

22nd of August 2014

Senator Sam Dastyari
Chairperson
Senate Standing Committees on Economics
PO Box 6100
Parliament House
Canberra ACT 2600



By email: economics.sen@aph.gov.au

Dear Senator,

RE: NATIONAL APPROACH TO RETAIL LEASING ARRANGEMENTS

We enclose our submission relating to the Senate Standing Committee on Economics' inquiry into the need for a national approach to retail leasing arrangements to create a fairer system and reduce the burden on small to medium businesses with associated benefits to landlords.

Leasing Information Services Pty Limited (LIS) is the largest independent retail leasing data provider in Australia. We are also specialist retail valuers. We invite you view our website at www.leaseinfo.com.au.

The inquiry's term of reference include the following areas:

- a. the first right of refusal for tenants to renew their lease;
- b. affordable, effective and timely dispute resolution processes;
- c. a fair form of rent adjustment;
- d. implications of statutory rent thresholds;
- e. bank guarantees;
- f. a need for a national lease register;
- g. full disclosure of incentives;
- h. provision of sales results;

- i. contractual obligations relating to store fit-outs and refits; and
- j. any related matters.

In this submission, we refer specifically to points (f) and (g), exploring the need for a national lease register and the need for the full disclosure of incentives. They directly fall under our area of expertise and business experience and we can shed the most light on the issues associated with those areas.

The recommendations below arise out of many years of being a part of the retail industry and seeing the frustration arising out of the circumstances within it for both tenants and landlords.

We enclose our submission and welcome the opportunity to meet with the Senate if the need arises.

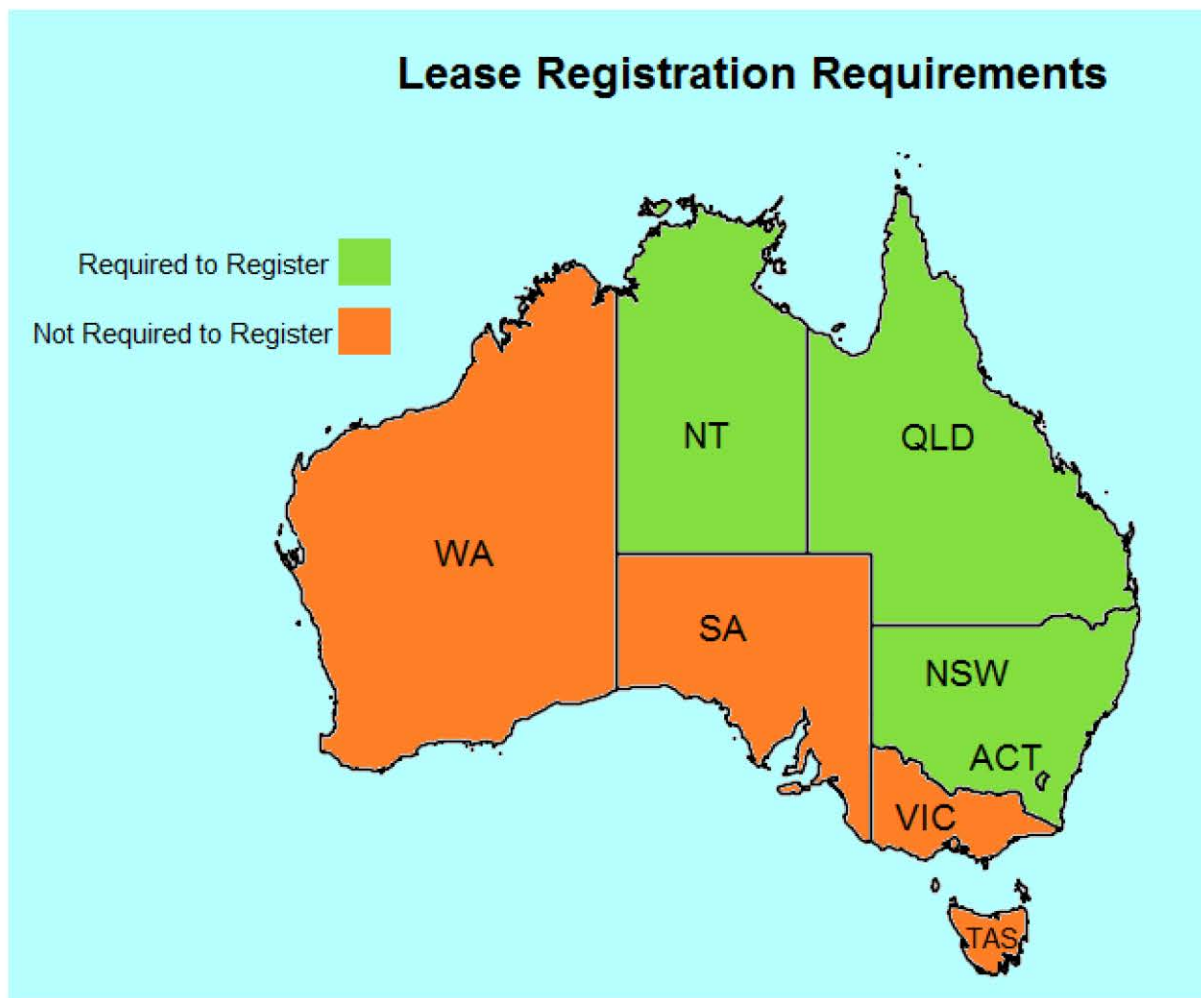
Yours sincerely,
Leasing Information Services Pty Limited

Simon Fonteyn
Managing Director

F. A NEED FOR A NATIONAL LEASE REGISTER

What is currently in place?

The legal requirements around lease registration vary greatly from state and territory around Australia.



The map above illustrates the jurisdictions where registration of leases is required (green) and those where registration of leases is not required (orange).

The retail leasing market is one where the landlords have historically held the upper hand in terms of information around the terms and conditions of leasing arrangements. This is particularly the case in shopping centres, where the Landlord has all the sales and rental information of all the tenants within the centre and the tenant only has their own sales and leasing data.

As a result, tenants have less information and this decreases their bargaining power. LIS was designed as a tool for tenants and all industry representatives to equip themselves with leasing information sourced from the publicly available registers and presented in a user friendly and comprehensible manner. The information is used to create better and more efficient leasing outcomes with associated benefits for the economy and consumers.

In NSW, QLD, ACT and NT based shopping centres and key retail strips, LIS is able to provide extensive data coverage in those areas due to leases being registered that are entered into for over three years.

The type of data coverage includes reports on rental pricing of retail premises in shopping centres and popular strips, details of commencement and expiry, MAT figures, and demographics reports. However, LIS is not able to offer a national service, despite being overwhelming demand by both tenants and landlords for this information.

The problems with the current state of leasing registration laws

In an environment where businesses are often operating across the country, the lack of consistency within the State and Territory laws in relation to registration of leases **limits productivity** and creates **barriers to information** leading to **information asymmetry** and in turn **price distortions** within the respective markets.

The lack of consistency within the laws throughout the States and Territories limits the services of data to retailers and creates information asymmetry within those markets.

The lack of fully disclosed leasing information leads to non-efficient pricing, often in the form of unsustainable rents, particularly hurting smaller business and thereby reducing competition, which ultimately effects pricing and choice for consumers.

Information Asymmetry

Information asymmetry within the retail leasing market is a serious economic issue which leads to price distortions due to the fact that one party possesses more or

better information than the other. This creates an imbalance of power in transactions which leads to inefficiency and in the worst case scenario, market failure.

Although our aim as a business is to simply empower all participants within the retail market, favouring neither tenants nor landlords, our experience has shown that it is generally the tenants who lack key information to make informed and enabling decisions. Often left in the dark with a limited number of comparables, great burden is put on tenants within an already competitive industry to secure the optimal rent.

The Solution

Many reports and commissions have discussed the issues revolving around information asymmetry; we refer your attention to the following which in our opinion are of relevance to shedding light on what the solution should be:

- NSW Government Review Retail Leases Act
- Queensland Government Review Retail Leases Act
- South Australian Government Review of Retail Leases Act
- Productivity Commission Inquiry Report 2008

As per the Productivity Commission Inquiry Report 2008, State and Territory governments should 'facilitate the lodgement by market participants of a standard one page lease summary at a publicly accessible site.'¹

An alternative solution is the registration of the Disclosure Statement for each retail lease, particularly if there is a national uniform approach to Disclosure Statements. Disclosure statements are an efficient way of making the key data available to the market in order to create more transparent and fair conditions. They also provide the added benefit of requiring incentives to be disclosed, which is discussed below.

¹ Productivity Commission 2008, The Market of Retail Tenancy Leases in Australia, Inquiry report no. 43, Canberra, 253.

Case Study 1: The importance of having access to data in retail leasing

THE BENEFITS OF RETAIL DATA

The following two case studies demonstrate the importance that data plays in leasing arrangements.

Two retailers ‘Noggi’ and ‘Chatime’ with almost identical permitted uses had signed a lease commencing on the same commencement date 21st January 2013 with identical size. The overall conditions of the leases are the same. However, Chatime had been able to negotiate a better deal using registered leasing data sourced from LIS.

Noggi VS Chatime

Queens Plaza, Brisbane, QLD		
Shop Number	TLG8	TLG17
Lessee Trading Name	Chatime	Noggi
Shop Size m2	30	30
Commencement Date	21-Jan-13	21-Jan-13
Expiry Date	20-Jan-20	20-Jan-18
Term	7y/0m	5y/0m
Option	0	0
Original Base Rent p.a.	\$ 70,000	\$ 120,000
Original Base Rent/m2	\$ 2,333	\$ 4,000
Original Marketing Levy	\$ 3,500	\$ 6,000
Rent Increase	5%	5%
% Rent	10%	10%
Outgoings Type	Net Lease	Net Lease
Outgoings Method	By Area	By Area
Incentives	Rent credit means the aggregate of 21 days Base Rent, Variable Contribution, Rates, Taxes and Assessments (not including GST). Fitout Contribution of	Rent credit means the aggregate of 21 days Base Rent, Variable Contribution, Rates, Taxes and Assessments (not including GST)

	\$20,000.	
Shop Use	Food – Juice Bar	Food – Food – Takeaway

Comparison of two leases in Queens Plaza, Brisbane:

In comparison to Noggi, Chatime had the following benefits:

- Original base rent \$50,000 lower (42% lower rent)
- Marketing Levy less by \$2,500
- Longer term of 7 years
- Incentive of \$20,000 towards Fitout Contribution

Conclusion:

This case study highlights the absolute necessity to register both the lease and the incentive, in order to prevent major rental price distortions in the retail leasing market.

Case Study 2 – Small Fashion Retailer, Brisbane

The following submission is from a client of LIS who has used our data to negotiate their leases:

We have run a small fashion boutique in Brisbane for more than 20 years. We recently engaged Leasing Information Services and IPS to help us understand the retail leasing market in our centre and across other similar centres, to negotiate a renewal of our lease in our centre. They were able to give us detailed reports on comparable rentals for fashion and similar size stores and an expiry profile, which gave us a strong basis on which to negotiate a reasonable market deal. The Landlord was willing to listen to the evidence presented and we reached a very good compromise.

The data and services provided are absolutely vital for small retailers in QLD to make informed decisions. After all, we are talking about huge sums of money, often more than half a million dollars and we need to be able to make that sort of investment in a fully informed way, with as much information as possible.

We did notice that some centres other than our own did not register their leases on time, even though they had been there for several months and we were not able to find out their incentives. If the QLD Government could legislate to mandate registration on time (say within 3 month) and require the inclusion of incentives, that would increase transparency and lead to more informed small business decisions.

G. FULL DISCLOSURE OF INCENTIVES

Following the Global Financial Crisis of 2008, the market for obtaining tenants has become more competitive due to the downturn in business and also the restriction of available bank funding that was prepared to lend to this sector.

In order to attract tenants, landlords have been including incentives in transactions. Incentives comprise of three main types:

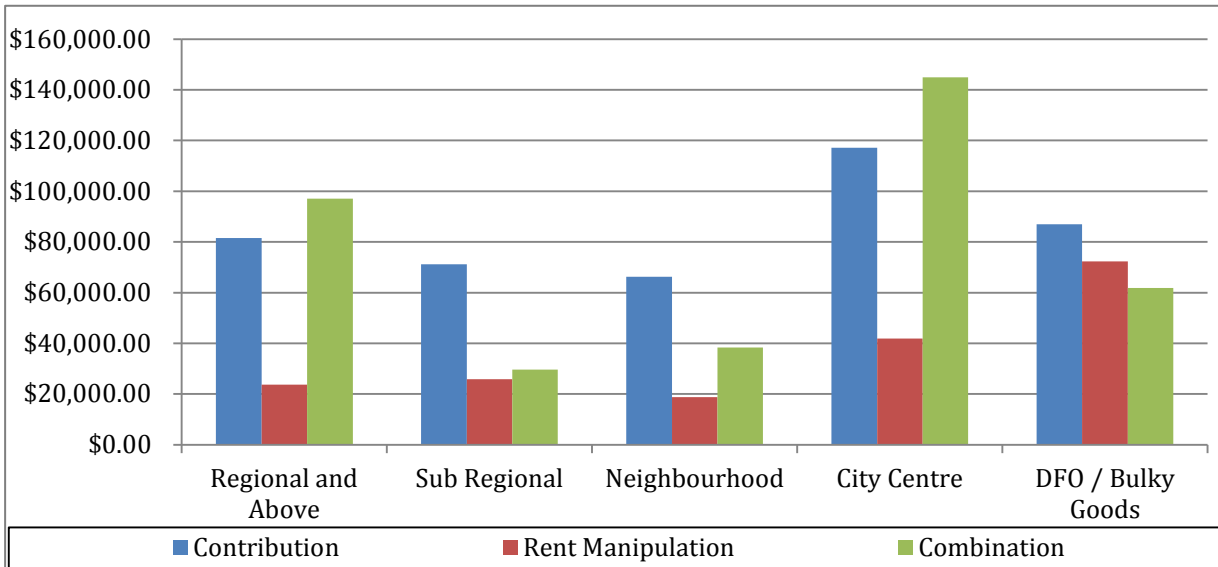
1. Financial contributions by the landlord to the tenant's fitout,
 2. Rent free periods,
 3. Cash
- Or some combination of the above three methods.

The vast majority of incentives, (we estimate at least 80%) are not registered on title with the lease. There have been several articles written on this subject as to why, including legal and periodic journals and we close them in Annexure A.

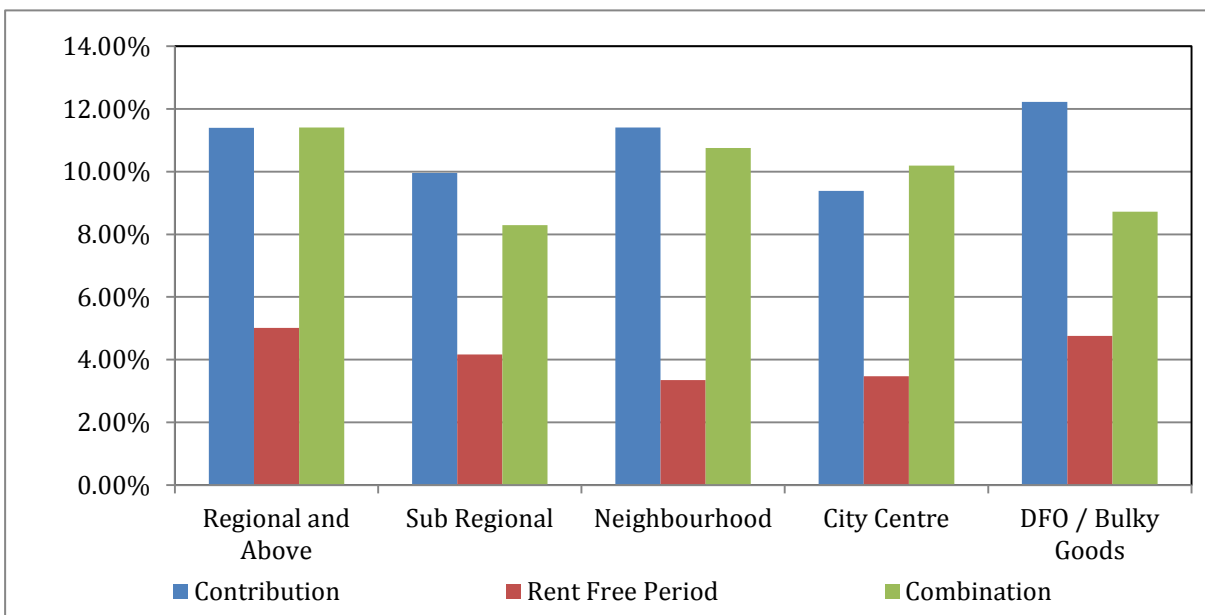
Incentives have come to form an integral part of the retail leasing landscape in Australia. They have a material impact on the leasing market as to the overall effective rents achieved. LIS data shows that incentives amount to between 3–10.75% of the total rent paid throughout Australia based on the registered and available leases disclosing incentives over a six year period, between 2006 and 2012.

The graphs below exhibit the value of incentives over a lease term of base rent, demonstrating the significant proportion of the total rent that incentives make up.

\$ Value of incentives over lease term of base rent by Centre Format - NSW



Percentage value of incentives over lease term of base rent by Format - NSW.



As retail conditions remain very difficult and retailers struggle to procure fitout finance from traditional sources such as banks, the requirement for the provision of incentives by Landlords, particularly in relation to fitout contributions, will only continue to grow into the future. Therefore, full transparency on this issue should be available to all market participants.

The Solution

The solution to information asymmetry arising as a result of the increased practice of the use of incentives can be achieved in one of two ways:

1. Mandating that incentives be registered on title, or else the lease is void.
2. Registering the Disclosure Statement on Title, which includes the incentives.

ANNEXURE A

'A sheet over a pool of blood' Robert Harley, Australian Financial Review, 8 August 2013. Explores the increase of incentives within retail leases.

'A sheet over a pool of blood'

Property Observed



Robert Harley

The lease incentives being paid to retail tenants are on the rise. The near absurd level of lease incentives paid to some CBD office tenants – up to 40 of the total value of the lease in some cases – commands most attention.

Following *The Australian Financial Review's* reporting last week, one tenant representative, Simon Gunnis emailed his analysis. He calls it "a sheet over a pool of blood."

Retail lease incentives have not reached office tower levels. But in a tough retail environment, where an empty store cannot be hidden like a vacant office floor, landlords are doing aggressive deals.

The Australian Real Estate Investment Trust reports the difference between the rent being paid by the outgoing tenant and that by the new. Its called the lease spread. And for most REITs it has turned negative.

But as well as dropping the rent, landlords are paying incentives. In well capitalised shopping

centres, its usually a contribution to fitout. In the strip shops, where the owners are less well capitalised, or less willing to dip into their pocket, its often in the form of a rent free.

Simon Fonteyn, the managing director of largest provider of independent retail leasing data, Leasing Information Services, says incentives are highest for new developments and for tenants with expensive fitouts like those in food.

In recent years, Stockland, the GPT Group and Charter Hall Retail REIT have reported lease - and yes they have risen. Perhaps the CFS Retail Property Trust will talk about the level of incentive payments in its delayed Melbourne CBD project when its reports its results in two weeks.

Colliers International director of research, Nora Farren, says retail lease incentives in malls average 9 per cent to 12 per cent of total lease payments on a five-year term. "Its rising," she says. "Its harder to keep tenants and its harder to get new tenants."

The latest NAB Commercial Property Report, released Wednesday, notes concern about the "still very high" leasing incentives in retail.



As well as dropping rent, landlords are paying incentives. PHOTO: ANDREW QUILTY

The rise in lease incentives comes at a time when a new round of negotiations over retail lease legislation is underway in Queensland, NSW and Victoria.

One of the issues on the table whether the side deals and the quantum of lease incentives should be revealed as are leases are registered.

Fonteyn "fully supports the principles of full transparency in all retail leasing markets, including the registration of all incentives and other

such matters that are currently kept hidden in side deals."

The executive director of the Shopping Centre Council of Australia, Milton Cockburn, says that many retailers themselves would not want the incentives disclosed.

"The idea that a government would pass legislation and demand that these agreements be disclosed will not happen," he says.

rharley@afr.com.au

Lack of equity sinks Pacific Retail IPO

Robert Harley

The biggest initial public offer (IPO) in Australian real estate this year, the **Pacific Retail** real estate investment trust (REIT), has failed to raise the \$367 million required in new equity.

Insiders said the offer would be reworked, modified and re-launched.

The proposal attracted more than \$250 million in equity, largely from institutional investors, but fell short on the retail component.

One problem was that the raising had not been grandfathered from changes to controls on retail broking commissions under the new Future of Financial Advice reforms.

Pacific Retail was to buy \$550 million worth of shopping centres – four in Victoria from the **CFS Retail Property Trust** and one in NSW from Federation Centres. The sales were conditional on the raising. CFS declined to comment.

Analysts had been wary of the float. When it was first mooted, NAB analyst Peter Cashmore gave the Pacific IPO a 50/50 chance of success because of the size of the raising, the metrics of the sub-regional shopping centre assets, and the other opportunities across the REITs.

Investment bank Moelis handled the IPO with retail brokers, including ANZ Banking Group and Bell Potter.

Article: Is this deception on a grand scale? By Sebastian Dimarco from Shopping Centre News 2013.



Is this deception on a grand scale?

Sebastian Dimarco
Principal
Dimarco Lawyers
Sydney



'Incentives' are everywhere! Contribution to fitout; rent-free period; rental rebate and I've heard a new one lately – landlord will pay all outgoings. Very often, these 'incentives' are not documented in the lease. Why? The usual reason is so that the value of the property, determined by the rental income, can be protected, which throws up the disturbing question; why do you want to protect it? Is it to deceive someone? As leasing gets tougher, as owners are forced to accept vacancy factors and often, stagnant rental levels, incentives covered by 'side agreements' are increasing. It's a very dangerous scenario.

In the mid-1980s as a young(er) property lawyer, I was asked to advise on a leasing deal in which the landlord insisted that although the rent would be discounted for the first two years of the term, this arrangement would not be recorded in the lease document. Being quite naive, at first I didn't understand why the landlord insisted on recording the discount in a separate document and why the tenant would agree to this.

At Law School (early classes Leasing 101) I had learned that if a tenant did not want to lose possession of the premises to a buyer of the premises or a mortgagee in possession or receiver, the tenant had to ensure that all of the lease terms were set out in the lease. I also had learned that for a lease in New South Wales, if the duration of the term and the options when added together exceeded 3 years, the lease terms would have to be included in a lease which would have to be registered at the Land Titles Office (now LPI NSW). Later (as a practising solicitor) I understood that if the landlord had mortgaged the premises, the mortgagee of the premises would review the lease and have to provide the mortgagee's consent to the lease before the lease could be registered.

In their early years, lawyers often learn as much from their clients as they did at Law School. My client told me not to worry about the discount being in a separate (unregistered) agreement.

My client explained to me that the landlord wanted to 'maintain' the value of his property and that not disclosing the discount in the lease would assist his cause. My client also explained to me the relationship between rental return and the value of a shopping centre. However, I remained concerned for my

client. At Law School I had also learned about the Trade Practices Act, 1974 which contained section 52(1) in the following terms: "A corporation shall not, in trade or commerce, engage in conduct that is misleading or deceptive."

Now it seemed to me that by omitting the discount from the registered lease, someone was being misled or deceived – precisely what a corporation in trade of commerce was not entitled to do under section 52. The reason I was concerned for my client was that my client (a corporation), by being a party to this transaction with the separate 'side agreement', might be regarded as an active participant in what appeared to me to be misleading or deceptive conduct.

Fast Forward

These days nearly all lease transactions include some sort of 'incentive' as part of the commercial deal to entice the tenant to enter into the lease. The incentive may be a rent-free period, fitout contribution, or a rent reduction. If it is a rent reduction it may be described as a 'discount', 'rebate' or 'promotion allowance'. Of course there is nothing wrong with these arrangements when they are transparent and all of the affected parties have understood and agreed to them.

However, despite having advised on literally thousands of these lease arrangements, I still from time to time have some disquiet about these arrangements when they are kept secret in ancillary documents such as 'Agreements for Lease', 'Side Deeds' or 'Contribution Deeds'. Not too long ago I received instructions to advise a client on such a transaction which caused me to reflect on current leasing practise.

The Transaction

The tenant and the landlord commenced negotiations for a large tenancy having an area of say, 3000 square metres. The tenant wanted a long lease, say 8 years, with an option to renew. After some negotiation regarding the rent, the tenant made a final offer of, say \$370 per square metre, indexed annually in accordance with the consumer price index. The landlord responded by saying he would accept \$370 per square metre provided that the registered lease specified a rent equal to \$420 per square metre and the tenant accepted a \$50 per square metre rebate (indexed) for the whole of the initial term of 8 years.

The landlord insisted that the rebate would have to be documented in an unregistered 'Side Deed'. The landlord also offered an option to renew for 6 years, with rent to be determined by reference to a market review, subject to a cap. My client agreed to these terms.

When the 'Heads of Agreement' landed on my desk (or my inbox), I did some quick mental arithmetic and calculated that the rebate was worth about \$150,000 during the first year alone of the initial term. I then got my calculator out and worked out that ignoring indexation, the value of the rebate over the 8 years term was \$1,200,000, a serious amount of money. Although I had been involved as an advisor on many of these types of transactions, this one required particular care in that:

- The initial term of the lease was long, increasing the possibility that during the initial term, the property might be sold. If the vendor did not disclose the arrangement to the

purchaser prior to the sale contract being entered into, the purchaser may refuse to permit the rebate to continue.

■ Given the duration of the lease, it is not out of the question that a mortgagee or receiver of the current or a future owner might take possession or ownership of the property. In any of these instances, if the rebate was not disclosed when the loan was made or the lease was given consent by the lender, the lender may refuse to permit the rebate to continue.

■ The amount of the rebate was substantial – both in dollar terms and in percentage terms – more than 10% of the total rent over the term.

These are all risks that a tenant has to deal with and attempt to minimise when transacting with a landlord who insists that the true rent be 'inflated' in the lease document.

There are steps that a tenant can take to minimise the risk of losing the rebate during the initial term.

An agreement was negotiated with the landlord that if the premises are sold during the initial term, the landlord must either pay out the rebate (based on various assumptions about what the future CPI increases might be) or obtain the agreement of the purchaser in favour of the tenant to continue permitting the rebate to apply.

Then there was a further problem. The 'real' starting rent was \$370 per square metre and the intended effect of the lease and the side deed when read together, was that all future rent would be calculated having regard to this starting rent.

However, the landlord and the tenant's agreement in relation to the rent payable at commencement of the option term was that it would be calculated by reference to the prevailing market rent, but any increase would be capped at 14% above the rent payable in the final year of the initial term. But which rent? The real rent or the inflated rent?

Further provisions had to be drafted to ensure that the cap would be computed with reference to the net rent in final year of the initial term after taking into account the rebate – more drafting and more expense! In the end, somewhat to my surprise, the landlord agreed to a clause to be contained in the registered lease along the following lines:

Despite the review of the rent to the Market Rent at the commencement of the option term, the rent payable during the first year of the option term shall not exceed 114% of an amount equal to 88% of the rent payable under this lease during the final year of the initial term of this Lease.

Ironically, in the end, the landlord agreed to insert into the registered lease a clause which would suggest to any discerning mortgagee or purchaser that there might be more to the lease arrangement than what is contained in the registered lease.

However, by no stretch of the imagination could one say that the registered lease gives an honest representation of the lease arrangement. And what about section 52 of the Trade Practices Act, 1974?

Australian Consumer Law

Section 52 of the Trade Practices Act, 1974 has been superseded by section 18 of the Australian Consumer Law, which is contained in the Competition and Consumer Act. Section 18 prohibits a person, in trade or commerce, from engaging in conduct which is misleading or deceptive or is likely to mislead or deceive. So I return to the same questions which troubled me as a young lawyer:

■ Does a landlord who insists on incentives and rebates being contained in confidential unregistered documents engage in misleading or deceptive conduct (or conduct which is likely to mislead or deceive)?

■ Does a tenant who participates in such a transaction similarly engage in misleading or deceptive conduct (or may the tenant be considered as having aided and abetted the landlord in engaging in misleading and deceptive conduct)?

Most major shopping centres are indirectly owned by the public via corporate or trust structures, often as part of a superannuation portfolio. Investors expect managers to provide accurate information regarding the performance of the shopping centre and investors are entitled to expect that managers do not operate the shopping centre in a manner which is likely to distort the manager's reported performance or mislead investors as to the true value of their investment.

Similarly, lenders have a strong interest in receiving information about the performance of the centre which will not mislead or deceive the lender. To this end, lenders expect that landlords will provide the lenders' valuers with an accurate and fair representation of the rents being paid by tenants so that their valuation reports are credible.

Tenants also, are entitled to assume that if their rent is to be reviewed to market, the valuer will be able to readily obtain accurate information as to the rents being paid so that their rent as determined is truly the market rent.

By engaging in the practice of concealing the true rent by omitting rebates and the like from the lease document, a landlord risks engaging in misleading or deceptive conduct or conduct which is likely to mislead and deceive.

However, it is my view that in truth, the primary object of omitting rebates and other incentives from the lease document is to mislead and deceive. What other reason can there be for complicating transaction documents, such as in the transaction described above?

The incentives are getting bigger and bigger. In the Sydney office market, incentives in the vicinity of 25% and even 30% of the face rents specified in the registered lease are not unheard of.

In my view, if landlords continue on this path, it must only be a matter of time before an investor, a bank or perhaps a tenant who has relied on the misleading and deceptive registered lease and lost a lot of money, will decide to take legal action to recover their loss.

And what is there to stop an aggrieved lender asserting against a tenant that he was also a party to misleading and deceptive conduct, by agreeing to split the commercial transaction over two documents, one public and one private?

A final comment

There is some irony in the fact that secret side deeds are such a prevalent leasing practise that their existence, at least, is no longer a secret at all. One might argue that everyone knows that side deeds are a regular feature of leasing transactions these days, so why be concerned? However, at the level of the individual parties concerned this is a zero-sum game – the benefit to one participant equals to cost to the other.

A contributing factor of the Global Financial Crisis was the deception on a grand scale within the banking industry, in respect of the quality and value of assets, namely mortgage and debt portfolios.

Upwardly distorted valuations enabled poor quality assets to be packaged sold to unsuspecting investors resulting in enormous human suffering for many innocent individuals. In the long run, only truth and transparency can benefit all of society. The opposite benefits a few at the expense of many. **SCN**