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Australian Government Productivity Commission

Public Inquiry The Market for Retail Tenancy Leases in Australia

Submission from

The Royal Institution of Chartered Surveyors (RICS)

1. Introduction

We are writing in response to the Australian Government Productivity Commission Public Inquiry Circular and Issues Paper, 'The Market For Retail Tenancy leases in Australia', published on 29 June 2007, inviting comments on the operation of the retail tenancy market in Australia.

The Royal Institution of Chartered Surveyors ("RICS") is an international, independent, impartial, non-profit making organisation committed by Royal Charter, to acting in the public interest and providing impartial, authoritative advice on major issues affecting business and society. RICS has 130,000 members globally and represents, regulates and promotes the work of land, property and construction professionals throughout 120 countries. Under the terms of its Royal Charter, RICS is required at all times to act in the public interest.

RICS has offices, staff and members throughout Australia and is registered as RICS Australasia Pty Ltd trading as RICS Oceania. For further information contact:

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The recommendations RICS makes are primarily based on two sources of information:

a) The representative views of Australian RICS chartered property professionals in Australia. RICS has 1,300 chartered members in Australia who represent a wide spectrum of the property profession. A small working party was formed, headed by Dr David Parker FRICS, representing our Commercial Property Faculty and this group of RICS professionals gathered views from members who undertake a wide variety of roles in the commercial and retail tenancy market. The RICS members whose views have been sourced include those providing property advice and services to landlords and tenants and consultation conducted with agents, advisors, investors, academics and researchers.

b) Independent research, supported by RICS, and conducted in Australia by Professor Neil Crosby FRICS, from the University of Reading, UK, that compared the positive and negative aspects of the UK and Australian Retail Tenancy Markets (Copy of the summary research is attached as an Appendix.)

2. Summary of Recommendations

Recommendation 1: That existing legislated measures for; provision of information and disclosure statements prior to lease negotiation; mandatory dispute resolution and the operation of Commissioners be retained.

Recommendation 2: That retail tenancy legislation across the States be harmonised.

Recommendation 3: That specifically, retail legislation is harmonised nationally to allow appropriately qualified valuers, to undertake rent reviews and other retail valuation tasks, including RICS Chartered Valuers.

Recommendation 4: The disclosure statement at commencement of lease negotiations be simplified.

Recommendation 5: That a system of registering retail leases, which can be accessed by all, be facilitated nationally.

Recommendation 6: That further independent study on the issue of tenants' rights at the end of a lease is conducted, to determine whether further safeguards for tenants or a longer minimum lease term should be introduced.

Recommendation 7: That any new definition of unconscionable conduct be simple and be communicated widely to the industry.

Recommendation 8: That mandatory mediation controlled by appropriately qualified mediators, including RICS Dispute Resolution Faculty member and RICS Chartered Valuers, be retained and harmonized across states.

Recommendation 9: That retail legislation nationally should allow all professionally qualified mediators and RICS Dispute Resolution Faculty members, to undertake adjudication and expert witness work.

3. RICS Comment & Recommendations:

3.1 *What are the strengths and weaknesses of the current structure and functioning of the retail tenancy market? What are the effects (both positive and negative) on your business, and the wider community?*

The general RICS view is that the current structure and function of the Australian retail tenancy market has many POSITIVE aspects. These include, *in most States*;

- the mandatory, legislated code of conduct for retail tenancy leases, This is deemed more suitable in the Australian market place than a voluntary code – which has proved ineffective in the UK and NSW previously;

- the requirement to provide appropriate information at the commencement of lease negotiations and disclosure statements before the leases are signed. This RICS believes encourages tenants to better understand the implications of signing a lease and to seek professional advice at an early opportunity
- the mandatory dispute resolution/mediation process required before dispute between a tenant and a landlord can go to court,
- the successful establishment and operation of registrars or commissioners who educate, investigate and help resolve disputes on retail tenancy matters

Recommendation 1: That existing legislated measures be retained, but harmonised across State jurisdictions, in particular for;

- **the provision of information and disclosure statements prior to lease negotiation;**
- **the mandatory dispute resolution procedures before disputes can go to court;**
- **the operation of appropriately qualified impartial parties acting as educators and ombudsmen for the industry.**

RICS also believes that the current structure and function of the Australian retail tenancy market has a number of issues which should be improved. These include the need for the scope of legislation to be nationally consistent. Currently, defining the scope of legislation in different States is a major problem. The scope of legislation varies between States and can be conditional upon size because, in many States it is purely small premises legislation; any retail unit under 1,000 sq metres is included. In South Australia and Victoria a rent criteria is used based on \$ value. The Victorian limit is so high it includes most shops in most centres. Victoria also has a criteria related to the tenant being listed on the stock exchange. As the rent limit is so high the listing criteria basically controls which tenants are included.

In addition the definition of retail is not always consistent between States.

The different legislation across the States causes market inefficiency and requires greater legal costs for those working across State boundaries. RICS would encourage a review to determine appropriate common criteria to balance reduction in red tape with protection of tenant interest.

Recommendation 2: That retail tenancy legislation across the States be harmonised.

3.2 *What are the implications, if any, for the market in retail tenancy leases, of trends in urban and regional development, and changes in consumer preferences, in technology and in ways of working? How might such changes affect retail tenants, landlords and investors?*

A move to principles based law should be encouraged to permit law to adapt to evolving retail property market.

3.3 Are there any competition, regulatory and access constraints on the effective and efficient operation of the retail tenancy market?

RICS is aware that in some states retail legislation identifies that members of specific professional bodies (Australian Property Institute or Real Estate Institute) must undertake rent reviews. RICS does not agree with this restraint of trade and argues strongly that all appropriately qualified professionals, who hold any required State Valuation Licence, be identified as being able to undertake such rent reviews.

RICS Chartered members have a minimum degree level equivalent property education followed by 2 years structured and assessed property training coupled with extensive experience. These qualifications have been recognized by NSW Office of Fair Trading for registration as a Valuer in NSW and so through all other State bodies through mutual recognition. Additionally RICS members must abide by international valuation standards (IVSC) as set out in the RICS Valuation and Appraisal Manual. The RICS qualification is globally recognized.

In this respect the NSW legislation (Retail Leases Amendment Act 2005 (NSW)) has been amended, but other states are yet to address this major issue, which we see as a 'Restraint of Trade'..

Recommendation 3: That specifically, retail legislation is harmonised nationally to allow appropriately qualified valuers, to undertake rent reviews, including RICS Chartered Valuers.

Concerning the disclosure process, RICS notes that generally there are two processes in each State. First the giving of a draft lease plus the lease commissioner's guidance note to tenants as soon as or before any negotiations commence and then the disclosure statement prior to the signing of the lease. While RICS recognises the need for a disclosure statement to be provided prior to the lease being signed, we believe 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.

Recommendation 4: The disclosure statement prior to lease completion be simplified.

3.4 Are there restrictions on the availability of information to landlords or tenants that impact on business decisions and operations?

RICS notes that it is difficult for market participants to get aggregated information on lease terms. In some states where a process for notification of leases or registration is present, it is difficult to produce proper analyses of this information in a cost effective manner. In NSW it is possible to buy information on individual leases. In Victoria, the Small Business Commissioner has a box of notified leases and has no resources to do anything with them. Policy discussions concerning renewal rights in Victoria in the run up to the 2003 Act were based on information provided by the landlords which indicated that most tenants renewed and those who did not, chose to leave.

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.

Recommendation 5: That a system of registering retail leases, which can be accessed by all, be facilitated nationally.

3.5 *Are the main factors influencing the level of rents and associated tenancy conditions appropriate and transparent to the landlords and prospective tenants?*

RICS concludes that landlords and prospective tenants should undertake an appropriate level of research and due diligence concerning terms prior to entering into a lease. However, RICS is concerned that prospective tenants often fail to obtain appropriate advice prior to entering into a lease. RICS encourages the implementation of a business education programme, similar to RICS' highly successful "Property in Business" programme, to encourage prospective tenants to obtain appropriate advice prior to entering into a lease.

3.6 *Are the provisions of leases establishing the rights of landlords and tenants when leases end, appropriate and transparent?*

RICS believes that this issue, together with the issue of harmonising legislation, are the single biggest issues affecting retail tenancies in Australia. RICS recognises that there are both advantages and disadvantages in establishing tenants rights at the end of retail leases, for example a tenant's right to renew; a tenant's first preference to renew or mandatory independent rent reviews at the end of a lease. There has been research¹ suggesting that, where there is no right to renew, tenants' renewal rents are significantly higher than new letting rents. Other research² indicates that from 1998/99 specialty shop sales increased by \$19,000 of which \$16,123 of this increase or 84.8% was absorbed by rental increases. A further question raised relates to the length of a maximum lease (5 years) versus the Australian Tax Office provision for fitout depreciation over 8 years. This situation for tenants at the end of a lease has to be offset against the landlord's right to manage and set rents. Some states give tenants preferential rights of first refusal but it is unclear how much opportunity these afford to tenants in practice.

RICS is cognisant of the lease renewal process in other countries where in the USA for example, legislation is non-existent and operates on open market conditions; perhaps indicating a benefit to landlords. Conversely the UK legislation is very supportive of a tenant's right to renew at market conditions. Further analysis of outcomes from other international retail tenancy legislation should be incorporated into the decision making process to identify best practice for the Australian market.

¹ See, for example, Fisher, JD and Lentz, GH (1990). Business Enterprise Value in Shopping Malls: An Empirical Test. Journal of Real Estate Research, 5(1): 167-75

² JHD Retail Averages quoted in settling rental (and other retail lease) disputes by Expert Determination by Don E Gilbert, Brisbane, Queensland, Australia © June 2006

RICS believes that further independent study on this issue alone should be conducted, to determine whether amendments should be introduced and an assessment of how the process has worked in SA and ACT. RICS would be willing to participate in such a study.

Recommendation 6: That further independent study on the issue of tenants' rights at the end of a lease be conducted, to determine whether further safeguards for tenants or a longer minimum lease term should be introduced.

3.7 *Is the notion of unconscionable conduct sufficiently clear?*

RICS is aware that the Federal Government is currently reviewing the definition of 'unconscionable conduct' as part of Trade Practices Legislation. However, RICS would not favour a lengthy and complicated legal definition that might make it more difficult for parties to bring forward or review grievances.

Information provided by the Shopping Centre Council, a representative body for landlords, show figures from ACCC indicating that there are only 7 leases in every 10,000 resulting in a complaint of unconscionable conduct. Anecdotal evidence from tenant representatives would suggest that these statistics may be unrepresentative but without further research with tenants we are uncertain whether these figures reflect a lack of understanding of "unconscionable conduct" and the process for redress, or a generally good business ethic in operation.

Recommendation 7: That any new definition of unconscionable conduct be simple and be communicated widely to the industry.

3.8 *What regulatory and other avenues are available for dispute resolution between landlords and retail tenants?*

RICS is in favour of retaining the current system operated in most States of disputes being referred to some sort of cost effective mediation prior to being allowed to go to court (see Recommendation 1). The RICS funded research appended to this submission found that the systems in Victoria and New South Wales were both successful in resolving the majority of disputes and well regarded by professionals.

In Victoria the success rate at, or before, mediation is 75%.

Recommendation 8: That mandatory mediation controlled by appropriately qualified valuers be retained and harmonized across states.

RICS believes that there should be no restrictions on the appointment of qualified professionals to adjudicate or act as expert witnesses on tenancy disputes. RICS believes it is a barrier to practice when legislation specifically identifies members of a particular property organisation as only being allowed to act in such a capacity. Not dissimilar to reasons provided in Recommendation 3. RICS has a well established Dispute Resolution Service which could be easily emulated for use in retail lease disputes prior to costly legal intervention.

Recommendation 9: That retail legislation nationally, should allow all professionally qualified mediators and RICS Dispute Resolution Faculty members, to undertake adjudication and expert witness work, including RICS Chartered Valuers.

3.9 *What is the scope of regulatory or policy change to improve the effectiveness, operation and economic efficiency of the retail tenancy market in Australia?*

Please refer to the Recommendations above

3.10 *If participants see a need to reform current arrangements, what should those reforms be and what are the likely benefits and costs of such reforms to retail tenants, landlords and investors?*

Please refer to the Recommendations above.

APPENDIX 1 RICS Fibre Paper – Commercial Lease Reform

Corporate Professional Local

Commercial lease reform in the UK: can we learn anything from Australia about the awareness of small business tenants?

FIBRE

Findings in Built and Rural Environments

September 2006

Sixty second summary

The way in which the commercial leasing system in the United Kingdom has treated small business tenants has been a cause of some concern to both business groupings and government. Initially the areas of most concern were upwards-only rent reviews, confidentiality clauses and dispute resolution. Since then the response in the UK has been to use voluntary codes of practice to address these and other emerging issues. In response to the same issue, other countries have gone down a legislative route, and this research by Professor Neil Crosby at the University of Reading Business School in the UK investigated how the Australians have attempted to solve their small business tenant problems. Many of the policy objectives of the Australian State Governments are similar to the UK and their response has been to ignore voluntary solutions and implement legislation or mandatory codes, which create an enforceable framework for both negotiations and the lease document.

Their particular small business tenant issue relates to retail although there is no reason why small commercial and industrial tenants should be treated differently when it comes to attempting to better inform tenants all the way through the letting process.

The Australian legislation has provisions for extensive information to be passed by landlord to tenant at the commencement of negotiations and this includes a copy of the proposed lease and a Government information brochure.

They also have to provide tenants with full disclosure of all financial and other details of the lease at least seven days before the lease is signed. Failure to comply can lead to fines and possible termination rights for tenants. The research found that this gave Australian tenants more information than UK tenants and was thought to drive them to take professional advice earlier in the process. Previous research undertaken by Professor Crosby has found that the UK's voluntary lease code is not fully effective and he concludes that the mandatory provision of information and disclosure could be used in the UK to better inform prospective small business tenants.

Other aspects of the Australian legislation include first, the use of compulsory low cost dispute resolution, often using mediation, prior to any dispute being entered into court; and second, the use of Government funded lease registrars or commissioners to undertake the investigation of non-compliance under the Acts, run the mediation service and attempt to educate small business in the implications and pitfalls of signing leases without due consideration. These two aspects of the Australian legislation received praise from property professionals interviewed for the research in Australia.



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