

The Market for Retail Tenancy Leases in Australia
Submission by the Small Business Development Corporation:

INTRODUCTION

The Small Business Development Corporation's (SBDC) Small Business Services Division provides information and guidance to small business landlords and tenants on all aspects of the leasing of business premises, including leasing business premises in shopping centres.

The SBDC has provided comment on issues it is exposed to through its advisory role and those considered to be of most relevance to small business raised in the Productivity Commission's Circular and Issues Paper, '*The Market for Retail Tenancy Leases in Australia*'.

BACKGROUND

Review of Western Australia's Retail Tenancy Legislation

In Western Australia (WA) the *Commercial Tenancy (Retail Shops) Agreements Act* (CTA) regulates retail tenancy leases and is administered by the Department of Consumer and Employment Protection.

In 2002/03, the CTA was reviewed and 61 recommendations were made to address a range of tenancy issues which had been identified. On 11 May 2007, the *Retail Shops and Fair Trading Legislation Amendment Act 2006* (the Amendment Act) was proclaimed. The Amendment Act progressed nine recommendations made in the CTA review.

Specifically, the new provisions in the CTA provide for small business operators to:

- be protected against unconscionable conduct including the misuse of turnover figures;
- have unconscionable conduct matters heard by the State Administrative Tribunal; and
- be protected in forming and joining tenants' associations and other similar bodies.

The WA Government has recently signalled its intention to address all remaining recommendations outstanding from the review that have stakeholder support.

The key outstanding issues from the CTA review that relate to fair dealing in the marketplace include:

- increasing the jurisdiction of the State Administrative Tribunal to determine commercial tenancy matters relating to retail shops covered under the CTA;

- supplying a valuer with relevant information about leases for retail shops in the same shopping centre, to assist in the preparation of more consistent rent reviews;
- improving the rights of tenants that have inadvertently failed to exercise, or incorrectly exercised, the option to renew their lease;
- improving the rights of tenants regarding shopping centre redevelopments or relocation within a shopping centre;
- making the provision of disclosure statements more compelling, thereby assisting tenants to make more informed decisions prior to incurring obligations; and
- improving a tenant's position in lease negotiations by prohibiting the passing on to the tenant of a landlord's legal costs incurred in the preparation and negotiation of a lease.

Other outstanding matters relate to improving the general effectiveness of the CTA.

Commercial tenancy inquiries

In 2006/2007, the SBDC responded to over 2,600 commercial tenancy inquiries. The high demand demonstrates that leasing of business premises continues to be an area of importance and concern to small business.

The SBDC considers that preventing problems is better than curing them. On this note, it is pleasing to report that a significant number of enquiries to the SBDC are from potential tenants requesting advice about entering into a business premises lease.

Of the 2,600 inquiries, 272 were disputes between landlords and tenants. The main areas disputed were: termination of tenancies; rent reviews and rent; operating expenses; repair/maintenance and structural alterations; options and right of renewal; assignment of lease; exclusivity and compensation payments by landlords under lease; and redevelopment clauses.

Key issue - security of tenure

Secure tenure is usually central to the value of a retail business. When leasing business premises, common key objectives for small business tenants are that the premises will:

- sustain a business with a designated income;
- allow a business to expand and grow; and
- have a lease that will easily be able to be assigned (ie transferred on sale of the business) to provide a return on capital in the medium or long term.

ISSUES

Structure and functioning of the retail tenancy market in Western Australia

WA Market

The retail tenancy market in WA includes large metropolitan/regional shopping centres and smaller suburban shopping centres.

Demand for space in large shopping centres in WA tends to be very high. Further, there is a concentration of ownership and management amongst large shopping centres, with no apparent competition between the owners. This concentration creates a market where retailers have little real choice in operating conditions, with lease terms and conditions presented as non-negotiable and standard to the industry.

In this scenario, there is limited capacity for prospective tenants (or tenants renegotiating their lease) to negotiate favourable lease terms and conditions, resulting in terms that can be heavily weighted in favour of the landlord, creating difficult business environments for small business tenants.

Based on the enquiries that the SBDC receives, small business tenants in large shopping centres tend to suffer from more end of lease difficulties (eg unfair rent increases) than those tenants in smaller centres.

At smaller centres it is more likely that tenants will suffer from problems that arise when centres are awaiting development/sale and are allowed to run down and retail spaces are left vacant. This can result in the centre becoming an undesirable place to shop, potentially leaving sitting tenants with less *trade flow*.

Functioning of the retail tenancy market

The SBDC's exposure to the retail tenancy market reveals that small retail businesses can suffer from a significant lack of bargaining power in the marketplace and this can lead to them being subjected to unfair business practices.

Following are some examples illustrating problems that the SBDC is familiar with:

(i) Options to renew lease

Tenants can find themselves in a weak position when they inadvertently fail to exercise an option to renew their lease if their landlord does not agree to overlook the mistake and renew the lease with the same conditions as before.

In some instances, landlords will substantially increase rent, charge steep outgoing charges or create unfair redevelopment provisions. As the tenant could stand to lose a considerable amount of goodwill and investment in the business, they agree to harsh terms.

(ii) Expiry of lease

A tenant with a lease under the CTA, is entitled to an option of a lease period with a minimum of five years. However, unless the lease provides otherwise, a tenant has no right to any further occupation beyond the statutory minimum.

Arguably, this puts sitting tenants in a vulnerable position vis a vis the landlord. Some landlords seek to take advantage of this situation by drawing out negotiations for the new lease until close to the expiry of the lease, which can create a scenario where tenants feel pressured to accept high rents that do not reflect the market rate and other onerous lease conditions, rather than face vacating their premises and paying relocation costs etc.

(iii) Delays by landlords

If a landlord delays discharging their obligations, tenants often lack the time and funds to pursue legal remedies to resolve the situation. Further, during legal proceedings tenants can find it difficult to sustain the delays and costs brought about when landlords appeal to higher courts. Currently, there are a lack of accessible legal remedies available to small tenants who cannot risk lengthy disputes with the larger corporate landlords upon whom they are dependent for their livelihood.

Recommendations from the CTA review propose that the State Administrative Tribunal's jurisdiction be increased to determine a range of commercial tenancy matters relating to retail shops covered under the CTA.

(iv) Commercially Inexperienced Tenants

There are numerous instances where inexperienced tenants, especially first time tenants, sign lease agreements without being aware of all the legal and commercial implications of these contracts.

(v) Small retailers subsidising large retailers

In Australia, significant market power is concentrated with a few large retailers. For example, it is rare for any shopping centre of substantial size to be without a Woolworths or Coles as anchor tenants. Their power enables them to negotiate low rents. Generally, on a per square metre basis, smaller retailers pay significantly higher rent. Indeed, it was reported in the *Australian Financial Review BOSS* magazine on 2 December 2005 that small retailers pay 70 per cent of the rent for 30 per cent of the space in shopping centres.

(vi) Provision of information

Small tenants often find it difficult to obtain information from landlords about aspects of their tenancy arrangements. Despite the proposed introduction of disclosure statements in commercial tenancy leases, opportunities remain for landlords to avoid the provision of relevant information.

For example, it is possible for a landlord to charge a tenant for expenses without providing receipts or detailed itemised accounts as proof of payment. The CTA review recommendations for increasing disclosure will assist to improve this position in WA.

(vii) Notification

Tenants are often disadvantaged by the lack of notification in relation to relocation, redevelopment and other changes to the premises or building, in which their business premises forms a part.

If a longstanding tenant has not signed a new lease and is operating on a month-by-month basis, a landlord is only required to give a month's notice to terminate the lease. This can have serious impacts on a small business tenant.

(viii) Inability of tenants to negotiate for exclusivity

The ongoing viability of a long-term tenant's business can be materially affected by the unexpected introduction of similar businesses into a shopping centre.

Unconscionable conduct

On 11 May 2007, new provisions were introduced in the CTA that provide for small business operators to be protected against unconscionable conduct including the misuse of turnover figures and protection from unreasonable refurbishment or fit out costs. Further, such matters can be heard in the State Administrative Tribunal.

By placing unconscionable conduct protection in the CTA, an opportunity will be provided for landlords and tenants to gain access to fast, low cost dispute resolution for unconscionable conduct claims. However, the provisions have not been law for a sufficient period of time to ascertain their effectiveness in countering undesirable leasing practices.

The SBDC is of the view that section 51AC of the TPA, unconscionable conduct in business transactions, has had little effect in protecting small business from unfair dealings in the marketplace. The notion of unconscionable conduct is considered an uncertain concept and the cost associated with pursuing a claim against larger competitors is a powerful deterrent to the majority of small businesses.

The SBDC would welcome a more vigorous and proactive approach from the Australian Competition and Consumer Commission (ACCC) in this area. In the past, it would appear that the ACCC has been reluctant to take litigation on behalf of small businesses in 'one off' cases unless the matter is taken as a test case to establish precedents for future private action.

If section 51AC of the TPA is to achieve its original goal of influencing firm behaviour and thereby prevent unconscionable conduct in marketplaces, the SBDC believes there is a need for increased funding for the ACCC to test more cases on behalf of small firms. It would also be appropriate for increased funding for the ACCC to seek leave to intervene in court proceedings where a small business has exhausted its funds and is unable to see a matter through to resolution before the court.

It is pleasing to note that Mr Graeme Samuel has recently indicated that the ACCC is changing its focus to more aggressively pursue unconscionable conduct in the marketplace.

Dispute resolution

The SBDC supports the calls by the small business sector for adequate access to justice. The CTA review recommended that the State Administrative Tribunal (SAT) be given the power to grant all remedies available at law and in equity, in respect of matters dealt with in the CTA.

Improved access to this low cost dispute resolution body will benefit small business landlords and tenants. However, it is worth noting that in the SBDC's view, the SAT's accessibility to small business could be improved by a friendlier interface for this customer group and reduced resolution timeframes.

The SBDC would also be supportive of the creation of an informal mediation service, specialising in the commercial tenancy area, which could be accessed by landlords and tenants prior to pursuing matters through the SAT or the courts.

Further, increasing tenants' awareness of their rights and responsibilities through education programs would assist to minimise the number of disputes that arise.

Improvements to retail tenancy

While the SBDC believes that implementing the outstanding recommendations from the CTA review will go some way to addressing problems in the retail tenancy market in WA, it would be supportive of further measures to protect small business tenants from being unfairly treated.

The SBDC would be supportive of:

- measures that increased transparency through improved disclosure provisions. This would allow tenants to better compare leases at different shopping centres and lead to improved competitiveness in the market for retail tenancy leases;
- establishing the right for valuers acting for tenants and tenants to access relevant lease information, including rent information. This would increase the instances of rent valuations and lease terms being fairer;
- shopping centre management being encouraged to consult with tenants in relation to matters such as tenancy mix, promotions and advertising and centre operating expenditure. Consultation would foster a spirit of co-operation and assist in outcomes mutually beneficial to landlords and tenants;
- a requirement that prospective tenants be cautioned by landlords, or their agents, to obtain legal and financial advice before entering into a lease. This will assist in protecting tenants by raising awareness of the need to obtain appropriate advice;
- the development and implementation of education and awareness strategies in relation to matters such as lease negotiation and preparation. An informed market is less likely to enter into leasing arrangements that carry a high commercial risk or are commercially unviable; and
- consideration being given to amending the TPA to better protect small business retail tenants at lease end.

Conclusion

The SBDC is of the view that the retail tenancy market requires regulatory intervention to address the inherent imbalance of power that exists in the marketplace.

The SBDC is supportive of the WA Government's decision to proceed with the development of a Bill to implement recommendations outstanding from the CTA review. Further, the recent introduction of provisions into the CTA that allow for the SAT to hear unconscionable conduct matters relating to retail tenancies is welcomed. Time will reveal the ability of these new and proposed provisions to better provide for a fair marketplace.

Thank you for the opportunity to comment on the Productivity Commission's Inquiry into the market for retail tenancy leases in Australia.