Australian National Retailers Association (ANRA)

SUBMISSION TO
AUSTRALIAN FEDERAL PRODUCTIVITY COMMISSION'S INQUIRY INTO
RETAIL TENANCY LEASES IN AUSTRALIA

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Executive summary

The Australian National Retailers Association (ANRA) shares the concerns expressed by the Federal Government about retail tenancy leases.

ANRA, whose members are all large retailers on a national scale, acknowledges that market forces determine rent price and that for some retailer's size and scale mean that they have a stronger negotiating position as a result of market forces at work.

However it is not just small businesses facing challenges when entering into commercial leases. ANRA's members, many of whom are considered 'anchor tenants', are also experiencing ongoing difficulties when entering into or renegotiating retail tenancy agreements.

There a range of issues that impede open and competitive behaviours in the market which need to be addressed.

In the current environment, retail tenants are forced to accept leases with a range of charges, terms and conditions without being able to assess their impact upon their businesses. Competition and opportunities to negotiate on a level platform do not exist.

The different legislative requirements in the different States and Territories compound this situation as ANRA members cannot adopt a national approach to their tenancies with national owners of shopping centre complexes.

Of particular concern to ANRA's membership is the lack of transparent information when negotiating or renegotiating their leases. Outgoings are an area of particular concern with accountability a continuing problem.

The complexity of both the Australian retail sector and the current framework means there is no single solution to the retail tenancies issue. However, it is clear that consistency and transparency, currently two of the biggest challenges facing tenants, will be key factors in any new approach.

While a more robust and consistent regulatory environment will ensure that tenants' rights are protected and that the system maintains a reasonable level of balance, any new system must not impose an onerous new cost and compliance burden upon retail businesses. ANRA is supportive of the streamlining of varying State and Territory legislations and a light-handed regulatory environment.

Introduction

The Australian National Retailers Association (ANRA) is a membership-based organisation that was established in 2006 to represent the interests of large national retailers across Australia generating annual sales in excess of $70 billion and employing around 600,000 Australians. The founding Board members of the ANRA include Coles Group, Woolworths, Bunnings, David Jones and Best and Less. The retail sector;

- contributes 6 per cent to Australia's economic output
- is twice the size of the agriculture, forestry and fishing industries and is larger than mining, transport and storage and communications
- is the largest employer in the country providing over 15 per cent of all jobs

ANRA members bring a unique view to the issue of retail tenancy leases given that a number of its members are both tenants and landlords. In addition, several of ANRA's members are considered 'anchor tenants' – retailers whose presence is considered essential for a shopping centre to succeed.

This document is ANRA's response to the Productivity Commission's call for submissions on retail tenancy leases in Australia. ANRA understands that the scope of Inquiry is to make recommendations for improving the operation of the retail tenancy market and identify, and where practicable quantify, the likely benefits and costs of its recommendations for retail tenants, landlords, investors and the community generally.

Background

What are retail tenancy leases and why are they so important to the retail sector?

- Retail tenancy leases provide access to premises for the conduct of a retail business. They are legally binding documents that define the relationship between the owner /manager of retail premises (the landlord) and the retailer (the tenant) and cover a wide range of issues including rent, lease term (the period of the lease), relocation, redevelopment, quality and maintenance of premises, annual rent reviews, fit-outs and terminations.
- Retail leases have important commercial implications for both landlords and tenants. The financial viability of an enterprise can be affected by the lack of appreciation of all the commitments entered into under a lease. A change in trading conditions from those expected, or decisions by the landlord or tenant can impact on trade or costs. In some circumstances, these can be a source of dispute.

- Retail tenancy is governed in each State and Territory by specific legislation with the Commonwealth adding specific protection against unconscionable behavior.
- Relevant legislation includes:

ACT	Leases (Commercial and Retail) Act 2001
Commonwealth	Trade Practices Act 1974
New South Wales	Retail Leases Act 1994
Northern Territory	Business tenancies (Fair Dealings) 2003
Queensland	Retail Shop Leases Act 1994
South Australia	Retail and Commercial Leases Act 1995
Tasmania	Fair Trading (Code of Practice of Retail Tenancies) Regulation 1998
Victoria	Retail Tenancies Reform Act 1998/Retail Leases Act 2003.
Western Australia	Commercial Tenancy (Retail Shops) Agreements Act 1985

Over the past decade there have been a number of important developments around the issue of retail tenancy leases:

- The Reid Report in 1997 found that often small business were disadvantaged in their dealings with landlords and recommended the drafting of a uniform retail tenancy code with a view to the adoption of uniform retail tenancy legislation around Australia.
- The Australian Government, in its response to the Reid Report in 1997, stopped short of a national code and instead decided to regulate against unconscionable behaviour (through amendments to the Trade Practices Act) and committed to work with the States and Territories to achieve greater consistency.
- Thus far the drive to achieve greater consistency has only had limited success. In 1999 the Joint Select Committee on the Retail Sector recommended among other things the revisiting of the issue of the need for a national and uniform retail tenancy code as recommended in the Reid Report. This recommendation was not taken up by the Australian Government.

Being able to have a representative view on the issue of retail tenancies has been a key issue for retail tenants over the past ten years. Challenges have included legislative barriers prohibiting the sharing of information and the size, scale and nature of the industry.

Given these challenges, it has been hard for retailers to present a united front and a small number of well organised landlords have been able to achieve a very strong market position. This influence has resulted in very little change favouring tenants over the past 10 years and goes some way in explaining the slow progress to obtain greater national consistency.

Retail tenancies – key issues

When considering the need for a new approach to retail tenancies, we should examine the situation in New Zealand. ANRA members who have a presence in both countries believe the system in Australia is over-regulated and inconsistent with multi-layered legislation. While the New Zealand market is vibrantly competitive, Australia in contrast has a small number of linked landlords controlling the market making it necessary to 'build in' tenant protections to the system.

A new approach to regulation is appropriate in the Australian context in order to address key accountability and transparency issues. ANRA's members have nominated the following concerns as being of central importance to any discussion of retail tenancies in Australia:

1. Inconsistencies in State and Territory legislation

Inconsistencies across State and Territory legislation are an important issue impacting on retail tenancy leases. ANRA members are all nationally based retailers with outlets in all States and Territories. Lease arrangements are therefore often with a few nationally based landlords, but differing regulatory requirements make it impossible to negotiate one uniform agreement with each landlord.

Instead, separate agreements are forged to satisfy the different regulations and then weeks are spent while lawyers reconcile the range of inconsistent regulations. This is a time-consuming and costly exercise that is unacceptable to both landlords and retail tenants.

Examples of inconsistencies include:

- Disclosure requirements are different across States and Territories
- In Queensland, landlords cannot recover land tax from tenants but they can in NSW and other states
- How and when rents are reviewed
- Whether some retail businesses are actually covered by retail tenancies legislation
- For how long and on which days particular tenants can trade

State governed planning codes and town planning have also contributed to the current situation. There has been a trend toward zoning retail areas in major malls only, leaving retail tenants with limited supply and site options.

The lack of a common judicial or administrative review, as well as the legislative conflicts make the negotiation, interpretation and resolution of disputes across States and Territories inefficient, costly and uncertain.

2. Lack of transparency

Retail tenants often find themselves in an information' vacuum' when it comes to negotiating or even assessing their leases. Across the board, there is a need for greater transparency in the dealings between retail tenants and landlords. The direct and indirect costs of leases to tenants are often significant and complex, and require further breaking down to understand and verify. Outgoings, category one works, costs of upgrades and management fees are all areas for concern. In addition there is a need to better define what can be attributed to leased premises as opposed to the landlord's corporate overheads.

All tenants need to have the right to initiate an audit of outgoings charged by landlords. Without this accountability, tenants cannot know whether they are being overcharged or charged for outgoings that they should not be responsible for. Governments may wish to consider the implementation of a Schedule of Management Fees to deliver greater transparency and accountability to both landlords and tenants.

Outgoings

Historically outgoings were calculated at between five and ten per cent of a tenant's total rental costs and were specially to cover the management costs of the shopping centre. Over time it has become equal to the rental price with little or no accountability on the part of landlords, and ANRA is concerned that outgoings have evolved from being a cost recovery exercise to becoming an income stream for landlords.

However, without transparency of outgoing costs, retailers cannot truly assess the current or future financial impact on their businesses. This restricts their ability to assess or challenge the costs, giving landlords undue advantage on the amounts and types of costs they recover from tenants.

Examples:

- Complex managers can let a contract to new cleaners who charge 100 per cent more than the previous cleaners. This increased cost is passed directly onto tenants who have no recourse. Tenants cannot question whether the price they are being charged is based on a competitive process or if it is at a reasonable market value.
- Lack of tenant control over the amount the landlord can charge for management fees can result in one centre charging $200 per square meter and another only $25.
- A tenant can have three properties in one centre and be charged at different rates for the same outgoing.

While there is clearly a need to re-examine regulation in this area, ANRA would be supportive of the development of a Code of Conduct administered by the ACCC rather than a legislative remedy.

'Category One Works'

In most shopping complexes, tenancy agreements require that maintenance or repairs be carried out on shops utilising designated contractors. For example, during refurbishments landlords can use their preferred contractors to erect hoardings, despite the fact these contractors charge between three and four times the going commercial rate for such services.

Further compounding this issue is that landlords seem keen to categorise expenses into categories that can be charged back to tenants. This could include centre upgrades being recorded as capital works or expenses.

Current invoicing processes do not detail all expensed items, which makes any attempts at auditing by tenants both costly and time consuming. ANRA would like to see greater clarity in how expenses and charges are categorised, with a consistent national approach. For example, rents should not be negotiated only to have tenants find out that certain expenses (e.g. water and power) are not covered. These practices are commonplace and have a significant impact on retailers small and large.

3. <u>The need for increased certainty, consideration and fairness</u>

Greater certainty could be achieved with greater protections for retail tenants. When a tenant enters into a five-year rental lease they should reasonably expect that major terms of that lease – such as locations, rent formulas, number of competitors - will not change during this time.

Unfortunately, the reverse is often true. Retailers can sign up to a long-term lease with the understanding that there are only 15 other competitors, only to have this change overnight with a complex deciding to introduce 30 more stores. Under the current system, no consultation is required with tenants and compensation for tenants' decreased sales is not a consideration for landlords.

Forced relocations are also of significant concern, with retail tenants given no say in their new location or which businesses they are located with.

The current practice of giving retailers only a few months notice of major periods of closure to refurbish or relocate is not acceptable to ANRA members, given the impact of loss of earnings and potential forward impacts on profitability.

Casual leasing is another significant issue for retailers, large and small. The bringing in of casual tenants to shopping centers results in competition with permanent tenants. For example, a chocolate retailer comes into a complex three weeks before Mother's Day and stays only until then. They pay only a small cost and do not contribute to outgoings or the running of the centre. Permanent retailers meanwhile lose sales to casual retailers who bear none of the overhead costs of permanent tenants.

ANRA's view is that landlords need to engage in real consultation when proposing redevelopments and changes to business conditions.

Examples
- "Make good" provisions - when tenants are held to provisions to make good the premises before exit they can be held to unreasonable demands. In one instance, a major retailer tiled an entire shop area. Upon exit the landlord charged that tenant $60,000 to return the property to its original condition. The landlord rented the premises unchanged and kept the make good fee.
- Outgoings, while already high, are also increasing at a rate twice that of the CPI.

4. Setting of rents

ANRA is aware of concerns about differential rents in the retail sector. While larger retailers may have some advantage negotiating rents due to their size and scale, there are other factors to consider.

Landlords, for examples, will often not commence a retail development without having major, long term tenancies on board to underwrite the returns on the development. The long term nature of these leases and the substantial risk large tenants take if the Centre is not successful, offset the higher per square metre rent paid by those tenants who take short term leases.

Nonetheless, ANRA members remain concerned about how rents are determined. Protections are required to ensure landlords cannot compare sales data or other information from one shopping complex and use this as a basis to set the rents in another location.

Neither should sales information alone be used as a basis to calculate rents alone. In particular, this can impact on retailers when forward rents are based on retrospective sales and subsequent sales figures are not as strong. If residential landlords were able to set their tenants' rents based on wages there would be a national outcry.

Conclusion

The Australian National Retail Association (ANRA) believes retail tenancy leases are at the very heart of defining the relationship between retail building owners and managers and the retailers.

Whether retailers operate small specialty businesses or large scale retail operations, it is important that they can operate in a transparent and consistent environment.

ANRA is the view that a balance must be struck so that smaller specialty retailers can still afford to rent premises in large shopping complexes, thus providing customers with choice and competition.

ANRA considers the issues of nationally consistent legislation and transparency of information, especially on outgoings and category one works are key to successful retail tenancies. Retailers are seeking increased certainty and fairness in their relationships with landlords.

Given the complex and inconsistent nature of the current framework, any new approach must seek to streamline and simplify the system to allow a level playing field for landlords and tenants alike. In that vein, ANRA is supportive of light-handed regulatory measures such as Codes of Conduct. Any proposed changes must be assessed carefully to a minimal cost impact for retailers and shoppers alike.