

AUSTRALIAN PROPERTY INSTITUTE INC.

**INQUIRY INTO
THE MARKET FOR RETAIL TENANCY LEASES
IN AUSTRALIA**

**SUBMISSION IN RESPONSE TO PRODUCTIVITY COMMISSION DRAFT
REPORT**

FEBRUARY 2008

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INTRODUCTION

This submission responds to the Productivity Commission invitation to comment on the draft report into *The Market for Retail Tenancy Leases in Australia* dated November 2007.

The Australian Property Institute (API) proposes that uniform or harmonized Retail Tenancy legislation be established throughout Australia. The purpose of uniform or harmonized retail tenancy legislation should be to ensure consistency, clarity and economies of scale for all participants involved in retail leasing throughout Australia.

At the outset, it must be stated that the API is somewhat disappointed that its submission was not given more weight in the Commission's draft report as opposed to the weighting given to parties with a greater commercial interest in the outcomes of the inquiry. The reason for this statement is that the API membership::

- Is generally unbiased,
- Is balanced in its representation of lessees and lessors,
- Is actively involved in all aspects of the retail tenancy market in Australia ranging from strip retail centres to super regional shopping centres,
- Is involved in Alternative Dispute Resolution (ADR) mechanisms,
- Determines the majority of rentals under retail shop leases in Australia, where the parties are in disagreement, and
- Meets the criteria of existing State and Territory retail legislation in relation to specialist retail valuers.

Further, the API believes that retail tenancy market in Australia is:

- Highly regulated,
- Governed by inconsistent legislation across Australia, and
- In some jurisdictions, weighted in favour of the tenant.

The API maintains that the primary issues affecting its members that need to be addressed in achieving a consistent, efficient and effective retail tenancy market in Australia are:

- Consistency of retail tenancy legislation across Australia,
- Transparency and access to information required by valuers in determining market rent,
- Ability to vary the time frame required to conduct a rental determination, and
- Protection for specialist retail valuers undertaking rental determinations.

GENERAL COMMENTS ON PRODUCTIVITY COMMISSION DRAFT REPORT

At the outset it must be emphasised that retail tenancy legislation was originally introduced to protect tenants from unacceptable practices by landlords and that prevailing legislation across all jurisdictions also provides protection to both tenants and landlords who are less knowledgeable of retail tenancy practices and issues.

With the foregoing in mind, the API has concerns that the Productivity Commission appears to have:

- paid too much consideration to parties with vested interests or where the interests are not across the entire retail market and therefore only address a specific sector;
- failed to recognise the significant differences between retail and commercial businesses and the necessary differences leases required to cater for that type of tenancy;
- ignored areas of the market that do operate efficiently;
- failed to recognise the States/Territories have in the past generally not worked together to achieve nationally consistent approaches;
- not taken into account that the state governments are largely responsible for much of the current inefficiencies as they have focused existing legislation on the major shopping centre owners;
- missed the fact that much of the existing legislation has been drafted with knowledge of problems needing addressing and that State and Territory Governments are unlikely to abandon good legislation. Consequently, the approach of the Productivity Commission is therefore unlikely to achieve the desired result of consistency across jurisdictions;
- not taken into account the benefits to both lessors and lessees in strip retail and small shopping centres of legislation which directs leases to be designed specifically for retail;
- failed to identify that there is a higher proportionate use of existing ADR mechanisms by lessors and lessees of strip retail and small shopping centres;
- given too much consideration to the major shopping centres which generally have lessees who are far more experienced operators;
- not understood that Lessors of major shopping centres recognise the importance of the success of the retailers in their shopping centres;
- not recognised that Lessors of smaller shopping centres and strip retail shops, whilst not intentionally setting out to ensure a retailer fails, do not understand the criteria which will result in the retailer failing;
- overlooked the fact that the commercial office market is operating efficiently;

- suggested interfering into efficient markets to the extent that state governments broaden their regulatory concepts to have regulatory control over commercial leases;
- Poorly analysed the incidents of dispute;
- not addressed the need for indemnity for specialist retail valuers,
- not given sufficient weight to the establishment of a national database for of information available for valuers and parties with vested interests,
- omitted the need to include provisions to vary the time required by the valuer to conduct the rental determination; and
- failed to recognise the enormity of the issues with lease renewals in particular agreements relating to rent and the lack of any dispute resolution processes (eg, rental determinations) being available to either or both parties.

COMMENTS ON THE PRODUCTIVITY COMMISSION RECOMMENDATIONS

Productivity Commission Recommendation 1

The following measures should be pursued by State and Territory governments to further improve transparency and accessibility in the retail tenancy market.

- *Enhance the use of simple language in all tenancy documentation and provide clear and obvious contact points for information on leases and dispute resolution.*
- *Elaborate the significance of jurisdictional differences in the definition of unconscionable conduct and align definitions where practicable.*

API Comment

The API agrees that all retail tenancy documentation should be written in simple language and provide details for accessing information in relation to leases and disputer resolution mechanisms.

All Retail Tenancy legislation should draw down relevant unconscionable conduct provisions from the Trade Practices Act.

The Commonwealth Government should work with the State and Territory Governments to establish an enforceable definition of unconscionable conduct.

Productivity Commission Recommendation 2

State and Territory governments should seek to improve the consistency of lease information across jurisdictions in order to lower compliance and administration costs. They should:

- *Encourage nationally consistent (plain English) models for retail tenancy leases and for tenant and landlord disclosure statements (for example, all jurisdiction and other specific provisions could be set out in annexes to the standard documents).*
- *Institute nationally consistent reporting by administering authorities on the incidence of tenancy inquiries, complaints and dispute resolution.*

API Comment

The API agrees that State and Territory Governments should seek to improve the consistency and access to lease information across all jurisdictions. This would need to include the registration of all retail leases across Australia.

As the professional body representing valuers who are called upon to determine rents, the benefits of having all retail leases registered are such that lease registration:

- Will greatly assist in dispute resolution mechanisms,
- Will enable the availability and transparency of information,
- Will inform the market of lease information and will makes the market more transparent,
- Will introduce efficiency into the market,
- Will provide protection for both parties.

The API recognises that NSW and QLD currently have registered leases while other states do not. Any registered lease would need to include all documentation relating to the lease, including side agreements and the shop area. In addition, the notation on the title of the registered lease would include lease registration number (electronically searchable), tenants name, shop number or identification, commencement and termination date. The lease registration number can then be searched to obtain a full copy of the lease documentation.

Reference to “Lease Information” should read “Lease Documentation” and this issue would be addressed through the harmonisation of retail tenancy legislation.

i. Disputes:

The following table (data sourced from Registrar of Retail Shop Leases, Queensland) summarises the type of centre in which disputes under retail shop lease legislation have occurred in Queensland. We would expect similar consistency nationally.

Centre Type	% of Retail Space	2005 %	2006 %	2007 %	Total %
Super Regional	5%	0.75	-	-	0.31
Major Regional	11%	0.75	1.82	2.50	1.55
Regional	21%	1.50	1.82	3.75	2.17
Sub Regional	27%	8.27	4.55	6.25	6.50
Neighbourhood	22%	14.29	6.36	12.50	11.15
CBD	5%	1.50	4.55	5.00	3.41
Bulky Goods	6%	0.75	2.73	-	1.24
Other Centre	3%	42.11	36.36	38.75	39.32
Other		30.08	41.82	31.25	34.37
Total		100.00	100.00	100.00	100.00

The incidence of disputes is disproportional in those centres where the Landlord is not a professional but an investor unaware of the dynamics of retail businesses. The existing systems and protections built into state legislation is not something to carelessly disregard. Disputes occur where a lessor or lessee believes the other party is breaching the protection provided in the state retail legislation. It should be noted of the above, 92.3% of disputes were instigated by lessees.

The Productivity Commission concludes there is a low incidence of formal disputes. We agree this is the case with the Regional Class of Shopping Centre and even including Neighbourhood centres but not overall. According to the Productivity Commission there are 290,000 (p. xix) retail tenancy leases in Australia with some 58,000 new leases written each year. This equates to the average lease being 5 years. The research of the Productivity Commission (p. xxvii) is that there are some 3,300 tenancy complaints each year. The fact that only half proceed to mediation and 80% of those are settled at mediation is testament to the success of the current systems.

The Productivity Commission appears to have focused on the upper portion of the market, opposed to taking into account the whole retail tenancy market. Therefore, the Productivity Commission should take more consideration of the smaller shopping centre retailers.

ii. Indemnity for Specialist Retail Valuers

Protection for Specialist Retail Valuers was not adequately addressed in the draft report. This is a critical issue for API members and must be a consideration in any form of harmonised legislation.

The NSW Retail Leases Act provides protection to a valuer who is appointed by the Administrative Decisions Tribunal (ADT) to make an expert determination.

The use of the expert determination as a dispute resolution mechanism in the retail tenancy legislation provides a cost effective and efficient dispute resolution process.

The protection for the Specialist Retail Valuer appointed to undertake the rental determination was provided because of the declining number of valuers willing to accept such appointments. Valuers were reluctant to take appointments due to the highly litigious nature of the work.

In many cases, the legal fees valuers were paying simply to have a claim against them investigated, were greater than the fee they received for undertaking the rental determination.

The protection provided to the valuer under the NSW Retail Leases Act is not extended in the event that a valuer is appointed through agreement by the parties or when the parties may agree to request the Presidents of the Australian Property Institute to make appointments.

The absence of protection for valuers who are not appointed by the ADT means that valuers are reluctant to accept appointments for determinations unless appointed by the ADT.

This situation has placed an increased administrative burden on the ADT which now effectively appoints all valuers for the purpose of rent reviews and has arguably increased the time involved in having an appointment made.

The Institute believes that the efficiency of the appointment process will be improved if the protection for the valuer is extended to the situation where the parties agree to appoint the valuer.

The Institute also believes that protection needs to be provided for the Presidents of the Australian Property Institute in the situation where the parties have agreed to request a Presidential appointment.

Productivity Commission Recommendations 3 and 4

3. *State and Territory governments should relax key restrictions in retail tenancy legislation to better align the regulation of the retail tenancy market with the broader market for commercial tenancies.*
4. *As unnecessarily prescriptive elements of retail tenancy legislation are removed, State and Territory governments should seek, where practicable, to establish nationally consistent template legislation for retail and commercial tenancies available to be drawn down to each jurisdiction.*

API Comment

The API will address recommendations 3 & 4 together.

The aligning of retail tenancy legislation with broader commercial office leases would create more problems.

There are significant differences between office and commercial leases which necessitate a different approach to lease structures

- A commercial lessee can relocate the business without significant impact to the turnover of the business. The retail business however, is not transportable.
- A retailer derives income from use of the premises whereas the office and/or industrial tenancy or “commercial” tenant only uses the premises to facilitate earnings. The goodwill in the commercial business does not relate to the premises. For example a market rental review in retail premises should disregard the goodwill attaching to the premises developed by the tenant. There is no parallel with a commercial tenancy.
- Office tenants are generally better equipped to understand leases. The expertise is more in administration. Retailers are less likely to have administration expertise.
- The concept of market rental is significantly different between commercial and retail. Offices for instance only need to have regard to the premises and can easily be compared on a rate per square metre, whereas with retail premises, consideration must also be given to the specific the premises’ retail use which is a major factor in arriving at the market rental value of retail premises.
- Discretionary reviews in commercial premises are not desirable but do not have the same direct impact on the business as in the case of retail. In retail the distortion is such that discretionary clauses can result in rentals that are unsustainable for the business.
- Depending on the structure of a commercial lease the circumstances in which the market rent is to be envisaged is defined. In the case of retail there is great benefit derived from existing legislated retail definitions.
- Turnover is an important tool for landlords of shopping centres to monitor performance of the centre and make changes as deemed appropriate to tenancy mix and structure which maximises performance of the centre. The business of a commercial lessee is immaterial to the successful operation of an office building.
- Disclosure statements are a critical step in retail but not relevant or of very limited benefit to commercial tenancies

i. Market Rental

The definition of market rental value is consistent across commercial and retail. It falls under the International Valuations Standards Committee definition as:

The estimated amount for which a property, or space within a property, should lease on the date of valuation between a willing lessor and a willing lessee on appropriate lease terms in an arm's length transaction, after property marketing, wherein the parties had each acted knowledgeable, prudently, and without compulsion..

The appropriate lease terms includes an assumption of use. In the case of office it is simply office but in the case of retail it is the actual retail use to which the premises are put.

Commercial leases seek to define the circumstances in which the market is to be envisage. Examples include review to a face rental rather than an effective rental. This is not appropriate for retail. The following definition is included in Queensland legislation and is generally mirrored in other states. To move away from this definition will bring inefficiencies into the market.

- (i) on the basis of the rent that would be reasonably expected to be paid for the retail shop if it were unoccupied and offered for leasing for the use for which the shop may be used under the lease or a substantially similar use; and
- (ii) on the basis of gross rent less lessor's outgoings payable by the lessee under the lease; and
- (iii) on an effective rent basis.;

Similar definitions are encapsulated in NSW, QLD and SA and are of great benefit to the market.

ii Legislation

- The solution of nationally consistent legislation for retail is the solution we seek provided it is prescriptive in relation to the issues that we addressed in our original submission;
- The prescriptive nature of the legislation has come about because of past practices that necessitated the introduction of the legislation in the first place
- State and Territory governments should be directed to agree on consistent retail legislation in accordance with the API's original submission which outlined a solution to achieve fair balance between lessors and lessees;
- The recommendations however seem inconsistent with the principle that "retail tenancy regulation is a State & Territory matter" ;
- A National Shopping Centre voluntary code of conduct has limited merit. Those shopping centre owners who would sign up to such a code would comprise those owners of neighbourhood centres and larger who account for only 22.9% of disputes but 97% of retail space. It is the 73.1% of disputes that need to be addressed. These currently have solutions through the State Legislation which the Commission wants to abandon.

Productivity Commission Recommendation 5

While recognising the merits of planning and zoning controls in preserving public amenity, States and Territories should examine the potential to relax those controls that limit competition and restrict retail space and its utilisation.

API Comment

The commission is correct in its conclusion that “Zoning and Planning controls affect the location, quantity and use of retail space” as it does with industrial, residential and other land uses.

Town Planning is a very important concept for the amenity of society. Proper planning takes into account demand. It encourages development and facilitates the infrastructure needed to support that development.

Examples of the lack of planning are evident in Brisbane and Melbourne where Factory Outlets and other developments have been developed on airport land that is not subject to relevant Town Planning controls. As a result, transport infrastructure needed to support the development has not been provided that has generated significant traffic problems such as delays of half an hour to exit the airport precinct.

The conclusions of the Commission in relation to town planning appear to be based on limited research which disregards the established social, economic and financial fundamentals of the Australian economy, matters that are carefully considered by State, Territory and Local Governments in formulating planning policies and zoning requirements that collectively protect both the tenant and the landlord.

In conclusion, The Australian Property Institute re-iterates the recommendations made in its original submission , the most significant of which are summarised as follows:

1. Data/Information Available to Valuers and Parties with Vested Interests

There needs to be a national “system” for collating data available for valuers and other parties with a vested interest in the outcome of a rental determination. Whether it be by lease registration or otherwise is somewhat academic. The fact is some states such as Victoria are disadvantaged and cannot, in many instances, undertake determinations as accurately or efficiently as they should be able to do. To this end, the API understands that there is bipartisan support for a “national data base” from the Australian Retailers Association and the Shopping Centre Council of Australia.

2. Time Frame to Conduct Rental Determinations

There needs to be national consistency for the completion of rental determinations and the commencing date of the appointment.

3. Security of Tenure

From a retailer's perspective, this is possibly the most important issue. In short, if a landlord commences a lease renewal, there must be a dispute resolution procedure if the rent cannot be agreed. That is, a rental determination from which the tenant may walk away if it doesn't like or accept the result.

4. Consistency between Jurisdictions

This is a significant critical issue that requires further attention. All players in the retail property and shopping centre industry in particular want/need either harmonised legislation or one national Retail Tenancies Act. This would generate significant economies of scale and provide certainty to all participants.

The APIs happy to discuss any of the matters raised in its submission or to provide any additional information required. Arrangements can be made by contacting Mr. Grant Warner, API National Director on telephone number (02) 6282 2411.

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