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Queensland Retail Traders & Shopkeepers 'QRTSA'

Response to Draft Report

Inquiry into the Market for Retail Tenancy Leases

in Australia

Background

Thank you for the hearing with our representative, Mr Don Gilbert, at the Productivity Commission hearing in Brisbane on 11th February.

Mr Gilbert informed us that he stated at the hearing that we would cover issues/concerns in writing. We also understand that the Draft Report is open for review, so we will cover what we feel are important issues.

As an overview, if one compares "The Market for Retail Tenancy Leases in Australia" to a broken car, does one ask one's mechanic to half fix the car or does one do it properly? QRTSA feels this is an opportunity to fix tenancy law in Australia once and for all.

It is also important that there be meaningful change to "balance" the inequity between stakeholders. From QRTSA's perspective, since the Draft Report

came out in November last year, the retail Listed Property Trust sector has been "hammered" in what should technically be a safer area to invest. This should never have occurred but has done so because of the following:

- Negotiation disadvantage at lease renewal time and behaviour the industry persists with; and
- The information asymmetry viz. centre, specialty shop and category performance levels and rent levels known to the landlord but not the tenant.

This is because income streams (and financial structures) are not what they are purported to be. The income streams have been severely weakened by negotiation disadvantage.

Format and matters heard

Mr Gilbert sought to explain both his and QRTSA's rational submission. The Table summarising the issues on pg 11 – 13 of Submission 50 covers the "basics" of what we believe are essential principles to be incorporated into State Tenancy Law. The best elements (the detail) could be picked out from the various states and territories including Victoria, New South Wales and the ACT. QRTSA material covered:

- Security of tenure – see below;
- Disruption to trade, maintenance, misrepresentation – covered in state tenancy law;
- End of lease rent review principles – see below;
- Fitout & pre-fitout works – third line forcing;
- Sales data: business closure and why – removal of information asymmetry. Our submission (sales and lease rental data) endeavoured to think outside the box and possibly collate data via BASS;
- The outgoings Code of Conduct – Mr Bruce York and Mr Gilbert had prepared the document which simply needs to be "tacked" on to any legislation;
- Enforcement – state system works reasonably well although the jurisdiction limit of $500,000, suggested by QRTSA, is still too low. Compensation should be "in equity", otherwise the one party subsidises the other's investment. Major landlords, with investments worth billions, who are not required to compensate in equity pose a major imbalance. In addition, the tenant is still required to pay the rent yet a landlord could significantly disrupt trade with losses easily exceeding the rent, which is archaic in the extreme, when all that is required is that rent owing be offset against losses and damages. "Behavioural change" would also stop bad behaviour and thus claims by one party against the other;
- When new tenancy law might come into operation; and
- Guarantees.

Mr Gilbert reiterated that QRTSA has used one of the most pre-eminent authorities as a reference point

on leases/retail leasing, namely Prof Neil Crosby, who advises the office of the Deputy Prime Minister in the United Kingdom. It tried to link parallels in his knowledge and experience with that of Australia. The QRTSA submission referred back to two of Westfield's executives, namely Mr Ian Newton and Mr Alan Briggs, and to statements made by them in February 1997 during the Fair Trading Inquiry about tenure, referring to the concept of a five-year lease and *"the issue of the sitting tenant and the problem of market rents on renewal, which is one of the most vexatious issues that faces all of us."*

Mr Gilbert pointed out that today, 11 years on, nothing has been done, despite an undertaking to work towards resolving end of lease issues with the Australian Retailers Association at the time. Only the ACT has a working model[i]. Had that model been operating since 1997/98, the extreme volatility, overvaluations, risky rental income stream scenarios, massive loss of shareholder/superannuation fund equity would not have occurred, as we have seen in recent times on the ASX.

Mr Gilbert believes that as long as the shopping centre Industry is allowed to continue operating without informed negotiations, and fair bargaining, so it will continue to be dysfunctional. For all stakeholders.

A far healthier market-place, will be one that is "demand driven", rather than the "supply driven" market which operates at present. The sole reason, is because the "floor price" or "average rents" or the "market rent" is above the natural equilibrium point where supply = demand; or should equal demand. Given the parties had a mechanism for "In good faith" negotiations and fair and equal bargaining on entering a new lease (or a lease renewal), this would allow the natural equilibrium point to be reached, for the market to operate freely and fairly.

Tenure, security of tenure, lease disputes, rental disputes, end of lease

Today, as a professional consultant, Mr Gilbert said that he could not advise anyone to: take his superannuation and invest his time, effort and intellectual property in a retail shop in the shopping centre industry; nor to put his money into a retail LPT investment; nor to purchase a shopping centre property investment.

This is because it is highly dysfunctional industry (as reflected in far higher falls in the LPT sector vs the all ordinaries - traditionally a "defensive" investment class[ii]) and the relationships between landlords and tenants in Australia's malls continue to fall as the expectations become increasingly unrealistic.

Mr Gilbert felt the Commission's understanding is very good with regard to the concepts of: tenure; rent (quantum); fitout and capacity to amortise set-up costs; and how these three are all related and interrelated.

With regard to tenure, Mr Gilbert felt that when a minimum lease tenure of 5-years is prescribed, the "culture and behaviour" of the shopping centre industry turns the "minimum" into the "maximum". It might be better to suggest a range of say 5 – 8 years in order that both parties optimise their "return" using a combination of tenure, rent and extent of fitout to reach agreement on commercially realistic terms. Mr Gilbert felt that 8 + 8 year terms suggested in our original submission might be modified down to 6 + 6 or 7 + 7 years. We believe the business owner or prospective business owner should be able to elect to shorten the term "at will" and/or elect to call for one "break" per lease term viz. for six years, say 2 + 4 years OR 3 + 3 years, with one "market review" opportunity during any one term of one's lease viz. to allow for changes in tenancy mix for example.

The introduction of lease "flexibility" would assist an informed market to operate.

Mr Gilbert quoted from John Farrell's commentary about how well the ACT model is working, with some 90% of leases being renewed in the ACT. This has removed the "power imbalance" and had significantly moderated the "behaviour" of the stronger party to contract.

In response, the Commission's opinion was that there appear to be difficulties in the renewal process in the ACT but Mr Gilbert felt that this is probably because business owners are not aware of how the renewal process operates or their rights under the legislation.

The benefit of the prescriptive lease renewal process legislated under S 51 & 52 of the ACT tenancy law to:

- make a firm offer of a new lease at "market rent" to be negotiated; failing which
- there is a requirement to mediate the rental "dispute", also at market rent; failing which
- it goes to expert determination in the last instance;

removes, therefore, the possibility of any "gazumping", stand-over tactics, use of duress, etc, etc.

Since the Fair Trading Inquiry, Mr Gilbert stated that the shopping centre landlords now have well organised "teams" called "Leasing Executives" signing people into leases, particularly when they are financially (or otherwise) "married" to a site. Together with this unequal bargaining and information asymmetry, these "teams" are able to unfairly "price gouge" a weaker party to accept non-commercial lease/rent terms. He also believes some "independent" retail leasing consultants are, in fact, working for shopping centre owners, leading small business owners into detrimental leases.

The process of entering a lease, particularly in the case of small business persons, was covered at length in meaningful discussion. Mr Gilbert believes that this is a "cultural" matter, one in which superannuants and the like, armed with their payouts, often buy businesses on "emotional" rather than "hardnosed" business logic and reasoning.

The Queensland experience was discussed, whereby financial and legal advice certificates are a prescriptive requirement for retail tenancies with fewer than five shops. Mr Gilbert felt many "accountants" are taxation accountants, and do not understand "business" per se as opposed to "businesses". He had encountered a business owner who had prepared a Business Plan; the accountant used the material and charged the prospective business owner some $4,000 - 5,000 for the privilege. Legal costs to peruse and advise on the lease were a similar amount. Breach of quiet use and enjoyment had forced the business owner to close the shop and he had incurred losses of upwards of $150,000 after just over one year's trading.

Other matters not covered at hearing

Detailed disclosure requirements – less important if end of lease tenure fitout dispute resolution was fixed

Mr Gilbert feels that Disclosure Documents have been "twisted" to protect the stronger party, (the landlord), requiring business owners, for example, to disclose representations relied upon (which in practice they do not do in fear of it being used against them viz. non renewal), vs the stronger party, the landlord, not disclosing to the weaker party what it ought to know. For example, it could include the reasons why the last business closed in that site, the last 20 shops that closed in a centre and previous business owners' contact details and the rental ranges being charged, etc.

In addition from the transcripts it is noted that a Code of Conduct was discussed at the hearing. A voluntary code had been suggested. Mr Gilbert feels, as had been suggested by Professor Crosby that they simply do not work. Voluntary franchise codes had also not worked.

Mr Gilbert feels that the behaviour of this industry will not change, without prescriptive Codes of Conduct or legislation. Quite simply they must be told what to do, starting from the largest

organisations and at the top.

Conclusion

The aim of the QRTSA submission was to be practical, informative, to think outside the "box" and to seek permanent solutions. The QRTSA and its members, made up of property owners, investors, superannuants and tenants, all need an open, informed, transparent Market for Retail Tenancy Leases in Australia to operate for the benefit of all stakeholders.

Via our representative, Mr Gilbert, we expressed what we believed to be the more important points summarised by the Productivity Commission (document dated 4th September 2007) which included: tenure and capacity to amortise setup costs; prescriptive end of lease dispute resolution mechanisms; access to sales and rental data; freedom to procure setup costs in the open market; prohibition from reletting to same or similar tenants; and State's relinquishing tenancy laws to Federal level and adopting "best practice" into prescriptive legislation.

Mr Gilbert has advised us that he has forwarded his paper "Settling rental (and other retail lease) disputes by Expert Determination"[iii] to the Productivity Commission to provide background knowledge and to assist the Commission to understand the issues and the use of Expert Determination as one possible solution and form of Alternative Dispute Resolution "ADR" to settle disputes.

All the other parts in our table are considered urgent/critical/important, except for slightly shorter tenure (or flexible tenure) and compensation in equity to avoid one party subsidising the others investment.

An open informed transparent market, would be one operating where the "floor price" or "market rent"

was arrived at via a mechanism of free and fair bargaining and negotiation.

Ian Baldock

Executive Director

Queensland Retail Traders & Shopkeepers Association

For an on behalf of our members

18th February 2008

Productivity Commission considerations – table from our original submission

Critical parts of law to address	**Reason**
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 renewal with fixtures and fittings not yet written off. The broad principles should be: ▪ 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; **[maybe less, say 6 + 6 or 7 + 7 years]** 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; ▪ At the request of either party up to one year before the end of the final term, more 8 year terms can be requested; ▪ 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; ▪ A requirement to do a refit will trigger a new 8 year term (to write it off); ▪ 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; ▪ At end of 8 + 8 years, to avoid a previous tenant's site goodwill being taken without being paid for 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; ▪ Less tenure can be requested by the tenant; ▪ Shorter tenure may be offered by a landlord if there is a genuine

	extension or 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. 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: ▪ 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); ▪ To ensure sales turnover is presented and available on the Web for each centre on a "User Pays" basis; ▪ 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; ▪ To note all business closures over three years with the reasons why.
Outgoings Code of Conduct	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 **[compensation in equity, by far bigger and stronger resourced organisations, for damage claims which they could avoid through better business practice, forward planning etc]** 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. ▪ Tribunals may not depart from decisions of other jurisdictions or higher authorities. ▪ Tribunals should be able to hear any matter, including matters about rent. ▪ No party should have to pay the other's legal expenses unless there is a judgement awarded against them. ▪ 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: ▪ at any time by mutual agreement; ▪ at the end of a lease or beginning of a new option period.
Guarantees	▪ Personal guarantees limited to three months gross rent; ▪ No business owner should have to disclose more about their personal assets than a simple letter from the bank, showing 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; ▪ On sale of business (assignment of lease), that party has no further obligations under the lease including guarantees.

Footnotes

[i] *" Note for example in the report that around 90% of leases are renewed in the ACT compared with around 60-to-70% elsewhere - case closed! The NFIB has a good working relationship with the landlords because they KNOW that they cannot engage in "conduct" as can their Interstate counterparts. We reach negotiated financial outcomes based on realistic and rigorous Sale Value models"* – email from John Farrell - NFIB

[ii] Chanticleer Australian Fin Review Feb 16 – 17, 2008 pg 64 & 61 *"the trading halt requested by Centro Properties Group and Centro Retail indicates that all is not hunky dory amongst the extended group of 23 creditor banks and investor".s*

[iii] http://www.wavoglobal.org/ - see "Publications". "News" - awarded Best Research Paper, 2007 WAVO Congress, Beijing, Peoples Republic of China