THE MARKET FOR RETAIL TENANCY LEASES IN AUSTRALIA

Background

In 2005-06, the NSW Government conducted a thorough review of its retail tenancy legislation, and appropriate legislation to up-date it was subsequently passed by the NSW Parliament. The NSW Act (the *Retail Leases Act, 1994*), is, perhaps, the most important piece of legislation in this area in Australia, as it has been almost universally used by other Australian states as the basis for their legislation. Not only that but the review also found that the NSW legislation was justified on cost-benefit grounds, which implies that, as it stands, the legislation in its current form is performing a highly useful purpose in the NSW retail business arena.

While the NSW review was thorough, it was focused principally upon NSW legislation and there were a number of broader issues that emerged which lay beyond its terms of reference. The following submission deals briefly with some of the major of these.

Legislative Harmonisation

One matter that requires consideration is that the legislation relating to retail leases across Australian states is not fully consistent. For example, appeal mechanisms vary. Some states having compulsory mediation before matters can be referred to a tribunal, while other states have a voluntary system. Generally, as one goes up through the tier of legal arrangements (mediation, tribunal, district court, supreme court, etc.), the costs of mounting a case become greater. In the NSW case, therefore, compulsory mediation is cheaper to operate than simply allowing disputants to elect to take their case to the next tier of legal consideration, the tribunal or perhaps a court.

Having differences between state legislation means that there can be no standard leases, Australia-wide, making it costlier for both national landlords and tenants to keep track of their legal requirements and in negotiating new or renewed leases. Potentially, harmonization or standardization of legislation could reduce these costs.

A major problem with harmonization is the question of which state's legislation should form the basis for the harmonisation exercise. In view of its recent review and its positive cost-benefit findings, a good starting point could be the existing NSW legislation. It must be recognized, however, that harmonization will require extensive state-wide consultation before any state-based legislative changes can be effected. One approach could be for the Commonwealth Inquiry to suggest and promote "principles of amendment", rather than trying to pressure uniform changes whose introduction might be problematic for the states. This could allow particular problems within individual states to be dealt with, while at the same time maintaining a suitable level of national uniformity. Experience has shown, however, that a persuasive "carrot" might be necessary to ensure prompt and uniform legislative amendment by the states.

Competition

No matter how effective the legislation, when one compares a small jeweller entering a lease with the management of a major shopping centre like Westfield, Lend Lease, Centro and other major retail lessors, it is hard to believe that their relative bargaining powers are equal. Indeed, much of the existing retail leases legislation seeks to address the relative imbalance in power between lessors and lessees. Any attempt to reduce the balancing effect of existing state legislation, would, in all probably, be resisted strongly by state governments and tenant groups. However, it is certain that the relationship between retail landlords and tenants could benefit from a greater element of competition than exists at the moment.

There are numerous domains of this perceived lack of competition but to date, the main focus has been upon the inequality of information available to the leasing parties. This matter has been dealt with extensively in legislative reviews and the literature, and is not a focus for this submission.

What has been only touched on tangentially, however, is the matter of retail tenants forming associations and lobby groups to assert greater power and influence over the retail leasing process, the retail leasing industry, and government. Undoubtedly, the existing legislation in all states represents the outcome of negotiations between the respective lessor and lessee power groups, moderated by government. It is certain that the existing legislative landscape for retail leases would look somewhat different if those representing lessee interests were more able to match the power (information-wise, legally and economically) of lessor groups, and be more effective in their representations. For example, the legislation might contain less accessible appeal rights to tribunals and courts so that the cost of disputes is kept down, a matter of particular concern to small tenants; there would most probably be no requirement in lease documents for tenants to disclose turnover figures, a source of ongoing tension that does not exist in leasing arrangements in the UK; and in all probability, more equitable legislative arrangements would be in place to resolve end-of-lease compensation matters, etc., etc.

It would seem, therefore, that an injection of more competition into the leasing process (and its related legislation) could potentially bring greater balance to the retail leasing industry in Australia. The problem, then, is how to build more effective tenants' groups and to recognize them, and lessor groups, in legislation. Indeed, if one looks at the existing legislation, such groups are non-existent, the legislation referring only to lessors and lessees. Yet it is precisely these interest groups, not individuals, who have been involved in forming and reviewing the legislation that binds their members.

Recognising the need not to be overly prescriptive, the Commonwealth Inquiry might consider the relative merits of forming tenants' groups at the shopping centre level (this does not address the problems for strip shops, where there are also many lessors), the regional level, or perhaps state and/or nation-wide. Whatever arrangement is chosen, if any, it is critical that the goal – injecting more competition into the leasing process - not be lost sight of. A review of how such groups work overseas - their effectiveness,

membership and financing - particularly in countries such as in the USA and the UK, might give some directional leads here.

Impact of Failing Retail Tenancies

Not all retail tenancy leases are successful from a business perspective. Quite a number fail and the consequences for the lessee can be catastrophic. Some lose their homes and all their possessions, as well as being declared bankrupt. Families can fall apart and the general impact can be highly disruptive, socially and economically. Often the result is that the community has to bear the cost of such failure (by way of social and community services). The level of losses can be quite high, often in excess of $500,000 where a home has been made part of the collateral for funding a business.

The large shopping centre owners are well aware of this problem and to a greater or lesser degree, offer support and advice to their tenants when things start to become problematic. Unfortunately, this support and advice is uneven and in the case of most strip shops, virtually non-existent. Nor is its arrival always timely.

An important problem for the retail industry, then, is how to minimize the number and impact of these failures. Solutions proposed range from mandating that all lessees have both adequate training and sufficient resources to take on the running of a retail business, and that the retail leasing process is accompanied by the production of evidence from the lessee that there is a good chance of his/her business being successful in the current market. While the greatest weight in demonstrating this must fall upon the lessee, it is also important that the lessor be convinced that each agreed retail leasing proposal relates to a viable business. In this proposal, responsibility lies with both leasing parties.

Other proposals have included the idea of an industry-wide fund being established, funded by a levy on both lessors and lessees, from which financial support can be drawn to assist lessees in need. One perceived problem with this approach is that its support is provided after the failure rather than before it occurs. Nor is it favoured by those retail businesses operators who are successful.

Whatever is done about this matter – and it is one that deserves more attention - the fact is that when a failure occurs, current arrangements tend to externalize substantial parts of the impact from the retail industry, leaving the public purse to bear the bulk of the burden. Consideration needs to be given, therefore, to enshrining in legislation all necessary steps that guarantee retail businesses' success, and in the event of failure, ensuring that the industry itself picks up the 'tab' for any damages that are sustained.

Conclusion

There is a multitude of issues surrounding retail tenancy matters in Australia. This submission has focused on three matters that tend to be overlooked because of their broad nature. While it proposes some possible solutions, it also advises further research in some areas.