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The Market for Retail Tenancy Leases

In asking the Productivity Commission to review the Market for Retail Tenancy Leases, The Federal Government and the Treasurer in particular, have instigated a process that is long overdue and could make or break the future of thousands of tenants

While most comments will be about problems between lessees and lessors, the real issue is the requirements imposed on both by the relative State Acts.

Over the years, there has been slow and limited progress in reviewing these Acts and the pressure for review has always come from lessees or governments reacting to lessee pressure in the lead - up to an election.

The results and reform have always been minimized for two reasons - Pressure from lessors to stop any significant reform has been intense and well funded and they have made amazing claims at times even implying that they are the retail industry.

Then there was a statement from one lawyer who said to the SA Attorney General at a review of the SA Act - 'Attorney, you can do what you like, you can say what you like, you can legislate what you like and we are here to tell you that we will find a way around it'.

If that represents the attitude of lessors, then there is no hope for tenants as long as the legislation by which we should all abide is capable of being swept aside.

We have absolutely no doubt that the various State Tenancy Acts will, by example be shown to be inept, providing little guidance as to how the parties should behave and generally easily skirted around by the average lawyer who might be employed to enforce a lessors demands. Few lessees, on the other hand, can even contemplate engaging a lawyer because of the costs.

What we do know beyond all doubt is that many small to medium retailers who rent space are reaching breaking point in trying to sustain their businesses against the rental and other demands of their landlords. Current trends in costs are un-sustainable. Pension funds investing in shopping centres therefore need to be careful.

The harsh if not unconscionable tactics of landlords are facilitated by incredibly poor legislation across Australia, which doesn't enable fair play or fair competition in the first instance and as such is used to the disadvantage of tenants by these predators.

The State Retailers Association has years of experience in genuinely trying to bring about even-handed legislation and we are of the opinion that this review is literally the last chance for tenants to achieve fair leasing / trading conditions in a country which makes much of giving everyone a "fair go".

It is not our intention at this stage to provide specific examples to bolster the general comments that follow, simply because that would require hundreds of pages of evidence.

We expect that the Commission will receive irrefutable evidence as to the harsh, if not unconscionable treatment that is dealt to many honest hardworking retailers across Australia.

This is serious because retailing is a major contributor to the creation of jobs and wealth in Australia - over 1.5 million employees and around $4.3 trillion in worth of the family owned businesses alone. Retailing is 23% of GDP. For further information on this subject we refer you to the recent Price Waterhouse Coopers report prepared for the National Association of Retail Grocers of Australia, (download from http://www.narga.com.au).

One major concern we do have is that lessees are increasingly afraid to speak out on any issue that involves their lessor and most feel that they have been abandoned by governments who seem only to be concerned with helping big business. They need to have their faith restored.

Should the Commission want further public evidence, we are prepared to organise a public meeting of tenants. This would be very useful as it would enable comment that otherwise won't be heard. We will pay all costs.

We make the following comments on issues as they relate to South Australia in particular.

TERM OF LEASE

In SA a lease is now for 5 years and for a business to have a future that simply sets up the scenario of a tenant being "ripe for picking" when or if a landlord decides to offer a new lease. The tenant will pay a premium for a renewal in terms of a harsh rent increase and an expensive shop refit - all of which the tenant will somehow have to amortise over the next 5 years and still make a profit.

Tenants must have the right to ensure the future of a viable business considering the often high investment they have made and the contribution they have made to the landlord.

If a landlord won't renew a lease or makes unreasonable demands regarding a renewal then the landlord should have to put their reasons in writing for it to be tested by a tribunal or court.

Refusal to renew can in some cases be an acknowledgement that because further rent increases are no longer affordable for the incumbent lessee, then the only way to achieve more rent income is from a new tenant who will often meet the demands simply because they in effect are given the previous tenants' business and good will for nothing.

Most landlords have no regard for a tenant's investment and no leasing act recognises or protects it in any way.

FIT OUT

Acts put no constraints on what a landlord can stipulate or demand as regards setting up a new business or re-fitting a shop at the time of providing a new lease to an existing tenant.

While landlords demand what they want, they make no guarantees that the tenant will benefit from the fit-out and generally ignore the tenant's comments as to what is feasible, desirable, affordable and likely to work.

But if these costs lead to nothing except debt, the tenant is always blamed for the outcome. Then there is the required use of or reference to "in-house" architects, trades people and suppliers which always adds to the costs.

Tenants have no option but to comply and most landlords provide voluminous documentation relating to fit-outs which exists only to reinforce what the landlord wants to achieve as regards the on-going presentation and value of their property.

A fit-out must be realistic in terms of presentation, disruption to the business, cost and likely benefits. The tenant must have the final say; it is after all their business and their money.

GUARANTEES/GUARANTORS

The demands on tenants to provide increasing guarantees to cover rent are becoming greater and this has the effect of reducing the available capital or borrowing power of a tenant.

Landlords are not exposed to a high degree of risk compared to a tenant and the current trends perhaps acknowledge that there are harder times ahead.

Guarantees should be limited to 1 (one) month's rent, given that rent is always paid one month in advance.

Guarantors must be people with an income that would support the guarantee, not just personal assets. Too often, well meaning relatives lose everything.

WARRANTY - FIT FOR PURPOSE.

Many leases contain a clause that states that "the premises are not necessarily suitable" for the purposes to which they will be used by the lessee.

This is not acceptable as it often allows substandard premises to be let, the tenant not necessarily being aware of the deficiencies.

Often that leads to the tenant having to undertake capital works (roofing, wiring, toilets, floors etc) that should have been done by the lessor to enable a building to be suitable for occupation.
"Lessee beware" certainly applies in all cases but a building should meet some basic standard requirements.

MARKETING FUND

The Marketing Fund in a centre is charged as a percentage of rent or area and based on a budget.

Marketing Funds, paid for by the tenants, are managed by the landlord and then usually to a program set up by the landlord.

While it is required that a marketing plan and budget be submitted to tenants, their comments are not generally welcomed as it is the landlords who claim the expertise in promoting a centre - as opposed to the businesses in that centre.

Most tenants don't feel that their money is well spent, particularly where it is used to provide a "promotional allowance" to a struggling tenant - that is really rent relief.

This process ensures that rent is paid and keeps the tenant in business in the short term. It also hides problems within a centre and should not be permitted.

Rent relief should be at the lessors' expense.

The auditing of the Marketing Budget is as unsatisfactory as is the auditing of the outgoings budget and further transparency is required. A better management process is essential for Marketing Funds / Programs, to ensure that tenants are empowered to see their money used to promote their businesses - not just the "image" of a centre.

MANAGEMENT COSTS.

Tenants usually pay the costs of Managing a centre and yet have no say in that process. We have seen some tables used to assess the fees so charged and consider then to be excessive to say the least.

If tenants pay for a "service", where is that service? We find very few cases where the management of a centre is actually "friendly" towards the lessees who are often treated with contempt.

There is a strong need for this source of income for lessors to be assessed as to its desirability and then what is the real cost.

In some cases, tenants pay all of the costs of the Management Office. It seems as if the property industry has found a way to negate all of its running costs. It may well be that "head office" costs are also levied against tenants in various centres.

CAPITAL COSTS

There needs to be a very clear statement on what landlord costs (capital) are and what tenants should pay for in terms of outgoings.

Landlords must be required to maintain retail premises to the degree that makes them pleasant and attractive, meeting the reasonable expectation of lessees and the public.

OUTGOINGS

Rarely will any tenant be happy with the management of the (necessary) outgoings of the lessor or centre and they are justified in their concerns about lack of transparency, reasonable costs and the opportunity to be involved in a process that they pay for.

We often see a failure to meet the simple reporting requirements of the Act which is so weak that failure to comply imposes no penalty on the lessor. So they deny the tenants any information or redress.

Lessees are rarely provided with any satisfactory answers when they question anything to do with proposed or actual outgoings and there is no requisite that the best price for any service or supply be obtained. The process is open to rorting and under the SA Act it is permissible to make a profit on outgoings if tenants are so advised.

We have caught out landlords making false claims or giving service contracts to family or friends.

TRADING HOURS

Many new leases in SA now contain a clause written by the lessor, where the tenant `requests the right to trade on Sunday' - yet the Act states that they cannot be forced to trade!

No lease should be allowed to contain any clause which tries to skirt around the Act or, because the tenant wants a new lease contains a mandatory requirement imposed by the lessor.

ELECTRICITY SUPPLY.

Of all users of this vital service, retail tenants in centres are the most likely to either be paying more than they need to, or denied access to the expected benefits of what is a very competitive market.

We recently saw a lease which openly provided tenants with power supply options in very harsh terms and then reserved the right for the lessor to recover any losses incurred (to the lessor) if the lessee engaged an outside and cheaper supplier!

While not all lessors do profit from the supply of power, many do and we have been able to assess the average profit at 18% - we even saw one case of a 100% profit!

As power costs are an increasing burden on any business, the right to access the best possible price must be made mandatory.

However, a lessor should have the right to charge for the delivery of power in a centre via their own systems.
Centres need to be more energy conscious, but don't worry because the tenants pay all the bills.

AIR CONDITIONING & OTHER FACILITIES

All too often we now see lessors arguing that they don't have to fix or replace faulty air conditioning and if the tenants want it they can fix or replace it themselves. This also leads to existing old and faulty air conditioning being fixed at tenants' expense, via outgoings, when it is not economic to do so.

Air conditioning, if provided in a centre, should be maintained by the lessor as a piece of capital equipment.

Due to poor design, many retail centres are not energy efficient, which puts heavy loads on air conditioners and many lessees report a poor trading environment when the equipment is overloaded.

Similar maintenance problems occur with escalators, travelators and lifts.

CASUAL MALL LEASING

Lessors make more profit by comparison from casual mall leases than from any other tenant, which makes the issue a vexed one -Lessors exist only to make a profit and casual leases are now an attractive and easier way to boost profits.

But while normal lessees must make profit out of 12 months trading, casual lessees pick their time - that is when they are most likely to make a profit from what are generally and in the best sites in the centre.

So, at times like Christmas, casual tenants can take the cream off the retail spend simply by selling products that are in high demand. Those sales are always at the expense of existing tenants.

While the Act covers casual leases, it is still felt that these retailers are advantaged by their location and do not necessarily paying the full costs of their tenancy - costs that are being carried by the full term tenants, ie air-conditioning, cleaning and marketing.

Noticeable in many centres now is the proliferation of casual and some not so casual retail spaces in what was public space, so disrupting traffic flows, causing congestion and to varying degrees hiding the shoppers easy view of the long term tenants.

Casual leasing controls are not equitable as far as permanent tenants are concerned and this aspect of leasing requires further attention to ensure that long term tenants are not disadvantaged.

RE-LOCATION

We know of very few lessees who have been forcibly re-located and not suffered a downturn of business. We also know of lessees who were re located to enable another tenant to move in to their former shop, for which the incoming tenant often paid a premium - unfair or just the lessor working the business?

Acts need to include a requirement that any lessor who suffers in any way as the result of a re-location is entitled to suitable compensation. There should also be a requirement that a tenant can only be forced to move once in the term of their lease.

DISPUTES

There is an urgent need for an effective system to deal with disputes- not court action, not mediation, but a return to the tribunal system which was effective. SA had a Tribunal which worked well, but it was abolished for cost reasons and now few retailers can afford to contemplate expensive court action, especially when the Act itself provides little protection.

Mediation, which isn't enforceable, is a blunt remedy and is useless in most cases.

MISLEADING CLAIMS

When a new shopping centre is proposed, the developers usually make flowery claims as to the opportunities for tenants. Those claims often refer to the potential number of customers to the centre, other likely tenants and other services proposed for the site.

This process attracts tenants for a variety of reasons - but they all rely to varying degrees on the claimed potential of the proposed centre - or expanded centre.

But things rarely turn out to be perfect and when tenants struggle to survive in a difficult outcome, they find that it is all their fault that things have gone wrong because didn't the lessor or developer give them a wonderful centre?

In cases where a development is a 'greenfield' site, relying on a considerable transfer of business, the likely outcome will rarely be as speculated. But who is to blame - it is always the tenant. Developers avoid all responsibility which is reprehensible considering that they received the "privilege" and undeniable benefits of planning approval which often involves a re-zoning of land.

Developers should be required to state the potential of their development and have to stand by their claims.

Recently in Adelaide, a centre doubled in size amongst much hype. Just after opening many businesses were concerned at the lack of business - only up 30% for the whole centre (100% larger) and individual traders down on the average 20%. -Yes that outcome was blamed on the tenants who also received a threatening letter talking about legal action if they talked to other tenants about their problems- rent in particular.

Landlords need to be held accountable for getting things wrong.

ASSIGNMENT

In SA, the SRA was successful in limiting the period of assignment liability to 2 years. That was a compromise, which is now rarely used.

Now, where a business is sold, the lessor demands that the vendor takes out a new 5 year lease which is then assigned along with a re-fit. Those are the harsh terms which the lessor demands in exchange for agreeing to the sale going through.

Lessors should not be able to gain from the sale of a business or impose harsh and unconscionable terms on a sale where those actions could frustrate the sale in any way. If the business is sound, the sale should proceed.

INTERFERENCE IN THE SALE

Further to the above, we recently had a case where a centre manager, himself a land agent, attempted successfully to make financial gain from the sale of a business and subsequent negotiations for a lease.

In simple terms, the agent demanded a fee (over and above his payment as centre manager) to discuss a new lease and approve of the new retailer - no discussion and fee -no agreement!

He also warned off the agent who was handling the sale of the business to refrain from making comment about what was happening.

Strict controls are needed on Centre Managers; they are a law unto themselves.

MARKET POWER- MISUSE

We know of few disputes where the lessor didn't hold at least one trump card - the right to eventually terminate and destroy a tenant's lifelong investment. Most Centre/Leasing Managers exploit this knowing full well that most Lessees will do almost anything to protect and maintain their retail investment. This is almost perpetual entrapment.

Every tenant also knows full well the unwritten and only `law' of tenancy -"upset the landlord and you will eventually pay".

The effectiveness of that `law' is only possible because it isn't against the law to exert the ultimate revenge against a lessee who fights back against the odds.

Lessors must be required to provide, in writing, the reasons for any of their decisions.
No landlord can lose everything in dealing with a tenant, whereas a tenant can lose everything if they upset a landlord. Sounds like feudal England!

We need remedies in the Act positively linking the Act to the Trade Practices Act and even outlining which actions are considered to be outside the law.

RENT AND REVIEW

When any lease is granted for the first time, it is reasonable to assume that both parties were happy with the proposed rent - they signed the lease!

Over the duration of a lease, most rentals increase by CPI or CPI plus a%, - usually 2% now. So, at the end of a lease, under this agreed system, the rent should still be at least as fair as it was the day the lease was signed. Parity had been maintained, if not enhanced.

Why then, on discussing a renewal which will ensure the continuation of the business, do lessors find it essential to impose significant rent increases(30% is common) when, in fact the lease payments are already reasonable?

This is simply a case of greed, enforced by the absolute exploitation of market power. The tenant pays up, saves their business, but usually has to also agree to an un-affordable shop refit. This process usually costs them any savings, if not leaving them with a sizeable debt.

This is little short of robbery and the tens of thousands of superannuants who gain from the large profits of shopping centres need to be concerned that this process can't continue - the exploitation has reached its limits.

A better way has to be found to manage this intolerable process and valuations of `like properties' isn't the answer. This will prove to be the major issue of this inquiry.

Then there is the matter of the huge disparity in the comparative rent paid by the favoured anchor tenants and other tenants.

This alone provides the anchors with yet another competitive advantage and many small tenants are clearly exploited to pay for the concessions made to other tenants.

We understand the notion that it is the anchors who attract business to a centre, but it is a two way street because the other tenants provide variety, service and competition and seemingly pay dearly for the privilege.

It is never established what (if anything) some anchor tenants pay in terms of outgoings or contribution to a Marketing Fund and this is an issue that must be clarified. The argument about confidentiality has no basis when it comes to the fair apportionment of operating costs.

TURNOVER INFORMATION

Most leases now require a lessee to provide a (monthly) audited statement of their turnover - not profit which presents a different and more realistic picture!

While this can only be demanded if it is linked to a turnover / rent clause in the lease, it is in fact, a charade to gain confidential information from a tenant which isn't reciprocated.

This process simply enables the lessor to gauge what size of rent increase can be imposed on the lessee at the time of a possible lease renewal.

TURNOVER INFORMATION continued

Time and time again, we have seen proposed rent increases that literally leave the tenant with two alternatives: pay up or leave. Either way they are worse off.

The Act allows for both parties to call for an independent valuation, which generally supports the lessors claims such is the method used to determine the rental value of a site. We once identified a property used (by example) to justify a rent increase, that had been empty for over a year because of an excessive rent demand. A flawed system.

As long as the rent is paid, the turnover or profit of a tenant is none of the lessors business. The lessors business is renting out empty space not exploiting the success of a tenant.

We wouldn't object to tenants providing turnover information as a percentage movement as long as the lessor had no right to any dollar figures initially or at any other time.

THE LEASE DOCUMENT

We are concerned at the trend for lease documents to be styled so as to represent an approach or request from the (potential) tenant making an offer to the landlord.

That is fine, but the document is far from that. It is written by the landlord and the tenant knows that failure to agree to everything therein could lead to a possible eviction.

Once again, because of the known power of the landlord, the tenant is intimidated into signing a document which is unreasonable, oppressive and sometimes contrary to the Act.

Where this document is provided (with the disclosure statement) in the absence of any meaningful discussions, it should be capable of any justifiable adjustment - but it isn't because there is usually a warning that any alterations will be at the expense of the lessee - just a further threat.

It must be made mandatory that no lease can be prepared if the parties to the lease have not agreed to the terms therein - or proceed to a process (tribunal) that will bring about a resolution.

Leases are far too lengthy and then in a style that makes comprehension an uncomfortable process. The notion of a standard lease is very attractive, but it would probably need an appendix to cover special issues.

The other alternative would be to enable a lease document to be altered in the same way that real estate contracts are changed by the parties involved, but we can't see landlords agreeing to a process as easy or fair as that.

LOCAL GOVERNMENT RATES

Most lessees now pay local government rates & taxes and receive nothing in return. This is easy money for the Councils and significantly reduces the lessors' liability for what should be their expense.

As most councils have a minimum rate, this is also applied to tenancies, no matter what their value and so it is very likely that this turns out to be a rort at the expense of the tenant.

A tenant does not own the property and shouldn't have to pay costs which specifically relate to ownership.

TRAFFIC COUNT

Most tenants suspect the head count provided by lessors due simply to a comparison between that count and individual turnovers. In some centres, tenants are now conducting their own counts to compare with the official count.

Some tenants report that these figures are not generally available to them which again denies them information about the claimed pulling power of the centre.

Via the Marketing Fund, tenants should have the right to instigate and access whatever market place information they agree would be useful to them.

DISCLOSURE STATEMENTS

The basic idea of a disclosure statement is sound, providing the document is all it needs to be to provide the prospective lessee with a clear picture of the ultimate outcome of signing the proposed lease.

The statement should show the annual rent for each year of the lease and what is proposed in terms of rent if subsequently there is a second term.

The terms of the lease need to be shown in `dot point' form along with a clear outline of what the lessor wants in terms of fit-out and likely costs; (remember most landlords claim to be retail experts.)

If, at the end of the term, no renewal is to be considered, that must be stated and if so, no fanciful shop fit should be demanded.

DISTURBANCE

When centres undergo expansion or refurbishment many tenants are subjected to unreasonable discomfort. Very often, the rebuilding or expansion enables tenants to become "captives" due to the provision of short term leases which entrap them and mke businesses unsaleable while the process continues - sometimes over more than one year.

There needs to some strictly enforceable rules protecting the rights of tenants in these circumstances. Of course, they have the right to give notice to leave within 7 days of learning of a relocation, but even that way they lose.

Once again, a proper & experienced process such as a Tribunal would achieve a lot in providing even-handed outcomes in these situations. Mediation is optional & the courts aren't affordable.

RISK Apart from the obvious power of lessors and their use of that advantage, attention needs to be paid to the relative risk taken by lessors and lessees. A lessor cannot lose their investment in individual dealings with lessees, though there may be a short term loss. But lessees can very clearly lose everything they own. This situation cannot be ignored and requires redress within the Acts - parity should be paramount.

CONFIDENTIAL EXAMPLES

We will be providing supporting evidence which in some cases we are obliged to keep confidential. Due to a shift in offices, this is still boxed-up and will take a few more days to review.

Compiled for the State Retailers Association of SA John Brownsea

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