

Re: The Market for Retail Tenancy Leases in Australia Inquiry

Dear Sir/Madam,

Firstly, may I take this opportunity to express my delight that such an open forum is being established by the government to investigate the retail tenancy market in Australia. It pleases me to no end to be able to voice my opinion and raise issues that concern me relating to my industry.

Upon reading the issues for consideration posted on the productivity commission's website, many of the topics to be discussed in this inquiry are far more comprehensive than I can reasonably raise and answer in detail in the given time frame. I did however delight in the outline stating "*Participants may comment on any matter they consider relevant to the inquiry*"

The brief contribution that I will add relates to the issues that have been concerning me for some time. Firstly I must establish my situation within the retail industry. I am a business owner of a small family run business having leased retail space in some of Australia's large retail shopping centres however my focus is more specifically South East Queensland at this time.

Disclosure of Sales Figures

Getting straight to the point, one of the issues that I would like to address is that of reporting sales figures to the retail landlord. It is in my opinion that businesses sales figures should be their own private information. Just like personal information and personal income information is not made public by governmental departments such as the ATO; I feel that disclosure of this information should be at the discretion of the business owner, not demanded from the retail lessor.

As a part of any retail shop lease, lessors stipulate a clause that the lessee must disclose the turnover figures to centre management each month. To the best of my understanding it is up to the lessee to make any necessary adjustments to particular clauses in the retail shop lease before they sign the document; however experience has shown that removal of this clause results in failure to successfully lease a retail tenancy with any shopping centre. In other words, no shopping centre I know of will grant a tenancy unless the lessee discloses their turnover figures.

Ability to Pay

I can highlight many reasons why I think that this mandatory disclosure should not be allowed, however I will firstly focus on what I feel to be one of the most important. My experience has proven that shopping centre rents are calculated on the tenant's "ABILITY TO PAY" and not what fair market value

is. Disclosure of turnover figures allows the lessor an insight in to the tenants business and can subsequently command rental returns according to their ability to pay. As we are aware all tenants are different. Some companies may invest significant amounts of time and money into sourcing product from more cost effective suppliers or manufacturers in the pursuit of increasing profit margins. The outcome of such a situation is being charged a higher rental rate simply base upon their ability to pay. This is hardly a fair situation.

Making example of perhaps a jewellery store where it is considered that margins are potentially higher than other retailers, the jewellery store will pay a higher rental amount than the store next door to it of similar size and location. This is hardly fair market value for rental and is a prime example of discrimination by lessors between tenants. I can not stress enough the importance of rectifying this inequality.

How would we feel as individuals given a circumstance where we were going to purchase a pair of shoes for example? The shop keeper knows that customer 1's personal income is say \$50,000 per annum and the shop keeper also knows customer 2's personal income to be \$200,000 per annum. If customer 1 paid \$50 for the shoes and customer 2 paid \$200 for the same item it would hardly be fair. Just because customer 2 has a greater capacity to pay does not mean that they should pay above a fair market price. If such discrimination between customers occurred as mentioned in a retail store the office of fair trading would scorn the retailer for such misconduct, yet some how it is permitted to occur within the retail tenancy market. This all stems from the acquisition and misuse of turnover figures.

Anchor Tenants & Rental Rate Inequality

Further to this is the common knowledge that anchor tenants such as major supermarket chains and department store retailers pay rental amounts any where up to one tenth that of any other retailers on a per square metre basis. Understandably, some concession can be made for the sheer volume of space leased by such tenants however a 10:1 ratio is considerably excessive given what everyone else pays. Obviously the issue is about bargaining power where the major retailer is in a superior position to command a rental discount to the landlord. This is a luxury that small retailers can only dream of. I suggest that a far grater level of equality be enforced by government giving all retailers access to space on a totally level playing field. I can see little reason why all tenants can not pay an equal rental rate per square metre. A governmental enforced maximum premium on base rent within a centre could overcome the inequalities of location.

Lease Renewal

May I draw attention to examples I have seen first hand come time for lease renewal in major shopping centres. On several occasions I have witnessed tenants approach the end of their lease term and have been presented their lease renewal. The rental amount on the renewal has been significantly

higher than the amount they were originally paying only a month or two earlier. This on its own is not unreasonable as it can be forgiven of the lessor to want to maximise their return on investment. However the problems occur when the tenant can not sustain such exorbitant rents and is forced to vacate the premises based on price. Given this now increased rental amount making the viability of the business no longer acceptable, I have been made aware of examples where a new tenant now occupies the same tenancy at a rental rate considerably lower than the original tenant was paying in the first place. Obviously this is hugely disruptive to any business especially small family run businesses with owners that personally rely on the income from their store. This is a prime example of the outcome where the tenant of a retail shop is losing any control and bargaining power they might have had with the shopping centre.

Disclosure to non related parties

Further to the ability to pay argument and making example of situations that have occurred to me, I must discuss the issue of disclosure of turnover figures to non related parties. In negotiations with shopping centre leasing agents I have frequently come across examples where my competitor's turnover figures have been disclosed to me even without asking. Whether this is a legal issue is not for me to answer, however I believe it raises moral issues and displays poor professional conduct. Having said this I can only imagine to what extent my personal information has been passed around to competitors and other parties that I would prefer did not have access to such content.

It is evident that the refusal by the lessee to sign a lease with such a clause stating the disclosure of turnover figures puts the lessee in an unreasonable situation. The potential tenant either signs the lease including the disclosure of turnover figures or they do not occupy the retail tenancy. Personally I think these issues need to be addressed.

Percentage/Turnover Rental

In addition to turnover figure disclosure may I now raise the issue of turnover rent or otherwise known as percentage rent? As you are no doubt aware, turnover rent is a situation where the lessee's rental payment is based on a percentage of turnover. Often this encompasses additional payment over and above the already negotiated base rental amount when the lessee's turnover reaches a predetermined level. This turnover rental amount is unjust when already paying an agreed base rental amount. I suggest that retailers should have the option to negotiate a percentage rental contract should they wish. Likewise the tenant should also have the option to engage into a base rental only contract should they wish. However the situation where percentage rental is paid over and above the base rental amount should be outlawed.

The problems I see with base rental plus percentage rental is founded upon inequality. The percentage rental payment is calculated on the gross turnover

amount which fails to take into account any of the expenses and overheads that the business may incur.

Furthermore, I believe it to be the equivalent to having a business partner that takes the better part or the cream of the businesses profit without making any contribution to the outgoings and running expenses of the business. This situation makes it very one sided as far as which party receives the reward for the effort. Quite obviously it's the shopping centre landlord that receives the lion's share of the reward for little or no contribution to the business in the form of capital or running expenses. It would be far more reasonable to suggest that if such a clause was insisted upon, then the lessor would have to contribute financially to receive this additional return over and above the base rental achieved. This is a situation that I find very unlikely any shopping centre would enter into, however the lessor is more than willing to take additional profits.

Given the generally cyclical nature of business and retail businesses in particular, the lessee is expected to absorb losses in quite times only to be forced to give away their profits in times of prosperity. It is of great importance that this issue be rectified.

This percentage based type of clause should be abolished from lease agreements where tenants already pay an agreed fair market base rental. Should a retail tenant wish to engage in a percentage rental agreement then it should be at the sacrifice of the base rental. Otherwise an agreed fair market base rental would be paid for occupation of the tenancy. Quite simply I suggest a fairer more level playing field for the retailer.

Assessing Value

As a qualified property valuer I am aware of the situation that exists for shopping centres to value their asset(s). Most importantly, a shopping centres' worth is based upon the rental return achieved from its tenants in addition to the worth of its land content and improvements of building, plant and equipment. It is common practice to offer a fit out contribution to a new prospective tenant rather than a lower negotiated rental amount. On paper, this keeps the rental amounts achieved artificially high which in turn distorts the true value of a centre. Prospective tenants (many of which are unaware of this facility) are able to consult their state lands authority (Department of Natural Resources in Queensland in my case) to acquire a lease search and comparison of particular retail tenancies within a shopping centre for a modest fee. I would suggest that as a part of every property contract, that front page announcement be enforced on any lease that such an option is available to prospective tenants. It would then be their choice to pursue this avenue or not. I would envisage this to be similar to the extremely prominent professional valuation recommendations noted upon contracts between buyer and seller upon purchasing a residential property in Queensland.

Acquisition of such a lease search will show the rental figure being contracted between the lessor and lessee. This of course raises the issue of accuracy of the content being displayed in the search making consideration to additions such as fit out contributions or rent free periods. More importantly these considerations are not itemised upon the lease search which will obviously distort the potential tenants perception of what is fair market rent. The figure displayed is not necessarily the total consideration paid to the lessor for the occupation of the tenancy. Again I feel this disadvantages any prospective tenant, who through a course of due diligence finds disparity in comparison of like with like and fair market value. I suggest that the rental amount lodged with the lands department be the effective or actual amount paid encompassing rent free periods and fit out contributions.

Ratchet Clauses

An additional issue that I find concerning runs parallel with the inequality mentioned above, and that is ratchet clauses. I understand that lessors would require curbing the effects of inflation by increasing rental returns parallel with the Consumer Price Index (CPI). On the surface this seems a fair and reasonable request given that it was implemented in accordance with CPI increases. Many lessors specify in lease agreements that a 5% (for example) ratchet increase in rental is to be expected from the lessee. In other words the rent review will only result in rent increases even in the event of deflation. Obviously when the economy is experiencing a situation such a deflation, many retail businesses are especially susceptible to such economic fluctuations. Consumer spending or the lack there of is often quickly felt in the retail industry. A ratchet clause by its very nature is only in the upward direction. This is once again a one sided situation that disadvantages the lessee. A rent increase in accordance with CPI is fair and reasonable. A ratchet clause resulting in rent reviews in only an upward motion is unfair. Furthermore, taking example of the ratchet clause with say a 5% rent increase per annum also seems unfair in an event where the CPI increase may only be say 3%. Again, a parallel with CPI is fair but forcing increases greater than CPI is clearly unjust. It is clear to me that a correction of such disparity will never occur until a point where government legislation catches up with this inequality.

I have drawn the conclusion that the main outcome indented by this inquiry is to facilitate a better and fairer retail tenancy market in Australia by listening to the parties concerned. I am of the mind that everyone in business is entitled to make a profit and benefit from their efforts, both lessor and lessee alike. This is the delight of living in this country that embraces freedom, free enterprise and entrepreneurial endeavours. However, this free enterprise must stem from the foundations of equality where each party is not unfairly

disadvantaged and prosper from there ideas, skills and investments of time, effort and money.

I hope that my contribution along with that of others raises concerns of businesses occupying retail tenancies with in Australia. My desires will be met when the commission acts upon the concerns of retailers, advocating modification of relevant legislation with the ultimate outcome of a fairer and more equal retail tenancy market for all involved.

Kind Regards,

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Brett Carlton