
8 Market information, transparency and disclosure

The Commission was repeatedly told that there is an information imbalance in the relationship between shopping centre landlords and retail tenants. One retailer association stated that retailers often find themselves in an information ‘vacuum’ when negotiating or assessing their leases. While such claims are not new (similar concerns were expressed to the Reid Inquiry), they are made in the context of extensive information disclosure requirements under current regulations, considerable public information available from tenancy authorities and the development of a lease information and advisory sector. This chapter reports on and assesses the availability of market information, market transparency and disclosure in the retail tenancy market, before considering participants’ suggested options for change.

Section 8.1 presents participants’ views on information availability and market transparency while section 8.2 evaluates available evidence of information failure in the retail tenancy market. In section 8.3, options for improving information available to landlords and tenants are assessed, taking into account the current availability of market information and the actions available to business to improve the information base and its utilisation. Section 8.4 sums up the Commission’s assessment of key information gaps and possibilities for closing them.

8.1 Participants’ views

During the course of this inquiry, the Commission received a number of requests from tenants for advice on how and where they could obtain assistance and further information for particular tenancy problems. It was also suggested that the complexity of leases and disclosure statements creates a barrier to good decision making even though these documents increase the amount of available information.

Disclosure of information

A number of participants commented favourably on the disclosure requirements under the current retail tenancy legislation. Indeed, some suggested that the

provisions in Australia could be taken up in other countries, with Professor Neil Crosby stating:

The means by which tenants are informed at the commencement of lease negotiations by the provision of information including draft leases and information guides does appear to be extremely efficient and useful, either informing tenants or persuading them that they need professional help early in the process. This aspect of the Australian system has already informed the lease reform debate in the UK which is currently focusing on the dissemination of the new third voluntary lease code to small business tenants. The information and subsequent disclosure provisions of the legislation should be retained and may well become part of the UK process in the future. (submission no. 84, p. 3)

Tribe Conway & Co, however, stated that the rules in place for the provision of disclosure statements placed unnecessary constraints on landlords and tenants, because disclosure provisions:

... entitles a lessee to terminate the lease where the disclosure statement was not given 'at least 7 days before a retail shop lease is entered into' [in NSW], it is commercially impossible for a lessor and lessee to enter into a lease within 7 days after the provision of a disclosure statement.

Often a lessee may wish to enter into a lease, and take possession of retail shop premises quickly, and within less than 7 days after receiving a disclosure statement. Bizarrely this is prohibited. (submission no. DR144, p. 1)

Not enough information?

Some considered disclosure provisions had not done enough and that retailers continue to operate in an environment of considerable uncertainty due to lack of information. The Australian National Retailers Association argued that there is scope to achieve greater certainty 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 location, 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. (submission no. 92, p. 8)

A number of other participants claimed that they had entered into a lease without being aware of critical information, such as imminent changes to the tenancy mix and traffic access changes (elevators being moved, changes to access doors amongst others), that subsequently had a significant adverse effect on their business. For example, a small retailer informed the Commission:

I wished I had been a little bit more knowledgeable about dealing with leasing executives and know that I should have had a lot more written into the leasing contract and not accepted their verbal untruths. (confidential submission)

Other participants, however, suggested that often it is a lack of business acumen rather than a lack of disclosure of information that results in problems. The National Retail Association (NRA) commented:

There are fairly extensive disclosure requirements for landlords under some State legislation, particularly for new leases. However, individual landlords and prospective tenants have difficulty in accurately assessing business potential for a particular lease. (submission no. 47, p. 13)

Many of these considerations were echoed in response to the draft report. For example, the Small Business Development Corporation believed that the disclosure requirements in place had a positive effect on the market, stating:

... disclosure and dispute resolution are key areas that assist to address imbalances between market players. (submission no. DR194, p. 9)

Conversely, participants repeated concerns that disclosure had not gone far enough, with key information needed to assess locations absent from the disclosure statement. As expressed by TCM Consulting:

Currently the level of Disclosure required by Shopping Centre Landlords is grossly insufficient. ... When the level of investment on rent, employment, stock purchases and other expenses are tallied even small Retail Tenants are making 'million dollar' decisions, with very little real understanding of how the Shopping Centre, and the immediate precinct within the centre, are performing. (submission no. DR183, pp. 5-6)

While many participants repeated concerns over the extent and nature of information delivery in response to the draft report, others held a different view. Todd Trevaks, retail consultant, stated:

My own experience is that the more detail there has been in disclosure statements, the more helpful that has been to me as a consultant to retailers. In fact one of the problems that I find is that there may be not enough information in the disclosure statement. (transcript, p. 527)

Such sentiments suggest that while the disclosure of information is important to enable efficient decision making, improvements could be made to the method in which this information is delivered.

Too much information?

While information is essential to good business decision making, some participants expressed concern at the substantial increase in the size of disclosure statements and

the burden of ‘red tape’ placed on both lessors and lessees. As the Shopping Centre Council of Australia (SCCA) stated:

... prescribed disclosure statements in each State and Territory have been exhaustively examined during each review of retail tenancy legislation and have grown in length with each review. The pro forma NSW Lessor’s Disclosure Statement, for example, is now 6 pages in length but when populated by the lessor can be twice that length. This statement contains (in the case of shopping centres) 40 separate items of information that must be supplied. Seventeen of these questions are specific to shopping centre tenancies. (submission no. 83, p. 26)

Some participants expressed concern that the increasing length and complexity of the documentation has had its own adverse effects. The Australian Retailers Association (ARA), for example suggested that the length of the documentation may result in less informed prospective tenants rather than the reverse:

In most shopping centres retail leases with the major landlords can run up to sixty pages. ... The majority of small businesses do not seek professional advice before entering into the lease and sign it not knowing the full ramifications of the contract. (submission no. 119, pp. 4-5)

RICS Oceania noted that disclosure statements had become so complex that legal advice is required:

... the current disclosure statement required has become unduly complicated, necessitating the need for legal intervention, and therefore incurring significant costs on behalf of both landlords and tenants. It has been stated that ‘Agents’ will no longer deal with the disclosure statement, landlords generally use inhouse legal resources and tenants are directed to seek legal advice on this matter. (submission no. 39, p. 4)

The SCCA made the further point that disclosure statements cannot predict every business eventuality that may occur and, while designed to help tenants make informed decisions, they cannot ‘guarantee that a tenant’s business plan will succeed’ (submission no. 83, p. 26).

The Victorian Government indicated that it is committed to reducing the regulatory burden on business through its *Reducing the Regulatory Burden* initiative and, in this context, retail lease disclosure provisions have been identified as an area of priority review:

Current disclosure requirements and forms will be examined to identify opportunities to reduce administrative and compliance burdens on business. This will include clarifying and streamlining information disclosure requirements, particularly in cases where businesses must also comply with additional disclosure requirements (such as under the Franchising Code of Conduct or the Sale of a Small Business vendor’s statement under section 52 of the *Estate Agents Act* 1980). (submission no. 111, p. 8)

In response to the draft report it was also suggested that information contained in

the disclosure statement be confined to factual matters. As stated by Professors Duncan and Christensen:

Disclosure Statements should be retained in the contracting process but only the answers to factual information of relevance should be sought from the recipient not information which could not be reasonably known at the time of the request. (submission no. DR153, p. 4)

However, requirements to disclose potential changes to the tenancy mix and centre developments, for which details may not be known at the time of negotiation, convey important signals about risk. For example, the fact that a landlord will not state that the tenancy mix will not change provides important information to a prospective tenant — that is, there is a risk that the tenancy mix *will* change over the period of the lease. The challenge in designing an effective disclosure statement is to balance the need for information with the cost of provision and the ability of a tenant to make sense of what is provided.

FINDING

Attempts to increase information through disclosure provisions have led to longer and more complex documents. Such documents do not necessarily improve a tenant's understanding of the lease and may even have the opposite effect.

Information imbalances

Many retailers claimed that there is an imbalance in the information available to landlords and retail tenants. The Franchise Council of Australia (FCA) said:

Shopping centre landlords have access to turnover information of all tenants in centres operated by the same owner. However, tenants have no reliable, timely sources of information on net effective market rent levels. ...

The information asymmetry leads to a risk of abuse of market power by the shopping centre landlords, as tenants find it hard to compare rent levels between shopping centres, and the landlord has an unfair advantage in rent negotiations as they know the tenant's ability to pay. (submission no. 117, p. 5)

The NRA said that:

Shopping centre tenants are required to disclose sales, for legitimate reasons, and this information, in processed form, should be reciprocated in cases where it is relevant to a better informed negotiation and business decision. (submission no. 47, p. 13)

The Retail Traders Association of WA (RTAWA) indicated that greater transparency of a shopping centre's performance would enable tenants to 'understand the market, benchmark a centre's performance with other centres and to enter a lease with their eyes open'. They suggested that:

It would be beneficial for tenants if a landlord were required to release aggregate information about:

- the annual turnover of tenants;
- the number of leases terminated prior to the expiry of the lease term; and
- the number of tenants whose businesses failed. (submission no. 65, p. 5)

Also, the Southern Sydney Retailers Association (SSRA) claimed that the lack of information on rents paid by shopping centre tenants led to uneconomic and unsustainable rent levels:

What is ‘unfair and obnoxious’ is a situation where a rent which is inflated, unsustainable and uneconomic, that if any small business is actually paying it, they will certainly face ruin and bankruptcy — can be represented by the landlords as the ‘market rent’, through a system of undisclosed secret rebates and secret kickbacks. (submission no. 113, p. 6)

Landlords, however, presented a different view. Westfield, for example, argued that retailers already have access to their own representative organisations and retail consultants who have a solid data base of information, including information concerning the trading performance of centres, centre sales and growth in sales as well as the sales performance of particular retailer categories (submission no. 85).

In a similar vein, Colonial First State Property Management submitted:

As far as the non-national retailer is concerned, there has been a massive proliferation of tenancy advocates who provide advice and negotiate on behalf of such tenants; there has been a massive increase in the amount of information provided to tenants, not only by landlords (as a requirement of the law or otherwise), but by relevant government bodies and private seminars; there are tenant associations that continually support and educate tenants; and tenants regularly talk to each other. (submission no. 78, p. 6)

The SCCA also noted that the majority of tenants in the larger shopping centres are national or State chain retailers or major franchisors and these retailers are very well informed on prevailing market rents. Many of these retailers also have their own property departments with responsibility for lease negotiations (submission no. 83).

The Real Estate Institute of Australia (REIA) indicated that:

For a nominal fee (around \$18 in the ACT) a tenant may access the lease agreement for any particular retail premises and ascertain the agreed level of rent as well as any associated lease conditions. In addition, tenants may purchase detailed reports from publishers which contain information on the average turnover and rent levels for a whole range of retail sectors (for example, food, fashion, liquor). (submission no. 112, p. 13)

While acknowledging the information available from lease registers, some

participants noted that such registers do not operate as well as they might because of the age and cost of the information and the fact that the information fails to disclose detail about ‘sweeteners’ and ‘side-deals’. The FCA, for example, said:

Although lease registration information exists in NSW and Queensland, they are not up to date and are costly to access. As a result, tenants have no means of determining what is the net effective rent paid by other tenants, and hence the fair market rental value. Confidential deals and rebates also further restrict the free flow of information. (submission no. 117, p 6)

Many concerns expressed over the information imbalances identified above were repeated during the hearings in response to the draft report. In particular, many participants repeated concerns over the lack of available verifiable information on shopping centre rents (including incentives). For example, as commonly put to the Commission, the RTAWA submitted:

... that Western Australia needs compulsory lease registration regulations to be enacted to give more transparent information, particularly with rental reviews/market rents. (submission no. DR171, p. 4)

Others believed that the usefulness of lease data to retail tenants is not as great as what may have been first thought. As the NRA put it:

... from the individual tenant’s point of view, he shouldn’t be too concerned with the passing rent of some other use or space or lease conditions elsewhere. In my opinion, there are very remote connections between rental value compared directly on that basis when you get into very highly specific uses and lease conditions and business opportunities. (transcript, p. 410)

However, the RTAWA believed that data on rents paid for other locations is useful as such information may provide:

... both parties equal information about what the playing field is. If I then choose, because I know my business, to pay 6 X, that’s either my stupidity or my knowledge of my business and they’re right, and if I feel that I can do that. But at the moment I go in there and I might be paying 6 X because I’ve gone in there with the best of intentions but no knowledge. Then once I’m in there, having a quiet chat to Anthony two tenancies up, and he says, ‘You paid what?’. (transcript, pp. 693-4)

Rent information for similar locations, notwithstanding that each lease and location is unique, would allow tenants and potential tenants to recognise ambit claims made by the landlord and to have greater confidence in their assessment of the market. However, it should be recognised that ultimately, the negotiation between a landlord and tenant occurs on a one to one basis and that the rent agreed will represent what an individual tenant is willing to pay for a particular location at that time given the nature of their business.

8.2 Evidence on information failure

Information disclosure

Concerns about information imbalances in the retail tenancy market have led to an array of legislative measures. These measures aim to level the information available to both tenants and landlords and facilitate informed decision making (chapter 3). Importantly, such measures do not seek to prescribe what can be negotiated within a lease contract. Instead, government intervention of this kind attempts to better inform market participants. The Victorian Government, commenting on the legislation in that state, said:

Disclosure of information is a significant feature of the Act. Appropriate availability of information helps to ensure both parties are aware of their rights and obligations under the tenancy agreement and allows small business tenants in particular to make informed business decisions about their lease. The Act requires the landlord to provide a tenant with a Disclosure Statement The contents of the Disclosure Statement are prescribed by regulation and include information about the term of the lease, permitted use of the premises, occupancy costs, rent payable, outgoings and, if applicable, information on the shopping centre in which the premises is located. (submission no. 111, p. 5)

Despite these measures, many of the perceived problems in the market for retail tenancies are believed to come about because small tenants (and some landlords) lack information and understanding about their obligations and rights, and the forms of recourse available to them.

The information required in disclosure statements covers most areas of concern raised by participants to this inquiry. Examples of disclosure statements presented to the Commission suggest that a lack of information and reliance on verbal agreements should not be an issue if disclosure statements are diligently executed (box 8.1). Shopping centre landlords, for example, are required to provide details on planned developments, centre foot traffic and tenant mix, including any proposed changes. Despite these requirements, it is clearly not possible for landlords to foresee all changes in the tenancy mix five or more years out as these will be influenced by changing market conditions.

In relation to verbal agreements, the disclosure statements examined by the Commission included a section requesting information on any representations made to prospective tenants — ‘Please provide detail about all statements and representations made to you by the lessor or the lessor’s agent that you are relying on in entering into this lease’.

Box 8.1 Information provided in retail tenancy disclosure statements

Retail tenancy legislation in most jurisdictions sets out extensive requirements for disclosure statements. The information in disclosure statements covers most areas of concern raised by participants to this inquiry. Sample disclosure statements provided to this inquiry by two major landlords set out provisions for:

- any/all verbal representations made by landlords or their agents which were relied on by the lessee when agreeing to the lease;
- whether or not options to renew were available;
- (non) exclusivity;
- trading hours;
- planned redevelopments during the lease term — both council approved and those awaiting approval — and relocation provisions;
- rent increases and reviews (including the nature of these) and whether turnover rent is payable;
- the collection of turnover information;
- outgoings payable (and in some instances increases over the lease term);
- fit-out requirements;
- details of tenant mix — stating whether or not it will change — including anchor tenants (their lease length);
- centre foot traffic;
- centre turnover per square metre by broad category; and
- details of ongoing issues with a lease assignor if applicable.

Further, the disclosure statements suggest tenants seek legal and financial advice before signing, even in jurisdictions where sign-off conditions were not required. In general, disclosure statements closely follow sample statements published by State Registrars (such as Lessor's Disclosure Statement published by the New South Wales Department of State and Regional Development).

The disclosure statements also suggest tenants seek legal and financial advice before signing, even in jurisdictions where sign-off conditions are not required.

FINDING

A lack of information and reliance on verbal agreements should not be an issue if disclosure statements are diligently executed.

Public information available from tenancy authorities

State, Territory and Australian governments also provide a range of information on retail tenancy matters. Information aimed at improving retailers' knowledge and understanding of leasing matters is freely available on the web and in printed brochures. A number of the tenancy authorities also run workshops on retail leasing (chapter 3).

The agencies that administer retail tenancy legislation collectively receive over 20 000 enquiries a year on retail tenancy matters (see chapter 9 for more details). In the context of a market consisting of an estimated 290 000 leases, with 58 000 new leases negotiated annually, the number of enquiries is considerable — equivalent to about 40 per cent of the number of leases signed each year or 7 per cent of current leases. Enquiries are broadly distributed across jurisdictions in proportion to the estimated number of retail tenancy leases.

The enquiries are broad ranging including requests for information and tenancy advice (including for potential new retail lessees), as well as complaints. Western Australia's Small Business Development Corporation, which received 2600 enquiries in 2006-07, noted that a significant number of these were from potential tenants requesting advice about entering into a business premises lease (submission no. 81, p. 2).

Market responses to information differences

During this inquiry, the Commission was informed of an active leasing advisory service industry that advises landlords and prospective tenants on business plans and leasing conditions, and provides negotiation services. Many firms in this industry operate across State boundaries. This advisory industry is in addition to the realty sector that provides leasing and property management services to landlords. There are also a number of training courses that have evolved in recent years. For example, the 'Seed' program, a joint initiative between Westfield and the ARA, conducts a range of training initiatives including a diploma of retail management run through The University of Western Sydney.

Centre landlords stated that they often encourage prospective tenants to seek leasing advice prior to commitment. Nevertheless, comments such as, 'it is a pity more retailers are not prepared to seek and be willing to pay for such advisory services and be attentive to the advice' were frequently made to the Commission in industry visits.

Overall, there appears to be a substantial range of information and services about

retail tenancy leases and costs (including rents) available on a fee-for-service basis. This information covers shopping centres and other retail property (for example, shopping centre benchmarking reports which include information on occupancy costs are available from market providers such as Urbis for approximately \$3500). Because some of the data are primarily derived from public registers of leases, more information is available in jurisdictions where most leases are registered. Accordingly, the most comprehensive market information appears to be available in jurisdictions such as New South Wales and Queensland where lease registration by market participants is more prevalent.

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Leasing advisory and market information services have evolved in recent years to provide information to landlords and tenants.

Remaining information gaps

Despite the presence of market-based information providers/advisors, and the mandatory disclosure requirements, a number of information gaps remain. For example, there is little market provision of shopping centre rents and disclosure of disaggregated foot traffic within centres.

Rentals

Information on rentals in shopping centres is scarce in many States — with the exception of New South Wales, Queensland and the Australian Capital Territory where lease registration is more common place. Further, the Commission was not informed of any landlord that routinely provides potential tenants or those renegotiating their leases with rental data for a given centre. While the lack of such information does not necessarily create market inefficiencies, it does lessen market transparency and the negotiating position of centre tenants. The lack of this information can limit a tenant's ability to recognise ambit claims, in some cases making a tenant more likely to accept a rent on terms favourable to the landlord. Such information also aids valuers when they are requested to settle disputes over market rent reviews.

Allied to the lack of information on shopping centre rents, there is an absence of information on incentives provided to some tenants. Incentives are a normal part of negotiating contracts and are common in many transactions (from commercial leasing to purchasing a car). There is also some debate about the value of lease registration as a means of providing rent information given that incentives are common place. Some considered that the presence of incentives distorts market

information and as such information on ‘face rents’ (that is, not accounting for incentives) could be misleading and/or meaningless. For example, as stated by Senator Andrew Murray:

... 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 ... that registration of leases would somehow improve information in the marketplace, appears to be naïve. (submission no. DR 178, p. 5)

Others, however, considered that corrections for the level of incentives could easily be made, with Leasing Information Services stating:

Valuers adjust for this [incentives] all the time, where they look at the face rent; they make an allowance for a market level of incentive and they arrive at the effective rent. ... It’s much more prevalent in actual fact in other markets, being office; incentives can represent up to 20 to 25 per cent of the actual deal. In large office deals the incentive may be 20 to 25 per cent of the deal. In retail we’re talking about a much smaller proportion. In shopping centres the level of incentives are generally somewhat higher than on strips. Strips tend to be more in the form of a rent-free [period]. To make another point, approximately 20 per cent of those incentives are already reported on the lease.

... there are industry groups that report market level of incentives for retail, for any sector. If you just log into any major valuation company ... they will show you what the level of market incentive is by centre type, by state, so you can see in New South Wales for regional centres the market level incentive is 10 per cent. So it’s quite easy to effectively adjust to get the effective rent without having to simply change the whole system. (transcript, p. 204)

Further, most incentives are negotiated in confidential deals as neither party — landlord nor tenant — want such details to be provided to the broader market. Thus, even where there was strong competition between landlords for tenants (as occurs in shopping strips and other commercial tenancy markets) incentives would not be voluntarily disclosed and do not appear to diminish the value of ‘face rent’ information in these circumstances.

Disaggregated centre foot traffic

While retail tenancy regulations require landlords to disclose overall centre foot traffic, the foot traffic that passes through individual entrances is usually not provided (either to a new tenant or on an ongoing basis). For the individual trader, centre traffic past a particular location is most relevant to help forecast potential sales when deciding to establish a business in a centre. For the established retailer, centre foot traffic past their location is also important as it allows the retailer to

gauge how sales are related to centre traffic. As for data on rents, the lack of this information will not necessarily create market inefficiencies as, for instance, potential tenants can gauge foot traffic in any particular location prior to signing a lease (through observation). However, the lack of verified information (and other information on centre performance) can diminish the negotiating position of tenants as it reduces the transparency of the effect that centre management has on the returns of individual retailers.

Incentives for the market provision of rental information and additional information on foot traffic do not always exist. Given the strong demand for retail space within larger shopping centres (as evidenced by low vacancy rates — chapter 2), landlords typically do not need to advertise to attract tenants. Similarly, for disaggregated foot traffic data, centre managers are not required to release information on their performance in order to justify claims when negotiating leases as in many cases tenants can be replaced if they do not like the terms that are offered (although this comes at some cost). Thus, the strong demand for retail space in centres relative to its supply creates its own constraint to the market provision of this information that might otherwise occur.

Constraints on sector performance

Information asymmetries exist in the market for retail tenancies — centre landlords are likely to have greater knowledge about centre performance than potential tenants, and tenants are likely to know more about their own trading ability than their landlord — and some constraints exist to the market provision of information. Nevertheless, such information differences, to the extent that they remain, may not actually affect the efficient operation of the market. In most cases, it is not in the interests of either landlords or tenants to take advantage of the other party to the point that their business fails (box 8.2) — businesses have a strong commercial incentive to guard against such an eventuality.

Some participants suggested that the lack of information held by retail tenants, has led to a higher number of business failures that otherwise would be the case (for example, in submission no. 113 amongst others). Such an ‘information failure’ would only occur if, from a landlord’s perspective, it were perceived that the gain from exploiting one tenant to the point of business failure was greater than the costs of doing so. Alternatively, from a tenant’s perspective, if they were making decisions regarding their ability to pay rental amounts based on insufficient information — such as on the incorrect probability of tenancy mix changing and of a redevelopment — then the possibility that their business would fail increases. In part, both of these would be represented by higher business exits than that observed in comparable industries.

Box 8.2 **Compatibility of landlord and tenant incentives**

The interests of retail landlords and tenants are not incompatible, limiting the potential for information asymmetries to constrain the efficient operation of the retail tenancy market. That is, the success of one party is reliant on the success of the other. For tenants and landlords, lease agreements represent an ongoing contract (for a set period) over which a commercial relationship exists between both parties. As such, if a landlord attempts to exploit a tenant to the point where the business fails, some costs will also be imposed on the landlord — either through a vacancy period, the cost of finding a new tenant, and/or the cost of legal action to recover the money owed under the lease.

Ultimately, a practice of exploiting tenants by using information differences would also reduce the number of potential tenants available to a landlord and depress the landlord's long-term rental return. Landlords usually have a long-term interest in the value of their asset (as a going concern at market value) and it would be against their longer-term interests to pursue such a strategy.

Ideally, to assess the evidence of information failure, and its significance, characteristics of the 'fully informed' market would need to be known — that is, the 'counterfactual'. As such evidence is not available, other indicators of the operation of the market are required. For this purpose, the Commission has drawn on evidence from:

- business exit rates;
- vacancy rates in various retail formats; and
- information on business profitability.

These indicators provide no *prima facie* evidence of overall market failings, albeit at an aggregate level.

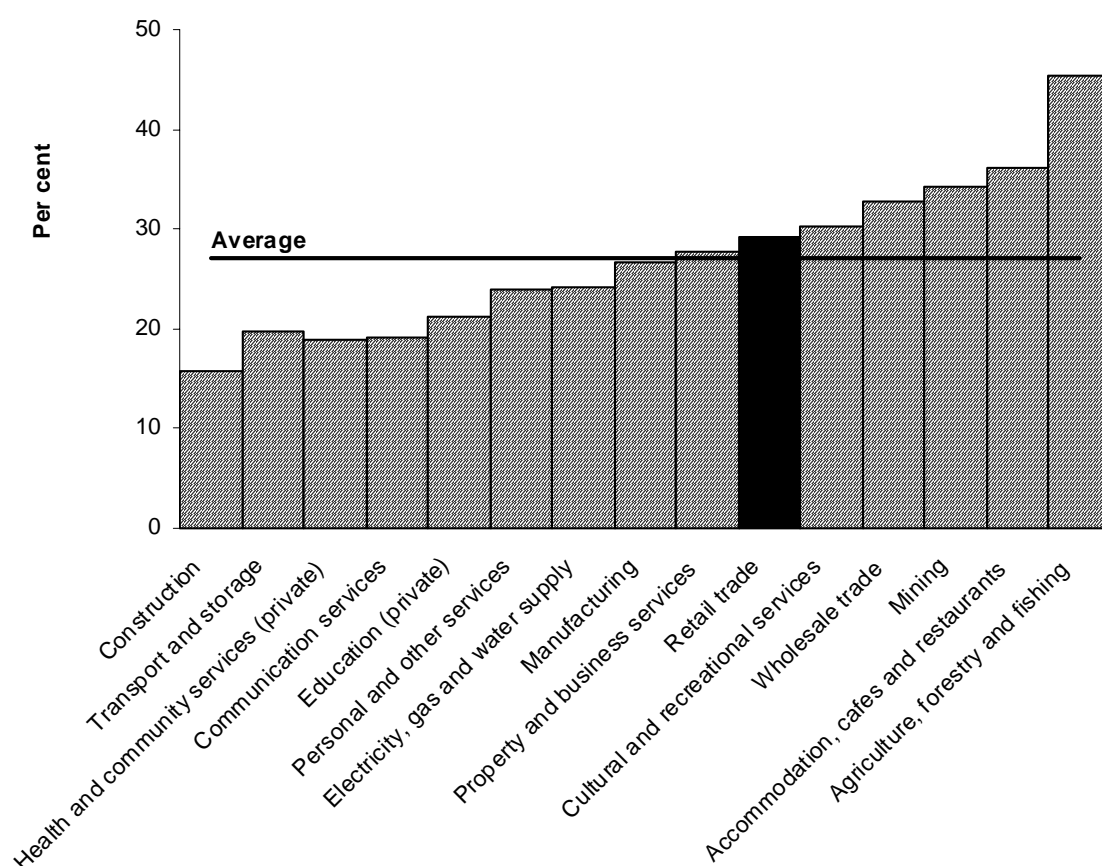
Business exit rates for retail businesses are not significantly different to economy wide averages (those in retail trade and personal and other services — chapter 2). Further, data on exit and entry rates show that for retail businesses, these rates are in line with the relative share of retail businesses in the Australia economy. This suggests that, there is no systematic industry-wide failure in the retail market that consistently leads to higher rates of business failure than what would be expected on the basis of broad industry comparisons. It should be noted, however, that there are many factors that influence business entry and exit rates. Also, if the information asymmetry is permanent and has led to a new market balance, both the stock and flow of businesses would have adjusted accordingly.

In relation to shopping centres, if there were particular information-related problems it would be expected that renewal rates would be low and vacancy rates high —

prospective tenants would see business in these retail concentrations as too risky, reducing the overall performance of this type of retail format. However, the low vacancy rates that exist (chapter 2), expansion relative to other retail formats (chapter 2) and high renewal rates (chapter 6), suggest that many retailers believe that shopping centres offer attractive opportunities.

Also, if conducting a retail business within a shopping centre (or elsewhere) were constrained by available information, negatively affecting performance, it could be expected that retail profitability levels would be low relative to other activities. While information on retail business performance within shopping centres is not available, aggregate information on profitability in the retail sector does not reveal substantial profit gaps. Indeed, the proportion of retail businesses operating at a loss is close to the industry-wide average over the period 2001-02 to 2005-06 (figure 8.1).

Figure 8.1 Businesses operating at a loss, 2001-02 to 2005-06^a
Average per cent of businesses operating at a loss



^a A wider set of businesses operate under a retail tenancy lease to those in retail trade. Despite this, the retail trade sector provides a proxy for these businesses.

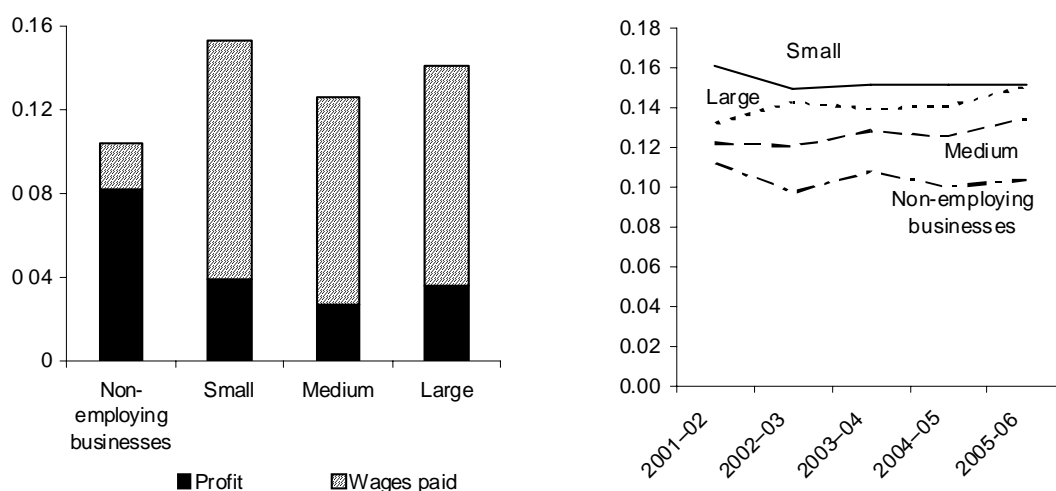
Source: ABS (Australian Industry 2005-06, Cat. no. 8155.0, Canberra).

While this broad relationship is maintained in each individual year reported, the proportion of retail businesses operating at a loss increased from 27 per cent (around the average) to 31 per cent from 2001-02 to 2005-06.¹

Further, the average profitability and business returns excluding wages and salaries paid to retailers show that returns to ‘small’ retailers (those most likely to be affected by information imbalances, chapter 2), are on par with medium to large businesses (figure 8.2). Wages and salaries were excluded (as for many small businesses) as owners do not draw a wage from their business, inflating profit levels relative to other kinds of businesses. Thus, whilst this measure does not directly conform with standard profit calculations, it provides a less biased means for comparison. For example, actual profit figures — the dark shaded areas on the left panel of figure 8.2 — show profit levels for non-employed retail businesses are greater than those reported for other business categories prior to adjustment, but below when wages and salaries are excluded.

Figure 8.2 Operating profits of retail businesses, 2001-02 to 2005-06^a

Average operating profit (excluding wages and salaries paid) as a proportion of average total income



^a Business size defined by number of employees. Small businesses are those which employ less than 20 employees, medium 20 to 200 persons and large above 200.

Data source: ABS (*Australian Industry 2005-06*, Cat. no. 8155.0, Canberra).

¹ During the draft report hearings, the SSRA claimed that the number of retail businesses operating at a loss had increased three-fold over the period from 1997 to 2006 (transcript, p. 119). However, as of 2002, the ABS used different industry classification codes which more than doubled the number of retail businesses from 2000-01 to 2001-02 and accounted for the majority of the increase in businesses operating at a loss reported over the period from 1997 to 2006. Due to the changes in classification codes, comparisons in this report are only made between data which was collected under the same codes.

For the other categories of retail businesses, profit levels with and without wages and salaries indicate a similar pattern of returns. On average, small retail businesses (those employing less than 20 employees) have performed as well as medium to large retail businesses, as measured by profits expressed as a percentage of total income, over the period 2001-02 to 2005-06. Again, it needs to be recognised that many other factors influence business profitability. Despite this, the average and trend results do not provide *prima facie* evidence of information asymmetries which adversely impinge on the operation of retail businesses for those most likely to be affected — small businesses.

It should be noted that data on business entry and exits and aggregate profitability can only be used to evaluate any systematic failure in the market — that is, the extreme outcome. However, it is more likely that the effects that any information asymmetries have on the operation of the market would be at the margin, and thus not evident in aggregate average measures.

The impact of information differences on the operation of this market are more likely to be in the form of altered relative negotiating positions for the parties to a lease. As it is not in both parties' interests to take advantage of the other to the point of failure, any effect of differences in negotiating power would be through the distribution of returns in favour of the party which can achieve a commercial advantage. For retail tenancies, shopping centres would hold a commercial advantage through repeated negotiation and the opportunity to establish effective tenant screening processes. These landlords would negotiate with a wide range of tenants. A tenant (or prospective tenant), despite possible knowledge of their potential trading prospects in a particular location, who negotiates leases infrequently and/or who does not effectively utilise the services of professional advisors, is less likely to hold a commercial advantage. These tenants also face a less transparent market when entering centres as rents are not usually advertised (as is the case for tenancy markets generally). Other tenants would not lack information or be at a commercial disadvantage due to their own information resources and/or repeated negotiations — such as retailers and franchisors controlling multiple stores. Also, if a retailer's product is in high demand, this will afford the retailer a commercial advantage. In contrast, in shopping strips, as there is a more diverse set of landlords and tenants, it is likely that any commercial advantages created by information differences would be more varied between market participants.

The distribution of returns from retailing created from information differences, however, spread between market participants, does not represent an efficiency loss. Rather, it represents a return to superior information gathering and negotiating skills. The presence of this return provides a strong incentive for market solutions to develop to counteract any information differences that remain — a situation that has

been witnessed in the retail tenancy market.

Thus, while there exists some potential for information differences to affect the trading performance of individual retailers, these gaps are likely to be filled through the development of market solutions and the current disclosure requirements. However, to the extent that impediments exist to the market provision of information, additional government action may be warranted to improve the information available to market participants and aid in efficient business decision making.

8.3 Assessing the case for change

To warrant further measures to improve information and understanding in the market for retail tenancies, it needs to be shown that extra interventions will further improve commercial decision making without creating excessive compliance and administrative costs or otherwise erode market efficiency.

In response to the concerns outlined above relating to the remaining information differences and the complexity of information disclosure, a number of participants suggested options for change which focused on further increasing the information available to market participants to support decision making. These included:

- measures to improve lease transparency and understanding;
- the development of template leases and disclosure statements; and
- mandating lease registration.

Improve lease transparency and understanding

A number of suggestions aimed at further improving lease transparency, education and understanding were made to the Commission. Broadly, the suggestions were about making leases more understandable to landlords and tenants (box 8.3). Compulsory sign-off requirements were also suggested (submission no. 121), recognising that despite the current provision of education services and disclosure requirements, tenants and landlords should seek professional advice before committing to a lease.

Improving the understanding and knowledge of individuals entering into small business about their obligations and rights under tenancy leases should improve self reliance and decision making. If parties to a lease are more aware and better understand their contractual obligations, the available recourse if breaches arise, and the limits of those forms of recourse, then they are more likely to enter into

commercially sound contracts. But it appears that the longer and more complex disclosure statements become, the less likely prospective tenants are to read them and understand the implications for their business. Legislation prescribing provisions within disclosure statements needs to be sensitive to the costs of preparing such documents and the likelihood that provisions will be read and the implications understood. Given this, highlighting key lease provisions — such as occupancy cost, planned rental increases, lease length, existence of options, shop size, and total outgoings payable on the first page of a lease and/or disclosure statement — also known as an ‘epitome’ of a lease — is likely to be beneficial, as such measures create a layered approach to information provision, potentially making disclosure statements easier to understand.

Box 8.3 Suggestions to make leases and leasing more understandable

Participants to the inquiry suggested a range of options, including:

- greater use of simple language;
- simplification of lease charges (such as a provision that landlords can only charge rent, inclusive of outgoings and marketing — or estimate thereof — to reduce the complexity of charges within lease) (submission no. 119);
- stronger education and awareness programs of retail tenant responsibilities and rights by State Registrars (or applicable department), including of dispute settlement procedures;
- one page disclosure of key ‘controversial’ clauses (such as fit-out requirements, end of lease provisions and effective rent) at the beginning of the disclosure statement;
- educational programs for potential tenants about how rents are determined and why they would be expected to be different for different tenants (such as an anchor store versus a speciality clothing store) (submission no. 112); and
- greater awareness programs about available information (such as lease databases in some States) and the merits of engaging consultants when negotiating leases (submission no. 112).

Improved disclosure and transparency of lease terms should also reduce the perception that landlords, in some instances, deceive or mislead tenants when entering into negotiations. As stated by the REIA:

... the implementation of [educational] measures ... will improve the efficiency of the retail tenancy market in Australia for the benefit of landlords, tenants, real estate agents and consumers. These measures will act to improve understanding of the market, lower transaction costs, decrease the risks associated with business failure and prevent many disputes from arising in the first place. If these suggestions are not seriously considered, it is likely that the perception that small retail tenants are at a systemic disadvantage will persist into the future. (submission no. 112, p. 14)

Nevertheless, the provision of more information or educational resources is costly to both the small trader (in terms of time) and the service provider. For those services publicly funded, costs are generally passed on to taxpayers. Also, empirical evidence is not currently available to support the case that the provision of additional information has improved decision making. It is therefore a matter of judgement, at this stage, whether the net benefits of programs to date are positive.

Further, current provisions for disclosure statements are significant and possibly, as some have suggested, excessive. These requirements have led to lengthy disclosure statements that set out tenant and landlord rights and responsibilities. Despite this, as expressed by some submissions, the longer and more complex these documents are, the less likely prospective tenants are to read them and understand the implications for their business. Given this, some tenants felt they were unaware of conditions stipulated in their leases until well after the contract had been agreed (such as no automatic right for a new lease).

The Commission's assessment is that while extensive disclosure provisions exist, gains from additional requirements are likely to be made through improving the delivery of the information disclosed, such as through simple language and a one page summary of key terms where this is not already done and harmonising requirements across States, rather than through increasing disclosure requirements.

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Improving lease transparency and disclosure through the use of simple language and a one page disclosure of key provisions, is likely to improve understanding of lease terms and conditions.

Use of reference leases and disclosure statements

While retail tenancy legislation sets out the legal framework under which leasing transactions may be undertaken, it does not set out best practice guidelines. The use of 'best practice' or 'reference' leases and disclosure statements could replace the current prescriptive requirements set out in the legislation. Further, as there is an issue of what content is sufficient for prospective tenants to evaluate the opportunities for their business, a distinction could be made between what might be appropriate for retail premises in shopping centres and those in shopping strips and other retail formats.

Reference leases and disclosure statements could set out what the industry (both retailers and landlords) and government consider as best practice, and provide guidelines for all retail tenants. Such templates could cover current contentious areas (and be updated as new ones arise) and might include provisions for:

Overall, reference lease documents and disclosure statements could be used as an aid to improve market transparency and make retail leasing simpler. The Commission's assessment is that such a development could be of some benefit if complemented by the development of a standard set of items for disclosure and mandatory inclusions in lease documentation. Further, while incentives exist for industry to develop these measures (to lower the transaction costs of doing business), due to the atomistic nature of the market, it is not likely that a uniform template lease would be developed. Given this, a role could be played by governments to facilitate the development of such template leases and disclosure statements.

Mandate lease registration to improve market information

Landlords, tenants and tenant organisations have advocated mandatory lease registration (box 8.4) in order to overcome a lack of information relating to shopping centre rents. This possibility received strong support from many participants throughout the draft report hearings and subsequent submissions. Leasing in shopping centres is typically undertaken through direct negotiation between the landlord's agent and the prospective tenant. Although prospective tenants may lodge expressions of interest, vacancies are typically not advertised widely. This differs significantly from the wider retail tenancy environment where retail space is advertised. The approach adopted by shopping centres has led to suggestions that there is a lack of information about going rents, which is believed to hamper efficient decision making by prospective tenants.

In view of this, a number of submissions suggested a nationally consistent register of leases be established. Ideally, such a register would:

- detail the effective rent paid by tenants (inclusive of all costs and landlord contributions that relate to the lease but not necessarily the details of these costs and contributions); and
- require prompt lodgement of leases (longer than three years in length) after agreement has been reached.

Box 8.4 Views on mandatory lease registration

The Council of Small Businesses of Australia advocated the development of a national register of retail tenancy leases:

... all Australian leases must be registered with the National Retail Leases Register. (submission no. 94, p. 12)

Similar sentiments were expressed by the Australian Property Institute (API):

The API supports the establishment of a National Data Base which would add transparency to the leasing process ... (submission no. 70, p. 15)

RICS Oceania developed the idea further, advocating not only lease registration, but also for a government agency to analyse the data and provide reports to industry participants:

If there is a common lease registration process established in all States, then there also needs to be a format for analysis. RICS supports the establishment of this process nationally so as to improve the transparency and efficiency of the market. In addition to a national process of lease registration there must be an appropriate administrative framework, suitably resourced, for providing lease information to those in the market who wish to obtain it. (submission no. 39, p. 5)

Also, Westfield did not oppose the registration of leases at the State and Territory government level:

Westfield would not, however, be opposed to the States and Territories concerned adopting lease registration requirements similar to those applicable in New South Wales, Queensland or the Australian Capital Territory and views this as a measure that would address any perceived shortcoming arising from the lack of general availability of rental information. (submission no. 85, p. 18)

The SCCA said:

To improve the transparency of the retail tenancy market there should be mandatory registration of leases in those States which presently do not require registration (Victoria, South Australia, Tasmania and Western Australia) to ensure details of rents or other lease conditions are publicly available to inform retailers during lease negotiations. (submission no. 83, p. 3)

Lease registration already occurs in a number of tenancy markets (for example, residential) and is optional in *all* States and Territories for retail tenancies (generally, for tenancies longer than three years) (table 8.1). Lease registration confers indefeasibility of title under property legislation in most states, except for Victoria where indefeasibility is conferred to the tenant in possession (chapter 3). The cost of doing so, and title search costs are low (additional costs, ranging between \$7 to \$20 across the jurisdictions, are imposed if a copy of the actual lease document is requested). Because registered leases are available to the public, registration also provides, as a by-product, public information about the market and lease conditions.

Table 8.1 Retail tenancy lease registration by State

<i>Jurisdiction</i>	<i>Requirement</i>	<i>Purposes or apparent intention/access</i>
New South Wales	Voluntary under the <i>Real Property Act 1900 (NSW)</i> for leases longer than 3 years. If registered, the <i>Retail Leases Act (1994)</i> requires it be done within 1 month.	Registers claim in law on real property. Registration cost: \$90 Title search cost: \$29 Requirement for timely registration.
Victoria	Voluntary under the <i>Transfer of Lands Act 1958 (Vic)</i> for lease longer than 3 years. The Small Business Commissioner must be notified under the <i>Retail Leases Act 2003 (Vic)</i> .	Registers claim in law on real property. Registration cost: \$97 Title search cost: \$20 Notification is required for information purposes.
Queensland	Voluntary under the <i>Land Titles Act 1980 (QLD)</i> for lease longer than 3 years.	Registers claim in law on real property. Also, for mortgages over a lease to be valid, the lease must be registered. Registration cost: \$115-\$170 Title search cost: \$12-\$19
Western Australia	Voluntary under the <i>Transfer of Land Act 1893 (WA)</i> for leases longer than 3 years.	Registers claim in law on real property. Registration cost: \$85 Title search cost: \$14
South Australia	Voluntary under the <i>Real Property Act 1886 (SA)</i> for leases longer than 1 year.	Registers claim in law on real property. Registration cost: \$108 Title search cost: \$18
Tasmania	Voluntary under the <i>Land Titles Act 1980 (Tas)</i> for leases over 3 years.	Registers claim in law on real property. If unregistered, parties forgo potential common law legal action over the lease and rely on equity. Registration cost: \$86 Title search cost: \$20
Northern Territory	Voluntary under the <i>Land Title Act (NT)</i> enacted in 2000 for all leases.	Registers claim in law on real property. Registration cost: \$135 Title search cost: \$15
Australia Capital Territory	Voluntary registration under the <i>Land Titles Act 1925 (ACT)</i> for all leases.	Registers claim in law on real property. Registration cost: \$90 Title search cost: \$14

However, to register a lease there are often a number of additional requirements that must be met. For example, in Queensland Barry Nilsson Lawyers suggested that the cost of registration was significantly greater than just the amount paid to the titles office:

... when you want to register a lease, let's say it's a lease for a shop in a shopping centre, which is the typical situation that I'm involved with, you must attach a survey plan of the shop to the lease, and which identifies the shop. That survey plan must be prepared by a surveyor, and there is a whole range of requirements about the particulars of that survey plan. ... in my experience, the cost of that is about \$300 to \$500, to get a survey plan done, and that is invariably passed on to the tenant. (transcript, p. 403)

The arguments in favour of compulsory lease registration rest on the potential net benefit that may accrue from additional information about the lease market. Because vacancies in shopping centres are not widely advertised, the main benefit would accrue to tenants and potential tenants in centres. Outside of centres (where a large proportion of retail tenants operate) rental charges are commonly advertised, thus limiting the overall information value of lease registration.

If all leases were registered in a timely fashion, existing tenants and potential tenants would be able to compare rents paid within shopping centres, and between centres and location types (for example, strips versus centres). This information would clearly place them in a more informed negotiating position. For example, as stated by the Western Australian Retailers Association:

Australia and Australians need a fully national lease register so they can be fully informed about exactly who is being charged and what they are receiving. (submission no. 118, p. 42)

A nationally consistent register of leases would also enable landlords to compare rents and may promote greater competition for tenants.

The fact that not all leases are registered, however, suggests that the value that some parties place on increased legal security is outweighed by other factors such as the cost of registration and commercial confidentiality. Indeed, the information benefits created to an individual tenant from registering their lease are likely to be well below the collective benefit to all tenants (as they already know the terms and conditions of their own lease). Thus, compulsory registration could only be justified if the overall information benefit from doing so exceeded the cost, and was determined to outweigh considerations of commercial confidentiality.

Additional requirements for mandatory lease registration would increase both compliance costs and the cost to government of regulation. For example, in all States and Territories, lessors and lessees can register leases to legally validate claims on real property. Thus, introducing legislative requirements for this to occur is likely to be unwarranted (indeed, the provisions currently available to protect legal rights can already be viewed as the minimum necessary). Also, the mandatory registration of retail tenancy leases would invalidate any confidentiality provisions that have been included in contracts, limiting businesses' freedom to contract.

In some States, where the incidence of registration is higher, many retail tenants seemingly do not make use of the available information, or of specialists who analyse and report on this information. Also, it is unclear whether tenants in these States are in a significantly improved negotiating position and consequently are making better business decision than their counterparts in those jurisdictions where lease registration is less common. Nevertheless, it was suggested that one reason

why many tenants do not make use of available information was that such services have only recently developed (in the last three years). However, patronage of these services has increased substantially, indicating that many tenants value the information provided (submission no. DR156). Also the FCA suggested that retailers in States where information was not available, such as Victoria, make use of data from other jurisdictions as a second best option in order to improve decision making:

New South Wales has become the benchmark for rentals and that's where a lot of franchisors get their information from and make decisions about in Victoria. ... if the information is available in New South Wales we will use that information and extrapolate it all over Australia. (transcript, pp. 587-8)

In a survey of users of lease information, many felt that access to such information was useful to their business and improved their lease negotiation outcomes (box 8.5). Importantly, the most significant improvements to their business were reported to be in the form of improvements in rents paid, negotiating rental increases and dispute settlement.

The regulatory structure for lease registration is already in place in all jurisdictions. While there is scope for market participants to use these provisions more fully, the Commission's assessment is that there appears to be little justification for further government intervention as there are currently no legal impediments to the registration of retail tenancy leases. The current provisions also do not place restrictions on the commercial provision of information (by allowing confidential lease agreements not possible with mandatory registration). Nevertheless, the Commission considers that there would be merit in alternatives that seek to enhance available lease information.

Alternatives to lease registration

The purpose of lease registration is to provide indefeasibility of title for parties to a lease — that is, it registers a 'legal interest' in a property. But calls for mandatory lease registration are based on improving market information (a by-product of registration). In most States, it appears that the legal benefit of registering a lease to the parties of a lease is less than the cost of registration, the result being a limited number of leases registered. As the cost of registration is borne by the individual who registers the lease, to which no direct private information benefit accrues (they are already aware of the information contained in the lease), there is no incentive to register a lease for information purposes only. This suggests that mandating lease registration is not the most efficient means to improve market information. Nevertheless, making use of the established lease registration system would result in an administration cost saving compared with the establishment of an independent system.

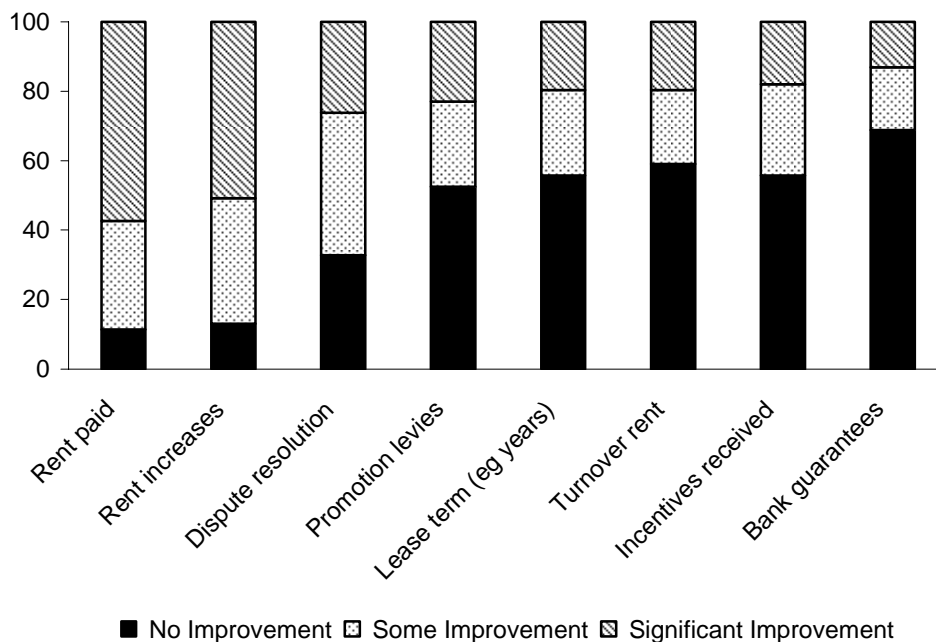
Box 8.5 Benefits of information on lease terms and conditions

In March 2008 a short survey was conducted by Leasing Information Services of its clients on the usefulness of information on lease terms and conditions. A total of 60 responses were received from businesses and their representatives (in some cases lease consultants) who reported involvement with over 12 000 retail stores Australia wide. Over half of the stores were reported to be operating in New South Wales, Queensland and the Australian Capital Territory where lease information is currently publically available. Of the remainder, the majority operated in Victoria. Most were operating within shopping centres. However, a significant proportion also had some stores on retail strips.

Over 85 per cent of the respondents rated the information obtained from lease registers as very useful to their business during end of lease negotiations, in assessing new locations or opportunities and during market reviews. Further, over 65 per cent of respondents stated that access to this type of information had improved negotiation outcomes in these areas. The gains made from access to information were concentrated on improvements in outcomes relating to rents paid, rental increases and dispute settlement.

Circumstances where lease information has improved negotiation outcomes

Per cent of respondents



Source: Based on survey data provided by Leasing Information Services.

A number of alternatives to mandatory lease registration were put forward in response to the draft report. These included an expansion in the data collected under

the Victorian lease notification requirements (submission no. DR156), the use of the Valuer General in each State to collect and publish information on retail rents (submission no. DR156) and the lodgement with a nominated agency (possibly a government authority) of a one page disclosure of key lease terms (transcript, p. 404).

The lodgement of this information would not only improve market transparency, allowing retailers to compare the cost of operating in different locations, but potentially also aid in the settlement of rental disputes. For leases which include mid-term 'market' rent reviews (most prevalent in shopping strips), access to rental information, it has been argued, has improved dispute settlement. Leasing Information Services submitted:

In NSW ... of the last 379 mediation reports between July 2006 and December 2007, 208 had 'rent' listed as an issue for mediation. Of these 208, an average of 80% had been resolved within five weeks of applying for a hearing. (submission no. DR156, p. 7)

In contrast, it was argued that in Western Australia where lease registration is less common, and thus data is scarce, disputes over 'market' rent reviews are more common and difficult to resolve (submission no. DR 156). However, in the context of the number of leases in operation the number of disputes over 'market' rent clauses appears to be very small.

It should also be noted that information on incentives provided to tenants, if not contained within the lease, would not be collected through this process. However, the extent to which this would diminish the usefulness of the information created is likely to be limited. Leasing Information Services suggested:

In fact, retail leasing incentives represent a much lower proportion of total rents [in] the commercial office market when compared to retail. Research undertaken by Leasing Information Services in 2006 indicated that incentives typically represent a very small proportion of rents over the term of the lease. Across the board of retail strips and shopping centres, incentives represent less than 5 per cent of the total net rent of a five-year lease. (transcript, p. 193)

Further, the lodgement of a one page summary of key terms would avoid any need to amend State Torrens legislation — which in some jurisdictions also has limits on what length of leases can be registered — or significantly alter current legal practice in jurisdictions such as Victoria nor impose significant additional compliance costs on business. As put by Barry Nilsson Lawyers:

... the cost to the parties to prepare that epitome of the lease would be minimal, especially given that most institutional landlords require their lawyers to prepare a sign-off letter which has the commercial terms, and many tenants, larger, more sophisticated tenants who engage lawyers, again require an epitome or summary of the lease to go

the provision of information can only be justified on the ground that the provision of extra information would enable small retail tenants to make more informed business decisions without creating constraints on the efficient operation of the market. To the extent that there are information gaps, there would be a role for industry participants and advocacy groups. This role would be enhanced though the lodgement at a publicly accessible site of key lease terms.

The Commission has also identified a number of areas where information delivery may be improved. There would appear to be scope to improve the information on retail tenancies through the greater use of simple language and the use of a one page summary of key lease terms and conditions. There may also be scope to improve coordination between relevant information-providing government agencies.