SHOPPING CENTRE

COUNCIL OF AUSTRALIA

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

A submission on the Productivity Commission's Draft Report
by
the Shopping Centre Council of Australia
February 2008

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INTRODUCTION

The Shopping Centre Council of Australia (SCCA) congratulates the Productivity Commission on the thoroughness of its investigation of the market for retail tenancy leases in Australia and its preparedness to consult with relevant parties.

We agree with the overall assessment of the Commission in its draft report released on 13 December 2007. In particular, we agree that:

- Overall the market for retail tenancy leases is operating reasonably effectively and that generally there is competition amongst landlords for tenants and amongst tenants for retail space;
- The case for greater prescription in retail tenancy legislation is weak;
- An alternative approach to the regulation of the market for retail tenancy leases is warranted and the alternative approach should maintain, where practicable, the features of the current system that are working well, such as dispute resolution and the provision and disclosure of information.
- The alternative approach should progressively unwind provisions in retail tenancy legislation in each State and Territory in areas that have sought to govern market behaviour; and
- There should be a move towards national consistency in retail tenancy legislation.

We support, with qualifications, the first four recommendations made by the Productivity Commission in its draft report and we address these in more detail in this submission. We do not believe the Commission has provided sufficient justification for the fifth recommendation and we have outlined our arguments in this submission.

The Commission noted, during the public hearings, that most of the complaints it received during the course of this inquiry related to shopping centres and, in particular, to 'large' shopping centres. Most of those complaints concerned end-of-lease issues. This is not surprising given the present 'tight' market for retail leases. As the graph (prepared by Jones Lang LaSalle) in section 5 demonstrates, the retail boom of the last seven years has seen vacancy rates in shopping centres driven down. (We also address in section 5 whether this is also an outcome of a shortage of retail space in shopping centres.) As the graph shows, the vacancy rate for shops in neighbourhood shopping centres in December 2001 was above 8%. In December 2007 this was below 3%. In sub-regional shopping centres, over the same period, the shop vacancy rate has nearly halved - from over 3% to below 2%; and it has also halved in regional shopping centres – from 2% to below 1%.

The pressure on market rents in large shopping centres has not only come from the supply side of the equation. The demand for retail

space in these shopping centres has also grown substantially. As Michael Baker, an international retail adviser, has recently noted: "Regional centres are among the best places for retailers in Australia. The regionals' 8.6% sales growth [in 2006-07] outperformed the overall retail sales increase of 6.4%, which shows the benefits of retail clustering, strong management and high-growth locations. . . Their large size, depth and breadth of merchandise assortment, complementary service/entertainment offerings, strong management, prime locations and proven capacity to evolve in tune with consumer preferences, makes them magnets for consumers and retail tenants alike."[1]

It is not surprising, in circumstances of falling vacancy rates and booming retail sales, that market rents have increased. This is not a case, however, of landlords extracting excessive rent increases. As we pointed out in our first submission, occupancy cost ratios in shopping centres (i.e. rent and outgoings as a proportion of sales) over the same period have not increased substantially. As noted in Table 4 of that submission (p. 54), the occupancy cost ratio for neighbourhood centres (i.e. supermarket-based centres) increased from 10.9% in 2001-02 to 11.6% in 2005-06; for sub-regional centres there has been little movement - 12.2% in 2001-02 and 12.1% in 2005-06; nor was there much movement for regional centres - 16.1% in 2001-02 and 16.2% in 2005-6.

As we noted in that submission, "while average rents have obviously increased over the last five 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." (p. 55).

We note that the Productivity Commission has found that Australia is unique in its adoption of a highly regulated retail lease market and that other countries, including New Zealand, have seen no need to regulate this market. In order to assist the Commission we have **attached** to this submission a "Report on Retail Tenancy Regulation in New Zealand and Australia." This report concludes that, despite the absence of retail tenancy legislation in New Zealand, there is no evidence that retail tenants in New Zealand are at any disadvantage compared to retail tenants in Australia. Indeed, the report concludes that the retail tenancy relationship in New Zealand is much less adversarial than it is in Australia and that retail tenancy disputes are unusual.

The question must be asked: why do retailers (many of them Australian retailers) in large New Zealand shopping centres (predominantly owned by Australian companies) survive and prosper without legislative protection while some Australian retailers in Australian shopping centres simply demand more and more legislative protection? We believe, as we noted in our first submission, that the existence of retail tenancy legislation has led to the development of a 'protectionist' or 'regulation' mindset amongst

[1] *ICSC Research Review Vol. 14, NO. 3, 2007, Michael Baker, Urbis*

many retailers and retailer associations. It has also encouraged a 'culture of complaint' which will have been apparent to the Productivity Commission during the public hearings.

Regulation begets more regulation. The automatic response of retailer associations to just about any issue that arises in the retail tenancy market in Australia today seems to be to demand more and more regulation. This is obvious from the submissions made to this inquiry by most retailer associations. The more prescriptive the regulation, however, the more it needs constant amendment to cover unforeseen circumstances until the market is so clogged with 'red tape' it becomes highly inefficient.

We have also, in this submission, addressed some issues in retail tenancy regulation that were raised during the public hearings conducted by the Productivity Commission in various cities between 1 February 2008 and 20 February 2008. Obviously we have not been able to address all of these matters in this submission by the due date of 22 February 2008 but will do so promptly over the next few weeks as transcripts become available.

We also note, during the course of the public hearings, that some retailers and retailer associations have made specific claims about bad treatment by landlords. As the Commission knows there are always two sides to such stories. Where possible we have referred these cases to relevant companies to investigate and to respond directly to the Commission.

Finally we would like to make an observation about the nature of this inquiry. This is summed up in a humorous exchange between Commissioner Byron and Mr Michael Lonie of the ARA at the public hearing in Sydney on 4 February 2008. Mr Byron painted a hypothetical situation of setting up a small retailing business and, following a quip from Mr Lonie, noted: "Well, I have to say, having read all the submissions, I'm a little bit dissuaded at the moment." (Transcript p.61.) Although a jocular exchange this raises a serious point. The Commission has received a very one-sided view of the retail tenancy market, particularly the shopping centre industry. It is the nature of these sorts of inquiries that they will present an opportunity for some retailers to complain about the terms of their lease or their alleged treatment at the hands of their landlord. The Commission should not lose sight of the fact that, on its own count, it has only heard from around 50-60 retailers. This is a very small number given that the Commission estimates there are around 290,000 retail leases in Australia. (On one occasion during the public hearings, on page 197, the Commissioner described '30,000-plus' retail shops as "a relatively small percentage". Fifty to sixty must therefore be described as 'infinitesimal'.) Nor should the Commission lose sight of the fact that the actual number of retail tenancy disputes is very small. Fewer than 1% of retail leases results in a dispute requiring referral to mechanisms established to settle such disputes and the vast majority of these disputes are settled by mediation.

The Commission has not heard from, and these sorts of inquiries will never hear from, the much larger number of retailers who just get on with it. The Commission has not heard from the successful retailers

who, having begun with just one shop, have built very large and successful retail chains, or have turned that single shop into a very successful franchise, mainly as a result of shrewd leasing deals with shopping centre landlords. The Commission has not heard from the many retailers who, having run into retailing difficulties, were able to survive because a shopping centre landlord was willing to take a risk, and provide incentives, promotional allowances and retailer assistance, to tide them through the bad times. The Commission has not heard from the many retailers who, having successfully built their retailing businesses, were able to sell those businesses for substantial amounts of money at an opportune time. These retailers will never tell their stories to the Commission because they have nothing to complain about.

Actually it's not correct to say that the Commission did not hear from such retailers. One of the earliest submissions to this inquiry (No. 20) was from a family of retailers who operate three takeaway food shops, two of which are in shopping centres. It is worth recalling the comments of these retailers who said their businesses "are doing well and we have no issues with any [of] our landlords." The retailers made the simple point that nobody had ever forced them to sign a lease. "We look at each opportunity to open a new shop on its merits and make our best assessment of how busy a particular location is likely to be, the amount of competition there is, the likely demand for our products, and whether or not the rent represents good value for money." In today's highly regulated retail tenancy environment, such an acknowledgment of individual responsibility is rare.

1. DRAFT RECOMMENDATION 1

The following measures should be pursued by State and Territory governments to further improve transparency and accessibility in the retail tenancy market.

- ***Enhance the use of simple language in all tenancy documentation and provide clear and obvious contact points for information on leases and dispute resolution.***
- ***Elaborate the significance of jurisdictional differences in the definition of unconscionable conduct and align definitions where practicable.***

1.1 Simple language in tenancy documentation

The SCCA supports measures that will improve the transparency and accessibility of retail tenancy documentation. A distinction needs to be made, however, between, on the one hand, material such as retail tenancy guides and disclosure statements and, on the other hand, legal documentation, such as leases.

In recent years, some state and territory governments have made a special effort to ensure the material they provide to inform retail tenants and retail landlords is presented in clear and simple language, and in languages other than English (in NSW these are Arabic, Chinese, Korean, Turkish and Vietnamese.) For example, in NSW, the Retail Tenancy Unit has substantially simplified the Lessor's and Lessee's Disclosure Statement and the Assignors' Disclosure Statement to ensure they can be easily understood, particularly by tenants. These simplified retail tenancy documents can be seen at www.retailtenancy.nsw.gov.au/staticsite/onlineforms. Particular care has also been taken in providing general retail tenancy information, such as the *Protecting Your Lease* package, in easily understood language.

We support the Productivity Commission's recommendation that all state and territory governments should review this information to ensure it is transparent and accessible to tenants and landlords.

The Productivity Commission has also suggested (Draft Finding 15) that lease transparency and disclosure could be improved through the use of simple language and a one page disclosure of key provisions and that this was likely to lead to further benefits by improving business understanding.

It is more difficult to apply the principles of transparency and accessibility to leases since these are, by their nature, more complex and legalistic. Given that the lease governs the detailed relationship between the landlord and the tenant, we do not consider it appropriate for governments to dictate lease language. We would also point out that the key provisions of the lease are usually set out in the letter of offer given by the landlord to the tenant.

Nevertheless it may be appropriate for landlords to review their standard leases to ensure they are as easy to understand as possible, particularly since retail tenancy legislation generally

requires that a copy of the draft lease be provided to the tenant once negotiations begin over a tenancy. We note, for example, that some years ago Lend Lease Retail revised its standard retail tenancy lease to ensure it was greatly simplified and expressed in simpler language and this lease is still in operation. The GPT Group, similarly, has a simplified 'plain English' lease.

1.2 Contact points for information on leases and dispute resolution

At the same time as state and territory governments are reviewing their documentation it would also be appropriate for them to investigate whether this information also provides clear contact points for information on leases and dispute resolution.

Once again we note that some governments have already given considerable attention to ensuring that these contact points are widely known and advertised among retailers and landlords. Staff of the Registry of Retail Leases in Queensland, for example, conduct special education/awareness campaigns and disseminate a range of educational material at functions such as trade fairs, conferences and seminars, as well as by other means. Registry staff travel on a regular basis throughout regional Queensland to perform this role.

1.3 Unconscionable Conduct

When negotiations first began on the replication of the unconscionable conduct provisions of the Trade Practices Act (section 51AC) in state and territory retail tenancy legislation, the SCCA and the Property Council of Australia warned that this could lead to differing provisions being introduced in the various states and territories. This warning became true almost immediately the 'draw downs' began. Differences in unconscionable conduct provisions have occurred in both the standard of judicial administration of unconscionable conduct provisions and differences in the unconscionable conduct provisions themselves.

As each state has 'drawn down' these provisions, they have gradually lessened the standard of judicial oversight of these provisions. In NSW, for example, it was originally stipulated that unconscionable conduct matters must be heard by a former Federal or Supreme Court judge in recognition of the fact that, under the Trade Practices Act, administration of unconscionable conduct matters is a matter for the Federal Court. In 2005, however, NSW amended these provisions so that such matters can now also be heard by a Deputy President of the Administrative Decisions Tribunal of NSW. In Victoria, unconscionable conduct matters are heard by the Victorian Civil and Administrative Tribunal, whose members have the status of judges. In Queensland, unconscionable conduct matters can be heard by the Retail Shop Leases Tribunal which means that non-lawyers are deliberating on such matters. In Western Australia such matters can be heard by non-judicial members of the State Administrative Tribunal.

Similarly, some states have not been able to resist 'fiddling' with the drafting of the unconscionable conduct provisions. While NSW and Queensland drew down the provisions in a form consistent with section 51AC, Victoria added three new items to the list of items

which, while not of themselves unconscionable, can be taken into account by tribunals in deciding whether or not conduct is unconscionable. The Victorian Government persisted in this variation despite being provided with legal advice that this would expand the concept of unconscionable conduct and would introduce additional uncertainty into the law. When Western Australia 'drew down' the provisions of section 51AC in 2006 it followed the Victorian model, instead of the NSW/Queensland model (and which has also now been adopted by the Northern Territory.) This could mean that the law in relation to unconscionable conduct in Victoria and Western Australia is now different to the law in NSW, Queensland, the Northern Territory and the Trade Practices Act.

Given the jurisdictional differences which have been created by state governments in 'drawing down' the unconscionable conduct provisions of the Trade Practices Act, we strongly support the Productivity Commission's recommendation that there be an alignment of definitions of unconscionable conduct between the states and territories that have 'drawn down' section 51AC. We note, incidentally, that the Federal Parliament has since amended section 51AC of the Trade Practices Act in 2007 to add 'unilateral variation of contracts' to the list of matters that the court can have regard to when deciding whether or not conduct is unconscionable.

We would add, as part of this review, that there should also be an alignment of the standard of judicial oversight of the unconscionable conduct provisions between the states and territories, and between the states/territories and the Commonwealth, to ensure that there is no diminution in the standard of judicial administration.

We also believe that the reviews referred to in paragraphs 1.3.4 and 1.3.5 above should be driven by the Federal Government which has the opportunity to enforce uniformity by threatening to repeal section 51ACAA of the Trade Practices Act ("Concurrent operation of State and Territory laws") if the states and territories do not co-operate in this matter.

Other matters that have been raised during the public hearings on unconscionable conduct are addressed in section 8 of this submission.

2. DRAFT RECOMMENDATION 2

State and Territory governments should seek to improve the consistency of lease information across jurisdictions in order to lower compliance and administration costs. They should:

- ***Encourage nationally consistent (plain English) models for retail tenancy leases and for tenant and landlord disclosure statements (for example, all jurisdiction and other specific provisions could be set out in annexes to the standard documents).***
- ***Institute nationally consistent reporting by administering authorities on the incidence of tenancy inquiries, complaints and dispute resolution.***

The Commission invites comments on the feasibility and benefits of more widespread lease registration and facilitation of this process by landlords.

The Commission invites comments on the feasibility and benefits associated with the introduction of a voluntary national code of conduct for shopping centre leases enforceable by the ACCC.

2.1 National consistency in lease information

We strongly support national consistency in retail tenancy legislation and in the provision of retail tenancy information, such as lessor and lessee disclosure statements.

We recommended in our first submission (see paragraph 4.1.5, pp. 39-40) two means by which this could be achieved. While our preference is for the second approach we nominated – i.e. by the states and territories surrendering their powers in this area to the Federal Government – we noted, if that approach is considered too radical or ambitious, that the states and territories should agree to bring their legislation into conformity with each other.

For this to occur, however, we still believe the process needs to be driven by the Federal Government through the Council of Australian Governments (COAG), perhaps by the establishment of a COAG working group. We note that the present Federal Government is seeking to reinvigorate COAG and has already established a COAG working group on red tape reduction which could be the vehicle for progressing this matter. It would be no advance, however, if this process simply resulted in the same amount of retail tenancy regulation or, worse, resulted in additional regulation. Part of the COAG working group's task, therefore, would be to critically examine existing regulation and recommend the repeal of regulation which serves no useful purpose or which is even harmful. For this reason, therefore, state and territory representation on the COAG working group should not be drawn only from the traditional areas of retail tenancy units or registries which have a vested interest in the retention of existing regulation. There should be representation also from bodies such as the NSW Better Regulation Office, the Victorian Competition and Efficiency Commission and their equivalents in other

states and territories to ensure there is rigorous and objective analysis of the need for regulation.

We do not believe that this process should seek to achieve nationally consistent (Plain English) models for retail leases. It would be impossible to reach a model retail lease which would be suitable for all retail property formats other than the most straightforward tenancy. In such cases, it would be best to encourage private organisations, such as the Property Council of Australia, to revive the old 'BOMA standard lease' which could be used by small landlords. The Property Council of New Zealand, for example, publishes a standard retail lease which is still in use and the PCNZ is in the process of updating this model lease.

The retail tenancy relationship in shopping centres, particularly the larger shopping centres, is far more complex and does not lend itself to a standard lease. We note that the Western Australian Government began an exercise in 2005 to reach agreement on certain standard retail lease clauses but abandoned it after one year when it proved impossible to find a consensus on the form of these clauses, even though their use would have been voluntary.

We also recommended, in our first submission, a possible first step in achieving greater consistency in retail tenancy legislation would be for the states and territories to reach agreement on uniform retail tenancy documentation, such as the disclosure statements (see paragraph 4.1.6, p.40.) We believe agreement in this area could substantially reduce compliance and administrative costs for national landlords and national retailers. We noted that "the Victorian Government, in consultation with relevant parties, has commenced a review of the disclosure statement in Victoria. We believe this disclosure statement 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" (p.40.)

2.2 National consistency in reporting of tenancy dispute information

Only two States (NSW and Victoria) produce detailed reports of retail tenancy inquiries, complaints and disputes but not in a comparable format. Victoria publishes its totals in the Annual Report of the Small Business Commissioner and makes available, on request, a breakdown of these disputes. The NSW Retail Tenancy Unit does not publish its figures but makes a breakdown available on request. Since these States generate the bulk of retail tenancy disputes it would be very valuable to, at the very least, have consistency in reporting between these two states. Queensland, although a less disputatious state, also has a specialist Retail Shop Leases Registry and should also be part of any nationally consistent reporting arrangement. It may be difficult to extend this process to other states and territories at this stage because of the very small number of retail tenancy disputes they experience.

Such a reporting scheme could be important in assessing problem areas in the retail tenancy relationship and in guiding policy

responses. We believe, for example, if there had been adequate examination of the number, and nature, of disputes over security deposits in NSW, there would not have been such a costly decision (for both tenants and landlords) to regulate security deposits (see Case Study 2 in our first submission on page 22.)

2.3 Lease registration

The Commission has invited comments on "the feasibility and benefits of more widespread lease registration and facilitation of this process by landlords." This is prompted by the Commission's reluctance to mandate the registration of leases, particularly "in the absence of any compelling evidence that this measure would generate net benefits to the broader community" (p.212.)

We accept that it is difficult to establish whether there has been a difference in outcomes in lease negotiations between, for example, Victoria (where lease registration is not common) and NSW (where lease registration is usual.) It must be emphasised, however, that it is only in recent years that we have seen the advent of specialised lease information advisory firms that have been able to collate this information to tenants and tenant advisers in a comprehensive, cost-effective and relevant form in states where registration is common. We also understand that these lease advisers use lease data from NSW as a basis for estimating lease information in Victoria.

It seems that the availability of this information has led to a blossoming of retail tenancy advisers in the lease registration states. The more frequently that small retail tenants put such negotiations in the hands of responsible and reputable professional advisers the less likely that uneconomic deals will be struck. (We acknowledge that there are also some incompetent retail advisers but, in a more competitive environment, the market will take care of these.)

We dispute the claim that the ability of major landlords to view turnover information provides an uneven playing field when it comes to lease negotiations. It would be an uneven playing field if one side had this sales information and the other side did not. What is important, however, is that there is a widespread *perception* among retailers and retailer associations, which will have been obvious to the Commission from the public hearings, that this gives landlords an advantage in lease negotiations. While this perception exists there will always be a danger that a state or territory government will prohibit the disclosure of turnover information to landlords. We have demonstrated in our original submission the damage this would do to the management of shopping centres and to the operation of retail businesses (paragraph 3.2.1, pp 28-31) and the commission has acknowledged this in its draft report.

We repeat the suggestion made in our original submission: "It is our strong view that if an information imbalance is perceived to exist the best means of addressing it would be for all State and Territory Governments to require registration of leases." We pointed out that since registration is already voluntary in all states and territories, this would not be a substantial charge on public resources (and the additional cost can be recovered in registration and user charges.) The additional (minimal) cost to retailers would be balanced by the

benefits that registration would bring in terms of greater knowledge of prevailing rents at lease negotiation time.

We strongly oppose compromise suggestions that have been made, such as expanding the operation of section 25 of the Victorian Retail Leases Act to require landlords to disclose rents and other lease information to the Small Business Commissioner or the Retail Traders Association of WA's suggestion that the RTA be the repository of lease information in that state. We have already pointed out that section 25 is an example of unnecessary business regulation and should be repealed (Case Study 1, p.21 of our original submission.) As for the RTA WA's suggestion we repeat that the necessary infrastructure for lease registration already exists in the relevant government authority in WA (Landgate) and would continue to exist since there would continue to be some retailers who would want to register their leases. It would make no sense for this infrastructure to be duplicated in a private body such as the RTA WA, even assuming that participants would be prepared to disclose such information to a private body.

We would like to comment on two "straw men" constructed by the Law Institute of Victoria (LIV) in its puzzling opposition to lease registration (Submission No. 141). We say "puzzling" because we are unaware of complaints from the Law Society of NSW or the Queensland Law Society about the practice of lease registration.

First, the LIV suggests that actual market rents may differ from face rents because lease incentives may not be registered, suggesting that this renders the information of little use. We note that the NSW Government made a similar claim in its submission to the Commission. This argument has been effectively demolished by retail tenant advisers, Stephen Spring and Simon Fonteyn, when they appeared before the Commission on 5 February 2008. It is unlikely that retail tenant advisers would be calling for the extension of lease registration around Australia if they found it to be of little or no use.

The use of prevailing market rental information tends to be most valuable for tenants in regional and large sub-regional shopping centres. In cyclical downturns it is true that such centres may offer lease incentive in order to attract tenants. In periods of tight vacancies, however, such incentives will not be common. Incentives are most likely to follow a redevelopment of a shopping centre but usually such centres are 'stabilised' (i.e. reach a stage where the landlord is making no tenant contributions) within a period of two to three years after the redevelopment.

Mr Fonteyn, in particular, has noted that experienced lease negotiators understand the realities of the property cycle; can estimate the value of lease incentives in shopping centres; and can make an intelligent adjustment to calculate market rents from face rents. As Mr Fonteyn told the Commission: "If you just log into any major valuation company . . . they will show you what the level of market incentive is by centre type, by state (p.204)." Such negotiators also know whether a centre is affected by a redevelopment and can make similar adjustments. In any event, often the most common lease incentive is a financial contribution by the landlord to the tenant's fit out costs and this does not have a

significant impact on market rents if measured over the five year period of an average lease.

Second, the LIV also claims that the information contained in leases is often irrelevant because of the time that can be taken to register leases. We accept that lease registration can take some time, mainly because of the number of steps involved in the lease execution process, and this can take even longer if a shopping centre has more than one owner who must sign the lease. For this reason the SCCA has recommended to the NSW Government (with the support of the Australian Retailers Association) that the mandatory registration period under the Retail Leases Act be extended from one month to three months. The vast majority of retail leases, however, are registered within three months of execution and usually much sooner. Since rents cannot be increased within the first 12 months of the lease, and lease clauses do not change, the relevant lease information does not suffer from the fact that it may take three months for registration. If it was common for leases to take years to be registered we would accept the criticism of the LIV as valid. Such cases, however, are exceptional.

We maintain that registration of leases in all states and territories would provide a simple and cost-effective solution to perceptions that there is an imbalance in the information available to both parties in lease negotiations.

2.4 Voluntary National Code of Conduct for Shopping Centre Leases

The Productivity Commission has also invited comments on "the feasibility and benefits associated with the introduction of a voluntary national code of conduct for shopping centre leases enforceable by the ACCC." The Commission has floated this suggestion as a cornerstone of an alternative approach to retail tenancy regulation – as a genuine attempt to 'unscramble the egg'.

If we understand it correctly, the idea is that, as part of a progressive unwinding of the current prescriptive retail tenancy legislation, shopping centre owners should negotiate a voluntary national code of conduct for shopping centre leases. This is based on the idea that regulation can really only be justified in a shopping centre context since it is only in shopping centres where an imbalance of negotiating power may exist and where retail vacancies tend to be low. According to the Commission if such a code were developed it would not be as prescriptive as retail tenancy legislation, and this would be of benefit to owners and retailers, and its existence would then facilitate the removal of retail tenancy legislation that currently constrains market efficiency and imposes significant compliance costs.

While the SCCA congratulates the Commission on giving thought to an alternative approach, we are sceptical about whether this is a viable alternative. Although the Commission recognises a code "should not be developed to add an additional layer of regulation on the market and should only be pursued if the current legislative arrangements are to be reformed", we believe it is too much of a leap of faith for shopping centre owners, given our experience over

the past two decades, to enter into negotiations on such a code without a clear commitment from all eight state/territory governments that the *quid pro quo* would be delivered i.e. that shopping centres would then be released from retail tenancy legislation.

We have seen no evidence that this approach would be acceptable to retailer associations and/or to state governments. Retailer associations that took part in the public hearings appear to be unanimous in opposing the notion of a code. The LIV has also opposed it in its final submission (DR147.) Given this level of opposition we could not take the risk of negotiating such a code, having it made under the Trade Practices Act (and therefore enforceable by the ACCC for those who sign up to the code), and then find that those who sign up to the code are simply saddled with an additional layer of regulation.

We are also concerned that this could result in a lawyers' picnic. If there is an inconsistency between the provisions of the code, and provisions in state or territory retail tenancy legislation, the code would presumably prevail over retail tenancy legislation (by virtue of section 51AEA of the Trade Practices Act). We suspect there would be constant legal challenges by retailers and/or retailer associations, particularly given the amount of opposition evident in the public hearings to the concept of a code of practice.

We are also concerned that, in referring to this as a code of conduct for shopping centre leases, the Commission makes the assumption that all shopping centres are the same when it comes to the balance of negotiating power i.e. that the conditions that apply in 'super regional' shopping centres are the same as those that apply in small 'neighbourhood' centres. The conditions that apply in the latter are usually more akin to conditions in shopping strips (i.e. smaller landlords, generally higher shop vacancy rates and significant bargaining power resting with tenants, particularly major tenants.) If that is accepted, the question should be asked: why shouldn't neighbourhood shopping centres also be removed from regulation? There are more than 1300 shopping centres in Australia. Only 65 of these are regional shopping centres (super, major and regional) and perhaps only about another 100 could be considered leading sub-regional shopping centres. When tenants complain about the conditions that apply in 'large shopping centres' (high market rents, low vacancies etc.) we are talking, at most, of around 15% of shopping centres. As the Productivity Commission will have observed over the past eight months, the retail tenancy 'debate' in Australia is actually a debate involving a very small proportion of the retail tenancy market.

There are also practical issues to be considered in the operation of such a code. Such a code, for example, would require a dispute resolution process but we doubt whether state or territory governments would make available the existing processes if state or territory legislation was no longer applicable to the leases of the centres governed by the code. If not, would the ACCC be the relevant dispute resolution body? We doubt this is an appropriate role for the competition regulator.

In this context, we would point out that the voluntary code of practice on casual mall leasing in shopping centres, negotiated between the SCCA (and now also endorsed by the Property Council of Australia) and the Australian Retailers Association (and now also endorsed by the National Retailers Association and the Retail Traders Association of Western Australia) does not involve the ACCC, other than the fact it was necessary to gain the ACCC's authorisation of the code under section 88 of the Trade Practices Act because of legal advice that some provisions may involve a "substantial lessening of competition".

The negotiation of this code of practice does not give any comfort to the feasibility of a broader code of practice as envisaged by the Productivity Commission in its draft report. First, the SCCA and the ARA decided to negotiate this code only because, once the South Australian Government adopted a regulated code of practice on casual mall leasing, both organisations were concerned that other state and territory governments would similarly enter the field and we would end up with eight separate (and different) codes of practice around Australia, as has occurred with retail tenancy legislation generally. Second, in devising the code, both organisations realised that a private dispute resolution process would be necessary and the only request we made of state and territory governments was to nominate a relevant person (such as the Victorian Small Business Commissioner) to nominate an independent mediator whose services would be paid for by the disputing parties. (Incidentally, the State Administrative Tribunal of Western Australia, which would be the relevant body in that State to perform this nomination role, has refused our request.)

For these reasons we have, reluctantly, come to the conclusion that the proposal for a voluntary national code of conduct for shopping centre leases, enforceable by the ACCC, would not be practical or viable. We do, however, support the Productivity Commission's attempts to design a less prescriptive and more targeted regulatory system and strongly support the draft finding that there should be a scaling back of the existing regulation of retail tenancy leases and we have outlined how we believe this can be addressed in section 2.1.

3. DRAFT RECOMMENDATION 3

State and Territory governments should relax key restrictions in retail tenancy legislation to better align the regulation of the retail tenancy market with the broader market for commercial tenancies.

3.1 Relaxation of constraints on commercial decision making

The Productivity Commission recommends this as a medium term (i.e. two to five years) change for state and territory governments. It recommends that provisions in retail tenancy legislation (it nominates minimum lease terms and lease assignment, as two such provisions) should be evaluated according to the principles the Commission sets out in Chapter 5 of its draft report (i.e. Box 5.6 on page 92.) The Commission argues: "Retail tenancy provisions that do not align with conduct in the broader commercial tenancy market, that potentially constrain the efficient operation of the retail tenancy market, or that do not provide any clear public benefit, should be removed."

We strongly support this recommendation. We have previously argued in this submission (paragraph 2.1.4) that, as part of the drive for greater harmony in retail tenancy legislation, there should be a critical examination of existing regulation and the repeal of regulation that serves no useful purpose or that can even be harmful. Our recommendation is that this will only be achieved if it is driven by the Federal Government through a COAG working group. We have also argued that this working group should have a wider representation than the usual bodies involved in state and territory retail tenancy reviews (retail tenancy units, retail lease registries etc.) The working group should also include bodies whose task is to critically consider business regulation, such as the Better Regulation Office in NSW, the Victorian Competition and Efficiency Commission and their equivalents in other states and territories.

The Productivity Commission has already nominated the minimum five-year term as one such provision for critical examination. The imposition of this provision, as the Commission has noted, imposes financial costs on tenants who wish to negotiate a lesser term (because of the need to obtain a solicitor's certificate.) (In Victoria, this cost is also imposed on taxpayers because of the requirement to obtain the approval of the Small Business Commissioner's Office.) In Queensland, however, retailer associations have refused to accept a minimum-term provision because they believe it operates to the disadvantage of retailers by removing flexibility.

Is there any evidence that retailers in Queensland are seriously disadvantaged by the absence of a minimum term provision in the Retail Shop Leases Act? The Commission has noted in its draft report (p.100) that in NSW, where a minimum initial lease term applies, around 9% of leases were for less than five years and 25% were for more than five years; in Queensland, which has not had a minimum lease term provision for many years, 7% of leases were for less than

five years and 30% were for more than five years. Obviously the absence of such a provision does not lead to a greater proportion of leases being negotiated for less than five years or for a fewer proportion of leases to be negotiated for more than five years. The Commission has noted: "This suggests that regulations on lease terms are having little or no sustained effect and that lease terms are primarily determined by commercial negotiation."(p.102.)

There are many other examples of regulations that should be examined as part of this exercise. We nominated two in the case studies contained in our first submission (pp. 21-23) that impose significant costs on retailers and landlords. We could have nominated many more, such as the requirement in Western Australia (but not in any other state or territory) that all 'break clauses', which have been freely negotiated between two businesses, must be approved by the State Administrative Tribunal.

An important first step in this process of achieving greater harmony and removing unnecessary regulation is to ensure that the differences in state and territory legislation are not compounded by further regulation. We therefore support the Commission's suggestion in the draft report – which should be upgraded to a recommendation – that there be a pause in legislative change in the retail tenancy area (p.xxxii) to ensure that states and territories do not pursue measures that lead to greater prescription in retail tenancy legislation nor further widen the gap between the retail tenancy market and the broader market for commercial tenancies.

4. DRAFT RECOMMENDATION 4

As unnecessarily prescriptive elements of retail tenancy legislation are removed, State and Territory governments should seek, where practicable, to establish nationally consistent template legislation for retail and commercial tenancies available to be drawn down to each jurisdiction.

The Commission invites comments on the desirability and feasibility of establishing a nationally consistent framework for tenancy leases through the drawing down of nationally consistent template legislation for commercial (including retail) leases to each jurisdiction.

The Commission invites evidence on the costs and benefits of its draft recommendations for retail tenants, landlords, investors and the community generally.

4.1 Nationally consistent template legislation for retail and commercial tenancies

We support the Productivity Commission's recommendation that nationally consistent template legislation for retail tenancies be developed to be drawn down to each jurisdiction. (We disagree that this should include commercial tenancies and address this in section 4.2 below.) We believe that it should be the objective of the COAG working group, to which we have referred in paragraphs 2.1.4 and 3.1.2 of this submission, to achieve nationally consistent template legislation (from which unnecessarily prescriptive elements have been removed) which could be drawn down in each jurisdiction. While challenging, we do not believe this is an impossible task.

Our preference, expressed in our first submission, would be for the states and territories to surrender their powers to the Federal Government. We believe this is the only way in which a truly national uniform system of regulation can be achieved and, most importantly, can continue into the future. Nevertheless we accept that this is probably politically unrealistic.

For this reason we agree that the negotiation of nationally consistent template legislation, which can be drawn down by each state and territory, is the most realistic way to pursue the objective of uniformity.

4.2 Regulation of commercial tenancies

We do not believe that this template legislation should also cover commercial (i.e. non-retail) tenancies.

NSW and Queensland do not regulate commercial leases. The ACT only regulates leases relating to commercial premises that are less than 300 sqm in floor area.

Victoria, in 2003, substantially reduced its regulation of commercial leases. This has not led to any concerns or complaints from tenants of office buildings. There may well be further deregulation of commercial leases in Victoria in the future, particularly with the emphasis that state now puts on 'business red tape reduction.'

It is notable that, during the review of retail tenancies legislation in Victoria in 2000-2003 the Property Council of Australia, Victoria Division, argued that "commercial buildings and commercial tenants in them should not be covered by [the then Retail Tenancies Reform Act]" and, as noted above, was partially successful in gaining certain exemptions for some premises in the new Retail Leases Act 2003. During the review the Victorian Government received no submissions opposing the Property Council's arguments, despite the review team discussing this proposal with relevant professional associations representing commercial tenants. Subsequently some commercial tenants (for example, barristers) have sought and been granted an exemption from the Act by regulation. No evidence of market failure requiring legislative correction could be found. We believe that is also the case in other jurisdictions that regulate commercial leases.

As part of the review processes envisaged by the Productivity Commission to achieve the template legislation we believe the opportunity should be taken to deregulate the market for commercial tenancy leases.

While this may seem inconsistent with the Commission's objective of better aligning the regulation of the retail tenancy market with the broader market for commercial tenancies (at least in States outside NSW and Queensland) we believe it is a much better public policy outcome. We note that there have been no serious arguments advanced in NSW and Queensland in favour of regulation; nor have there been any claims that commercial tenants in these states are at a disadvantage compared to commercial tenants in other states. If there is no justification for regulating the commercial tenancy market then advantage should be taken of removing this unnecessary regulation in other states and territories.

5. DRAFT RECOMMENDATION 5

While recognising the merits of planning and zoning controls in preserving public amenity, States and Territories should examine the potential to relax those controls that limit competition and restrict retail space and its utilisation.

5.1 Background

This recommendation appears to be predicated on a series of assumptions:

- there is a shortage of retail space in aggregate in Australia;
- planning and zoning controls have restricted the amount of retail space in aggregate;
- planning and zoning controls have restricted the location and use of retail space; and
- planning and zoning controls have limited competition for retail space.

It is important to critically examine each of these assumptions.

In making this recommendation, the Commission appears to have taken at face value complaints about planning laws leading to lower competition in retail tenancy without assessing whether in fact there is a link between the supply of land for retail purposes and the level of competition in the market for retail tenancies. Even if planning rules do lead to a smaller supply of retail space than would otherwise be the case, that does not necessarily translate into greater concentration of shopping centre ownership or into less competitive outcomes for retail tenants. Without even an abstract link between planning controls and competition in the market for retail tenancies, it is hard to know how the states and territories would go about examining "the potential to relax those controls that limit competition".

One implication of these assumptions is that retailers, as a group, are suffering because planning and zoning controls have effectively limited their number and their ability to compete. That is, these controls have restricted competition amongst retailers themselves. If this were correct, one would expect to find that retailers themselves were making above-normal profits. We are not aware that this is a claim that retailers would support.

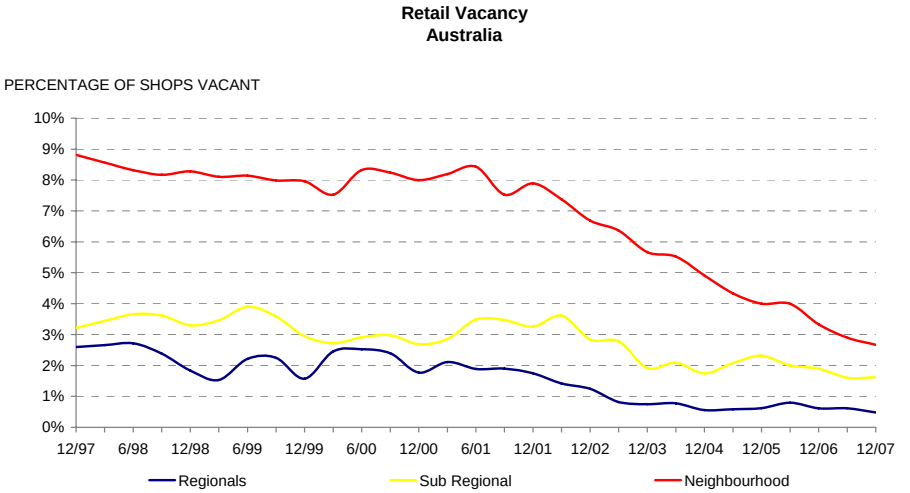
The key point is that the aggregate supply of retail space inevitably comprises a mix of outlets, from neighbourhood shopping centres through strip shopping to various types of sub-regional and regional shopping centres and other retail formats. If the Commission's recommendation is suggesting that there should be an increase in the aggregate supply of retail space, how should this be effected? If the answer is that only major shopping centre space should be increased, what are the implications for other types of retail outlets? If the recommendation applies to all types of outlets, what are the implications (a) for retailers in aggregate, and (b) for efficient use of the economy's scarce resources?

The SCCA believes that the precise meaning of this recommendation, and its full implications, including for existing retailers themselves, needs to be carefully thought through and made transparent. This exhortation extends to the costs and benefits of deviating from the 'centres policy' approach. Accurately assessing the net benefits of planning and zoning regulations is difficult, for, while there are good *in principle* reasons for government intervention to control land use at particular locations, it is difficult to present conclusive *empirical* evidence to support arguments for particular land use restrictions. These practical difficulties arise from being unable to quantify the external costs and benefits of the restrictions with any degree of certainty.

5.2 Is there a shortage of retail space in Australia?

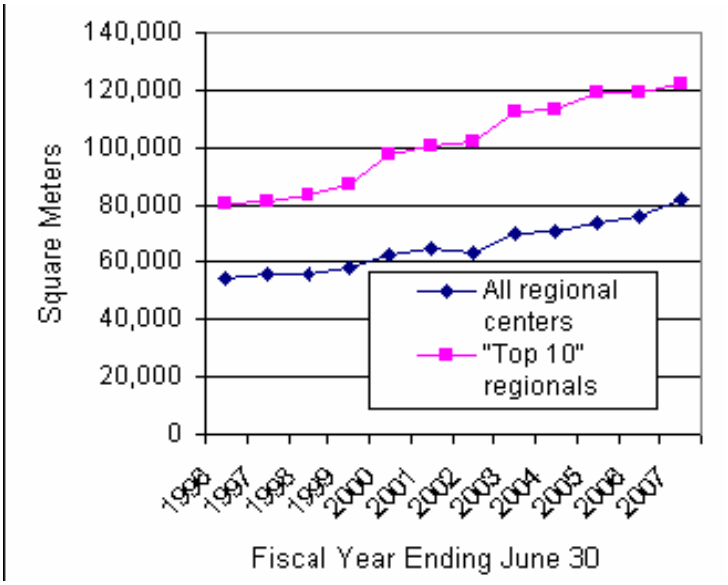
The SCCA believes there is no evidence of a chronic (as opposed to a cyclical) shortage of retail space in Australia. Nor does the draft report establish that there is a shortage of retail space in Australia.

As the Commission itself has noted, there is no evidence of a shortage of retail space in retail strips and local shopping areas (p.192). Nor is there any evidence of a significant shortage of space in neighbourhood centres (see the Jones Lang LaSalle study below which shows vacancy rates in neighbourhood shopping centres are consistently well above those in other centres – ranging from 9% to 2.7%). Certainly the vacancy rates in major regional shopping centres are low at the present time but this does not in itself demonstrate a lack of supply of regional shopping centre floor space. If the vacancy rate never changed it might, but vacancy rates in shopping centres, as in all property markets, rise and fall depending on the state of the economy, retail sales, and the number of new retail developments completed at any one time. (Moreover, relatively low vacancy rates in major regional shopping centres reflects their preferred status as retail outlets within an inevitably differentiated retail space spectrum.)



As the graph demonstrates, the retail boom of the last seven years has driven down vacancy rates across all types of shopping centres. As a result, the vacancy rate for neighbourhood shopping centres has fallen from nearly 9% in 1997 to 2.7% in 2007. The rate for regional shopping centres was almost 3% in 1997, fell to 1.6% in 1999, rose to 2.5% in 2000 and in 2007 had fallen to 0.5%. As the economy slows and more retail developments are completed, these vacancy rates can be expected to rise again.

The average gross lettable area (GLA) of Australia's regional centres, including anchors, increased by almost 6,000 sqm, from 75,798 sqm to 81,787 sqm in the financial year ending 30 June 2007. During 2006/07, regional shopping centre space has grown across the various store formats, with small specialty stores, large specialty stores and discount department stores getting the lion's share of the increase. While the supply of retail space has fallen, demand for retail space has increased as a result of booming retail sales. Average sales in regional shopping centres over 2006/07 grew by 8.6% leading to the conclusion: "Regional centers are among the best places for retailers in Australia. The regionals' +8.6% sales growth outperformed the overall retail sales increase of +6.4%, which shows the benefits of retail clustering, strong management and high-growth locations".[2]



Average GLA of All Australian Regional Centres and the Top Ten Leading Regional Centres. Source: Urbis

If this inquiry had been conducted in 1997, for example, the Productivity Commission may well have come to the conclusion that there was an (aggregate) over-supply of retail space in Australia. Indeed the Reid Inquiry in 1997 believed there was excess supply of major shopping centre floorspace as a result of overdevelopment.

[2] *ICSC Research Review Vol. 14, NO. 3, 2007, Michael Baker, Urbis,*

This suggests that what we are experiencing at present is a cyclical shortage of retail space, but a shortage that is largely concentrated in regional and sub-regional shopping centres. If retail sales growth slows (which presumably is part of the objective of the Reserve Bank's current monetary policy setting in slowing demand growth), and given the large amount of retail space coming on stream (see below), we may well be moving into another (cyclical) period of oversupply of retail space.

Australia has around 2.1 sqm of retail space per capita. This is a significantly greater amount of retailing space per capita than is available in the United Kingdom (1.3 sqm); slightly greater than New Zealand (2.0 sqm); but much less than is available in the United States (3.7 sqm). On these comparisons, there is no compelling case to suggest that our level of retail space is not about right. A recent study conducted as part of a review of retail planning policy in Victoria noted: "An important influence on the level of retail floorspace supply in Australia is the limited domestic market, coupled with high levels of economic concentration in key retail sectors. These factors largely explain the relatively restrained supply of retail floorspace in Australia in comparison to the United States."[3]

5.3 Is there a chronic shortage of space in regional shopping centres?

According to data presented in the submission by the Australian Retailers Association (No. 119), in the 12 years from 1995 to 2007 the retail floorspace in 79 regional shopping centres grew by 61.29% (from 3.9 million sqm to 6.3 million sqm). (We note that this figure of 79 must include some large sub-regional centres.) This is a graphic demonstration of the continuing growth in regional shopping centre floor-space. This is the equivalent of 34 regional shopping centres coming on stream over this period, or an average of around three new regional centres each year. This is the equivalent of 2,000 new specialty stores being created in regional shopping centres each year.

The ARA submission also claims that the fact that the vast majority of this extra regional shopping centre floor space occurred in existing retail zones and only 14% in greenfield sites is evidence of barriers to potential competitors entering the regional shopping centre market.

The fact that most additional regional shopping centre floor space occurs in existing retail zones is hardly surprising. Large shopping centres evolve over time. Very few regional shopping centres are built from scratch. Even in new land release areas, shopping centres are invariably built in stages. They may start as a supermarket based centre and then, if consumer demand warrants and there is a discount department store available to anchor it, the centre will be redeveloped as a sub-regional centre. Subsequently, if there is sufficient customer demand and a department store available as an anchor tenant, the centre may be redeveloped as a regional shopping centre. Rarely does this process occur in one go. It certainly does not

[3] *Retail Policy Background Paper No.3, The Changing Retail Scene in Australia, Ratio Consultants for the Department of Sustainability & Environment, September 2006, p.6*

indicate that there are no new competitors entering the regional shopping centre market as neighbourhood and sub-regional shopping centres are very widely held.

It must be also be recognised that regional, major regional and super regional shopping centres are the premium end of the market. As such, there will inevitably be a limited number of them. It is the same in any industry – you would not expect to find 5-star hotels on every corner or premium grade office buildings in every suburb. This does not mean there is a 'shortage' of supply of these centres, it is just a reflection of the level of demand for them. If you cannot afford to rent office space in the only premium office building in your area, it does not mean the office market is not working or that there is a shortage of supply. It simply means you must cut your cloth accordingly. There is no fundamental 'right' for a retailer to be able to open a shop in the most popular shopping centre anymore than there is a 'right' for someone to own a house in the most popular suburb.

Finally, even if the supply of retail space is constrained by planning laws, there is no direct connection to the level of competition or contestability of the market for retail tenancies. That market allocates the existing stock of retail space and there are no obvious barriers to entry to the ownership or management of retail property.

5.4 What determines the number of regional shopping centres?

With the exception of Perth (see below), the main determinant of the availability of retail space available for lease in major shopping centres is not the planning system but the availability of major retailers to 'anchor' such shopping centres or anchor the redevelopments of shopping centres. Anchor tenants are critical to the viability of a shopping centre as they are the primary drivers of consumer foot traffic in a shopping centre. Specialty retailers in a shopping centre are able directly to leverage their own businesses off that customer foot traffic as this, in turn, directly drives the sales that such specialty businesses are able to generate.

If you abolished all planning restrictions tomorrow you would not see new regional shopping centres sprouting up everywhere. For example, bilateral or multilateral agreements for a given amount of aviation capacity flown between countries does not guarantee that the full capacity will be used. Indeed, the contrary is the case. What capacity is used depends on the economic viability of the flights. In a sense, abolishing planning restrictions might raise the prospect of wasteful (excessive) use of scarce investment resources. More realistically, however, such a relaxation is likely to lead to a gap between potential investments permitted and those actually taken up – plus, possibly, sub-optimal investments where they are made (from a 'centres policy' perspective).

Even with a relaxation of planning restrictions, development would still be dependent on the availability of anchor tenants which, in turn, would depend on the level of consumer demand. Only last year, for example, Myer decided to open a department store in Townsville. Its location was the subject of fierce competition from the existing sub-

regional shopping centres and from the CBD. Myer's final decision to agree to be part of Stockland Townsville will see a substantial redevelopment of that centre as a regional shopping centre.

While Australia is limited in the number of department store chains (two), and the number of discount department store chains (three, in the ownership of only two companies) there will be a limit imposed on the growth in the number of shopping centres which is unrelated to planning considerations. It is the population constraints (reflected in the strength of retail sales in an area), and the availability of department stores (which is also tied to the strength of retail sales), which are the major constraints on the availability of regional shopping centres. In this context, it may be that the resurgence of Myer as a separate company will now see the establishment of more regional shopping centres.

5.5 Is there a concentration of shopping centre ownership?

It has also been claimed that there is a lack of competition among shopping centres because of the concentration of ownership within the sector. We would dispute that there is a concentration of ownership of shopping centres in Australia. As we noted in our first submission there are[4]:

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

This spectrum of ownership, ranging from many small owners to a relatively smaller number of larger owners, is typical of many industries, especially in a relatively small, dispersed market such as Australia.

Over 450 owners own only one shopping centre and 85 owners own only two shopping centres[5]. All these shopping centre owners compete fiercely with each other and with other retail property formats for retailers and for customers. Even the regional shopping centre market, with 16 different owners, has a much lesser degree of ownership concentration than many other industries in Australia such as media, petrol or supermarket retailing. It certainly does not constitute a monopoly, duopoly or oligopoly.

Moreover, for most retailers, locating in a regional shopping centre is only one option alongside a sub-regional centre or a high street location. As noted previously just because a retailer cannot find a tenancy in the shopping centre *of their choice* at the rent they would like to pay does not mean there is no competition or that that shopping centre has a 'monopoly' in the retail tenancy market. On the contrary, if a shopping centre is popular and successful, it is to be expected that there would be high demand for tenancies there and therefore low vacancy rates and higher rents. This is the market

[4] Property Council of Australia, *Directory of Shopping Centres in Australia*, 2007
[5] Urbis, *Concentration of Ownership*, 2005

at work. 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'. No amount of regulation can really change these market realities, although they may (differentially) add to costs faced by landlords, tenants and ultimately consumers.

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. They do not *have* to be there but they *want* to be there. Given the opportunity they will pay to be there.

For example, we note the comments by Hype DC Pty Ltd in the hearings on 4 February:

> *"there is no competition between lessors for tenants . . . . even in a strip centre there's only one shop usually available at one point in time, so there is only one landlord you can negotiate with, and the case is even worse in the large regional shopping centres where, as I said, if you wish to have a shop in Doncaster and you wish to have a shop in Chadstone, which we do, there is just one landlord you can negotiate with . . . unless there are simultaneous shops on offer which are by and large similar, then there is no competition between the landlords for our space".*

It is not clear what Hype DC expects. They seem to be arguing that a permanent state of oversupply of retail shopping space, or premium retail shopping space, should exist whenever they want to sign a lease. If they want to locate in one particular shopping centre, or be in a premium shipping centre in one particular location, then obviously there is only one landlord to negotiate with and surely they do not expect there to be ten different shops available for them to choose from at the one time. That would potentially be a waste of scarce resources. More realistically, investment providing an excess supply of retail space would not be viable over time, and investors doing their sums would recognise this and (not) act accordingly.

The claim that retailers do not have a choice of location 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 major shopping centres competing with each other, and with other retail formats, for tenants – Bondi Junction and Chatswood are just two examples in NSW.
- the catchment areas of shopping centres overlap considerably and also overlap with other retail property formats so each of these retail formats is constantly battling to maintain and expand its market share;

- 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.

To take one example of the competition faced by regional shopping centres and the choices facing tenants and potential tenants - the Chatswood region in the northern suburbs of Sydney. Here there are two regional shopping centres (Chatswood Chase and Westfield Chatswood), each under different ownership and management, only a few hundred metres apart, with a very lively retail plaza and high street between them. In addition, there will be a new retail precinct when the new Chatswood transport interchange opens and Precision Group announced this week that its first Sydney shopping centre, Metro Chatswood, will be anchored by a Woolworths supermarket.

There are four other shopping centres, under different ownership, within a one kilometre radius of these centres and if we go out to a radius of five kilometres, which is still within the primary trade area of the two regional centres, we find another nine shopping centres. There are around 1,850 individual shops within a radius of five kilometres of Chatswood. Of these only around 400 or so are located within Westfield Chatswood and Chatswood Chase. In other words, the shops within those two centres represent only 22% of individual shops within the Chatswood region.

Head west to, say, Mt Druitt, which has one regional shopping centre (Westfield Mt Druitt) and another two regional centres (Westpoint and Penrith Plaza), both under different ownership, overlapping its trade area There are a further 30 competing retail formats within Westfield Mt Druitt's trade area. These centres are also about to get another competitor in the form of the new Rouse Hill Town Centre, a regional shopping centre, which opens next month.

5.6 Do planning and zoning controls restrict the amount of retail space?

Planning controls obviously have an influence on the total amount of retail space, just as they have an influence on the total amount of office space, industrial space, hotel space and so on. With the exception of planning laws in Perth, however, Australian planning laws do not impose a numerical limit on the amount of retail floor space. Nor do they impose greater restrictions on the supply of retail space than they do on the supply of other property classes.

Australia has seen a massive increase in shopping centre floorspace over the past 25 years. In the year 1981, 300,000 sqm was added to shopping centre stock - an increase of almost 3% of existing stock. In 1991, almost 400,000 sqm of shopping centre retail space was created (a 3.5% increase), in 1998 there was an extra 800,000 sqm built (a 7% increase) and in 2005 an additional 700,000 sqm of shopping centre floorspace.[6]

The amount of retail space per head of population has also grown substantially over the last 15 years. If we examine, first, the supply of shopping centre space, the amount of shopping centre floorspace

[6] *Australian Shopping Centre Industry Development History, Centro Properties, 2007, sourced from JLL and CFS Research*

almost doubled in Australia between 1991-92 and 2005-06, from 9.2 million sqm to 17.3 million sqm, an increase of 88% in 14 years. This was much faster than the rate of growth of the population, resulting in an increase in the amount of shopping centre floorspace per head of population from 0.53 sqm in 1991-92 to 0.84 sqm in 2005-06 (up nearly 60%).

If we look at the supply of non-shopping centre space over this same period, this also increased, although not at the same rate of growth as shopping centre floorspace. Retail floorspace other than in shopping centres (i.e. strip retailing, CBD retailing etc.) grew from 23.6 million sqm in 1991-92 to 27.5 million sqm in 2005-06. This was less than the rate of growth of the population over the same period, resulting in a slight fall in the amount of non-shopping centre floorspace from 1.35 sqm in 1991-92 to 1.34 sqm in 2005-06. Overall, however, the total floorspace per head of population increased from 1.88 sqm in 1991-92 to 2.18 sqm in 2005-06. There is no evidence that this amount of floorspace per capita has stabilised or has begun to decline.

A recent survey[7] by Landmark White in NSW, Queensland and Victoria, has shown there is substantial new retail development in the pipeline (that is, in the planning stage, the development approval stage or under construction). In Queensland for example, there is an estimated 1.5 million sqm of retail space at various development stages (an increase of 44% in the last 12 months.) There is around 730,000 sqm awaiting development approval (of which 100,000 sqm is sub-regional shopping centre floorspace and 50,000 sqm is regional floorspace). There is another 320,000 sqm under construction including about 60,000 sqm of subregional and 30,000 sqm of regional shopping centre floorspace. Over 610,000 sqm of bulky goods retail is in the pipeline including 26 projects awaiting development approval and 17 under construction. In NSW, there is over 2 million sqm in the development pipeline and in Victoria, some 840,000 sqm of new retail supply. (Landmark White did not survey the other states or the territories.)

There is only one State Government which currently imposes a numerical limit on the amount of retail floor space and that is the Western Australian Government. Under *Statement of Planning Policy 4.2 – Metropolitan Centres Policy*, the WA Government imposes retail floorspace limits on shopping centres in Perth. This has had significant implications for the supply of retail space in WA. In Perth, for example, the largest shopping centre is limited to 80,000 sqm of retail floorspace which is significantly less than the size of some regional shopping centres in other states. The largest shopping centre in WA, by lettable floor area, ranks number 34 nationally. This month the retailer David Jones was reported[8] as saying that its planned expansion of stores in WA was being hampered by these restrictions. The SCCA has been seeking the abolition of these limits for some time and has recommended this be an outcome of the Government's current review of the metropolitan centres policy. If

[7] *Landmark White, Landmark Byte, Retail Market Updates, November 2007 and January 2008*
[8] *West Australian, 12 February 2008, p.37*

the Commission is suggesting that numerical limits like this on retail space be lifted, then the SCCA would strongly agree.

5.7 Do planning laws restrict the location and use of retail space?

The Commission is correct in its draft finding 12 that zoning and planning controls restrict the *location* and *usage* of retail space. In restricting the location of retail space, however, it must be recognised that planning laws impose no greater constraints on the retail property market than they do on other commercial property markets. Planning laws dictate where retail development can and cannot occur, just as they dictate where office, industrial, or residential development can occur. 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.

So why have governments intervened in the market to stipulate where retail developments should occur?

In general terms, planning laws have been introduced to maximise positive externalities (by increasing the use of Government funded public goods such as public transport infrastructure, for example) and to minimise negative externalities (such as excessive traffic congestion or adverse effects on public health where housing is too close to a hazardous industry). It should be noted that national competition policy reviews of state and territory planning legislation have all acknowledged that there are sound public policy reasons for regulating land use and none have resulted in the abolition of planning controls in any significant way. For example, Victoria completed a review of its Planning and Environment Act 1987 in 2001 and found that the legislation "achieved its objective in an effective and efficient manner, and that *the competition restrictions identified were in the public interest*"[9].

In the case of retail development, governments in Australia (and in the UK and elsewhere) have for many years required major 'trip-generating' activities like retail and commercial development to co-locate in 'urban centres' (or 'activity centres'), with established public transport services and infrastructure, and prohibited them from locating outside such centres.

Governments have intervened in the market in this way in order to minimise the environmental and economic costs to the community of dispersed retail and commercial development and to maximise the public benefits. The potential costs include greater traffic congestion and air pollution as people make multiple car trips to dispersed shops and offices; greater demands on scarce public resources for duplicated infrastructure; and the 'blight' caused by half empty and run down town centres and shopping centres (which inevitably lead to calls for taxpayer funding of urban regeneration and 'main street' programs).

The public benefits of centres policies include greater use of public transport (and therefore more efficient use of the public investment in this infrastructure); more vibrant urban centres; and more

[9] *National Competition Council, 2003 NCP Assessment, page 10.6*

convenience, choice and competition for consumers because retail and commercial services are located close together. These 'centres policies' also give confidence to governments in terms of their own investment decision-making. Concentrating retail, commercial and public facilities in designated 'centres' optimises the investment of taxpayers' funds in public infrastructure such as public transport, roads and utilities.

As the ACCC noted in its submission (no. 128):

> *"The creation of dedicated shopping districts or centres effectively reduces transport and time costs for consumers who wish to engage in comparison and multi-purpose shopping, making such areas an attractive destination. Consequently, retailers catering for these types of consumer categories choose to co-locate to minimise costs and maximise people traffic and profits. In particular, multi-purpose shopping by consumers means that the co-location of retailers selling dissimilar goods reduces consumer search costs. Similarly, comparison shopping by consumers means that the co-location of retailers selling similar goods reduces consumer search costs."*

In this context we noted comments by Professor Zumbo during the Commission hearings in Sydney (p.331) that if "people cannot build a shopping centre next to you or very close to you because of zoning laws, that's a very high barrier to entry, . . .". Professor Zumbo does not seem to realise that current planning restrictions on shopping centres actually *require* them to locate next to each other or close to each other in urban centres – thereby enhancing, not diminishing, competition.

All Australian Planning and Transport Ministers have committed to this 'centres policy' 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". This objective seeks to ensure that provision of public goods is efficient and that social and environmental externalities are minimised.

Retail developments that are permitted outside these urban centres 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. Out-of-centre developments which generate significant transport demand (such as major retail developments) are therefore to be discouraged because of their significant community and environmental cost.

In NSW, for example, the concentration of commercial and retail activities in urban centres has been the basis of planning laws for over 40 years. During this period, many shopping centre developers (like some retail outlet centre developers today) wanted to locate in stand alone, out-of-centre locations, as developers were able to do in the United States. They were, however, largely prevented from doing so and instead were required to locate in existing centres. That is

why, today, the vast majority of major Sydney shopping centres are located in urban centres, with obvious community and environmental benefits. Some other states which did not impose such requirements decades ago, such as some parts of Queensland, are now confronting the problems that dispersed retail development has generated.

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. This has come, however, at a significant social and environmental cost including the spectre of 'urban blight' in some of the United States' major cities.

Some of these cities, such as Sacramento in California[10], faced with declining CBDs and urban centres, are now rethinking their approach and instituting restrictions on out-of-centre developments As a general observation, it is interesting to note that New Zealand, which has less rigorous planning rules than Australia, actually has less retail space per capita than Australia.

5.8 Do planning laws restrict competition for retail space?

The Commission appears to be under the misapprehension that allowing other retail formats to locate on non-retail land (such as airports, industrial land or other out-of-centre locations) is one way of providing 'competition' for traditional shopping centres. The draft report states: "A number of retail developments have also emerged outside of current planning regulations, that potentially offer competition to existing retail centres" and that the distinction between bulky goods zoning and general retailing "appears arbitrary, especially if sufficient public infrastructure exists to support retailing at the bulky goods sites" (p.192).

This argument misunderstands the way the planning laws operate. As noted above, these laws (or centres policies) require retail development to locate in urban centres and restrict retail development in dispersed 'out-of-centre' locations. These policies recognise, however, the special needs of bulky goods retailers (such as furniture showrooms, homemaker centres, hardware and white goods retailers) which need large floor spaces for the display and handling of bulky stock. When these large floorspaces are not available inside or adjacent to urban centres, governments have allowed these retailers to locate outside centres in light industrial zones or in clusters in special 'bulky goods zones' beside main roads (although many bulky goods stores are in fact located in or adjacent to urban centres). Being allowed to locate on less expensive land

[10] *The Council of the City of Sacramento has adopted a "Power Centre and Big Box Retail Policy" which encourages these shopping centres to locate "in the Downtown or within a revitalization or redevelopment area".*

outside centres obviously gives bulky goods retailers a significant cost advantage in terms of rents but this is arguably justified by the much larger floor spaces they require.

Given the cost advantages of locating in industrial or bulky goods zones, however, all retailers would seek to locate in these zones if they could - which would of course completely undermine the whole aim of the centres policy in the first place. It would also have adverse consequences for the bulky goods retailers themselves because it would drive up the price of this land.

Governments have therefore prohibited traditional shopping centres and general retailers from locating in these zones and strictly limited this cost advantage to genuine bulky goods retailers (who are the only ones who warrant it due to their large floor space requirements). This in turn has required a clear definition of bulky goods retailing to ensure that general retailers cannot locate on this land too.

Clearly the distinction between general retailing and bulky goods retailing is far from 'arbitrary' but rather a critical part of a successful centres policy and a distinction that can mean millions of dollars difference in the value of land (This was highlighted in the Epicentre auction in the ACT a few years ago where a parcel of land zoned for bulky goods retailing with pre-auction valuations of $12-13 million actually sold for $39 million because of a loophole in the planning controls which arguably allowed the site to be developed for general retailing (a retail outlet centre)).

As the NSW Government states in its centres policy - *The Right Place for Business and Services*- "Regulation of the (bulky goods) format is often required to stop bulky goods outlets selling non-bulky goods……Where such concerns exist, councils are encouraged to apply floor space limits or restrictions on the type of goods for sale. *This is a fair restriction in return for the cost and locational advantages not available to other retail outlets*." (p.11).

5.9 Retail outlet centres

If there is no clear definition of bulky goods retailing, it creates a loophole which general retail developers can use to locate in cheaper industrial or bulky goods zones even though their retail offer is not bulky. Such loopholes were exploited by some (but not all) retail outlet centres and 'warehouse retailers' who sought to get around planning restrictions by claiming they were similar to bulky goods retailing, and therefore required special planning treatment. Retail outlet centres, however, are simply shopping centres by a different name, albeit centres with a much lower standard of finish, presentation and fitout than most traditional shopping centres. The average tenancies in outlet centres are usually of a similar size to tenancies in shopping centres and the centres don't need the larger spaces required for the handling of bulky goods.

There is no reason why they should have special and more advantageous planning rules applied to them. This was recognised by Justice Lloyd in the NSW Land and Environment Court decision on the Orange Grove Road outlet centre (which had located itself in a bulky goods zone) when he stated that "*the use in the present case*

is that of a retail shopping centre." The NSW planning policy *The Right Place for Business and Services* also states (p.12) that factory outlets that are not ancillary to on-site manufacturing "*are simply shops seeking low rents."*

The attempts by some general retailers (such as some retail outlet centres) to locate in bulky goods zones led to a number of court cases all of which found that the uses in question were general retailing and were not permitted in industrial or bulky goods zones. The draft report refers to these court cases and suggests that they are evidence of the commercial advantage enjoyed by some shopping centre landlords. This is not the case. These court cases were about shopping centres acting to protect their shareholders interests against competing shopping centres who were seeking to evade the law and locate on less expensive land where shopping centres are not permitted.

Allowing these retailers to locate outside retail zones in areas where traditional shopping centres are prohibited and where land is much cheaper than in retail/commercial zones, provides them with an unfair advantage in terms of the rents on offer. This is not fair to retailers in shopping centres, and in other retail locations, who are prohibited from locating on this land, and who pay rents that reflect the higher cost of land in commercial and retail zones. By contrast, forcing competing retail developments and competing retailers to co-locate in urban centres actually provides greater competition not less. Among other things, co-location facilitates comparison shopping by consumers which helps to keep prices competitive.

The majority of retail outlet centres in Australia are in fact operating in the proper retail and commercial zones and the SCCA has never been involved in legal action against outlet centres located in commercial and retail zones (and where they, arguably, provide closer, and therefore greater, competition to established shopping centres). There was no legal action, for example, associated with the development of the Brand Smart outlet centre in a retail zone in Parramatta CBD just down the road from Westfield Parramatta.

We would also point out that existing shopping centre owners paid the prevailing market price when they bought their retail zoned land or shopping centre. The centres were not a free land grant. Either someone bought the land decades ago and took the risk of developing a shopping centre on it (and is now enjoying a capital gain) or it was bought recently at the prevailing market price. This is not evidence of a lack of competition, anymore than capital gains in the residential property market are evidence of a lack of competition.

It is one thing to say "lift restrictions on where *all* retailing can occur" and "lift restrictions on where all retailers, *except traditional shopping centres*, can occur". While both would have a significant environmental impact, the former would provide a level playing field for competing retail development whereas the latter would provide a substantial windfall to every retail format except traditional shopping centres. It is not competition when one party is given a significant cost advantage over another.

In economic terms, the retail property market is regulated as it is considered good public policy to do so. That is, the negative impact caused by the loss of market efficiency is lower than the positive impacts derived from:

- more efficient use of public goods;
- the positive social externalities that flow from centres policy; and
- the reduction in negative externalities that would arise if the market had no regulation.

Treating retail outlet centres differently from traditional shopping centres undermines this policy because:

- the market remains regulated and actually gives one market participant an advantage over another without consideration of which market participant has the more productive use of the resource; and
- the goals in terms of externalities and provision of public goods that justify the market regulation are not achieved by this policy.

6. DECLARATION OF TURNOVER INFORMATION

In submissions and during public hearings retailer associations have argued for the outlawing of the provision of turnover information to landlords or have argued that this information should be collected by a third party and made available to landlords and retailers on request in a form in which individual retailers' turnover cannot be identified.

6.1 The need for turnover information

The SCCA, in its first submission, outlined some of the reasons why turnover information is necessary for landlords in order to successfully operate their shopping centres. We do not propose to repeat these arguments but would refer the Commission to paragraph 3.2.1 (pp. 28-31) of that submission. We would again stress, however, that not all of the uses for turnover information which we described are of benefit only to the landlord. The use of this data to effectively target shopping centre marketing and promotional strategies, for example, is as much to the benefit of the centre's retailers as it is to the landlord.

We would also like to take this opportunity to correct a statement by the NSW Government in its submission (No. 136): "It is noted that shopping centre landlords in the United Kingdom or the United States of America do not collect [turnover] information from tenants and yet are able to successfully manage their centres (p.14)." This is not correct. There is no legislative prohibition on the collection of this data in the USA. It is routinely collected by major landlords and there is not even a major debate about this in that country as there is in Australia. This information is considered to be vital for the management of shopping centres.

In the UK, it is the case that turnover information was once rarely collected. This is changing, however, as the shopping centre industry in that country is becoming more sophisticated and as major institutions become involved in the ownership and management of large centres. We are aware of three large owners, including Westfield, that now require the reporting of turnover information in their new leases. Once again there is no legislative prohibition on its collection. We are further advised that there are now instances in the UK where turnover is directly collected through a live connection with retailers' point-of-sale equipment.

Also, as we have noted in the report on New Zealand, in the attachment to this submission, shopping centre leases in that country routinely require the monthly declaration of turnover information and, once again, this hardly generates a debate among retailers in New Zealand.

In other words, here are three countries, all of which now have a significant and growing Australian presence in retailing and retail property ownership, which not only permit the declaration of turnover but also accept this is a vital aspect of good management of shopping centres. Only in Australia has it become a matter of public debate.

6.2 Retailers' use of turnover information

The draft report notes that prohibiting the collection of turnover data, or making it more difficult for the landlord to access this data, "would limit shopping centre owners from managing their assets properly" and that this could ultimately disadvantage tenants by limiting the performance of the centre (p.134). It would actually disadvantage tenants in a much more direct way. We made the point in our first submission (p.30) that this information is also vital to individual retailers for benchmarking purposes. It might be useful for the Commission to understand, in more detail, the nature of the benchmarking information that is made available to retailers at no charge.

The provision of benchmarking information to retailers is now common among major landlords. One of our members, the Westfield Group, has provided a sample monthly sales report, prepared by its research team, which obviously does not identify the retailer for whom the report was prepared, nor the relevant retail category. This is **attached**. Westfield has advised that there are over 430 recipients on the distribution list for these sales records, representing more than 100 different retailers, and that the requests for this information are growing. These are obviously mainly from retail chains but the information is also available, upon request, to individual retailers. Westfield has advised that the increasing demand for customised sales analysis by individual retailers, together with the increasing number of retailers requiring reports, was a key reason why it has heavily invested in a new system for turnover reporting which is expected to be fully operational this year.

The attached report enables the particular retailer to know, each month, for each Westfield shopping centre in which the retailer is located:

- the number of other stores in the same category;
- the area of the store (m2) and the area of all the stores in the same category;
- the sales per square metre for the category and the sales per square metre for the store, for the particular month, and the percentage variance for both, and where the store ranks in that particular category;
- the actual MAT (moving annual turnover) for the preceding 12 months, again by category and store, and variance, and ranking within the category;
- the monthly MAT on an annualised basis, again with variance; and again with the ranking within the category.
- the same information is given for each state and territory (in this case four states and the ACT) enabling each store to also be benchmarked against state and total figures for the above.

Most major landlords now provide similar vital, and free, information for retailers and this enables them to pinpoint the stores that are doing comparatively well and those that are doing comparatively poorly. This enables them to take any necessary corrective action

quickly. Armed with similar information from other landlords, these retailers can also make informed decisions about states, locations and centres in which they wish to be located (or from which they wish to withdraw) and this is obviously valuable information for them at lease renewal time. Sales reports are particularly important to retailers who are making changes to their businesses or are operating in a changing industry or environment. In times of change the reports help retailers understand how quickly they are improving or declining and enables them to act at the earliest opportunity.

Major retailers constantly compliment our members for providing this information. Many retailers seek guidance on an ongoing basis and make regular calls throughout the year to discuss the implications of the findings. Often this is followed by a request for further, more detailed, customised analysis in investigate specific issues. Retailers in, say, the unisex category (which is a fairly broad sales category) may request analysis comparing their performance to a number of specific retailers that they see as occupying a similar position to them in the market. Other retailers ask for an analysis of trend to help them understand changes in their relative position within the market.

We have made the point before: there is an obvious disconnect between the position of those retailer associations which are pressing for turnover information not to be disclosed to landlords and the position of many of their members who are using turnover information supplied to them by landlords to better inform their business decisions.

6.3 Third party collection of information

Perhaps for this reason, some retailer associations have modified their previous argument that the disclosure of turnover information to landlords should be prohibited. They now argue that "an independent body should be responsible for the collection of such information if it is to be collected" (ARA submission, No.119, p.21). The ARA further proposes that this information "should be collated in a format that does not identify any individual retailer and available to all at cost" and that the "costs of such collection would be born by the industry."

This proposal has a superficial plausibility until it is more closely examined. What is meant by the "costs would be born by the industry"? At present, as noted above, this information is supplied to retailers (in a form that is immediately useful) at no charge. Is it fair to ask these tenants to pay for information they now obtain for free? Would all tenants in major shopping centres be prepared to contribute to the cost of such a scheme? It seems unlikely that those tenants who don't currently bother to collect this information from their landlords would happily contribute to the cost of such a scheme. If they don't then the cost of such a scheme to other retailers (who presently receive this information for free) will be prohibitive, given that the third party (presumably a government department or an accounting firm) will have to set up the necessary and expensive software systems to enable the collection and analysis of this data, as well as incur significant labour costs, not to mention making a return on these investments. More likely, of course, it will be the

landlords who will be charged a hefty price for information that is vital for the ordinary running of their business. In what other field of business has the government intervened to force the owners of a business, and their customers, to 'buy back' information that is vital to their basic success?

There is also an issue of timeliness. How quickly would such a third party, since it would be the centralised body for information relating to all major owners and retailers, be able to deliver the customised reports which retailers are now requesting of their landlords? If it is occupied with these sorts of requests how long would it take to respond to requests from landlords about relative centre performance or detailed reports about the performances of particular precincts or categories within centres?

It is only necessary to pose these questions to realise how unrealistic such a 'compromise' solution would be in practice. At a time when all governments are attempting to reduce the regulatory burden on businesses, it makes no sense to be erecting a new regulatory super-structure. Obviously no consideration has been given by the ARA, or by any by other retailer association, to the viability or practicality of such a scheme. It simply appears as a throwaway line in a submission.

6.4 Information asymmetry

What is the objective of prohibiting the disclosure of turnover information to landlords? What is the objective of having this information only available to landlords in an aggregated form from a third party? The only answer to these questions can be: to ensure there is a level playing field when it comes to lease negotiations.

It makes no sense – if there is a *perception* (as opposed to a reality) that this gives one side of the bargaining table an unfair advantage – to correct this situation by removing information from one side. This is particularly the case when that action can injure retailers both directly (as noted in 6.2 and 6.3 above) and indirectly, as noted by the Productivity Commission in its draft report (draft finding p.134.)

The Productivity Commission has noted in its draft report that a lack of information already bedevils the retail tenancy industry. Surely the answer to this *perception* is to equalise the amount of information available to the bargaining participants by increasing the information available to tenants. This can best be done by ensuring that the tenant is fully informed of the prevailing rents within that shopping centre or in that area. This is why we have recommended that the practice of lease registration become more widespread around Australia (see paragraph 2.3 of this submission.)

We believe this will also increase the *efficiency* and *effectiveness* of the retail tenancy advisory industry and this must also be of assistance to retailers, in particular to small retailers. It should be stressed that one of the most significant developments in the retail tenancy industry in Australia over the past few years has been the rapid growth of the retail tenancy advisory industry and the increasing sophistication and professionalism of those coming into the field. We note the comments by Mr Simon Fonteyn, of Leasing Information Services, (p. 188) that the fastest growth in the users of

lease information has been the 1-10 store category. Only five years ago the retail advice industry was a very small field, dominated mainly by those more interested in pursuing an ideological agenda. The field has grown significantly in the past couple of years. Many of those now hanging out their shingles have cut their teeth working as leasing executives for major shopping centre companies. As the use of these experts by small retailers increases, as is bound to happen, the imbalance in experience at the bargaining table will be further diminished. The availability of comparable rental information for these advisers will further close any possible gaps in the relative professionalism and experience of the two parties to a lease negotiation.

6.5 Pharmacy Guild

One of the retailer associations to make much of the alleged unfairness of the availability of retailers' turnover information to landlords has been the Pharmacy Guild of Australia. (We refer to the comments by Guild officials at the public hearing in Sydney on 7 February 2008.) In fact, around Australia, it is gradually becoming the case that turnover rent clauses are being deleted from retail tenancy leases for pharmacies because of an agreement by all states and territories to further restrict the ownership of pharmacies.

This was done not because those governments regarded turnover rent clauses as wrong but as part of the battery of legislative protection that governments provide to pharmacists in Australia. In this case it was to ensure that only pharmacists (and not, for example, supermarkets) can own pharmacies. Thus section 92 of the Pharmacy Practice Act in Victoria provides that "a provision in a bill of sale, mortgage, lease or in any other commercial arrangement in respect of a pharmacy or pharmacy business that gives to any person other [than a registered pharmacist] . . . the right to receive any consideration that varies according to the profits or undertakings in respect of the business, is void." With the disappearance of the percentage rent clauses from pharmacy leases landlords are not in a position to enforce the reporting of sales figures.

The fact that the Pharmacy Guild has used the public hearings around Australia to complain about rents in shopping centres – even though this provision has been operating in some states now for years - would appear to give support to the Commission's draft finding that: "It is unclear that prohibiting the reporting of turnover data would lower average occupancy costs" (p.134.)

Incidentally, since the Guild has made much of alleged high rents in shopping centres, it is worth pointing out the trend in occupancy costs in shopping centres over a period of time. The only meaningful data on occupancy costs for pharmacies in shopping centres is that provided by the annual Retail Averages prepared by Urbis. We have set this out in Table 1 and Table 2 below. These show that occupancy cost ratios for the 'pharmacy and cosmetics' category (i.e. rent and centre outgoings as a proportion of sales) have not increased substantially. Although occupancy cost ratios obviously vary from year to year, as is to be expected because of lags in turnover and rent, the trend shows that rents have increased largely in line with turnover growth over the past 6 years.

Table 1: Occupancy Cost Ratios for Pharmacies in Shopping Centres, 2000/01 to 2003/04

Year	Regional Centres	Sub-regional Centres	Neighbourhood Centres
2000/01	12.1%	8.4%	7.9%
2001/02	12.2%	8.4%	7.6%
2002/03	12.6%	8.7%	8.0%
2003/04	12.1%	8.7%	8.1%

This information has to be presented in two separate tables since, beginning in 2004-05, the SCCA adopted new industry-wide guidelines for sales and occupancy cost reporting, in order to achieve greater uniformity in reporting. While this has been successful in standardising industry reporting, it has meant a break in the Retail Averages series. For this reason occupancy cost ratios for 2004-05 and later years cannot be compared to earlier years. Nevertheless, we now have three years of figures under the new guidelines, which is sufficient to examine trends, and these later years are set out in Table 2 below.

Table 2: Occupancy Cost Ratios for Pharmacies in Shopping Centres, 2004/05 to 2006/07

Year	Regional Centres	Sub-regional Centres	Neighbourhood Centres
2004/05	12.5%	8.5%	6.9%
2005/06	12.6%	8.4%	6.6%
2006/07	13.1%	8.6%	7.3%

(These tables have been prepared by Urbis. It should be noted that the reported turnover from pharmacy tenants includes prescriptions. The prescriptions component of turnover cannot be removed because it is not reported separately. Occupancy costs are exclusive of marketing levies and tax.)

In relation to pharmacy rents we note that the Guild has also raised concerns about the difficulties faced by pharmacies when seeking a renewal due to the location restrictions on pharmacies. We would point out that these location restrictions were introduced by government at the pharmacy industry's request in order to limit potential competitors. We would therefore suggest that rather than seek even further protection from competition (such as through automatic renewal of leases) the industry should request the Federal Government to lift the location restrictions.

7. OUTGOINGS

In submissions and during the public hearings there have been claims that shopping centre landlords are profiting by allocating centre outgoings incorrectly or inappropriately; that outgoings should be independently audited; that there should be a code of conduct on outgoings; and that all leases should be gross leases.

7.1 Regulation of outgoings

The administration of outgoings is already highly regulated by state and territory legislation. These provisions are always thoroughly examined, debated and amended during the regular reviews of retail tenancy legislation. It is therefore surprising that this can be raised as an issue for discussion in this inquiry.

The Victorian Retail Leases Act, for example, includes 12 separate sections (many with numerous sub-sections) that impose the following requirements on landlords in relation to outgoings:

1. Outgoings are specifically defined in the Act (s.3.)
2. The disclosure statement, which is required to be given to the tenant at least seven days before signing the lease (s.17), must set out the estimates of the outgoings for the current financial year, itemised by expense category, and the estimated total amount of outgoings.
3. Section 39 specifies the circumstances in which a tenant is liable for the payment of outgoings:
    - they must be specified in the lease;
    - the lease must specify how the outgoings or any part of them are to be recovered;
    - the amount recoverable must be in accordance with the Regulations; and
    - the amount recovered from a tenant is limited to the proportion of the total outgoing which the lettable area of the premises bears to the total lettable area of the premises which benefit from the outgoings.
4. Section 40 stipulates that a tenant is not liable to contribute towards an outgoing that benefits specific premises unless the tenant's premises benefits from the outgoings.
5. Tenants cannot be asked to contribute to capital costs (s.41); depreciation (s.42); contributions to a sinking fund for capital purposes (s.43); interests on landlord's borrowings (s.44) or land tax (s.50).
6. Section 49 places restrictions on the recovery of management fees in outgoings.
7. Section 46 requires that an estimation of outgoings must be provided to the tenant before the lease is entered into and

at least one month before the start of each accounting period;

8. Section 47 provides that a written statement must be made available to tenants at least once during each accounting period; and a reconciliation of estimated and actual expenses must occur within three months of the end of the accounting period.

9. Section 48 specifies the time period within which the adjustment of estimated outgoings and actual outgoings must take place and, in the final adjustment, the tenant is only required to pay outgoings "properly and reasonably incurred" by the landlord.

10. The Act also stipulates (s.47) provisions for the auditing of outgoings which are discussed in more detail in section 7.2.

It should be noted that the Retail Leases Act (and equivalent legislation in other states and territories) also impose similar regulations on the administration of a shopping centre's promotions and marketing fund (see sections 69 to 72.)

7.2 Auditing of outgoings

The Retail Leases Act (and similar legislation in other states) already makes special provision for the independent auditing of outgoings. Section 47 requires that the outgoings statement, which must be given to a tenant within three months of the end of the relevant accounting period and be prepared "in accordance with relevant accounting principles", must also be accompanied by a report prepared by a "registered company auditor (within the meaning of the Corporations Act)".

The auditor is required to state whether the outgoings statement correctly states the landlord's expenditure during that accounting period and also specifically report on each individual outgoing to which the tenant is required to contribute that comprises more than 10% of the total amount of outgoings.

This section also requires the tenant be given a reasonable opportunity to make a written submission to the auditor on the accuracy of this outgoings statement.

It is difficult to think of what additional regulation could possibly be applied to the administration of outgoings. If a tenant, or group of tenants, believes a landlord has not observed these regulations (and are not satisfied with the auditor's report referred to below) then they can, at very little cost, lodge a retail tenancy dispute notice with the Small Business Commissioner's Office.

7.3 Landlords' responsibility for outgoings

A theme in the public hearings is that because certain outgoings are recoverable from tenants, the landlord has no interest in ensuring that these expenditures are kept as low as possible. On page 422 of the transcript the Commissioner noted: "[Gross rents] seem to take a lot of the heat out of it. It also seems to put the incentives in the right place in terms of making sure that the centre management are actually trying to minimise the costs rather than just having a blank

cheque to incur whatever they think and send it all back to the tenants."

We discuss the pros and cons of 'gross rents' and 'net rents' below (section 7.5) but it is important to note that it is a misconception to believe that landlords have no incentive to keep outgoings low under a 'net rent' arrangement. For a variety of reasons - including the fact that the Act stipulates that tenants are only liable for outgoings that benefit their tenancy and then only for their (proportion) of the gross lettable area of *all the tenancies that benefit from the outgoings* - the landlord remains liable for a substantial proportion of the total outgoings of a centre. It is estimated that, in major shopping centres, only around 60% of total outgoings are recoverable from tenants. Since landlords are still paying around 40% or more of total outgoings out of their own pockets, they have a very substantial interest in ensuring that outgoings are kept as low as possible, consistent with the need to maintain a high standard of appearance and amenity for customers.

To give one example of this, the SCCA and the Property Council have been in negotiations for over a year with the Liquor Hospitality and Miscellaneous Union (LHMU) over its 'Clean Start Campaign' which seeks to force cleaning contractors to sign up to 'Responsible Contractor Agreements'. Among other things this will substantially increase the weekly wage rates of cleaners and will increase the cost of cleaning contracts. While we have not ignored our responsibilities in this area – both the PCA and the SCCA have adopted 'Principles for Fair Contracting' which our members have endorsed – we have not supported the union's campaign. If it was the case that we had no interest in the costs of outgoings – in this case cleaning costs – we would not have involved ourselves in this issue and would simply have passed the additional costs on to retailers.

Landlords are also acutely aware that the money with which their tenants pay outgoings comes out of the same pocket as the money with which they pay their rent. (This is the case irrespective of whether the tenant is paying 'gross rents' or 'net rents' - see section 7.5 below.) Obviously if the tenant is paying excessive amounts for outgoings – money that does not go to the landlord – it will be more difficult for them to pay the rent the landlord desires for the premises. Again the landlord has a strong vested interest in keeping the level of outgoings low.

Shopping centre managers are also publicly 'benchmarked' on their operating expenses. The Property Council of Australia publishes, annually, in each state, a booklet called "*Benchmarks – Survey of Operating Costs*" for shopping centres. This provides significant comparative information on operating expenses (outgoings) and provides a reliable tool for centre owners and managers, and for tenants, to evaluate the performance of centres as well as to assist in preparing operating budgets. The publication provides a series of tables and charts, broken down according to the type of shopping centres (regional, sub-regional, neighbourhood and city), showing median costs on a dollar per square metre basis for all statutory charges and all items of operating expenses. This is a valuable tool for tenants concerned about the level of outgoings they are paying.

We have **attached** one such booklet to (the hardcopy of) this submission for the Commission's information.

Similarly it is nonsense to suggest that although outgoings are audited – therefore providing comfort that what the landlord says is spent has actually been spent – there is no check on whether the expenditure has been incurred *efficiently* or *effectively.* Once again, this assumes that the landlord has a 'blank cheque' to pass on to tenants and this is not the case. With a very large proportion of outgoings being paid directly by the landlord, and with the landlord having to ensure a proper standard of amenity of the shopping centre in order to continue to attract tenants and customers, the landlord is vitally interested in how effectively and efficiently the various contractors and service providers are doing their jobs.

7.4 Code of Conduct on Outgoings

The Commission heard evidence that the SCCA had rejected a code of conduct on outgoings and that there was need for such a code to operate in shopping centres to regulate outgoings. It is useful if the Commission is aware of the background to this proposed code of conduct on outgoings.

This code was presented to us by the Australian Retailers Association in 2003. At that time Coles Myer Ltd (as it then was), Woolworths Ltd and David Jones Ltd were members of the ARA. (They subsequently resigned from the ARA and formed their own association, the Australian National Retailers Association.) The ARA did not deny at the time that the proposed code had mainly been prepared and pushed by Woolworths, Coles Myer, and David Jones – all three being companies not covered by retail tenancy legislation in any state or territory because of their size and obvious negotiating strength. In 2003 Mr Bruce York, who has given evidence to the Commission on this matter, was the Property Lease Administration Manager for Woolworths and has acknowledged that he was one of the main authors and proponents of the code.

It is interesting to note that, since the resignation of these three companies from the ARA, the issue of a proposed code of conduct on outgoings has never been raised by the ARA with the SCCA again. The ARA did not advocate such a code in its submission to the Productivity Commission, nor in the public hearings. The ARA knows that if there are deficiencies in the regulation of outgoings it has the opportunity during retail tenancy reviews to have that changed.

The proposed code of conduct was, and remains, an attempt by companies with superior negotiating strength to the landlords with whom they bargain (even large landlords) to also gain for themselves the added protections afforded by retail tenancy legislation to small retailers.

Mr York claimed during the public hearings that the proposed code was rejected because of the "additional cost" it would impose on landlords (p.228). He is correct but those costs would mainly arise because the proposed code would merely have duplicated what is already provided in retail tenancy legislation. The proposed code was thoroughly considered by the SCCA and was rejected because it was unnecessary. Much of the detail in the proposed code is already

regulated by retail tenancy legislation (see sections 7.1 and 7.2 above) so, for those retail tenants covered by such legislation, the code would be superfluous. Worse, it would be confusing for tenants and landlords since a code (unless made under the Trade Practices Act) cannot override legislation and many would be genuinely bewildered by possibly conflicting provisions.

In the case of those companies not subject to retail tenancy legislation, such as the three 'authors' of the proposed code, these tenants already have the ability and bargaining strength to make provision for matters relating to outgoings in the leases they negotiate with shopping centre owners. Indeed our members at that time reported that in new leases being negotiated by these 'majors', some were already insisting on changes to previous provisions relating to exclusion of items from outgoings and in provisions relating to the reporting of outgoings. Coles Myer, for example, in early 2004 advised our members of a new disclosure format for outgoings "that will form part of all new leases entered into by Coles Myer." (Note, incidentally, the use of the words "will form part of all new leases"; not "will form part of the negotiations over new leases".) While some of these changes to outgoings negotiated by the majors were not to the satisfaction of our members, the SCCA believed that these should properly be matters for lease negotiation, not for a code. That is still our view.

We note that Mr York conceded that the company he represented (Woolworths), and its competitor (Coles), have the ability to – and frequently do – use their bargaining strength to negotiate lease provisions which ensure they do not pay certain outgoings (p.230). In such cases, of course, those expenses then fall on the landlord because retail tenancy legislation prevents the majors' share of these expenses being allocated to speciality tenants. It would be extraordinarily hypocritical for these companies to also want the further protections that would come from a code of conduct on outgoings and we note that, following Mr York's retirement from Woolworths, this proposed code has not been raised again with the SCCA by either Woolworths or any other major tenant.

7.5 Gross rents

There has also been argument before the Commission that all leases should incorporate 'gross rents' whereby the rent paid by the tenant is an all-inclusive amount which includes both the rent and an additional amount as a consideration for the tenant's estimated share of centre outgoings over the period of the lease. If this amount turns out to be an underestimation of the actual expenses incurred, it will obviously be to the advantage of the tenant; if it turns out to be an overestimation it will be the tenant who will be disadvantaged. (In reality most 'gross rents' are actually 'semi-gross rents' whereby the landlord still recovers, as outgoings, statutory charges - such as insurance, land tax (where recoverable) and rates - but all other operating expenses are 'grossed up' as part of the rent.)

The advantage of a 'gross rents' arrangement, from a tenant's perspective, is greater certainty in estimating future total occupancy costs over the period of the lease. Other tenants say it is not difficult to take the estimate of the first year's outgoings (provided in the

disclosure statement) and make reasonable assumptions of what those outgoings will be in year two, year three etc. From a landlord's perspective, a 'gross rents' arrangement has the advantage of savings in administrative costs of not having to pay staff and arrange systems to supervise outgoings, prepare outgoings statements, prepare the annual estimates of outgoings, do the reconciliation, arrange auditing etc.

The disadvantage of a 'gross rents' arrangement, for a tenant, is the removal of transparency and accountability. Under a system of 'net rents', the tenant has the assurance of an audited outgoing statement certifying that the services they are paying for have indeed been delivered. Under a 'gross rents' arrangement the tenant has no idea how much is being spent on cleaning, on security and the like.

It is odd that in retail tenancy debates occasionally some retailer association officials will complain about a lack of transparency in the administration of outgoings but, in the next breath, argue for gross rents. Mr Bruce York, for example, spent much of his time before the Commission claiming that retailers should have the right to appoint their own auditors to audit outgoings and then said: "If the introduction of an audit requirement pushed landlords into gross leases, I don't think the retail industry would be weeping tears of blood" (p.231). Apart from overlooking the fact that there already is an independent audit requirement this argument is illogical. Does it really make sense to say, in effect: "we are so concerned about the transparency of the administration of outgoings that the audit provisions should be made even tougher but if you adopt a totally non-transparent system we don't mind."

Other retailer officials naively believe that, even with a 'gross rents' system, tenants would still be entitled to an audited outgoings statement. This is not the case and, as noted above, abolition of the cost of administering outgoings is one of the incentives for some landlords to adopt a 'gross rents' arrangement. Even under a 'semi-gross rents' arrangement, retail tenancy legislation stipulates that a landlord does not have to provide an audited outgoings statement if the recoverable outgoings only relate to insurance and statutory charges and are accompanied by copies of assessments, invoices, receipts etc.

Retail tenancy legislation does not dictate whether landlords should use 'gross rents' or 'net rents'. This is not surprising since, both for landlords and tenants, there are obviously advantages and disadvantages in either arrangement. Nor does the SCCA have a policy on this matter since, although most of our members operate on a 'net rents' basis, some of our members prefer to negotiate 'semi-gross' rents. It is our strong view that this should not be a matter for regulation but should remain a matter for negotiation. If a net rents arrangement is used by landlords, the tenant has the strong protection of retail tenancy legislation (as outlined in sections 7.1 and 7.2 above.)

8. UNCONSCIONABLE CONDUCT

During the public hearings there have been claims that the unconscionable conduct provisions are not working and need to be changed. In particular, Professor Frank Zumbo claimed that "section 51AC has effectively fallen into disuse"; that it should be replaced (or, more likely, duplicated) with a "statutory duty of good faith"; and that there should be a "new regime of unfair contract terms". Professor Zumbo said the statutory duty of good faith (and presumably, although this is not clear from his remarks, the 'unfair contract regime') should apply in all business-to-business relationships but he felt it could apply immediately in retail tenancies though retail tenancy legislation

8.1 Has section 51AC fallen into disuse?

The ACCC, in its submission to the Productivity Commission (No. 128), has revealed that it received only 244 retail tenancy complaints over the period 1 July 2002 to 30 June 2007, of which 127 were complaints of unconscionable conduct (pp.20-22.) This averages around 50 retail tenancy complaints a year, of which around half are complaints of unconscionable conduct.

It is important to note the ACCC's comments: *"[Unconscionable conduct] generally present as a complex web of interlinking accusations and claims (i.e. misleading and deceptive conduct, harassment and coercion, misrepresentations) and personal grievances, and require intensive, time consuming investigations to untangle the legally relevant facts. As discussed above, when investigated by the ACCC, some of these allegations cannot be substantiated by sufficient evidence necessary to establish a breach in court proceedings and therefore must be discontinued. However, the majority of unconscionable conduct allegations received by the ACCC are discontinued because the facts do not indicate that the conduct is unconscionable within the meaning of the TPA. While the ACCC considers that these matters are sometimes due to a misunderstanding among small business complainants of the concept of unconscionability, under the TPA, it is nonetheless determined to pursue such matters as enable it to clarify the law and thereby firm up a better definition of what constitutes unconscionable conduct." (p.30.)*

What does this tell us? First, since the Productivity Commission has estimated the number of retail leases in Australia as 290,000, complaints of unconscionable conduct represent a tiny fraction (0.009%) of those retail leases. Some retailer associations argue that these figures should be ignored because most aggrieved retailers are too afraid to complain. There is no evidence for this argument and it fails to explain why around 50 retailers each year do complain (and why more complain under the dispute-resolution provisions of retail tenancy legislation). Even if this argument was valid, the logical extension of this argument is that there is no point in changing the law since retailers will always be too afraid to complain.

Second, an equally plausible explanation for this tiny amount of complaints is that the incidence of such behaviour has always been vastly exaggerated by retailer associations and by industry activists. In addition, it can be argued that these figures suggest that the unconscionable conduct provisions are working well. It must be remembered, when assessing the effectiveness of the unconscionable conduct law, that it does not operate in isolation in the retail tenancy market. It exists against a backdrop of highly prescriptive rules, beginning even before the lease is signed, which already regulate behaviour in the industry and which already have serious legal and commercial consequences if they are breached. These include prohibitions on misleading and deceptive conduct. It must also be recognised, as we pointed out in our first submission (p.46), that shopping centre managers now spend significant resources on education and compliance courses for their management and leasing staff, to ensure they are aware of their legal and ethical obligations in dealing with tenants.

Third, there is no evidence that the ACCC has been ineffective or incompetent in this area. The ACCC's submission details the thoroughness with which it investigates such matters (pp.24-30.)

Fourth, the ACCC has reasserted its intention that, where required, it is determined to pursue such matters through the courts to "enable it to clarify the law and thereby firm up a better definition of what constitutes unconscionable conduct."

It is evident from these facts that the assertion that section 51AC has fallen into disuse is absurd. In any event this assertion ignores the fact that the provisions of section 51AC have now been replicated in most of the states' and territories' retail tenancy legislation and actions for unconscionable conduct can be, and are being, pursued through tribunals in these state and territories.

The Productivity Commission's draft finding is correct: "While there is a relatively limited case history pertaining to unconscionable conduct claims, threat of action under unconscionable conduct provisions appear to have had an influence on market conduct. It is likely that further interpretation and clarification would deliver additional benefits."(p.178.)

8.2 A statutory duty of good faith

The case for replacing section 51AC, therefore, has not been established by Professor Zumbo and others who have argued similarly before the Commission. Nor is there any evidence that a statutory duty of implied good faith would have any greater advantages for tenants than the present provision. The difficulty with an implied duty of good faith is that it is also a matter of subjective interpretation, perhaps even more so than unconscionable conduct.

In any event, Professor Zumbo acknowledged that if there is to be such a radical change to the Trade Practices Act it should apply to all commercial transactions and should not simply be confined to retail tenancy transactions. Nor is an inquiry into the market for retail tenancy leases an appropriate forum for considering such a substantial change to competition law.

8.3 Unfair contract terms

Professor Zumbo has also proposed "a new regime for dealing specifically with unfair contract terms" as an alternative to section 51AC. He acknowledges that no other country in the world has extended the notion of 'unfair contracts' to business-to-business transactions. Once again such a substantial change (to the Trade Practices Act) would be a law that applies to all commercial transactions and not one confined to retail tenancy transactions. For this reason it should also not be a matter for this inquiry.

Nevertheless we are strongly of the view that requirements that businesses act fairly in dealings with the public, or that an employer act fairly in dealings with employees, are not simply transferable to business-to-business transactions. (We note, incidentally, that apart from Victoria no other Australian state has adopted an unfair contracts regime for business-to-consumer transactions.) The inclusion of such a subjective concept as 'unfair' in transactions between businesses has been thoroughly examined on many occasions and there is good reason why it has not been introduced anywhere in the world. In Australia it was considered by the Senate Committee examining small business protections under the Trade Practices Act in 2003. As was noted in the majority report of the Senate Committee "the consequence [of amending section 51AC of the Trade Practices Act to include words such as 'harsh' or 'unfair'] would make the meaning of the section so open to a variety of different interpretations that it would be inimical to the development of a coherent and relatively clear body of law." Not surprisingly, other governments around the world have also baulked at such regulation.

Unlike individual consumers, businesses (including small businesses) usually have sufficient knowledge, have access to specialist and legal advice and have sufficient bargaining power to resolve such matters without the need for intervention by governments. Businesses cannot wait for several months (or, more likely, years) for a magistrate or a judge to determine on a case-by-case basis whether in their subjective judgment one business has acted unfairly to another business.

Professor Zumbo has also suggested that retail leases should be vetted by an undefined agency and, once the lease has been approved, this would exempt that lease from any action for unfair contract. Such an approach would be impractical, requiring every amendment to a lease to also be 'vetted', adding months and possibly years to a negotiation process. It would also be a regulatory nightmare, at a time when all governments are seeking ways to reduce the burden of red tape on business, to be adding such a regulatory superstructure. It also fails to acknowledge that a lease is on foot 24 hours a day, seven days a week, usually for a period of five years or more. Vetting a lease at the outset cannot possibly cover all eventualities over the period of the lease.

Advocacy of such an approach in the retail tenancy market also fails to acknowledge that retail tenancy legislation is already a regulation of business-to-business contracts. Retail tenancy legislation is industry specific and contains detailed provisions regulating retail

leases. The general approach of the legislation is to lay down detailed rules on all aspects of the retail tenancy relationship and these rules override the provisions of a lease. As a result of this approach there is an extensive body of rules about acceptable behaviour by owners and managers in transactions with retail tenants without ambiguous terms such as unfair.

8.4 Exchange of rental information by landlords

Professor Zumbo also made the claim that retail landlords are sharing rental information among themselves. Of course he did so cleverly, not by making accusations backed up by evidence, but by posing a series of rhetorical questions: "Does that occur? To what extent does it occur? . . . We need to explore the level of price information exchange that goes on between landlords." (p.327) He also used words such as "cartel behaviour", "cosy oligopolies" and "clubs", without any evidence that this sort of behaviour is occurring, to further smear landlords. Professor Zumbo provided no evidence for such claims.

Professor Zumbo is critical that the Productivity Commission has not investigated "the level of pricing information exchange that occurs between landlords." He has presented no evidence that such behaviour occurs. Among his rhetorical questions he has not asked why major landlords, who are in fierce competition with each other for tenants and, particularly for (a limited number of) major tenants, would benefit from exchanging pricing information.

There is an inherent lack of logic in Professor Zumbo's accusations. He has also argued for a full disclosure of rental information through a system of registration of leases. A moment's thought, however, would realise that this would provide full access to competitors' pricing decisions - what Professor Zumbo sees as possible cartel behaviour at present (and therefore a breach of the Trade Practices Act). In NSW and Queensland there is already near universal registration of leases so there is nothing that presently prevents one landlord spending time and money 'searching' the leases of a competing centre or centres.

Professor Zumbo is also critical of what he calls 'secret pricing' in shopping centres. "Are any tenants getting preferential treatment? Are there any secret rebates? . . . are there any payments or incentives being offered to tenants, whether they be anchor tenants or other tenants, that we need to know about?" (p.327) On the one hand Professor Zumbo is accusing landlords of excessive secrecy in the pricing decisions and, on the other, is accusing them of exchanging information about pricing decisions. Where is the logic in his argument? Nor is it clear why Professor Zumbo, or anyone else, "need to know about" an incentive granted to a tenant to assist them through a difficult trading period.

9. THIRD-PARTY RENT SETTING AT END-OF-LEASE

Mr Steve Simpson, a valuer, argued before the Commission that if a landlord and tenant could not agree on a rent for a new lease, after the landlord had offered the tenant a new lease, it should be the subject of an automatic market rent review, which means the rent would be determined by a specialist retail valuer. The Australian Property Institute made a similar proposal in its submission.

Mr Simpson's proposal is a fundamental breach of property rights. Although the proposal is framed as one applying only if the landlord indicates he wants to renew a lease, the proposal would *require* a landlord to accept the renewal of a lease with the most fundamental term of the lease – the rent - having been determined by a third party. (Mr Simpson's proposal permits the tenant to "walk away" from the lease, if he is unhappy with the rent determined, but does not permit the landlord to do so.) The fact that the landlord has indicated an intention to renew is meaningless because that does not mean the landlord is willing to renew a lease at *any* rent.

What would happen if a market rent was determined at a level that the tenant regarded as unsustainable? Mr Simpson says there could be two options: "either it binds both parties, and they are stuck with it, or the tenant has – pick a time frame – 10 days to accept the determination or walk away." (p.469.) The API gave only one option in its submission (DR172), arguing for a rental determination "from which the tenant may walk away if it doesn't like or accept the result." In reality, no government is going to legislate to force a rent on a tenant that the tenant claims will send him broke. Inevitably this would mean that such a determination would only be binding on the landlord and the tenant would be free, at the end of this rent determination process, to "walk away." So the landlord will have spent many months (and many dollars) after the end of the lease, with no additional rent coming from the shop, only to then find he had to begin to find a new tenant and to begin negotiations again.

On a practical level, the proposal also falls down on a number of grounds and these are set out below.

1. Using NSW as an example, on the Productivity Commission's figures there are around 96,000 retail leases on foot in NSW. Assuming each lease is, on average, for five years this means around 19,000 leases would come up for renewal in NSW each year. Even if we assume that in only around one-third of such cases would the landlord and tenant not be able to agree on a new rent, this means there would be around 6,400 *additional* market rent reviews required each year in NSW. This means an *additional* 123 market rent reviews added to the workload of retail valuers in NSW each week. Since each market rent review takes around 30 to 40 days to complete, this suggests we would require around 600 additional retail valuers in NSW alone. (It is likely that 6,400 is an underestimation of the

additional number of valuations required each year for the reasons set out in point 6 below.) This only refers to the number of additional retail valuers required in NSW. The additional number of valuers required in Australia would be around 1,800.

2. The Australian Property Institute admits there is already a *chronic* shortage of retail valuers in NSW to undertake the existing workload of mid-term market rent reviews and options leases. (We understand there are also shortages in other states.) In response to this shortage the NSW Government has already taken extraordinary steps to increase the number of valuers prepared to undertake retail property valuations. These steps include changing the method of appointment of retail valuers to ensure they cannot be sued for negligence. (We note that the API has argued to the Commission that this immunity should be extended around Australia.)

3. Even if it was possible to find or train an additional 1,800 retail valuers, which we doubt, such valuers require a minimum of 5 years experience in valuing retail shops so the chronic shortage would last for at least five years and, more likely, for much longer. In the meantime, of course, the cost of retail valuations – which can already be a significant imposition on landlords and tenants – would skyrocket as owners and tenants bid for the services of scarce valuers.

4. Because of the continuing chronic shortage of retail valuers, leases would inevitably expire before the determination of the new rent can be completed. In reality tens of thousands of retail tenants would be in 'holdover' (without the protection of a lease) for indefinite periods while the rent is being determined. Many landlords could not wait that long to have the rent determined. Since the landlord would not be able to seek a higher rent while these processes are in train, he would most likely terminate the 'hold over' – by giving 30 days notice – and begin negotiations with a new tenant.

5. Inevitably the proposal would have the opposite effect to that intended because landlords would not renew leases for fear of having an unacceptable rent imposed on them. Given the delays that would be involved in determining the rent, the landlord would have no option but to notify the tenant that he was not going to renew the lease and, after the lease had expired, would begin negotiations with the tenant on the rent required for a new lease.

6. Given that the tenant will be free to "walk away" at the end of the process, it is inevitable that most tenants will be likely to opt for this method of rent determination rather than attempt to reach agreement with the landlord. After all, what does the tenant have to lose? The assumption earlier that only around one-third of expired leases would result in this type of rent determination would prove to be a vast underestimate. The number of additional valuers required would therefore be even greater.

It is astonishing, in the light of these legal and practical concerns, that Mr Simpson can state: "I don't see how in real terms the landlord is necessarily disadvantaged by that process." (p.469.) For the reasons outlined above, and for many others, the process is unworkable and should not be entertained.

10. REDEVELOPMENT OF SHOPPING CENTRES

Some concerns were raised during the public hearings about the issues that arise when a shopping centre is redeveloped and additional retailers are introduced to a shopping centre.

10.1 Redevelopments are critical to the survival of shopping centres

At the outset, it must be recognised that like retail generally, shopping centres must constantly reinvent themselves to stay relevant and contemporary. Shopping centres are vibrant and complex organisations. As one retail consultant puts it: "Shopping centres aren't 'set and forget' exercises. They require a continual improvement process – capital improvements, functional improvements, aspirational improvements, promotional improvements and mix improvements."[1]

Shopping centres 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. 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. We referred to this, in our first submission, as "the relentless pursuit of relevance." (p.12)

Regular changes to the tenancy mix, as well as regular refurbishments and redevelopments, are therefore a very necessary fact of life in a shopping centre. On average, shopping centres are significantly upgraded every seven to ten years. Retailers who choose to locate in a shopping centre because of its attractiveness to customers must accept this fact of life. Without regular reinvigoration and refurbishment, shopping centres could not deliver on the promise they hold out to retailers of higher customer traffic than they would enjoy in other locations.

In the vast majority of cases, redevelopments bring major benefits for all – centre owners, retailers and customers. Indeed most redevelopments do not involve the relocation of more than a few existing tenants because most redevelopments are expansions of a centre through the construction of a new wing or precinct with new retailers. It is also because relocations can be an expensive option for landlords given the costs and compensation required under retail tenancy legislation (see section 10.3 below).

Redevelopments are also an important way in which floorspace, particularly shopping centre floorspace, is expanded to accommodate new retailers and permit existing retailers to expand. Without regular redevelopments, and the expansion of floorspace which follows, the supply of retail space would be constrained, placing greater pressure on market rents. That is why retail tenancy legislation has always

[1] *What makes shopping centres work? Peter James Ryan, Red Communication, in Inside Retailing, February 2008*

recognised the need for shopping centres to expand and regulation has been directed at protecting tenants during redevelopments. These protections are examined during each retail tenancy legislation review.

Nevertheless, there is no denying the fact that redevelopments can be a difficult time in a shopping centre's life, both for landlords and tenants. For tenants there is a period of uncertainty following the issuing of the notice of relocation; the negotiations with the landlord over the relocation; trading during the period of physical construction and then, when the relocation is completed, possible relocation to the new part of the centre and stabilisation of the centre following the redevelopment. (Although as noted above, only a few tenants are likely to be relocated as part of a redevelopment.)

These are also difficult times for the landlord. The viability of a redevelopment needs to be assessed and approved within the company. No redevelopment becomes a definite proposal until it receives final approval, usually from the company's board. But that is only the beginning of the process. The next step is to gain local government approval and achieving development consent can be a long and difficult process. Inevitably the conditions attached to the development consent will impact substantially on the viability of the redevelopment. The process of physically staging the redevelopment and satisfactorily relocating tenants, in order to cause minimum disruption to the business of the centre and the individual retailer's trade, becomes a substantial juggling exercise.

The alternative, however, is to allow a shopping centre to stagnate and die. That is hardly in the interests of the retailers of the centre. That's why experienced retailers, although they may be inconvenienced for a period, understand the necessity for such redevelopments and negotiate the best commercial arrangement they can with the landlord. They also welcome the longer-term opportunities the redevelopment will bring.

10.2 The drawbacks of strata titled shopping centres

One can see the consequences of a lack of refurbishment and redevelopment in many strata-titled shopping centres.[2] Due to strata laws which require unanimous or at least 75% majority support among unit holders for major capital works in a strata-titled property, it is very difficult to gain approval for a major refurbishment of a strata-title shopping centre. A complete redevelopment is even more difficult because it requires termination of the whole strata scheme. As a result, and as a visit to many strata-titled arcades will demonstrate, strata-titled centres are often shabby and dated with a generally low standard of presentation.

The other key drawback of strata-titled shopping centres is the lack of control over the centre's tenancy mix. Each unit holder is either a retailer themselves or leases their shop to whomever they like and the body corporate cannot dictate who can sell what. At first glance

[2] *According to the Property Council's Shopping Centre Directory, there are 67 shopping centres and arcades owned by strata schemes in Australia. Most appear to be small shopping arcades.*

this may seem like a good deal for a retailer – independence, no one to tell them what to do or what to sell – but as most retailers would soon realise, it means they may end up with a retailer on either side of them (and indeed throughout the centre) selling the same thing as them or selling something much more downmarket or upmarket than them. A strata-titled shopping centre is therefore more akin to a strip location than a traditional shopping centre. In this regard, the fact that there are no major successful shopping centres that are strata titled speaks for itself.

10.3 Relocations and redevelopments are already highly regulated

The redevelopment of shopping centres, and the protection of tenants during such redevelopments, is highly regulated. Retail tenancy legislation in every state provides significant protections for retailers in these circumstances. If we take the Victorian Retail Leases Act as an example (although provisions are similar in all states and territories) these protections include:

- Proposed redevelopments must be disclosed before a tenant signs a lease.
- A tenant cannot be relocated, for example, unless there is a relocation clause in their lease and the relocation clause is subject to the provisions of the legislation.
- The landlord is required to give the tenant details of a "genuine proposal for a refurbishment, redevelopment or extension to be carried out within a reasonably practicable time and which cannot be practicably carried out without vacant possession of the premises".
- The tenant must be given at least three months notice, offering the tenant "reasonably comparable alternative premises" on the same terms and conditions as the existing lease.
- The rent for these alternative premises must be "the same as the existing rent adjusted to take into account the difference in the commercial values of the premises". (This usually involves a commercial negotiation between the landlord and tenant.)
- The tenant is entitled to payment of its "reasonable costs of the relocation" including relocating fit out and legal costs and there are processes for independent determination of these costs if agreement cannot be reached.
- Most importantly, the tenant always has the option of deciding against any proposed relocation and can, within one month of receiving the relocation notice, decide to terminate their lease instead.

In practice, relocations generally occur on mutually agreeable terms negotiated satisfactorily between the two parties. If the parties cannot agree, retail tenancy legislation in all states provides avenues for resolving disagreements by mediation or, if mediation is unsuccessful, by the relevant tribunal or court.

Redevelopments can also impact on retailers even if they are not required to be relocated. This is also regulated by retail tenancy legislation. A landlord is liable to pay a tenant "reasonable compensation", among other grounds, "if the tenant suffers loss or damage as a result of a landlord unreasonably taking action that causes significant disruption to the tenant's trading."

We would point out that such compensation is only payable in shopping centres. If a retailer is in a strip location and the local council decides to dig up the footpath outside their shop, for example, and access to their shop is impeded, they have no legislated right to compensation at all.

10.4 Traffic Projections

Concerns have also been raised in the public hearings about the impact of poorly designed shopping centre redevelopments on tenants when the expected foot traffic does not eventuate.

As we pointed out before, it is very rare for a redevelopment not to succeed once the centre stabilises. However, any redevelopment (or 'green field' development) can obviously only estimate the likely customer traffic. There can be no certainty that anticipated foot traffic will eventuate. The shopping centre developer will commission the best projections they can before they risk significant capital on a major redevelopment. Company boards do not sign off on proposed redevelopments unless they are convinced that the redevelopment has a reasonable rate of return on the projected capital invested. If these projections turn out to be wrong and the redevelopment is not a success in terms of foot traffic or sales, then the centre owner suffers as much - if not more - than the retailers. In these cases, which are fairly rare, centre owners will generally offer generous rent concessions or rent holidays or other forms of lease incentives to tenants until the redevelopment has stabilised. Evidence was given in the public hearings of one tenant in these circumstances receiving nearly two years rent free, a very substantial sum, as well as a very substantial fit out contribution.

Ultimately of course, customer traffic estimates are just that, estimates, and no shopping centre owner can guarantee that they will eventuate. Indeed our members have advised that most shopping centres would be reluctant to provide foot traffic projections given their inherent uncertainty. Nor should any prospective tenant reasonably expect a guaranteed level of foot traffic in a new development or redevelopment. In these circumstances, both the centre owner and the tenant are taking a risk that the development will succeed and this risk should be reflected in the terms of the lease that is negotiated. As noted above, retail tenancy legislation requires that sitting tenants are not forced to take these risks and can, instead, terminate their lease if they choose not to be part of the redevelopment.

10.5 Introduction of competitors

It is also sometimes claimed by retailers that the introduction of another retailer selling the same products (as a result of a redevelopment or simply a change to the centre's tenancy mix) is unfair because it reduces their turnover.

There are a number of issues to consider in response to this claim. First, some retailers are sufficiently powerful to be able to negotiate exclusivity clauses in their leases. In such cases if the landlord introduces a new competitor it is clearly a breach of the lease and the tenant has legal means of redress.

Second, if the landlord made verbal representations that no competitors would be introduced, and then introduced competitors, action could be taken against the landlord on the grounds of misrepresentation.

If, however, there was no exclusivity clause in the lease and no verbal representations to that effect, then there should be no expectation that the retailer will not face additional competition at some stage. Indeed for a retailer to argue that they should have a legislated right not to face competition, or not to face additional competition, would seem to fly in the face of competition policy. It is notable that the two organisations to argue this before the Productivity Commission – those representing pharmacists and those representing newsagents – are organisations which have traditionally been protected, by legislation, from competition.

Third, if the tenancy was not in a shopping centre but in a street location the tenant would have absolutely no control over whether competing retailers were located next to them or nearby. Providing the zoning is permissible, the tenancy mix that ultimately eventuates is largely a laissez faire, market-determined one without any overall consideration given to the impact a new retailer will have on other retailers. The landlord of an empty shop does not particularly care which retailer fills his shop provided they can pay the rent.

In a shopping centre, however, much greater consideration is given to the introduction of competitors. It makes no sense to introduce a competitor if the introduction of that competitor substantially damages an existing retailer. While no-one would argue that such judgments can be made with complete precision, they are usually based on a careful assessment of increased demand for particular products or services, and whether existing retailers can meet that demand.

A shopping centre manager has to put the interests of the centre (and therefore its customers) first. If there is only one coffee shop in a centre and it regularly has long queues of customers waiting to be served, the manager, in the interests of the centre and its customers, would be remiss not to seek to meet this demand by introducing more coffee shops. The coffee shop owner of course is quite happy to have customers queuing up for his product as this maximises his turnover but it is not in the interests of the centre or its customers. If the centre manager did not act to meet this excess demand, then customers would eventually get tired of waiting and take their custom elsewhere and this would ultimately be to the detriment of all the centre's retailers.

For this reason, in the absence of an exclusivity clause in the lease or a verbal representation by the landlord, retailers in a shopping centre cannot expect the landlord not to introduce competitors if there is demonstrated customer demand for them.

10.6 Centre management's accountability for performance

The Commissioner has queried in the public hearings whether shopping centre owners and managers are accountable for a decline in a centre's performance, given that they receive a share of the profits (through percentage rent clauses being 'triggered' or through rent increases on renewal) when a centre is successful. That is, as it was expressed at one stage in the hearing, that shopping centre owners and managers share the upside with retailers but not the downside.

This is not correct. The shopping centre owner and manager do share in the downside if a centre's performance declines. Shopping centre owners keep a close eye on the sales performance of their centres and receive regular (usually monthly) reports on sales, sales per square metre, and other key indicators. In the short term, if these figures show a significant decline, the performance of the centre's manager is likely to be questioned by the centre's owner. If the decline continues, it will become apparent to the industry as a whole (for example, through published league tables such as the *Big Guns* and *Little Guns* lists published in *Shopping Centre News*) and this will damage the owner's and the centre's reputation in the market.

Ultimately, of course, market forces come into play and the decline in performance will be reflected in reduced rents and a reduced return on the owner's capital. No shopping centre can continue to ask for significant rent increases on renewals if the centre's performance does not justify it. This may not be an immediate outcome but then neither are increased rents from *improvements* in a centre's performance – these increases are not realised until a new or renewed lease is negotiated. (It is true that percentage rent clauses may be 'triggered' earlier but these are usually set at such a high level that they are rarely triggered. If they are triggered, then, as one retailer stated at the public hearings no-one should be complaining because this would mean the retailer is doing extremely well.)

In reality, most shopping centre managers do not wait until lease expiry to act if a retailers performance declines. In these circumstances action is taken immediately to assist the retailer through difficult times. This can be either direct assistance through retailer assistance programs (as outlined in Westfield's first submission to the inquiry at page 27) or indirect assistance in the form of various lease incentives. This is, very definitely, 'sharing in the downside".

ATTACHMENT 1

Report on Retail Tenancy Regulation in New Zealand and Australia

Background

Australia and New Zealand have much in common in the areas of governance and regulation. They also share a common market in some areas, such as food regulation and government procurement, and have achieved harmonisation in a range of other areas as a result of the Australia New Zealand Closer Economic Relations Trade Agreement. In the operation of the market for retail tenancy leases, however, the two countries stand in marked contrast in their respective approaches.

Retail leases in Australia are heavily regulated. Each State and Territory (except Tasmania) has detailed legislation governing the relationship between retail landlords and retail tenants. (Tasmania operates under a statutory code of practice made under the Fair Trading Act.) In New South Wales, for example, the *Retail Leases Act* now contains 154 substantive sections as well as three substantial schedules. A simple matter such as regulation of the payment of security deposits now requires 29 separate sections of legislation.

In New Zealand, by contrast, retail leases are not regulated. Some aspects of leases are regulated by the *Property Law Act* but this Act applies to all property classes and is not specific to retail property.

In New Zealand it is the lease that governs the relationship between retail property landlords and tenants. In Australia the lease is frequently overridden by the provisions of retail tenancy legislation.

Interestingly there is no pressure or calls for retail tenancy legislation in New Zealand, either by retailers or by government. This is despite the strong presence of Australian companies in the ranks of retailers and owners of major shopping centres. According to the Property Council of New Zealand's *2007 New Zealand Shopping Centre Directory*, the Westfield Group is the largest owner of shopping centres in New Zealand and AMP Capital is the second largest owner. A stroll through any New Zealand shopping centre also graphically demonstrates the strong presence of Australian retailers in New Zealand.

Despite the absence of retail tenancy legislation in New Zealand, there is no evidence that retail tenants in New Zealand are any worse off than retail tenants in Australia. The absence of any demand by the New Zealand Retailers Association for retail tenancy legislation, and the fact that there have been no proposals by the New Zealand Government or Parliament to regulate this area, would suggest there is no significant market failure. It is the opinion of Property Council of New Zealand officials that regulation of retail tenancy leases by Parliament is unlikely since there are no obvious failures in the operation of the market and the number of retail tenancy disputes is not excessive.

There is no shopping centre data in New Zealand comparable to the annual *Urbis Retail Averages* in Australia so it is not possible to make a detailed comparison of rents per square metre, or occupancy cost ratios, between shopping centres in the two countries. The Westfield Group does not separately report its Australian and New Zealand portfolios so no comparison is possible between Westfield-owned centres in the two countries. Similarly there are no publicly available comparisons of AMP-owned centres in the two countries.

Nevertheless it is the opinion of shopping centre officials with experience in both countries that occupancy cost ratios for speciality retailers in New Zealand shopping centres are generally lower than they are in Australia.

It has been suggested that this disparity in occupancy costs is the result of a greater availability of retail space in New Zealand, possibly caused by that country's much less rigorous land use planning system compared to the systems applying in Australian States and Territories. This seems unlikely since, according to figures compiled by Urbis, there is more retail space available in Australia, both inside and outside shopping centres. On Urbis figures the total amount of retail space per capita in New Zealand is 2.0 sqm compared to 2.1 in Australia. The contrast in the amount of shopping centre retail space per capita - 0.4 sqm in New Zealand compared to 0.7 in Australia – is even greater. Whatever the benefits for retail tenants of Australia's highly regulated retail tenancy system, it seems that lower occupancy costs is not one of them.

An Australian observer of the retail tenancy market in New Zealand can't help but be struck by two other major differences between the two countries. First, there are far fewer retail tenancy disputes in New Zealand. Second, the retail tenancy relationship is much less adversarial in New Zealand than in Australia.

There is no data on retail tenancy disputes in New Zealand since there are no formal (i.e. State-sponsored) mediation and arbitration procedures in New Zealand, as there are in most Australian States. Discussions with officials in New Zealand, however, suggest that such disputes are not as common as they are in Australia (or, at least, as common as they are in NSW and Victoria, where most retail tenancy disputes occur.) The disputes that occur in New Zealand are generally disputes over interpretations of the lease and are decided by arbitration provisions included in the lease or by the courts under contract law.

New Zealand does not have the equivalent of section 51AC of the *Trade Practices Act* (relating to unconscionable conduct in retail tenancies) in its *Commerce Act* although there is an equivalent to section 52 (misleading and deceptive conduct) in its *Fair Trading Act*. While the Commerce Commission in New Zealand is the relevant authority under this Act, the Commerce Commission does not have the same involvement in retail tenancy matters as the Australian Competition and Consumer Commission (ACCC) has had in Australia in recent years.

It is also notable that the relationship between retail landlords and retail tenants in Australia is much more adversarial and more

legalistic than is the case in New Zealand. There seems little doubt that the existence of retail tenancy regulation, and the 'win, loss' nature of retail tenancy legislation reviews, is a major contributing factor to this adversarial approach.

In comparing the two countries it is also notable that the existence of retail tenancy legislation has led to the development of a 'protectionist' or 'regulation' mindset among most Australian retailer associations. Regulation begets more regulation. The automatic response by most retailer associations to just about any issue that arises in the retail tenancy market in Australia today seems to be to demand more regulation. Similarly there tends to be a 'regulation' mindset among government officials responsible for retail tenancy legislation. Few officials involved in retail tenancy reviews approach the task by asking the questions: is regulation necessary? what regulation can be removed?

This is perhaps not surprising after more than twenty years of increasing regulation in Australia and the constant rounds of retail tenancy reviews. As a result, however, a belief seems to have developed among many small retailers and retailer associations that risk in retail is now underwritten by government regulation and, as a result, if a retail venture fails then it must be the fault of the landlord. This mindset is notably absent in New Zealand, even among the Australian retail companies operating in New Zealand. The notions of business risk, individual responsibility and the need to thoroughly examine all aspects of a business venture before signing a lease, are still very prevalent in New Zealand.

This report examines several key aspects of the retail tenancy relationship and compares and contrasts the approaches of Australia and New Zealand. Because of the varying nature of retail tenancy legislation in Australia, the NSW *Retail Leases Act* has generally been used for comparison purposes. In New Zealand, the Property Council of New Zealand publishes a standard retail lease (*Property Council Retail Lease May 2001*) and this is usually the lease referred to below when discussing provisions of leases in New Zealand. This lease is presently being revised by the Property Council. It should be noted that the major shopping centre landlords tend to use their own standard leases.

1. Pre-Lease

In Australia 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.) are also often supplied although not required by law.

One of the key pieces of information required to be supplied by a landlord is the 'Lessor's Disclosure Statement' which must be given 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 or if information contained in the disclosure statement is incomplete or is materially false or misleading. Section 10 of the NSW *Retail Leases Act,* for example, provides for compensation for pre-lease misrepresentations. Section 11 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.

The disclosure statement in Australia has grown in length with each successive retail tenancy review, to such an extent that the Victorian Government has now announced a project to examine the disclosure statement as a major part of its 'red tape reduction' program.

In New Zealand there are no prescriptive requirements as to what must be disclosed to a prospective tenant. Each prospective tenant usually receives a letter of offer from the landlord (often no more than two pages) and an agreement for lease and a copy of a standard lease is usually attached to this document. No disclosure statement is required or is supplied. In many instances the letter of offer recommends to the prospective tenant that they seek legal advice on the offer. Once the agreement for lease is signed this becomes legally binding and, if a lease is subsequently not executed, this is the binding document between the two parties. Interestingly, there is no demand by the New Zealand Retailers Association for the introduction of a disclosure statement in New Zealand. The prevailing philosophy seems to be one of 'individual responsibility' and 'caveat emptor' i.e. it is the responsibility of the prospective retailer to familiarise themselves with all relevant aspects of the business before signing the lease.

2. Term of lease

In Australia retail tenancy legislation in all States and Territories (except Queensland) imposes a minimum *initial* lease term of five years. Although it is open for lessors to grant longer terms, the minimum lease has tended to become the maximum lease, at least in major shopping centres. (It should be noted that, although this minimum term was introduced as a 'protection' for retailers, the reason there is no minimum term in the Queensland legislation is because of opposition from retailer associations in that State, who maintain such minimum terms operate to the disadvantage of retailers.) Retailers can negotiate initial lease terms of less than five years but this requires certification, usually by a legal practitioner.

In New Zealand there is no statutory lease term (other than a requirement - which applies to all leases, not just retail leases – to obtain a subdivision consent if a lease of part of a certificate of title exceeds 35 years.) Lease terms in New Zealand's major shopping centres tend to range from five years to eight years, but it is generally accepted the average lease term is around five to six years. Retailers are free to negotiate shorter leases without the need for certification.

3. Rent reviews

In Australia, although many leases still make provision for mid-term market rent reviews, they are no longer common in major shopping centres. In these cases the lease sets out a formula for annual rent increases during the term of the lease. Retail tenancy legislation stipulates that the lease must state the method by which the rent is reviewed. It also lays down detailed rules about how such annual rent adjustments can take place (e.g. fixed percentage, fixed annual amounts etc.) The legislation also stipulates how market rent reviews are to be conducted and outlaws 'ratchet clauses' (i.e. upward-only rent reviews.)

In New Zealand, many leases still provide for mid-term market rent reviews even though the lease also provide for annual formulaic rent increases. Such mid-term rent reviews are generally at the discretion of the landlord. Leases usually stipulate that within a certain period prior to the review date, the lessor give notice of what they considers to be the market rent and, unless disputed by the lessee within a certain period, this is the new rent.

If it is disputed, the lease stipulates a process by which the rent is determined by independent valuers. In one major shopping centre last year, around three-quarters of the leases in their third year involved a mid-term rent review but only four of these reached the stage of appointing a valuer. 'Upward-only' market rent reviews are not prohibited and are the norm.

4. Relocations

In Australia, retail tenancy legislation in all States (except Western Australia) sets out minimum protections for tenants who are relocated, and these provisions override the provisions of a lease. These minimum provisions usually provide for a minimum period of notice of relocation; the notice must provide details of an alternative shop; and the rent for the alternative shop must be "the same as for the existing retail shop, adjusted to take into account the differences in the commercial values of the existing retail shop and the alternative shop." They also provide that the tenant is entitled to "payment of the reasonable fit out and legal costs of relocating." This usually becomes a commercial negotiation between the lessor and the lessee. The legislation also provides that a tenant can terminate the lease within one month of receiving the relocation notice.

In New Zealand, there are no statutory protections for tenants in the event of relocation. The provisions of the lease govern the conditions that apply in the event of relocation. Often the leases specifically state that, except where expressly provided, "no compensation whatsoever will be payable by the lessor to the lessee, whether for

interruption of its business, loss of profits arising from such an interruption, relocation costs or otherwise however arising." Some leases stipulate that the tenant is entitled to a proportion of the value of non-relocatable fixtures and fittings with the proportion decreasing the further into the lease the relocation occurs (eg. if it occurs in the first year of the lease, the tenant is entitled to 80% of the fit out cost; if in the fourth year, 20% etc.) In relation to alternative premises, leases often provide that they be in a location "suitable in the reasonable opinion of the lessor for the conduct of the lessee's business (having regard among other things to any obligation of the lessor to provide other lessees of the centre with alternative premises)". Leases also usually provide that a lease can be surrendered if the tenant decides not to accept the proposed relocation.

5. Assignments

In Australia, retail tenancy legislation in all States lays down protections for assignees in the event of assignment, stipulates the grounds on which assignments can be refused and curtails the ongoing liability of assignors for aspects of the lease, provided the assignor has observed the specified protections for assignees. The assignor must give the assignee a disclosure statement specifying certain information relevant to the business and an updated lessor's disclosure statement. The only grounds on which a lessor can refuse the assignment are a proposed change of use; the assignee has financial resources or retailing skills that are inferior to the assignor; or the assignor has not complied with the procedures for obtaining consent to the assignment. If the assignor complies with all procedures, and consent is obtained, the assignor and any guarantor "is released from future obligations under the lease unless it is found that the information contained in the assignor's disclosure statement is false or misleading or the statement was incomplete."

In New Zealand, the lease stipulates the rules that apply in the event of assignments. Some leases prevent assignments occurring in the first two years of a lease, which is not permitted under retail tenancy legislation in Australia. The grounds for rejecting an assignment under lease provisions ("not unreasonably withhold consent") is less restrictive than those specified by retail tenancy legislation in Australia. From 1 January 2008, under the Property Law Act, all landlords (not just retail property landlords) are required to grant or decline consent within a reasonable time and, if requested, give reasons for declining. They are also liable to damages if they unreasonably refuse consent. (A proposal in the recent Property Law Bill would have made it difficult for lessors to reject assignments on the grounds of change of use but this proposal was rejected by the Parliamentary Committee examining the Bill and the proposal did not proceed. Again, this would have applied to all property classes, not just retail property.) The protections built into retail tenancy legislation in Australia for the protection of assignees are not present in New Zealand. It is strictly a case of buyer beware, although there is recourse to the courts in the event of misleading and deceptive conduct.

6. Key money

The payment of key money, for the issuing of a lease and on assignments, is strictly prohibited by retail tenancy legislation in Australia.

Key money is not prohibited in New Zealand and is not necessarily seen to be a business evil. There are still instances of key money being paid to an assignor (on assignment) and to a lessor (for a lease.) Under the Property Law Act landlords cannot request key money to consent to an assignment. Although it is legal for landlords to request key money from a lessee for a new lease it is understood that this is now rare.

7. Outgoings (operating expenses)

In Australia the administration of operating expenses (outgoings) is tightly regulated by retail tenancy legislation and it has become common in recent reviews for additional highly prescriptive regulation to be imposed. The legislation usually defines outgoings ("reasonable expenses directly and reasonably attributable to the operation, maintenance or repair of the centre or building and areas used in association therewith; and charges, levies, premiums, rates or taxes (including GST) payable by the landlord") and stipulates how these are apportioned. Despite this definition some States do not permit land tax to be recovered in outgoings and one State does not permit management fees to be recovered in outgoings. Another State imposes a cap on increases in management fees. A strict distinction is made between operating expenditures and capital expenditure (which cannot be apportioned to lessees.)The administration of the marketing fund in shopping centres is similarly heavily regulated.

In New Zealand the administration of operating expenses is governed solely by the lease. While the leases of major landlords generally provide for the provision of an audited operating expenses statement (and an audited marketing fund statement) at the end of the accounting period this is not required by law as it is in Australia. Leases usually define "operating expenses" and, since capital items are not proscribed from operating expenses (as some are in Australia) it is estimated that a higher proportion of operating expenses are recoverable in New Zealand than they are in Australia. Some leases also require payments by tenants of an annual sum, not exceeding 5% of other operating costs, to cover centre repairs, renovations and replacements of an infrequent or irregular nature.

8. Recovery of lease preparation costs

In Australia the recovery by landlords of lease preparation costs is now largely prohibited by retail tenancy legislation in most States.

In New Zealand the recovery of lease preparation costs is not prohibited and is common practice in leases although some major lessees negotiate a cap on the costs that can be recovered.

9. Disclosure of turnover information and registration of leases

In Australia the reporting of turnover information by tenants is not prohibited by retail tenancy legislation but is constantly opposed by

most retailer associations in retail tenancy reviews. Leases in major shopping centres routinely include a percentage rent clause, which is only 'triggered' when a certain turnover is achieved, and this clause requires retailers to report their turnover, usually on a monthly basis.

In two States (NSW, Queensland), and in both Territories, leases are effectively required to be registered, and are available for searching.

In New Zealand it is common for leases to require the disclosure of turnover information, on a monthly basis, and the lease may stipulate that this is required "whether or not the lessee is obliged to pay percentage rent." This is generally not opposed by retailers.

Leases are not required to be registered.

10. End of lease notification

In Australia retail tenancy legislation generally stipulates that a landlord must give notice of his intentions prior to the end of the lease (usually not less than six months prior to expiry and not more than 12 months prior) and the term of the lease is correspondingly extended if the landlord gives notice less than six months prior to expiry.

In New Zealand, there are no similar provisions in relation to end-of-lease notifications. Most leases have no provisions about procedures that apply at the end of the lease, other than making provision for holding over.

11. Renewal of leases

In Australia, there is generally no right of renewal of leases imposed by retail tenancy legislation. In South Australia and the ACT a preferential right of renewal of lease provision has been inserted in the relevant legislation, at the instigation of retailer associations, in both cases against the wishes of the government of the day. These provide limited grounds on which the preferential right of renewal does not apply (such as a change of tenancy mix). In addition, both jurisdictions provide landlords and tenants with the ability to 'contract out' of these provisions by mutual agreement.

In New Zealand, there is no right of renewal or preferential right of renewal of retail leases although it is open to the parties, as in any part of a commercial arrangement, to include a right of renewal in a lease if they wish to do so.

Westfield

SALES RECORD

DECEMBER 2007

WESTFIELD AUSTRALIA

CATEGORY :
RAW

CENTRE	No of Stores		Area Sq M		December-2007					Actual MAT					Annualised MAT				
	Category	Store	Category	Store	Category Sales SPSM	%Var	Store Sales SPSM	%Var	SPSM Rank	Category Sales SPSM	%Var	Store Sales SPSM	%Var	SPSM Rank	Category Sales SPSM	%Var	Store Sales SPSM	%Var	SPSM Rank
Belconnen	9	1	582	83	2,593	4.6	3,331	24.8	3	12,907	7.5	14,726	13.1	3	12,854	7.0	14,726	13.1	3
Woden	8	1	589	140	2,854	8.1	2,916	13.2	4	14,001	10.7	13,275	19.2	5	14,001	9.5	13,275	19.2	5
ACT	17	2	1,171	223	2,724	6.4	3,070	17.6		13,457	9.1	13,813	16.7		13,431	8.3	13,813	16.7	
Bondi Junction	11	1	862	131	2,800	5.6	2,037	13.1	9	14,857	17.0	10,057	31.6	9	14,847	19.5	10,057	31.6	9
Chatswood	10	1	645	135	2,161	5.3	1,696	(4.2)	8	11,565	4.1	9,041	7.5	8	11,628	8.4	9,041	7.5	8
Eastgardens	9	1	734	164	2,740	9.7	2,344	2.5	5	14,151	3.1	12,198	11.7	7	14,151	10.2	12,198	11.7	7
Figtree	4	1	245	93	2,498	30.1	2,392	(4.0)	3	13,483	27.6	11,859	2.3	2	13,528	10.5	11,859	2.3	3
Hornsby	10	1	659	100	2,195	12.6	2,864	3.5	4	11,381	9.5	14,036	2.5	2	11,944	4.8	14,036	2.5	3
Hurstville	11	1	684	97	2,185	20.1	2,861	15.7	3	12,843	15.4	16,695	32.0	4	12,843	15.4	16,695	32.0	4
Kotara	11	1	789	151	3,522	41.4	2,429	18.3	10	14,158	10.9	9,437	(3.4)	5	16,106	(1.0)	9,437	(3.4)	10
Liverpool	10	1	797	103	3,070	23.5	3,396	35.9	2	15,696	(3.5)	15,945	107.0	4	15,777	2.2	15,945	24.8	4
Miranda	16	1	1,123	90	3,987	20.0	4,527	10.2	7	18,716	13.7	20,112	132.8	6	18,757	9.7	20,112	0.4	6
Parramatta	15	1	1,205	107	2,981	20.3	5,058	0.0	1	15,429	15.8	8,496	0.0	0	15,775	5.9	24,495	0.0	2
Penrith	15	1	1,150	151	3,630	9.9	4,130	5.9	6	17,297	6.1	18,195	3.7	6	17,470	5.0	18,195	3.7	6
Tuggerah	10	1	764	105	3,095	(1.2)	3,597	6.0	4	14,692	5.0	13,673	64.7	5	14,101	8.5	13,673	(2.5)	5
Warrawong	5	1	421	140	1,472	(8.3)	1,699	9.0	3	7,975	(1.4)	7,415	5.8	3	7,250	8.4	7,415	5.8	3
NEW SOUTH WALES	175	13	12,208	1,567	2,878	11.6	2,917	15.1		14,874	9.2	13,074	14.4		14,786	7.6	13,647	7.4	
Carindale	8	1	742	128	3,368	14.5	1,953	(29.3)	8	16,417	4.3	10,511	(18.8)	0	16,306	10.0	11,202	(13.5)	8
Chermside	14	1	1,234	111	3,468	8.1	4,054	(8.2)	5	17,114	(2.0)	21,244	(2.4)	4	17,114	0.7	21,244	(2.4)	4
Garden City	11	1	1,045	165	3,099	4.0	4,028	(3.1)	2	16,950	6.2	19,686	(2.6)	3	16,701	5.0	19,686	(2.6)	3
Helensvale	6	1	439	101	3,785	37.0	3,219	13.4	5	16,293	29.2	14,602	13.9	3	16,293	29.2	14,602	13.9	3
Strathpine	6	1	510	145	2,699	1.9	3,626	(5.7)	2	14,029	7.5	19,021	1.5	2	14,029	9.8	19,021	1.5	2
QUEENSLAND	53	5	4,644	650	3,164	7.5	3,408	(6.7)		16,121	6.1	17,494	(0.5)		15,847	6.9	17,343	(1.3)	
Airport West	6	1	512	100	2,410	(5.7)	2,083	3.2	4	12,122	(2.0)	10,113	8.6	5	12,122	(2.0)	10,113	8.6	5
Fountain Gate	11	1	893	112	3,883	10.0	5,354	15.3	3	17,948	14.6	25,262	22.2	2	17,948	14.6	25,262	22.2	2
Southland	11	1	1,012	130	2,741	10.7	2,761	3.1	5	12,876	8.6	13,405	(2.1)	5	12,993	5.6	13,405	(2.1)	5
VICTORIA	37	3	2,965	342	3,176	8.9	3,411	9.1		14,708	8.5	16,320	11.1		15,176	4.3	16,320	11.1	
Carousel	8	1	613	103	4,508	7.3	4,262	8.8	5	23,013	22.9	20,307	18.2	7	23,013	22.9	20,307	18.2	7
Innaloo	5	1	379	101	2,446	36.1	3,081	243.4	2	11,456	15.5	9,960	49.6	3	11,288	22.9	9,960	49.8	3
Whitford City	10	1	821	100	3,605	22.9	4,347	4.9	4	16,318	21.9	18,700	9.3	5	16,415	19.7	18,700	9.3	6
WESTERN AUSTRALIA	24	3	1,858	304	3,599	19.0	3,898	30.4		17,222	22.5	16,342	19.7		17,300	21.4	16,342	19.7	
TOTAL	328	26	24,768	3,086	3,044	12.1	3,183	9.8		15,189	10.6	14,773	9.27		15,178	9.0	14,999	7.2	

N.B. 1) Category information is not available where the category consists of 2 retailers or less
2) No of Stores is the number of retailers in the category, who traded during the month
3) Where stores have traded for less than 12 months:
- Actual MAT SPSM shall be labelled as "N/A" and the store will not be ranked
- Annualised MAT SPSM shall be calculated based on store's actual sales to date, extrapolated to full year sales using seasonal weightings
- Ranking will be based on annualised MAT SPSM

(Based on Actual MAT $ PSM)