



Real Estate Institute of Australia

**REIA SUBMISSION TO THE PRODUCTIVITY COMMISSION INQUIRY INTO
THE MARKET FOR RETAIL TENANCY LEASES IN AUSTRALIA**

BACKGROUND

1. On 19 July 2007, the Commonwealth Treasurer, the Hon. Peter Costello MP, requested that the Productivity Commission undertake an *Inquiry into the Market for Retail Tenancy Leases in Australia*, including its structure, function, competitiveness and regulation. The Productivity Commission published an issues paper on 29 June 2007 and called for responses by 27 July 2007.
2. The Real Estate Institute of Australia (REIA) is the peak national professional association for the real estate industry in Australia. The REIA has eight members, comprised of the State and Territory Real Estate Institutes, through which about 80% of real estate agencies are collectively represented. There are 8,184 real estate agencies around Australia.
3. The REIA met with representatives from the Productivity Commission on 11 July 2007, to discuss the nature of the Inquiry and to provide a preliminary industry viewpoint.

PURPOSE

4. The REIA's submission constitutes a response to the Productivity Commission's issues paper on the *Inquiry into the Market for Retail Tenancy Leases in Australia*.

ISSUES

5. The REIA has an active interest in Australian tenancy markets and welcomes the Productivity Commission *Inquiry into the Market for Retail Tenancy Leases in Australia*.
6. While REIA membership does not extend to landlords or tenants, real estate agents often act as intermediaries between these parties, being engaged to act on behalf of either the tenant, or more commonly, the landlord. In this capacity, the REIA is a well informed market observer that supports the maintenance of an efficient retail tenancy market.
7. Notwithstanding localised shortages of retail premises, trends in consumer shopping preferences and regulatory differences between jurisdictions, the retail tenancy market appears to be operating relatively efficiently across Australia. The REIA is not aware of any major fundamental flaw in the market that systematically disadvantages either landlords or tenants.
8. The various issues relating to the retail tenancy market are explored in more detail within the specific sections follow.

The Landlord – Tenant Relationship

9. **Similar Perspectives.** Retail tenants have traditionally sought to acquire the most suitable premises (size, location, functionality), at the lowest possible price, and with little or no ongoing interference from the landlord. Ultimately, the retailer wishes to make reasonable profits while maintaining control over their own business including the premises in which it is located.

10. Interestingly, retail landlords are not that dissimilar from their retail tenants. Like their tenants, landlords also seek to make reasonable profits from their business while maintaining some level of control over the premises, which is the basis for their business and which they own.

11. Both parties have similar goals and are somewhat co-dependent. Retail tenants must be profitable in order to pay their rent while landlords must receive a reasonable rent in order to provide the premises and deliver any associated services.

12. **Disputes.** As in most other business to business transactions, disputes between individual parties do occur from time to time. Despite the general concerns apparently held by some small retail tenants in large shopping centres, the REIA understands that most landlord-tenant disputes that are heard by tenancy tribunals actually involve smaller landlords and smaller tenants. This may be the case because larger complexes operate standardised business models, have specialist staff, have expertise in conflict resolution and are more concerned about maintaining a good reputation.

13. Anecdotally, disputes sometimes occur at times when a retail tenant is facing financial difficulty due to poor overall business performance. At these times, the tenant may be unable to pay the agreed rent to the landlord and may conclude that the rent was therefore unreasonably high. This neglects to consider that the landlord also suffers when rent is not paid and that rents are generally set according to the prevailing market rather than the circumstances of an individual tenant.

14. The tenant may also seek grounds to blame the landlord for the failure of the business by citing, for instance, inappropriate positioning within a building, ineffective advertising or a lack of pedestrian traffic. While it is certainly possible that the actions or representations of the landlord may impact on the performance of a retail business, rents are not the major cost faced by most retail tenants (see sections to follow for more detail) and landlords should not be held accountable for any underlying poor business decisions taken by a particular retailer.

15. While disputes may also occur at other times and for other reasons, it remains important to keep a sense of perspective and proportion when examining the retail tenancy market as a whole, so as not to be caught up in emotionally charged arguments relating to individual landlords and tenants.

The Role of Real Estate Agents

16. **As Intermediaries.** Real estate agents act as intermediaries between landlords and tenants in retail lease negotiations and may be engaged by either party to act on their behalf. While it is more common for an agent to be acting on behalf of a landlord, there is a clear trend towards the use of agents by tenants (sometimes referred to as tenant's advocates when not licensed as a real estate agent) and larger, more sophisticated landlords are increasingly undertaking both lease negotiations and ongoing tenancy management 'in-house' without engaging an agent.

17. Real estate agents remain most active in the leasing of premises located in traditional retail 'strips' which generally comprise many buildings of different sizes owned by independent landlords. These landlords typically have fewer in-house resources than the owners of large enclosed shopping malls and are therefore more inclined to seek expert assistance in the letting and ongoing management of their retail premises.

18. Given that property values have increased dramatically in recent years and that the value of large shopping complex assets is primarily realised by good management, larger enclosed shopping malls are generally in a position where they are able to employ full-time centre management that can also perform leasing duties. While there is some variation in the business models that are applied, 'in-house' managers are typically employed directly by the owners of the shopping complex and are therefore not required to hold a real estate agents license, although some do become licensed voluntarily and some business models can necessitate the use of licensed agents.

19. Real estate licensing legislation in operation in all Australian State and Territories exists to protect consumers by ensuring that persons dealing in property transactions on their behalf are adequately knowledgeable and skilled to do so. While tenant's advocates and 'in-house' property managers must undertake many of the same functions of a licensed real estate agent during retail lease negotiations, they are not always subject to the real estate licensing regime and thus there is often no requirement for these persons to demonstrate any knowledge of governing legislation, professional standards, dispute resolution processes or related insurance matters. On this basis, the REIA believes that it is in the interests of both landlords and tenants for the real estate licensing regime to be extended to cover both tenant's advocates and in-house property managers. The REIA has made previous representations on this issue, and has developed proposed practice standards for tenant's agents which are at Attachment 1.

20. **As Tenants.** It is important to acknowledge that around 73% of Australian real estate agencies are small businesses employing less than ten people, while 39% employ less than five people. Small real estate agencies are often tenants in their own right and are therefore subject to all of the same issues facing other retail and commercial tenants. From this perspective, the REIA is not aware of any concerns raised by agencies with regard to retail or commercial tenancy legislation. This may however reflect a greater familiarity with retail tenancy legislation and the exceptional negotiation skills of agents in this area.

21. **Insurance Issues.** While agents have few qualms with current retail tenancy legislation, some associated issues relating to professional insurances and legal proceedings have been brought to the attention of the REIA.
22. Firstly, there have been many instances in which agents have been caught up in disputes between landlords and tenants, often resulting in the agent or agency spending many years in court defending any role played in tenancy management or the initial negotiation phase. In cases where a tenant is otherwise facing bankruptcy, they may perceive that they have little choice than to seek damages from either the landlord or their letting agent.
23. In the case of smaller landlords, there may be little potential for a tenant to recover significant monies and any legal action would simply lead to the financial ruin of both parties. Larger landlords, particularly chains of large shopping complexes, will have significant resources and in-house legal expertise available to vigorously defend any action brought by the tenant. Real estate agents on the other hand are an attractive alternative target because they generally do not have access to in-house legal expertise, usually carry some level of professional indemnity insurance and are likely to have been the primary interface (acting on the landlord's instruction) with which the tenant has interacted.
24. As a result of this situation, insurance companies consider that any agency or valuation work connected with *retail* tenancies is far more risky than similar work connected with *residential* tenancies. Agents have reported that the increased possibility of legal action concerning retail tenancies translates into a 20% premium increase for the professional indemnity insurance policy of any agent or valuer undertaking work in this area. Agents and valuers must therefore carefully consider whether or not they will undertake sufficient work in the retail tenancy area to justify the significant additional insurance cost. This situation effectively restricts the participation of some agents and valuers in the retail tenancy market, eroding available expertise and competition in the market place.
25. The REIA considers that one of the key reasons why tenants do not more commonly engage agents is the perceived cost of doing so. Agents and valuers who choose to remain active in the retail tenancy sector must ultimately pass on any increased insurance cost associated with this role to either the landlord or the tenant. Any costs passed to tenants are worn by the tenant directly, while costs passed to landlords are subsequently passed to tenants. When considered on balance, the cost of engaging an agent or valuer to represent the tenant not only includes charges for the actual work undertaken (which should result in some on-going savings for the tenant in terms of rents or associated tenancy conditions), it also includes costs resulting from lower competition and increased insurance premiums.
26. The REIA suggests that if the risk of agents being caught up in disputes between landlords and retail tenants could be significantly reduced through the inclusion of limitations enshrined in State and Territory retail tenancy legislation, professional indemnity insurance costs could be reduced, more agents would enter the marketplace and tenants would be more able to afford to engage a licensed expert to assist in retail lease negotiations.

The Structure and Operation of the Retail Tenancy Market

27. **Retail Tenancies.** There are two types of retailers in Australia: those that are consumer destinations in their own right (e.g. Coles, Woolworths, Myer, David Jones, Rebel etc); and smaller speciality retailers that rely on idle browsing and impulse purchasing. While larger ‘destination’ retailers will draw in consumers wherever they are located, smaller speciality retailers must seek exposure to potential consumers by positioning themselves in high profile locations or by actively carving out a niche for themselves as a specific ‘destination’ worth visiting.

28. Retail tenancies are normally established through an enduring lease agreement between a landlord and a retail tenant. As both landlords and tenants are seeking some ongoing security in the agreement to enable each party to make associated business decisions (e.g. tenants require tenancy security to underpin their business investment while the value of the landlord’s property is linked to a secure rental income), less than 1% of leases are operated on a casual basis. Retail leases generally, and in some jurisdictions as required by law (e.g. as in the ACT), are structured to include an initial lease period of, say, three years, with an option for the tenant to extend the lease for a further period of, say, five years.

29. Disputes between the landlord and tenant sometimes occur at the expiry of a lease term. Retail tenants located within shopping centres have argued that the ongoing success of their business is dependant upon the indefinite continuation of their lease agreement on favourable terms. While this argument has some merit, it is important to remember that the landlord is also operating a business and, like their tenants, seeks to maximise the return on their investment. For this reason, some landlords may argue that they should have the right to lease their premises to the highest bidder at any given time.

30. On balance, it would seem that the practice of establishing lease arrangements over a fixed period with an option for later renewal is the most practical means of balancing the rights of both the landlord and the tenant. During the lease term, the tenant can be assured that they have security of tenure while the landlord has a secure income stream. At the end of the lease term, the landlord has the right to return to the marketplace to seek the highest rent available. While some small retailers may maintain that they require an enduring right of renewal to underpin their future business success, it is ironically competition from other retailers that enables the landlord to re-enter the marketplace and seek a better return on the leased premises. Retailers who are more successful are in a position to outbid the current tenant. If retail tenants were allowed to remain in a premises indefinitely, more successful retailers would be prevented from entering the shopping complex, to the detriment of consumers, the landlord and the overall tenancy mix (and therefore the other retailers located in the complex).

31. **Trends in Retail Tenancies.** Retail tenancies have been traditionally located along retail ‘strips’ in town centres and scattered at low density throughout residential suburbs. As consumer transport has improved greatly over the years, larger, more centralised, and often enclosed, shopping malls have become increasingly prevalent, particularly over the past 10-12 years. Indeed, local authorities are now planning and zoning for the inclusion of large shopping malls in almost all future and redeveloped suburbs.

32. While it may require a longer travel time for consumers to initially reach their shopping destination, larger shopping complexes will generally offer such an enormous range of retail goods and services that no other destinations need be visited. While consumers are voting with their wallets and continue to drive this type of development, some concerns have been raised by smaller retailers and smaller landlords alike. For instance, it has been argued that the establishment of large shopping complexes:

- a. can change the traditional look and feel of a suburb;
- b. diverts foot traffic away from traditional retail strips;
- c. may result in some previously thriving retail strips becoming devoid of tenants, decreasing foot traffic for any remaining tenants even further;
- d. results in retail monopolies by fewer, larger retail landlords where there was once a diversity of smaller buildings and landlords with smaller holdings;
- e. prevents retail tenants from purchasing their own premises in the primary retail hotspot (persons may buy shares in the complex but do not gain direct ownership or control of their own premises);
- f. increases competition amongst potential tenants for available premises within complexes; and
- g. can make tenants feel hostage to the whims of shopping centre management.

33. The REIA considers that it is these intractable issues that have fundamentally led to heightened concerns in the retail tenancy sector. However, as it is consumers that are largely responsible for driving the structural changes in the market, both tenants and landlords must now accommodate emerging shopping preferences as best they can. It would be improper to prevent the emergence of competition between traditional retail strips and modern shopping complexes, with consumers the likely losers.

34. Typical enclosed shopping complexes are comprised of a few major 'anchor tenants' and many small speciality retailers, sometimes also including banks and a post office etc. In-house complex management will usually seek to establish a reasonable mix of retail tenants (e.g. supermarkets, department stores, food, fashion, entertainment, liquor, sporting goods etc) in order to maximise the range of goods and services available, thereby increasing the attractiveness of the complex for target consumers, and in turn, the net demand for the goods and services provided by the retail tenants.

35. From the perspective of the owners of shopping complexes, increases in pedestrian traffic lead to increased turnover for retail tenants, which lead to higher rent potential, which lead to higher asset value and (if applicable) a higher share price. This model of centre management has been successful around the world and is rapidly taking hold in Australia. One of the central tenets of the model is to grow the size of the 'retail pie' such that both the tenants and centre management may share in any increased profits.

36. One of the main areas of concern for small retail tenants located in large shopping complexes is the perception that there is an unreasonably large rent differential between 'anchor tenants' and small retailers. According to anecdotal figures obtained from commercial real estate agents, a typical anchor tenant attracts annual rents of around \$340 sqm, while smaller retailers face rents between \$400 and \$2,000 per sqm, depending upon the size of the shopping centre and size of the tenancy. While the REIA does not dispute the existence of a large rental differential, it is useful to explore the logic behind this situation.

37. All large shopping complexes rely on the presence of 'destination' anchor tenants which are the primary attraction of the complex and which draw in the bulk of pedestrian foot traffic. Upon the inception of a new shopping complex, centre management will seek to persuade anchor tenants to establish their business at the outset, before it is certain whether or not the overall complex will be a success. In order to entice anchor tenants to take this risk, centre management may offer low rents or special tenancy conditions. It is also important to remember that large anchor tenants are likely to have specialist lease negotiators in their employment, may be negotiating on behalf of a chain of stores and will seek attractive rental rates per sqm on the basis of their large floor area, which is typically between 1,000 sqm and 20,000 sqm.

38. Once anchor tenants are established, it is possible for smaller speciality stores to benefit from the pedestrian traffic likely to be generated by their presence. It is reasonable for centre management to seek a rental premium from prospective tenants in this situation. Smaller retailers will also be seeking a much smaller floor area than anchor tenants (typically between 50 sqm and 150 sqm), are less likely to be negotiating on behalf of a retail chain and may be less experienced in lease negotiations. From the perspective of centre management, smaller retailers are more risky in terms of the likelihood of failure and require a greater effort to manage as a group due to their sheer number and diversity. This situation should encourage smaller retailers to use negotiators who have experience and expertise in arranging leases.

39. For the reasons outlined above, the REIA considers that it is no surprise that there would be a rental differential between large anchor tenants which attract pedestrian traffic and the smaller retailers which reap benefits from it. A more useful rental comparison would be to contrast different small retail tenants with one another, rather than with a dissimilar anchor tenant. According to the research reports *Supermarket Centres 2005/2006* (Attachment 2) and *Regional Centres 2005/2006* (Attachment3), rents levied on different small retailers are reasonably comparable within similar sized retail complexes. Key rental parameters for smaller retail centres and larger retail centres are contained in Table 1 and Table 2 respectively, below.

SMALLER SUPERMARKET BASED SHOPPING CENTRES						
Retail Type	Avg Stores per Centre	Avg Gross Leasable Area of Each Store (sq.m)	Avg Turnover (\$'000)	Avg Turnover per Square Meter (\$psm)	Avg Rent per Square Meter Excluding Marketing Levy (\$psm)	Avg Rent as a % of Avg Turnover Excluding Marketing Levy (%)
Food Retail	3.9	96	746	7,765	663	8.6%
Food Catering	3.9	81	376	4,625	726	15.7%
Apparel	3.8	104	424	4,098	587	14.3%
Jewellery	0.5	57	367	6,462	857	13.3%
Leisure	1.6	123	600	4,888	568	11.9%
General Retail	2.2	138	1,015	7,366	579	7.9%
Homewares	0.8	124	461	3,721	394	10.9%
Mobile Phones	0.3	43	366	8,522	903	10.6%
Retail Services	3.3	62	261	4,228	693	16.4%
All Specialities	20.3	95	527	5,547	628	11.4%

Table 1: Retail Rental Data for Speciality Retailers Located in Smaller Supermarket Based Shopping Centres 2005/2006. Source: Supermarket Centres 2005/2006. UrbisJHD Pty Ltd 2006.

LARGER REGIONAL SHOPPING CENTRES						
Retail Type	Avg Stores per Centre	Avg Gross Leasable Area of Each Store (sq.m)	Avg Turnover (\$'000)	Avg Turnover per Square Meter (\$psm)	Avg Rent per Square Meter Excluding Marketing Levy (\$psm)	Avg Rent as a % of Avg Turnover Excluding Marketing Levy (%)
Food Retail	11.1	84	1,032	12,329	1,389	11.5%
Food Catering	28.2	63	645	10,278	1,725	16.8%
Apparel	52.8	121	879	7,286	1,238	17.0%
Jewellery	9.9	64	932	14,632	2,137	14.6%
Leisure	9.6	139	1,370	9,878	1,200	12.2%
General Retail	14.7	112	940	8,377	1,206	14.4%
Homewares	10.2	141	1,010	7,164	947	13.2%
Mobile Phones	8.3	52	696	13,311	1,794	13.5%
Retail Services	19.4	73	559	7,647	1,348	17.6%
All Specialities	164.2	97	847	8,714	1,329	15.3%

Table 2: Retail Rental Data for Speciality Retailers Located in Larger Regional Shopping Centres 2005/2006. Source: *Regional Centres 2005/2006. UrbisJHD Pty Ltd 2006.*

40. Analysing Table 1, smaller supermarket based shopping centres typically have around 20 speciality retailers with an average rental of \$628 sqm, equating to around 11.4% of rental turnover. Tenants with either large floor areas or low turnovers tend to pay lower rents per sqm.

41. Analysing Table 2, larger regional shopping centres (i.e. those that have a large department store), typically have around 165 speciality retailers with an average rental of \$1,329 sqm, equating to around 15.3% of rental turnover. As with smaller shopping centres, tenants with larger floor areas pay lower rents per sqm.

42. Overall it may be said that notwithstanding differences in their size, turnover and relative location in the shopping complex, retail tenants pay higher rents when located in larger shopping complexes, that presumably are also more attractive to consumers and generate higher levels of foot traffic. This is evident by the differences in average turnovers for retail tenants in smaller and larger shopping complexes at \$5,547 sqm and \$8,714 sqm respectively. Retail tenants with lower turnovers or larger floor areas tend to pay lower rents per sqm.

43. **Constraints on Tenancy Availability.** Rents are primarily determined by broader market forces, including the total supply of retail space. One factor that can have a major influence on the total supply of retail space is the zoning restrictions imposed by local and State and Territory planning authorities.

44. The establishment of more centralised shopping precincts, including similar precincts such as ‘bulky goods’ zones, are attractive for a number of reasons from a planning and service provision perspective. Fewer centralised retail zones allow authorities to more efficiently complement these centres with improved transport linkages, parking availability, pedestrian infrastructure and recreational facilities. Not only does this reduce the total infrastructure costs borne by governments (and in turn, taxpayers), centralised facilities of this nature provide a basis for further complementary urban development.

45. It would of course be unreasonable and inefficient for planning authorities to duplicate similar retail precincts in close proximity to one another when they could instead be spread out to ensure that all residents had reasonable access to such facilities. Unfortunately, in cases where very large enclosed shopping complexes are constructed on these sites, the lack of direct competition between the complexes may result in some retailers feeling that they have little choice but to accept the tenancy conditions imposed by potentially fewer landlords.

Legislation

46. As listed on Page 2 of the Productivity Commission Issues Paper, all Australian States and Territories have established retail tenancy legislation, which sometimes also incorporates commercial leasing. Dispute resolution is available in all jurisdictions and, as listed on Page 3 of the Issues Paper, there have been several legislative reviews, both at the Federal and State and Territory levels over the past decade.

47. Retail tenancy legislation essentially enshrines an extra level of regulation and documentation for the protection of smaller tenants. This legislation will sometimes have limitations on its application as in, for instance, the ACT where tenancies exceeding 1,000 sqm are exempt. For smaller tenants in the ACT there is the requirement that tenants covered by the legislation provide a signed declaration that independent legal advice has been obtained prior to agreeing to the terms and conditions of the lease agreement.

48. In addition to specific retail tenancy legislation, the Commonwealth *Trade Practices Act 1974*, and State and Territory fair trading acts (FTA) govern conduct in general trade, prohibiting unconscionable conduct and misleading and deceptive conduct (including conduct that is likely to mislead or deceive) in all business transactions.

49. A third tier of legislative protection also exists in the retail tenancy sector by way of real estate licensing regulations which operate across all States and Territories. Unfortunately however, these regulations do not always capture in-house centre management or tenant’s advocates. The REIA contends that greater protection would be afforded to tenants in particular if real estate licensing regimes were extended to cover all persons professionally involved in the negotiation of retail leases, specifically tenant advocates or tenant representatives.

50. Although there are major areas of inconsistency between jurisdictions, there is nonetheless a comprehensive consumer protection framework covering the retail tenancy sector. Regulatory inconsistencies are not limited to the retail tenancy sector and unfortunately remain a major feature of the broader Australian consumer protection framework. The REIA has noted many of these inconsistencies in a previous submission to the Productivity Commission *Inquiry into the Australian Consumer Policy Framework*, which is included at Attachment 4.

51. The REIA strongly supports greater simplification and harmonisation of retail tenancy legislation across all Australian jurisdictions. It is a fact that many landlords and tenants operate in multiple jurisdictions and are continually frustrated by the lack of consistency in this and other regulatory areas. One solution to this problem would be to harmonise the principles and documentation underpinning all tenancy regulation including, retail, commercial, industrial, rural and residential. The responsibilities of all landlords and tenants should be fundamentally the same and it should also be made clear that some measure of caveat emptor applies to lease transactions. Ideally, a nationally uniform tenancy code should be developed and adopted by all Australian States and Territories.

52. REIA member real estate agents have reported that the many regulatory reviews that have occurred in the retail tenancy sector in the recent past have resulted in a significant shift towards increasing the protection afforded to tenants at the expense of the rights of landlords. A practical outcome of this fundamental shift has been that it can now be exceptionally difficult for a landlord to evict a retail tenant, even when rents are significantly in arrears or other lease conditions have been breached. There are examples in which landlords have sent several notices to the tenant, for instance requesting that rent arrears be paid immediately or making specific disclosures to the tenant, that have been completely ignored by the tenant. Landlords may subsequently be required to attend many hearings in tenancy tribunals and then be directed to 'give the tenant another go' or even assist in the promotion of the tenant's business. In some circumstances, landlords are not able to execute leases where tenants have not acknowledged the receipt of particular disclosures.

53. If, in the end, the tenant is finally evicted, the landlord will have incurred significant expense in actioning the eviction as well as facing the loss of any rents in arrears and costs involved in acquiring a replacement tenant. The REIA considers that legislation should be made sufficiently clear to enable problem tenants to be evicted with minimal loss to the landlord. In essence, an improved balance between the rights of the tenant and the rights of the landlord is required.

Relative Importance of Rent as a Business Cost

54. There appears to be a widespread perception by many in the small retail sector that rents are exorbitantly high in most situations and that landlords are effectively holding retail tenants to ransom. This is simply not the case for the reasons outlined below.

55. Firstly, rents are generally determined by broader market forces and will be higher in circumstances where there is a high level of competition for available retail space and lower where there is inadequate demand. If landlords seek to levy an unreasonable amount of rent, there is a risk that the premises will go untenanted until demand increases or the asking rent is lowered to meet the market. There is nothing more costly to the landlord than empty premises. Given the reliance on broader market forces, landlords simply take the market rent obtainable and, apart from seeking a reasonable tenancy mix to maximise rents in general, are not in a position to have regard for the business or lifestyle aspirations of individual tenants.

56. Secondly, tenants are not forced to acquire any given premises and usually have some level of choice with regard to available tenancies. As with retail products, premium tenancies will generally attract higher prices, while sub-optimum tenancies will be available at lower prices. Premium tenancies will be those that are more likely to result in higher business turnover for the retail tenant, due to factors such as pedestrian traffic levels, proximity to target customers, landlord funded advertising or even the physical attractiveness of the premises. Prospective tenants must weigh up the relative merits of different rental options as the cheapest premises are not always the best.

57. Thirdly, rents are often overstated in terms of total business operating costs. According to Table 1 and Table 2 above, while different retail business types have differing margins and cost components, rents are around 11.4% and 15.3% of total business costs in small and large retail complexes respectively.

58. Turnover rents are sometimes used as a means of reflecting underlying market forces and the co-dependence of the landlord and the tenant in the primary rental agreement. Under this arrangement, rents are levied as a fixed proportion of the tenant's business turnover. Where tenants are successful, rents will become progressively higher in line with the tenant's capacity to pay. Where tenants are less successful, rents will remain low in absolute terms, allowing the tenant 'breathing space' in the hope that the business will remain viable and potentially improve in the future. Turnover rents are a means through which both the tenant and the landlord may share in the risks and rewards of small retailing.

59. Some tenants object to this style of rental agreement due to the requirement that turnover records must periodically be provided to the landlord and because rents may become unexpectedly high in absolute terms for some very successful retailers. The provision of turnover records is of course required for such an arrangement to work in practice, and the higher rents paid by some tenants are off-set by lower rents received from others. One of the main benefits of a turnover rent arrangement is that it provides a powerful and enduring incentive for the landlord to work towards the success of all tenant businesses.

Negotiating Power

60. A concern often raised by smaller retail tenants is a perceived imbalance in negotiating power between themselves and larger landlords. The basis for this argument appears to stem from a perception that singular smaller tenants do not have sufficient market power and do not have access to sufficient market information or professional expertise to offset that held by the landlord. The REIA considers that smaller tenants do not face a systemic disadvantage.

61. **Professional Expertise.** First of all, it would appear that there is a reluctance on the behalf of small retailers to engage and pay for the services of a real estate professional during lease negotiations. As espoused elsewhere in this submission, real estate agents have the required property management expertise to assist tenants in understanding retail tenancy legislation, explain particular lease conditions, and can improve the tenant's negotiating position through an enhanced understanding of these factors and an ability to see things from the landlord's perspective. Similarly, it would also seem that smaller tenants are less likely to acquire other professional expertise that may assist in lease negotiations, such as advice from an accountant (in terms of affordable rent levels) or a solicitor (who may assist the tenant to understand their legal obligations under the lease and identify clauses which may impact on the financial viability of the business and connected assets).

62. **Market Information.** Secondly, smaller tenants appear not to realise that there is a significant amount of information in the marketplace concerning the rents paid by other tenants in the same or similar marketplace. While it is not a requirement that all lease contracts be made public in all States, in some jurisdictions such as the ACT, QLD and NSW, all property leases which are 'stamped' for the purposes of levying stamp duty are posted on the Department of Lands website (or equivalent). 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 such as those at Attachment 2 and Attachment 3 which contain information on the average turnover and rent levels for a whole range of retail sectors (e.g. food, fashion, liquor).

63. Many landlords will request that prospective or current tenants provide detailed information on their own business such that the landlord can assess potential rental levels, turnover levels and ultimately the businesses prospects of success and suitability for inclusion in the broader tenancy mix. For reasons outlined elsewhere in this submission, landlords must take these considerations into account to maximise the overall success of the shopping complex and the tenants contained within it. While individual tenants may object, it is in the interests of the tenant community that the landlord has access to information concerning the performance of the shopping complex.

64. **Collective Bargaining.** It appears to be a little known fact that small retail tenants may group together to negotiate with a large landlord under the collective bargaining provisions of the *Trade Practices Act 1974*. The Commonwealth Government introduced changes to the collective bargaining provisions on 1 January 2007 to enable small businesses to greatly reduce the time and cost involved in this process. Small retailers can now make a notification to the ACCC of their intent to collectively bargain rather than seek formal authorisation. Notification applications cost just \$1,000 as compared with \$7,500 for authorisation and tenants can begin bargaining in as little as 28 days from the date of lodgement (as compared with around six months under the authorisation route).

65. The Chairman of the ACCC, Mr Graeme Samuel has publicly stated that more small retailers should consider utilising the new collective bargaining regime and has strongly urged them to do so.

How Can the Retail Tenancy Market be Improved?

66. Notwithstanding localised shortages of retail premises, trends in consumer shopping preferences and regulatory differences between jurisdictions, the REIA considers that the retail tenancy market is functioning reasonably well on the whole. However, as in all complex regulatory environments, there is always room for improvement. From a legislative perspective, and as explored elsewhere in this submission, the REIA would support:

- a. some simplification of leasing regulation (e.g. the establishment of common principles underpinning retail, commercial, industrial, rural and residential leasing transactions);
- b. a more appropriate balance between the rights of landlords and the rights of tenants;
- c. the introduction of clear limitations on the circumstances in which tenants may seek damages from real estate agents involved in retail tenancy transactions;
- d. greater harmonisation between regulatory jurisdictions;
- e. the establishment of a national retail leasing code; and
- f. the extension of real estate licensing requirements to tenant's advocates and 'in-house' property management.

67. There is also a clear need for an education program aimed at small retail tenants to advise them of:

- a. the fact that rents are primarily determined by broader market forces;
- b. the reasons for rent differentials between anchor tenants and the smaller tenants that benefit from the pedestrian traffic generated by anchor tenants;
- c. the merits of engaging experts to assist in retail lease negotiations (i.e. real estate agents, solicitors and accountants);
- d. the availability of information concerning the rents paid by other tenants (both specifically and for particular retail sectors); and
- e. the potential to use collective bargaining provisions under the TPA.

68. The REIA believes that the implementation of the measures outlined above 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.

SUMMARY

69. The REIA considers that the retail tenancy market is efficient and functioning reasonably well on the whole. There is however a widespread perception in some sections of the community that smaller retail tenants are being held at the mercy of large landlords. This has particularly become the case as consumers and planning authorities drive a shift away from traditional retail strips towards large, enclosed shopping complexes.

70. Retail tenancy legislation has been moving in a direction that, arguably, now favours the rights of tenants over landlords. Landlords can now find it exceedingly difficult to remove problem tenants without detailed explanation, multiple notifications, lengthy tribunal hearings (or court hearings), orders to assist the tenant in their business activities and significant costs arising from these delays.

71. It would appear that, while some small retail tenants are adamant that they are at a serious disadvantage when negotiating retail lease agreements compared with larger more sophisticated landlords, there is a general reluctance to engage expertise that may assist in these transactions. Real estate agents are equally available to assist either landlords or tenants in lease negotiations, however, it is uncommon for tenants to seek this professional expertise, even though it is likely to improve their bargaining position. Tenants would also be likely to benefit from advice received from their accountant or solicitor, but again, it would appear that there is some reluctance to involve these professions in lease negotiations.

72. Small retail tenants also do not seem to be aware of the significant amount of market information available concerning the rents and lease conditions that have been accepted by other tenants. While it is reasonable that parties to a contract may choose to keep these details private, retail tenants may access the actual lease agreements of particular tenants in many jurisdictions (e.g. ACT, QLD and NSW) for a nominal fee. In addition, reports detailing the rents paid more generally in particular retail sectors can be purchased from major commercial real estate chains and other market research institutions.

73. There is a competitive retail leasing market in Australia and small retail tenants must make informed choices concerning the most attractive tenancy options for their business. If tenants choose to locate themselves within large shopping complexes, they should consider that there are both costs and benefits of doing so.

74. The collective bargaining provisions under the TPA have thus far been under utilised and remain largely untested in the small retail sector. Recent amendments to the provisions have greatly improved the efficiency of using the provisions while at the same time have greatly reduced the cost. The REIA would suggest that small retailers have an opportunity to maximise their bargaining position under the law but have so far either failed to recognise this potential or remain unaware of the provisions.

75. While the REIA considers that the retail tenancy market is operating efficiently, there are nonetheless some areas where improvements could be made from a regulatory perspective including; simplification across different leasing sectors, improving the balance between the rights of tenants and the rights of landlords, introducing limitations on involving agents in disputes, harmonising legislation across jurisdictions, establishing a national retail leasing code and extending real estate licensing requirements to tenant's advocates and 'in-house' property managers.

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Attachments:

1. REIA Practice Standards for Tenant's Agents dated 7 August 2004.
2. Regional Centres 2005/2006 (UrbisJHD Pty Ltd 2006) dated September 2006.
3. Supermarket Centres 2005/2006 (UrbisJHD Pty Ltd 2006) dated November 2006.
4. REIA Submission to the Productivity Commission Inquiry on Australia's Consumer Protection Framework dated 11 May 2007.