**Queensland Retail Traders & Shopkeepers 'QRTSA'**

**Submission**

**Inquiry into the Market for Retail Tenancy Leases**

**in Australia**

## Overview

Queensland Retail Traders and Shopkeepers Association is the largest retail association in Queensland representing the interests of principally independent retailers of various sizes, many of whom are also property owners; some disenfranchised by the illogical expansion of major shopping centres.

QRTSA welcomes the Productivity Commissions review into Retail Tenancies in Australia because:

1. It is timely;
2. The industry has been analysed in detail and is known to be quite adversarial; and
3. It is an appropriate time in Australia to introduce legislation across the country that could become an international benchmark.

This submission seeks to:

- Respond to all the questions raised in the terms of reference, but does not answer specific questions;

- Inform the Productivity Commission what is occurring in Queensland, so that it can come to it's own conclusions and make decisions to ensure the shopping centre industry becomes transparent, fully informed, fair, efficient[1] and "demand" driven, rather than "supply" driven and "engineered".

Considerable investigation and research has been carried out by Professor Neil Crosby, of the Department of Real Estate and Planning, University of Reading Business School, United Kingdom, who visited Australia and prepared a report entitled "An Evaluation of the Policy Implications fort the UK of the Approach to Small Business Tenant Legislation in Australia" in August 2006.

Professor Crosby met with a broad range of representatives from industry including shopping centre owners and managers, investment advisors, barristers and lawyers, retailers, academics, bodies representing shopping centre groups and retailers groups, valuers and consultants.

Professor Crosby's findings from his research in Australia, was considered in terms of the Policy implications for the UK, which in turn can be compared back to Australia.

The key advantages from both countries have been taken into account; the UK industry having been "moderated" by law over a considerable period, whilst Australia have had the two parties develop into "fixed positions" economically with relatively no law, but now in need of reform.

Ironically as this submission will demonstrate, much of this was covered in the House of Representatives Standing Committee on Industry, Science and Technology hearings for the Fair Trading Inquiry in 1997.

To this end the Productivity Commission might consider the inefficient use of both landlord and tenant capital, plus the consequential impact on the consumer and the public purse, balanced against legislation in Australia that considers/encourages:

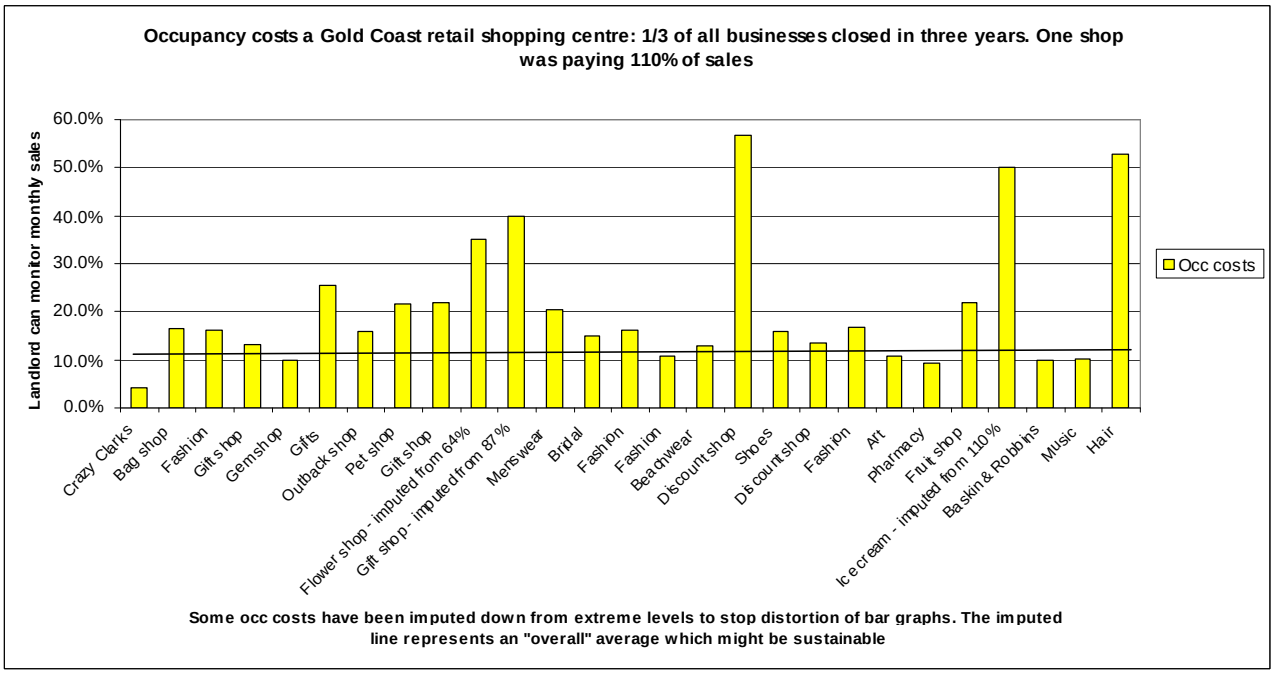
- The consequences of a sudden correction in the retail property industry (retail, commercial and industrial) because "contract rents, which are unrealisable are engineered rent; valuations based on engineered rents will not result in Market Value"[2]. The reason for this is that it is not an open market;
- Longer tenure versus perpetual leases in the UK versus short lease terms, that gives the one party the opportunity of using undue leverage[3] to negotiate non-economic lease terms[4] - see the graph on pg 4. 1/3 of all businesses on the Gold Coast in one shopping centre closed down with occupancy costs cited as being the reason;
- Tenure sufficient[5] that gives one party enough time to amortise set-up costs[6] particularly to maximise the write-off for zero based accounting under Australian Taxation Legislation, given the one party can easily plan ahead 10 or 15 years for redevelopment/extensions, demolition or refurbishment, including forward planning of tenancy mix. There is existing flexibility built into to tenancy legislation including relocation provisions[7];

- Quiet use and enjoyment provisions both at common law and which is already embodied into state tenancy law[8];
- Options and renewals given competent managers can easily screen for competent tenants on realistic lease terms (the average hypothetical landlord and hypothetical tenant)[9];
- Prescriptive end of lease rent dispute resolution mechanisms[10], to facilitate the operation of open transparent negotiation, failing which a method to resolve any impasse that could exist with reference to other forms of ADR. There is already an ideal model in the ACT legislation;
- Access to open transparent sales and rental data, including trends and or closures in tenant disclosure documents for a more informed market to operate and for more informed bargaining;
- A method to ensure utilities, outgoings fees and charges are properly acquired, apportioned, measured, recovered and accounted for on a competitive basis, including management fees, including the right to tender to create competitive pricing. The LPT sector is currently charging three to four times higher than independently managed centres; are they FOUR times better than the "average" managed centre or is the consumer forced to meet these expenses. Ultimately the consumer is paying. Only Western Australia have excluded management fees from outgoings recoveries, but a more preferable way would be to see a competitive market with the right to go to tender for price comparison purposes;
- That one's set-up costs can be procured in an open informed market using licensed tradesmen rather than being compelled to accept possibly hire charges by a "related

company" to the centre management which may amount to a "subsidy" and possibly even a breach of the TPA;

- To ensure enforcement of legislation is low cost and that natural justice and fairness can be achieved, without expensive and unnecessary legal procedure and where the parties are not awarded damages in equity;
- That as distinct from a place of work or the storage and manufacture of goods and services, retail property is a business opportunity and needs to be treated differently, however in both instances to avoid expensive relocation costs, and loss of business "goodwill", reasonable tenure at reasonable occupancy costs is important and so all classes of property should be included in any legislation;
- That once a lease term ends, if the landlord is to replace a old tenant with an new tenant, particularly if there are in situ fixtures and fittings that can be used, that the new and old parties can transact the value of the business as a "going concern" as though there was a new lease in place paying market rent. In the absence of this a landlord should be compelled not to lease out a shop to the same or similar business for 12 months to avoid "gazumping" or the goodwill of the shop being "stolen". This tends to happen in smaller centres, where family members take over a business without paying for the "business goodwill" at lease expiry;
- The model the Productivity Commission might consider is whether the states relinquish their jurisdiction of state tenancy law, similar to the corporations law or uniform state tenancy legislation, administered at a state level viz. similar model as the uniform Commercial Arbitration Acts.

Like the office market, the retail market would be far more efficient and less wasteful if it was market driven, rather than opportunistic and supply driven or driven by the wrong message about "engineered rents". In the process developers, investors, and parties to leases (landlords and tenants) can and do suffer in the process.




**Terms of Reference – 'TOR'**

The Inquiry into the Market for Retail Tenancy Leases in Australia has been called for by the Treasurer, Hon Mr Peter Costello, pursuant to Parts 2 and 3 of the Productivity Commission Act 1998. We quote from the Terms of Reference as follows: "*In undertaking the inquiry, the Commission is to examine:*

*1. The structure and functioning of the retail tenancy market … including … retail tenancies as a source of income for landlords, investors and tenants and the relationships with the broader market for commercial tenancies;*

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

*3. The extent of any information asymmetry between landlords and retail tenants and its impact on business operation;*

*4. Scope for reform of retail tenancy regulations to improve economic performance, including:*

*• Differences in … regulation between States and Territories, … scope for nationally agreed regulations and approaches; and*

*• The extent and adequacy of dispute resolution systems … including differences in dispute resolution frameworks between the States and Territories;*

*5. The appropriateness and transparency of the key factors … in determining retail tenancy rents;*

*6. The appropriateness and transparency … when the lease ends; and*

*7. Any measures to improve overall transparency and competitiveness... for retail tenancy leases.*

*The Commission is requested to:*

- *Make recommendations for improving the operation of the … market; and*

- *Identify and, where practicable, quantify the likely benefits and costs of its recommendations for retail tenants, landlords, investors and the general community."*

**Professor Crosby's findings with regard to the Australian market**

Professor Crosby's findings from his executive summary are listed below, and each point can be linked either directly or indirectly to the 'TOR' called for by the Hon Peter Costello.

1. There is no national tenancy code in Australia, where the responsibility for landlord and tenancy issues lies at a State and Territory Level despite calls from Government Committee reports and landlords' and tenants' organisation for national laws [Pt 4 of 'TOR'].
2. That since the 1980s legislation had developed to protect business tenants against abuse of market power by landlords, particularly large shopping centre landlords [Pts 1, 2, 3, 5, 6, & 7 of 'TOR'].
3. Voluntary codes had been dismissed as being ineffective [Pt 4 of 'TOR'].
4. The legislation varies between the States. It is aimed mainly at retail tenants, but also includes some office users [Pt 4 'TOR'].
5. Attempts to isolate part of the market has caused issues by defining retail floor space, exuding some listed companies, while some commercial users are excluded, other larger companies may be included. This was unsatisfactory and that the legislation did not use the number of employees to define a retail tenant [Pt 4 of 'TOR'].

6. The legislation was administered by lease registrars or commissioners and were responsible for education, investigation of non-compliance and dispute resolution. In Victoria 70% of the work of the Small Business Commissioner related to retail tenancy matters [Pts 1 & 4 of 'TOR'].
7. The information available to retail tenants before entering a lease including copies of leases differed from the UK, where no information was provided [Pts 3, 5, 6 & 7 of 'TOR'].
8. Non-compliance could lead to withholding of rent or termination of the lease and/or fines [Pt 6 of 'TOR'].
9. Legislation usually prescribes minimum 5-year terms, that upwards-only reviews (ratchet clauses) were banned and that other terms were prescribed. On having banned ratchet clauses, market reviews had disappeared[1112] and CPI or fixed increases were common [Pts 1, 2, 3, 4, 5, 6 & 7 of 'TOR'].
10. There was no right to renew in a State or Territory and only the ACT and South Australia had a preferential right to renew. There was a strong "right to manage" the centre, which held "sway at present over the tenant's claims of misuse of power at lease expiry" [as above].
11. The dispute resolution process was based on compulsory mediation before proceeding to court, and that in Victoria 75% of cased "settle" prior to going to hearing or at mediation. In that state, it was committed to low-cost, quick dispute resolution and the system was universally praised [Pt 4 of 'TOR'].
12. Landlords appear nervous of the unconscionable conduct provisions and the consequences of adverse publicity if being found to have acted so during

negotiations. While this acts as a deterrent, if there was other "prescriptive terms of engagement" in our legislation, they too would act as a deterrent for fair outcomes eg. logical tenure, ability to request multiple options, introduce some lease flexibility and end of lease dispute resolution.

**Professor Crosby's findings and policy implications for the UK**

Professor Crosby then considered the policy implications for the UK, noting that over this period the operation of the UK and Australian markets differ due to two major reasons, which has distorted market rents in this country. The UK offers:

- Security of tenure including perpetual leases unless otherwise agreed to by the parties often with multiple options; and
- Lease rent dispute resolution mechanisms built into the legislation.

Professor Crosby concluded that:

1. If government were to consider small business tenants, it would not change the emphasis to only retail tenants (suggesting that tenancy law might be modified in Australia to include commercial tenancy, but noted that the law had evolved in Australia in response mainly to the retail property industry, noting the difference between retail as distinct from commercial, is that the one is dependant on the "place" of doing business[13]);
2. That separating the legislation across segments or parts of the market and defining the scope of the legislation had caused numerous difficulties[14];
3. There was merit in introducing mandatory disclosure statements with a copy of a proposed lease to ensure tenants got a fair lease; and

4. Easier dispute resolution processes could be considered in the UK to resolve the small business policy issue.

From the results of Professor Crosby's findings, one can conclude there is quite a lot of overlap between factors operating in the Australian market, and the Terms of Reference called for by the Treasurer, suggesting there are factors lacking in Australian Tenancy Law, which are reasonable well known. It appears therefore what is lacking, is a means and medium to introduce fair legislation, to regulate it and enforce it.

**Other findings**

Lease tenure of small businesses were generally for only 5 years with no right of renewal rights, whereas major anchor stores, and in one case study in a 80,000 square metre Melbourne centre, the Myer Department Store and Safeway supermarket both occupied on 20-year terms, including some other less important stores. It was noted that the three minor anchors paid 50% more per square metre that a major retailer.

Ironically since ratchet clauses have been banned, landlords have moved towards CPI and fixed increases and away from market reviews; the market is rigid and structured, it is not fully informed and not working.

**Productivity Commission considerations**

| Critical parts of law to address | Reason |
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| Security of tenure | A business needs tenure to set-up, build up and close-down. Within a 5-year lease term, it is impossible, the business being most vulnerable at lease |

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| | renewal with fixtures and fittings not yet written off. The broad principles should be:<br>▪ That for any new lease in a shopping centre, tenure should be granted to amortise set-up costs twice under the taxation legislation viz. 8 + 8 years;<br>▪ 8 + 8 year terms may be split into terms within that at the tenant's request (say 3 + 5 = 8), and have at least one market review opportunity within each 8 year term and the commencement of the next 8 years;<br>▪ At the request of either party up to one year before the end of the final term, more 8 year terms can be requested;<br>▪ For strip shops the above principles apply but it is not a controlled environment and only a single 8 year term must be offered (or period totalling 8 years), but with options if agreed;<br>▪ A requirement to do a refit will trigger a new 8 year term (to write it off);<br>▪ Fitout requirements generally should be in sufficient detail for full costings to be done to negotiate the lease terms with IAS 38 or AASB 138 zero based costing principles, to avoid opportunistic leverage at renewal because of fitout cannot be written off and avoid unconscionable conduct arising;<br>▪ At end of 8 + 8 years to avoid a previous tenant's site goodwill being taken without being paid, and to prevent "gazumping" a landlord may not offer a subsequent tenant a lease under the same permitted use, unless the parties have had the opportunity to sell the goodwill on the forward assumption of another 8 + 8 year lease offered at market value;<br>▪ Less tenure can be requested by the tenant;<br>▪ Shorter tenure may be offered by a landlord if there is a genuine extension, redevelopment. It will force landlords to plan ahead. |
| Disruption to trade, maintenance of centre, misrepresentation | Generally, the provisions and principles are already established and must simply be enforced. I understand that in Canada, if centres renovate, extend or upgrade, business owners are sent away on holiday and come back to their shops either having been relocated or able to trade. It is cheaper for all concerned. |
| End of lease & rent review principles | The ACT end of lease dispute resolution mechanisms must be mandatory and the market review principles embodied in the Queensland, NSW and Victorian Acts should apply, with the permitted use and reasonable rent principles embodied.<br><br>The latter two principles are critical in the retail arena. |
| Fitout & pre-fitout works | To reduce or avoid significant cost burdens and third line forcing requiring tenants to do fitouts with only one supplier (often a related company belonging to the Landlord) should be outlawed. |
| Sales data; business closures and why | A commissioner should be appointed in every state:<br>▪ To collate sales data (excluding GST) for all centres from a Supermarket based centre upwards, perhaps on a quarterly basis in line with BASS (maybe off that data base);<br>▪ To ensure sales turnover is presented and available on the Web for each centre on a "User Pays" basis; |

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|---|---|
| | ▪ To ensure all Lessor Disclosure Documents (which have essential lease rent data vs whole leases) are "Registered" including incentives if any granted. This to include leases that do not proceed;<br>▪ To note all business closures over three years with the reasons why. |
| Outgoings Code of Conduct | This is already drafted. It is ready to go, simply attach it to the law as mandatory. |
| Enforcement | ▪ State Tribunals are geared to retail. Compensation should be up to $500,000 and enforcement in equity to avoid one party subsidising the other's "business". If one plays by the rules, there will be no need for it.<br>▪ Tribunals may not depart from decisions of other jurisdictions or higher authorities.<br>▪ Tribunals should be able to hear any matter including matters about rent.<br>▪ No party should have to pay the other's legal expenses unless there is a judgement awarded against them.<br>▪ In Tribunals, no costs may be awarded unless a claim is frivolous and vexatious. |
| When it comes into operation | New tenancy law can come into operation:<br>▪ at any time by mutual agreement;<br>▪ at the end of a lease or beginning of a new option period. |
| Guarantees | ▪ Personal guarantees limited to three months gross rent;<br>▪ No business owner should have to disclose more about their personal assets than a simple letter from the bank, that the proprietor has sufficient equity to cover set-up costs including stock, and that the business will cover the rent, provided it is paying current market rent;<br>▪ On sale of business (assignment of lease), that party has no further obligations under the lease including guarantees. |

**Conclusions**

These are the facts as we know them to be.

It is for the Productivity Commission to come up with it's own conclusions and

decisions.

It is our belief that this is not a fully informed market, where one can rigorously negotiate

without one's business goodwill being used as a sword against the sole proprietors

(which makes up 96% of retail shops and in total Aus$4.3 trillion worth of the Australian economy).

It must become a self-regulating industry and market, for the benefit of all stakeholders.

Ian Baldock

Executive Director

Queensland Retail Traders & Shopkeepers Association

for and on behalf of our members

24th July 2007

**Footnotes:**

[1] S 3 Retail Shop Leases Act 1994 Queensland "The object of the Act is to promote efficiency and equity in the conduct of certain retail businesses in Queensland".

[2] [2] See – IVS International Valuation White Paper on valuing property for securitized investments.

[3] "An Evaluation of the Policy Implications fort the UK of the Approach to Small Business Tenant Legislation in Australia". Professor Neil Crosby pg "*The use threats of prospective retailers waiting in the wings and the lack of the right to renew to replace tenants or force them to pay higher rents, which may include part of their goodwill to secure their position. Where the option to renew exists, tenants can, under the RLA, have their rents fixed by specialist valuers, appointed by the SBC, at the market rent as previously defined.*"

[4] Ref The Law Affecting Rent Review Determinations by Alan Hyam Barrister-at-law – pg 1 refers to a House of Lords decision *United Scientific Holdings Ltd v Burnley Borough Council* [1978] AC 904 which outlines the benefits for both landlords and tenants if the rent becomes uneconomic and the other party is not granted sufficient tenure.

[5] House of Representatives Standing Committee on Industry Science and Technology 'IST', pg 816, 24th February 1997, Mr Ian Newton, General Manager, Leasing Division, Westfield "*The next matter is non-renewal or termination of lease. Where a retailer and owner agree on a lease, they agree that at the end of the lease term the retailer will vacate without compensation. This is the essence of the agreement reached. The retailer must therefore make his profit from the shop*

*during the currency of the lease. This means that any cost to fitout must be recouped during the lease term. It would be unfair to change what the parties have voluntarily agreed upon".*

[6] 'IST', pg 779, 24th February 1997, Mr Alan Briggs, former General Manager Westfield *"The value of the goodwill decreases, depending on the term available to the merchant. We hold there is not inherent goodwill attached to a lease, with the exception if a merchant has a five-year lease, then say, then it has some value. The cash-flow of the business has some value across the period of five year (sic). One year into the lease it is four years; two years in it is three years, and so on as it gradually diminishes, the at the end of the lease these is no goodwill".*

[7] See *United Scientific Holdings Ltd v Burnley Borough Council* [1978] AC 904 which outlines the benefits for both landlords and tenants if the rent becomes uneconomic and the other party is not granted sufficient tenure.

[8] IST', pg 780, 24th February 1997, Mr Dale McDermaid, former joint MD Byvan *"In many cases – in fact in mostly all cases – the landlord has an obligation to pay for these relocations, subject to negotiation with the tenant that is being proposed to be relocated. As for disturbance, it is also clearly documented as to the parameters and procedures that are to be taken in regard to a disturbance of quiet enjoyment for the retailer."*

[9] [9] Only the Australian Capital Territory legislation S 51 & 52 provides for a lease renewal dispute resolution mechanism in the event the rent cannot be agreed, requiring the landlord to make a bona fide offer in writing at market rent which, if not agreed to, is referred to mediation and in the last instance, expert determination

[10] [10] 'IST', pg 779, 24th February 1997, Mr Briggs, GM Westfield *"Turning to rental renewals with a sitting tenant and the concept of market rent, we have as an industry formally recognised the issue of the sitting tenant and the problem of market rent on renewal, which is one of the most vexatious issues that faces all of us. It is a key component of retailer argument right the way round the country. We are actively working with the Australian Retailers Association and are committed to seeking a resolution. Indeed, one party ahs put together some preliminary work which we will work on to see if we can get it to fruition. The commitment is shared by the shopping centres Australia-wide under the aegis of the Property Council".*

Chair *"At the end of the term?"*

Mr Briggs *"There is no goodwill."*

Chair *"No goodwill"*

[13] 'IST', pg 788, 24th February 1997, Mr Briggs, GM Westfield *"What are you buying? You are certainly not buying a lovely shop in a lovely centre. You are buying the cash flow, the business".*

[14] 'IST', pg 778, 24th February 1997, Mr Briggs, GM Westfield *"Firstly, harmonised lease legislation. Inconsistencies in the retail lease legislation in each state and territory are an impediment to good business practice for retailers and retail property. The Property Council strongly advocates harmonised lease legislation."*