fewer customers and the shopping centre would struggle to survive. (In reality, as noted above, without an anchor tenant the shopping centre would not be built.) And if landlords charged the speciality retailers the same rent per square metre that they charge the anchor tenants then the shopping centre would be uneconomic and would be forced to close. In both cases the ultimate losers would be the speciality retailers. That's why this argument,

[62] Peter James Ryan 'Red Flag' *Inside Retailing* Online, 26 April 2007

with its implication that speciality retailers are actually subsidising the rent of the major retailers, is such a circular one and ultimately leads nowhere.

5.2.5 Rents in Australia compared to the USA

A similar 'phoney debate' has occurred recently with claims that retail rents paid by speciality tenants in US shopping centres are lower than those in Australia, again calculated on a per square metre basis. Speciality stores in Australian shopping centres, as noted earlier, are usually only around 100 sqm. In the US, speciality stores are rarely less than 200 sqm and are usually around 400 sqm or more. Because they occupy so much more space the US speciality retailers' rent per square metre (or, to be more accurate, their rent per square foot converted into square metres) is less than that of Australian speciality retailers.

There is also another reason why rents in the United States are lower than they are in Australia. The US has vastly more retail space per capita available for lease than Australia, both inside and outside shopping centres. Urbis[63] has calculated that the US is home to approximately 1.8 sqm of shopping centre space per capita compared to only 0.8 sqm per capita in Australia. (In total, the US has around 3.7 sqm of retail space per capita compared to around 2.1 sqm per capita in Australia.) Not surprisingly, given that rents are a function of supply and demand, the much greater amount of retail space available for lease in the US compared to Australia means rents are generally lower there than they are here - both inside and outside shopping centres.

Incidentally the total occupancy costs paid by speciality retailers in US shopping centres are not very different to those paid in Australian centres. Because US specialties occupy a much larger floorspace, they also pay a much higher proportion of shopping centre outgoings (known in the US as common area maintenance costs), so the difference in total occupancy costs for speciality retailers between the two countries is not as great as the differential in rents suggests.

Also, as pointed out earlier, Australian regional shopping centres generate much higher sales per square metre than those in the USA.[64] A comparison of sales per square metre (excluding anchor tenants) found Australian regional shopping centres were 36% more productive than their US counterparts. While the differences in average floorspace and the availability of retail space between the two countries are also a factor in this differential, it is also the case that Australian shopping centres are more productive because of the wider range of merchandise available in Australian shopping centres.

[63] Urbis JHD Research *El Dorado or Boot Hill?* Geoffrey Booth and Michael Baker 2006 pp. 23-24
[64] Urbis JHD *Retail Perspectives* February 2007 previously cited.

6. TERM OF REFERENCE 6.

The appropriateness and transparency of provisions in retail leases to determine rights when the lease ends.

A lease is an agreement by the owner of a property (lessor) and a tenant (lessee) for the use of the property for an agreed purpose, on agreed conditions, for an agreed term at an agreed price. A lease, like any other contract, has a finite life and imparts no ongoing right of occupancy.

Retail tenancy legislation in Australia has generally recognised that principle. This has been a matter which has been considered during the introduction of retail tenancy legislation in all States and Territories, and during the many reviews of this legislation over the past 20 years. In every case the Government of the State or Territory has declined to impose a continued right of occupancy when the lease has expired. (However preferential rights of renewal of retail leases in South Australia and the ACT were imposed by Opposition and minor parties in the Parliaments of that State and Territory against the wishes of the Government of the day.)

6.1 Full Disclosure and End of Lease Notification

Retail tenancy legislation generally imposes two conditions on lessors in relation to their obligations at the end of a lease.

First, it insists on full disclosure of the term of the lease before a tenant signs a lease. The disclosure statement given to the lessee by the lessor sets out the lease start date and the lease end date and, in those States which stipulate a minimum five year lease, it draws attention to this provision and the lessee's rights in the event that the lessee seeks a term of less than five years. In some States the lessor is also required to provide the lessee with a copy of a retail tenancy guide as soon as they commence negotiations on a lease. The *NSW Retail Tenant's Guide*, for example, has a special section on "the lease period".

Second, in most States and Territories, the lessor is obliged between 6 and 12 months before the expiry of the lease to inform the lessee of their intentions in relation to a renewal of the lease (see, for example, section 64 of the Victorian *Retail Leases Act* and section 44 of the NSW *Retail Leases Act*). If the lessor proposes to offer the lessee a renewal, this notification must contain advice about the terms of the new lease, including the rent. If the lessor does not propose to offer a new lease, this advice must also be given to the tenant. The legislation also imposes consequences on the lessor if this notification is not given during the time period specified. The purpose of these 'end of lease notification' provisions is to ensure that there is sufficient time for the lessor and the lessee to negotiate the terms and conditions of the new lease and also, if those negotiations are not successful, to ensure that the lessee has sufficient time to make alternative arrangements for their business.

In addition, although this is not common in many of the larger shopping centres, tenants can achieve greater security for themselves by negotiating leases for terms longer than five years. If the owner agrees, this is a fair way of gaining additional security of tenure since it involves the retailer taking on a share of the property risk.

6.2 'Security of tenure' provisions

Some retailer associations have argued for so-called 'security of tenure' provisions for retailers at the end of a lease, although many individual retailers do not support these provisions. These have included automatic right of renewal of leases, preferential right of renewal of leases', 'third party' rent setting or compensation for non-renewal of leases.

Providing an existing tenant with a 'right' to a new lease in the currently leased premises at the end of the lease term raises a number of fundamental concerns. The main concerns are that this 'right':

- would provide tenants with the benefits of freehold title but without the cost and risk of freehold title, which is fundamentally unfair and undermines long accepted principles of property ownership;
- is based on the misconception that it is always the tenant who is in a disadvantageous bargaining position at the end of the lease;
- would seriously impede a shopping centre manager's ability to successfully manage the centre, to the detriment of the owner/investors and the tenants;
- limits competition by restricting the entry of new retail tenants to the market which will inevitably discriminate against small retail tenants;
- reduces the value of property assets and therefore of property investments;
- over time, will constitute a deterrent to new investment in shopping centres, with possible adverse effects on retail rents generally as, in effect, demand pressure against more limited supply allows investors to 'price in' the additional risks and costs associated with granting such 'rights'.

It is useful, before considering these concerns in more detail, to begin by asking the basic question: why do retailers choose to rent a shop rather than buy a shop? Intuitively a retailer would prefer to hold freehold rather than leasehold over their shop. After all, a retailer who purchases their own shop will not have to worry about whether their lease will be renewed or worry about what level of rent they will have to pay in the renewed lease.

A retailer who rents a shop, however, finds there are significant advantages in leasehold over freehold which can outweigh the lack of security of tenure inherent in leasehold. These are demonstrated in the table below.

Table 6 – Owner Retailer v. Tenant Retailers

	Capital outlay required	Risk being carried	Advantages	Disadvantages
Owner retailer	• purchase of shop • fit out of shop • business set up costs	• property risk • retailing risk	• security of tenure • no rent	• greater capital outlay • more capital at risk • unable to easily change locations
Tenant retailer (shopping strip)	• fit out of shop • business set up costs	• retailing risk	• less capital outlay • less capital at risk • greater mobility • lower rent	• no security of tenure beyond term of lease • lower turnover
Tenant retailer (shopping centre)	• fit out of shop • business set up costs	• retailing risk	• less capital outlay • less capital at risk • greater mobility • higher turnover	• no security of tenure beyond term of lease • higher rents

6.3 Tenant retailer compared to owner retailer

The table above compares the position of the owner retailer and the tenant retailer (both in a shopping strip and a shopping centre).

A tenant retailer has to find the capital to launch the business (or purchase the franchise), and also to fit out the shop, but he does not have to find additional capital (or go further into debt and pay the ongoing interest on that debt) in order to purchase the shop. The tenant retailer, therefore, obviously has a much smaller capital outlay and much less capital at risk than an owner retailer.

The tenant retailer also carries no property risk. Like an owner retailer he still carries the risk that his business plan will not be successful. If it is not successful that is the limit of the tenant retailer's loss. He does not also carry the risk that property values will fall. That risk is being carried entirely by the owner of the shop or by the owner of the shopping centre. In the case of a shopping centre, the owner of the centre has to find the capital to build, extend and refurbish the centre.

Property risk is a very real risk. In the late 1980s and early 1990s, for example, shopping centre values were savagely slashed by the market and investment returns plummeted. Many owners went broke and shopping centres were sold off in a fire sale. The retailers in those shopping centres, however, generally survived. They did so largely because they were not carrying the property risk and did not have to service the debt on heavily mortgaged property that had now declined substantially in value.

Leasehold also gives the tenant retailer greater flexibility. While the tenant retailer does not have security of tenure beyond the term of his lease, he has absolute security of tenure for the term of the lease and on the conditions he has negotiated. Just as importantly, he does not find himself anchored to that location (for longer than the period of the lease) and if the location turns out to be a poor one for his retail offer he can relocate to another centre or to another retail location at greater convenience.

By purchasing a shop the owner retailer is anchored to that location or at least is exposed to the risk that, if he decides to move, any attempt to sell the shop will be (during poor trading periods) difficult to do. If the location turns out to be unsuitable, it is not easy to move locations. He has to find a buyer for his retail business (not an easy task if it is in a poor retail location) or, if he can't sell the business as a going concern, he has to find a buyer for the shop (which also might not be easy if it is a poor location for retail). Even if he finds a buyer for the business, or just the shop, it is unlikely that he will be able to recoup the money he spent in fixtures and fittings setting up his retail business.

For the owner of the shop or shopping centre to accept the property risk he has to anticipate that he will get a reasonable return on this capital. One person's rent is another person's income. So often in the retail tenancy debate the interests of the owner of the rented shop or the investor in the shopping centre are completely overlooked.

In the case of most shopping centres the capital to buy or build the centre, and to redevelop it, is usually provided by superannuation funds, life insurance funds, property trusts, property syndicates, and other property investment vehicles. These owners are generally ordinary investors who are saving for (or living out) their retirement and need to receive a reasonable rate of return on their capital. If they don't then they (or more likely their financial advisers) will seek to invest their money where the returns are better, such as in other forms of property, equities, fixed interest or private capital. Reduced investment in shopping centres would obviously not be in the interests of shopping centre owners, managers, retailers or customers. For retailers and customers, costs and prices would rise.

6.4 'Security of tenure' provisions are unfair

The argument for greater 'security of tenure' for tenant retailers is essentially an argument for having it both ways: gaining the relative security that comes from property ownership without taking on the cost or any of the property risk. That is why these measures are fundamentally unfair. Such measures increase the property risk for the owner because they diminish the return to the owner for carrying the property risk or they increase the risk of having to retain under-performing retailers.

Such measures also place retail property at an unfair disadvantage compared to other property classes. Why should a small retailer (not to mention a large business, such as national retailing chain) gain an advantage such as security of tenure beyond the period of the lease when this advantage is not available to other small businesses, such as an accountant or a solicitor in sole practice in an office building?

6.5 'Security of tenure' provisions are unnecessary

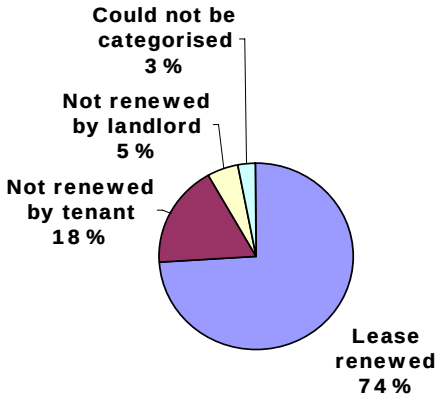
Measures designed to increase a retail tenant's security of tenure are also unnecessary because, as noted below, the vast majority of tenants (in excess of 80%) who have observed the terms and conditions of their lease and whose retail offer is still relevant to the customer base of that centre, do gain a new lease.

The SCCA has commissioned two independent reviews of lease renewals in shopping centres to accompany submissions in retail tenancy reviews and has also conducted its own review of lease renewals in the four major shopping centres in the ACT. The first independent study was by Jebb Holland Dimasi of Victorian shopping centres in 2000.[65]The second independent study was by JHD Advisors in Western Australia in 2001 and 2002.[66]

The survey of 17 Victorian shopping centres (representing around 70% of tenancies in regional and sub-regional shopping centres) found that of the 3,825 retail leases in the sample, 423 leases expired that year (11.1% of the total). Of the 423 expired leases, 314 (74%) were replaced by a new lease. Of the 109 leases that were not renewed, the majority (77) were not renewed at the instigation of the tenant, 20 were not renewed at the instigation of the landlord and 12 others could not be categorised.

Of the tenant-instigated non-renewals, seven tenants chose to vacate for retirement or personal reasons; 48 chose to vacate because their shops were not sufficiently profitable; five because the rent was too high or the lease conditions too onerous; nine were insolvent; and eight vacated for reasons unrelated to the lease. Of the 20 landlord-instigated non-renewals, 17 were due to centre redevelopments; one was because the tenant had not met the lease terms; and two were because the lessor needed to change the tenancy mix. This study showed that the vast majority of tenants in Victorian shopping centres (more than 90%) were not at serious risk of losing their business at the end of the lease.

Chart 1: Lease Renewals - Victoria 2000



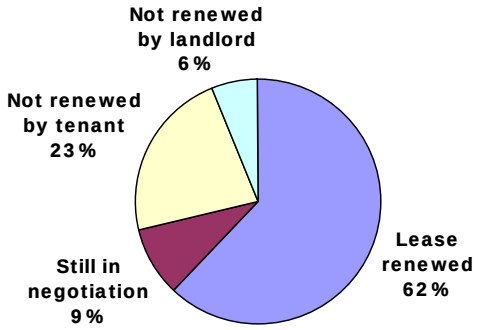
[65] *Retail Tenancies Legislation – Data Report* – April 2001, Jebb Holland Dimasi

[66] *Western Australian Retail Tenancies Review, Industry Structure and Lease Renewal Patterns*, December 2002, JHD Advisors

The survey of 18 shopping centres in WA (representing around 40% of all tenancies in WA shopping centres) found that of the 339 leases that had expired in 2001 and 2002, 211 (62%) had been renewed and another 29 (9%) were in 'holdover' (i.e. were still in lease renewal negotiations at the time of the survey.) Of the remaining 99 (29%) leases that were not renewed, 77 (23%) were not renewed because the tenant chose to vacate and only 22 (6%) were not renewed because the landlord did not offer a new lease.

Of the 77 tenant-initiated non-renewal of leases only four were not renewed because the rent was too high or because other lease conditions were too onerous. Of the 22 landlord-initiated non-renewal of leases, one was because the tenant's trading was unsatisfactory, one was because the tenant's standard of presentation of merchandising was unsatisfactory, one was because the tenant had not met lease provisions, four were because of tenancy mix issues and three were because of forthcoming centre redevelopments. (The importance of occasional adjustments to tenancy mix is spelt out in *Term of Reference 1*). Another 12 were for reasons that could not be categorised.

Chart 2: Lease Renewals - WA 2001 & 2002



As the JHD Report noted: "The overall conclusion from the analysis of reasons why leases were not renewed is that the majority of leases were not renewed at the instigation of tenants. Within that group, business failures or changes to company structures accounted for the majority of non-renewals. The number of landlord-initiated non-renewals was relatively small, and within that group, the number of leases that were not renewed because of the unsatisfactory performance of tenants was also very small."

In 2005, at the request of the ACT Government, the SCCA conducted its own survey of lease renewals at the four major shopping centres in Canberra - Canberra Centre, Westfield Belconnen, Westfield Woden and Centro Tuggeranong. This survey found that of the 180 leases that expired in 2004, 161 were renewed (89%), with a further six leases still in negotiation at the time of the study. Of the 13 leases that were not renewed (7%), 11 tenants chose not to renew for a variety of reasons (such as retirement, moving to another centre or location, business difficulties). Only two leases (1%) were not renewed at the instigation of the landlord (and these were for

tenancy mix reasons). Of the 117 leases that expired in 2003, 99 were renewed (85%) and 18 were not renewed (15%). Only three leases (3%) were not renewed at the instigation of the landlord and these were for tenancy mix reasons.

It should be noted that this very high proportion of renewals in the ACT occurred before the preferential right of renewal of leases provisions of the *Leases (Commercial and Retail) Act 2001* came in to effect – which will mainly be for leases which expire after June 2007. This demonstrates how unnecessary were these changes to lease renewal procedures. Regrettably these changes will now make it increasingly difficult for Canberra shopping centres to ensure that their retail offer is constantly up to date and reflects the desire of their customer base. This can only be to the detriment of all retailers in the centres.

(It should be noted that it is still too soon to assess what impact this legislative change will have on shopping centres in Canberra.)

6.6 'Security of tenure' provisions threaten viability

Measures designed to increase a retail tenant's security of tenure simply cannot be imposed without cost. They are destructive of the vitality of shopping centres and are therefore harmful to the ongoing viability of those centres.

While, as outlined above, the number of leases not renewed at the landlord's initiative is relatively small, it is vital that landlords retain the discretion and flexibility not to renew leases. Shopping centres are vibrant and complex things. They must remain relevant to the constantly changing tastes of their customers. They must have broad cross-sectional appeal for all customers from young people to mature aged persons. They also have to constantly adapt to demographic changes in their catchment areas.

If a shopping centre doesn't maintain an appeal to all of its customers (i.e. have the right 'tenancy mix') it will lose customers and stagnate. (This was outlined in *Term of Reference 1*.) That will be to the detriment of its tenants as much as its owners. Occasional changes to the tenancy mix of shopping centres, as well as fairly regular redevelopments, are therefore a very necessary fact of life in a shopping centre. Management of the tenancy mix is a constant and evolving process designed to maximise the customer pulling power of the centre for the benefit of all retailers. An automatic or preferential right of refusal undermines the capacity of centre management to undertake this necessary fine-tuning of a shopping centre. Retailers who choose to locate in a shopping centre because of its attractiveness to customers must accept this fact.

At the heart of arguments for measures such as first right of refusal for sitting tenants is the idea that landlords capriciously refuse to renew leases. This is nonsense. It would be an irrational act for a landlord to drive out of his shopping centre a well-performing tenant whose retail offer is still relevant and attractive to customers and who has observed his obligations under the lease. This is because there is always a real risk that that retail space cannot be re-leased or be re-leased quickly. Automatic rights of renewal and similar measures become, almost by definition, protections for poorly

performing or poorly managed tenants. This is why good retailers distance themselves from calls by retailer associations for such measures. These retailers know that the retention of poorly-performing tenants drives down the overall quality of a shopping centre causing it to lose drawing power among its customers. This will directly affect their own sales performance and could do so even more directly if customer traffic flow to their part of the centre is reduced.

6.7 'Security of tenure' provisions discriminate against small retailers

Such measures also, in the longer term, discriminate against small tenants. Security of tenure measures are likely to mean a greater propensity for owners to "play safe" and give preference to established retailers or state or national retail chains when seeking new tenants. Faced with a choice between an established retailer and someone seeking to set up in business for the first time, the lessor will be less likely to take a risk on the small retailer or would-be retailer.

Because these measures increase the property risk for owners they would then have to compensate by seeking to lower their overall risk when they take on a new tenant. They do this by seeking a higher rent at the outset and/or greater requirements for bank guarantees or personal guarantees from tenants. It is the small retailer, or would-be retailer, who ultimately suffers from the adoption of so-called 'security of tenure' measures. This perverse outcome is frequently the consequence of regulatory approaches seeking to reduce risks faced by one party. This is because those risks are not eliminated by the regulation; they are simply shifted elsewhere.

6.8 'Security of tenure' provisions are anti-competitive

National competition policy requires that legislation not restrict competition unless the public benefits outweigh the costs. There is no doubt that security of tenure measures are anti-competitive because they restrict the entry of new retailers into the market. In terms of the costs and benefits of security of tenure proposals, any benefits would obviously only accrue to those retail tenants who would not otherwise be offered a new lease by their shopping centre. The costs however, would be imposed on centre owners and managers, potential new retail tenants and, perhaps most importantly, shopping centre customers.

The costs imposed on centre managers and owners are significant. Essentially, they are the restrictions on the owner/manager's ability to successfully manage a centre and the reduction in the value of the property as a result of the limitations on its use. The costs are particularly high for potential new entrants to the retail market. If existing tenants are, effectively, given a lease in perpetuity, opportunities for new entrants to the industry are severely restricted. Competition is therefore diminished.

Shopping centre customers would also bear the cost because competition between retailers would be reduced. For example, there may be a potential new retail tenant who would be able to offer the same goods as an existing retailer in a centre but at a reduced price.

However, the customer would not be able to take advantage of this lower price unless the existing tenant decided to terminate the lease and leave the centre, allowing a lease to be granted to the new tenant.

6.9 'Security of tenure' provisions undermine property law and values

The law of property operating in Australia dates back centuries and provides the critical framework for a stable economy and society. Fundamental to property law are the different forms of land ownership – freehold, leasehold, strata, company title and so on - each distinguished by the rights that accrue to that title. While governments have sometimes legislated to marginally alter these rights and principles, they have been very wary of in any way undermining the stability and certainty of property laws and titles because of their importance to the effective functioning of society as a whole. Indeed, for this very reason, governments have been winding back old provisions that modified property laws, such as 'protected tenant' schemes which prohibited landlords from terminating the lease of certain residential tenants.

Freehold title provides a property owner with much greater rights over the use and disposal of their property than a leasehold title does, including providing security of tenure. For this reason, freehold title comes at a greater cost and with greater responsibilities than a leasehold title. Providing retail tenants with an automatic right to renew their lease undermines these principles. On one hand, it erodes the owner's freehold right to use their property as they wish; on the other, it provides leaseholders with a freehold right to security of tenure.

Moreover it should be recognised that by giving first time retail tenants a right to a minimum five-year lease term, as most retail tenancy legislation does, retail tenants are already provided with greater security of tenure than is enjoyed by any other type of tenant. A small commercial business in NSW operating out of an office building, for example, does not enjoy similar security by legislation.

In addition, government restrictions on an owner's freehold title arbitrarily diminish the value of the owner's property without any sound public policy reason for doing so.

6.10 'Security of tenure' provisions: the UK experience

The experience of the United Kingdom is sometimes cited by retailer associations when arguing for automatic rights of renewal. The *Landlord and Tenant Act 1954* (which applies only in England and Wales) provides for commercial leases to run for periods of 15 years and longer and with automatic right of renewal for the same length of time. However, these laws were introduced half a century ago and UK policy makers are now drawing away from this approach. Landlords and tenants can agree to opt out of the security of tenure provisions when the lease is negotiated and these 'opting out' provisions have recently been made much easier to achieve. There is concern that the long lease periods lock tenants in for the duration of the lease and owners can sue for rental loss if tenants withdraw

during the lease. It is highly doubtful if small tenants in Australia would commit to the obligations of a lease for 15 years or more.

It should also be noted that the UK does not have Australia's highly prescriptive retail tenancy legislation. Therefore, practices that are outlawed in Australia, such as 'upward only' rent reviews and charging tenants for all outgoings (not just in proportion to their lettable area), are permitted in the UK. Nor does the UK have compulsory disclosure provisions by landlords. As one retailer adviser has noted: "In one sense, it could be inferred the UK is way ahead of us in a few key aspects but way behind us in many others, more akin to the Wild West attitudes before Australian tenancy reform."[67]

To argue that UK 'security of tenure' provisions be imported to Australia, without acknowledging that the UK does not have Australia's extensive legislative protections for retail tenants, is an example of 'cherry picking'.

In terms of drawing on overseas shopping centre experience, the industry in Australia is more likely to look to the USA, Canada or New Zealand for relevant experience and in none of these countries is there automatic or preferential right of renewal of leases. Nor do these countries have retail tenancy legislation.

[67] Stephen Spring 'Springboard' Inside Retailing Online.

7. TERM OF REFERENCE 7.

Any measures to improve the overall transparency and competitiveness of the market for retail tenancy leases.

The SCCA has demonstrated in this submission that there is no evidence of significant failure of the retail tenancy market that requires correction. The market is, however, already heavily regulated and we are therefore loath to propose any additional regulation. Indeed, as a general view, Australia-wide harmonisation of state regulation based on a stream-lined model would be strongly preferred. The SCCA believes this type of initiative would be consistent with the Productivity Commission's recent report on red tape.

More specifically, we consider that there are a number of measures that governments could take to improve the transparency, efficiency and competitiveness of the retail tenancy market. We have identified the measures

below.

7.1 Efficiency and Competitiveness

One of the most frustrating and costly aspects of the present disparate systems of retail tenancy regulation is the lack of common documentation. National retailers and national retail property owners have to contend with eight different lessor and lessee disclosure statements, different forms in relation to assignments and so on.

The SCCA therefore recommends that the Australian Government, through the Council of Australian Governments (COAG), should encourage State and Territory Governments to standardise retail tenancy documentation, including the lessor's disclosure statement, the lessee's disclosure statement and the assignor's disclosure statement.

If this standardisation of retail documentation were successful, then the SCCA recommends that COAG should then pursue further measures to harmonise state and territory retail tenancy legislation.

A system of national regulation of retail tenancies should only be considered if such regulation is *in place of* not *in addition to* the present system of State and Territory regulation. We believe the only practical way in which a national, uniform system of regulation could be achieved is if the States and Territories agreed to surrender their powers to the Australian Government.

If the necessary political agreement could be achieved, the drafting of a Commonwealth Bill, to be negotiated with the States and Territories, in consultation with relevant stakeholders, would also present an opportunity to critically scrutinise existing regulation with a view to removing unnecessary regulation.

7.2 Transparency

The SCCA believes that a simple solution to address concerns that there is an imbalance in information at the end of a lease, because tenants do not have access to information about rents being paid by other tenants in a shopping centre, is to introduce mandatory registration of leases in those States which presently do not require it, namely Victoria, South Australia, Tasmania and Western Australia.

Registration would not involve significant additional costs and would ensure that rent information and other lease conditions would be publicly available around Australia.

8. OTHER ISSUES

8.1 The Reid Inquiry

In May 1997 a report of an inquiry by the House of Representatives Standing Committee on Industry, Science and Resources, titled *Finding a Balance: Towards Fair Trading in Australia*, was tabled in Parliament[68]. Although not an inquiry into the retail tenancy market, the report made a number of recommendations on retail tenancy matters. On 30 September 1997, the then Minister for Workplace Relations and Small Business, the Hon Peter Reith MP, announced in the House of Representatives the Federal Government's response to this report.

In recent times there have been claims in some quarters that the report's recommendations have been ignored[69]. This is simply not true. Certainly some recommendations were not adopted (see below) but in a number of areas the Government's response went further than the Committee had recommended, particularly in the area of effective enforcement of fair trading issues for small business by the ACCC. As a result of the Reid Report, the Australian Government:

- adopted a specific new provision in the *Trade Practices Act* dealing with unconscionable conduct (which, over subsequent years, has been 'drawn down' into State and Territory retail tenancy legislation);
- adopted a new provision in the *Trade Practices Act* allowing industry-designed codes of practice to be legally enforced and made mandatory under the Act and enforced as breaches of the Act;
- adopted a new provision to allow the ACCC to take representative actions on behalf of small business for misuse of market power by big business;
- appointed a commissioner with special responsibility for small business to the ACCC; and
- issued directions to the ACCC requiring the ACCC to enforce small business legal rights against unfair business conduct.

The Reid Committee also recommended the adoption of a Uniform Retail Tenancy Code, to be approved by the ACCC, "with a view to the adoption of uniform retail tenancy legislation around Australia." Unfortunately, the Reid Inquiry gave little thought as to how such a code would operate in practice, particularly given the existence of State retail tenancy legislation. In its response the Australian Government noted the existence of State and Territory regulation and the fact that the Australian Government "does not have a general constitutional power to regulate retail tenancies in a way that would cover all retail tenants and avoid legal complexity."

[68] This has become known as the Reid Report after its chairman, Mr Bruce Reid MP.
[69] Alan Jones interview with the Prime Minister, Radio 2GB, 1 June 2007

Instead, in December 1997, the Australian Government called a special meeting of State and Territory Ministers responsible for retail tenancy legislation to consider the Reid Report's recommendations. As a result of that meeting State and Territory Governments commenced a special series of reviews of their retail tenancy legislation to adopt an agreed legislative 'safety net' for retail tenants. This 'safety net' has been widened significantly in subsequent reviews of State and Territory retail tenancy legislation.

The legislative package of reforms announced by Mr Reith, which the Australian Government described as "Giving Small Business a Fair Go", was welcomed at the time by small business organisations. This Australian Government action came despite the Reid Report being a deeply flawed document. Access Economics, which was commissioned by the Property Council of Australia to examine the report, concluded: "The Committee's Report is found to pay scant regard for hard data on industry performance, to be internally inconsistent in its analysis of retail trade, to ignore adverse market reactions to its recommendations and, as a result, not to comply with key elements of its Terms of Reference."

We have **attached** to this submission this independent critique of the Reid Report by Access Economics in July 1997.