February 2008

Senator Andrew Murray

Submission in response to the Draft Report of the Productivity Commission re:
THE MARKET FOR RETAIL TENANCY LEASES IN AUSTRALIA

Main Failing in the Draft Report

The market for square metres of retail space should be little different to the market for any other good or service that is traded. With respect to this Productivity Commission (PC) inquiry, the questions are whether the retail space market offers the opportunity for excessive or monopoly profits, whether the market is structured to be less open than other markets are, and whether supply constraints distort pricing. If any of these are so, why would that be in the public interest?

Excessive or monopoly profits mean higher rentals than would otherwise be paid in an open market, and higher rentals mean higher end charges to consumers, because these costs are passed on. Even without monopoly profits, it is axiomatic in our system for open and transparent pricing to apply in markets, absent compelling reasons for it not to.

Retail tenancy laws across Australia have (broadly speaking) greatly improved over the years, although there are clear opportunities for further reform and harmonisation. However, a reasonably satisfactory state of affairs at the individual disclosure level – that is, tenant to landlord or party-to-party – is not matched by a fully open competitive market at the aggregate level. The Draft Report fails to address this fundamental weakness in the retail space market.

Argument

At the aggregate level, there is a lack of transparency and equity of dealings between retail tenants and their landlords or shopping centre owners.

A market-based approach means that a known market price for different types of retail space would benefit all market participants through improving informed decision making.

In March 2004 the Senate Economics Committee report on *The Effectiveness of the Trade Practices Act 1974 in protecting small business*, (the 2004 Report) recommended that there should be harmonisation of retail tenancy laws across the nation. In making that recommendation, the Committee noted at E.34 page xvii that:

> *there are inconsistencies and areas where the law could be strengthened, including in relation to the common practice of 'secret pricing' in retail tenancies. While the Committee does not support the compulsory disclosure of rental terms, the Committee does not support arrangements which prevent such disclosure. Such arrangements inhibit, rather than support, an informed market for retail tenancies.* [1]

It is surprising then, that the PC Draft Report into the *Market for Retail Tenancy Leases in Australia* fails to address those express concerns by the Senate Committee, or the broader question of whether secret pricing should apply at all.

Chapter 8 of the Draft Report, enticingly headed *Market information, transparency and disclosure*, has limited its investigation into the disclosure statements between retail lessors and their individual tenants, but has not dealt with the availability of market information at the aggregate level. Consumers who buy goods and services will either have a price list available to them of all the goods and services on offer, or will be able to see the price tag on each item. Yet consumers (prospective tenants) who are shopping for retail space will generally only be able to see the price of just one or two premises on offer. Put simply, why is there no advocacy by the PC of a price list for retail space in shopping centres that is known to all prospective tenants, that clearly indicates premiums and discounts determined by size, location, parking, drawing power and so on?

[1] Senate Economics Committee report on *The Effectiveness of the Trade Practices Act 1974 in protecting small business* 2004, pxvii

Why does the PC not advocate the same level of price and product disclosure in the retail space market as any other market?

There seems to be a great reliance on submissions which were opposed to 'more disclosure' as in the draft finding on page 145 that says:

> *A lack of information and reliance on verbal agreements should not be an issue if disclosure statements are diligently executed or use is made of market information services.*[2]

Neither disclosure statements, nor market information services provide information as to the rent per square metre being charged by the owner or lessor of a large shopping centre across the tenant base. The focus of this draft finding is on information that is shared between the landlord and the prospective tenant. It is party-to-party information; it is not general market information.

On a party-to-party basis the PC may well have grounds for believing that more information in disclosure statements may be unnecessary, but the PC does not address the aggregate market situation. It is disappointing that the Commission did not use, as its starting point of inquiry, the recommendation of the Senate Economics Committee quoted above.

In most other markets we are fully aware of the price of a range of goods and services. If someone is buying a house they have information available to them about the price of other houses in the area. That information includes what each house is made of, how big it is, how large the block of land is, and so on. People can, if they want, do a search of websites such as REIWA, the Valuer General or pay for a DOLA search (or the other State equivalents) to determine what the market rate for the type of house they are looking for is. If they do not want to do those kinds of searches, then they have the opportunity to simply study the real estate section of the newspaper over a couple of weeks to get an idea of the range of market prices.

[2] Productivity Commission Draft Report, *The Market for Retail Tenancy Leases in Australia*, November 2007, p145

No such market information for a shopping centre or centres in specific areas is available to prospective retail tenants.

Although the Draft Report refers to advisory services, these are not services which provide market price information. Such services help tenants understand the disclosure document, their lease and their obligations under that lease. Such advisory services are unlikely to let prospective tenants know that they could be paying more or less per square metre than other tenants in the same or similar shopping mall.

The issue is not whether large retailers are entitled to a heavily discounted price for retail space because of their virtues as anchor tenants. Fleet buyers of motor cars get a better price than individuals. But the individual buying a motor car is fully aware of the prices of all the motor cars, both in that dealership and in other dealerships. In contrast, generally only the chain retailers have extensive market knowledge of retail space prices across a range of locations.

Shopping malls are a microcosm of the marketplace. They include a diversity of business types, experience and financial acumen. On a party-to-party basis, disclosure statements do assist those who are single retailers or who are inexperienced in retail leasing in shopping centres, although I accept it is likely some of those entering into a retail shopping lease still do not read the disclosure statement in full.

While in a private contract between two parties it is up to both parties to get the appropriate legal and financial advice, the prospective tenant is still entitled to expect open market information, as in any other market.

To make an informed decision about where or whether to lease, a small business owner might try to find out the rent being charged by other people in the mall, or a similar business in another mall. However, there is nowhere to find that information, the landlord is very unlikely tell the prospective tenant, and most tenants in the shopping mall will not either because there will generally be a provision in their retail lease which compels them to keep the terms and conditions of their lease secret

The PC appears to think that this information is provided by advisory services, but where is the evidence for this? In any case why should the tenant have to pay for an advisory service for market information, which in other markets is freely and publicly available and accessible? If a consumer wants to know the price of different shoes, houses or cars, they do not have to pay for that information from an advisory service, because shoes, houses and cars are an open market.

The focus of the PC Draft Report on disclosure of information is too much centred on disclosure documents and party-to-party transactions and is not focussed on market information.

There is also no discussion in the PC's Draft Report which reflects Recommendation 10 of the Senate 2004 Report:

> *The committee recommends that the Commonwealth Government negotiate with state and territory governments, with a view to introducing measures which would prohibit retail lease provisions compelling tenants to keep their tenancy terms and conditions secret.*[3]

This has long been an area of concern for many retailers, and I am surprised, given that 'secret pricing' was raised in a number of submissions to the PC, that there is limited discussion of it in the PC's Draft Report.

The PC suggests that with the registration of leases, as is required in NSW and Queensland, information about the market rent will be available if a tenant pays a fee to the relevant authority to access the lease.

As is correctly pointed out in the submission from the Southern Sydney Retailers Association Inc (Submission 113)[4], many of the terms which actually impact on the rent that is paid, are contained in the Agreement to Lease, and this document cannot be registered. The Agreement to Lease is a much more extensive document, covering a much wider range of issues than the Lease, and therefore the assumption made by

[3] Senate Economics Committee report on *The Effectiveness of the Trade Practices Act 1974 in protecting small business*, 2004, pxvii

[4] Craig Kelly, *The Secret Market of Retail Leases in Australia*, July 2007, p4 (Submission 113)

the PC, that registration of leases would somehow improve information in the marketplace, appears to be naïve.

The terms of reference of this inquiry require the PC to investigate:

2. Any competition, regulatory and access restraints on the economically efficient operation of the market.[5]

As far as I can see there is nothing in the Draft Report that actually does make any meaningful investigation in relation to this.

Retail leasing is covered extensively in State legislation (the Draft Report refers to over 700 pages of legislation) but there is no explanation from the PC as to why it has not addressed the issues raised in the recommendations from the Senate 2004 Report or the matter of aggregate market information in relation to retail leases. It is difficult to see how the Commission can *make recommendations for improving the operation of the retail tenancy market*[6] without doing this.

Despite changes to the regulatory environment governing retail tenancies the underlying problem of a lack of transparency in the pricing of retail space remains. It is difficult to see why the PC would not support an initiative to strengthen the market pricing mechanism and to uphold the powers of a free transparent and open market. Yet the PC seems determined to accept the view that retail commercial property is a special case that should not be subject to standard open market principles concerning price and market information.

Market mechanisms that are open, widely known, and transparent are rightly lauded, in that they contribute significantly to vigorous competition, the lowest prices, and the best services and products. An open market is a means by which a price can be determined by the efficient operation of supply and demand. In important respects the Australian commercial property market is an exception, and an explanation for why this is so is just as important as fixing the inequity.

[5] Productivity Commission Draft Report, *The Market for Retail Tenancy Leases in Australia*, November 2007, pIV
[6] ibid