ATTACHMENT 2 – Responses and further information

1. Lack of traction in achieving a national approach (Mr Nardi, pg. 8)

Our submission to the inquiry provides a comprehensive history of the discussions and inquiries which have focussed on a national approach to national leasing. We reiterate our support for a national approach on the condition that it comes in place of, and **not in addition to**, the current system of state and territory legislation. Our submission also notes a number of barriers to achieving the various models of harmonisation which have been canvassed previously.

This commentary is found under headings 2.3 and 2.4 on page 5 onwards of our submission.

2. Status of the *Draft Code of Practice on the Reporting of Sales and Occupancy Costs in Australian Shopping Centres* (Mr Nardi, pg. 8)

During the review of the *Queensland Retail Shop Leases Act* in 2013, conducted by the Queensland Government, there was discussion between the Shopping Centre Council of Australia (SCCA) and major retailer associations on the practice of reporting sales to landlords. It was accepted that comprehensive and accurate sales information was important to both landlords and tenants for a number of management reasons. These are listed on pages 25-26 of our submission. The parties therefore agreed to seek to negotiate a Code of Practice in the belief that, with goodwill on the part of all concerned, the practice of sales reporting could cease to be a matter of disagreement between landlords and tenants. A similar controversial issue – the practice of leasing space in common areas for short-term retailing – has been resolved through the negotiation of the *Code of Practice on Casual Mall Leasing*. (This code had to be authorised by the ACCC before it came into operation since it contained some provisions which may have breached some of the provisions of the *Competition and Consumer Act*).

A series of meetings were held during 2014 and a *Draft Code of Practice on the Reporting of Sales and Occupancy Costs in Australian Shopping Centres* has been prepared. This Draft Code has been endorsed in principle by the SCCA and the National Retail Association. The Australian Retailers Association wishes to hold further discussions and to include some of its members. That meeting is currently being arranged.

3. Disclosure statements in Victoria (Mr Giugni, pg. 9)

The website of the Victorian Small Business Commissioner notes that "there are four Disclosure Statements used depending on the particular circumstance...".

The Disclosure Statements listed are for:

- Non-shopping centre retail premises
- Shopping centre retail premises
- Renewal of a lease
- Assignment of a lease with an ongoing business

4. **'Low hanging fruit' of retail lease harmonisation (Senator Xenophon, pg. 9)**

The Senator was interested to understand our perspective on potential 'low hanging fruit' where consensus could be achieved between stakeholders and costs saved in the context of the harmonisation of retail tenancy regulation. Our thoughts are as follows:

1. **A harmonised disclosure statement.** A common lessee's disclosure statement which could be adapted for use in every state and territory. This also requires an amendment to legislation in some states to introduce a provision similar to section 11A(1) of the NSW *Retail Leases Act* which gives some flexibility in departing from the layout of the prescribed disclosure statement provided it contains the relevant information.

2. **Removal of the statutory five-year minimum term.** This was removed from the Queensland *Retail Shop Leases Act* more than a decade ago and there has been no move by retailer associations to seek to have it reinstated. This gives greater flexibility to retailers and landlords in negotiating leases and reduces the current cost to tenants in seeking the necessary certificate of exemption.

3. **Removal of listed companies, and their subsidiaries, from the coverage of retail tenancy legislation around Australia.** (Some states already exclude them). This will remove unnecessary regulation and business red tape for both lessors and lessees. Listed companies have a bargaining power which exceeds that of most landlords and do not require the protection of retail tenancy legislation.

4. **Consistent coverage of retail tenancy legislation around Australia.** We have addressed this separately in our reply to written question 4 asked by Senator Xenophon.

5. **Common provisions around Australia in relation to obtaining consent to assignment of leases and common circumstances in which a lessor can withhold consent to an assignment.**

5. **More information on dispute resolution process and effectiveness (Senator Xenopohn, pg. 10)**

The SCCA's submission to the Inquiry provided a detailed overview of the dispute resolution mechanisms which are operational in each jurisdiction across Australia. Typically, these processes seek to have disputes resolved informally or mediated between parties before it can proceed to the relevant tribunal or court for deliberation. The reported success of these mechanisms demonstrates they are able to resolve disputes quickly and at a relatively low cost.

This commentary is found under heading (b) on page 14 onwards of our submission.

In the course of his questioning, the Senator asked, "do you see any merit in - or would you be resistant to - a fast-track dispute resolution process, mandatory mediation?". The short answer yes (and no) – we do see merit in fast-track dispute resolution and are not at all resistant. In our submission we outline that our members advise that the alternative dispute resolution processes work relatively well and that we have no concern about jurisdictions mandating that parties attempt to mediate a dispute prior to a matter being progressed to a tribunal or court.

We also provided an overview of the degree of success these mechanisms and related bodies achieve, as reported through various Annual Reports. For ease of reference, we note that:

- in NSW, the website for the office of the Small Business Commissioner notes that "mediation is so successful that about 94% of all matters referred to us for mediation are resolved prior to having a court decide the matter",

- in Victoria, the Victorian Small Business Commissioner reported that in 2012-13 that they received 1,103 applications for dispute resolution related to the Retail Leases Act. Of these, only 594 progressed to mediation and the success rate was 80.3%, and

- South Australian Small Business Commissioner reported that only 27% of formal cases received related to the Retail and Commercial Leases Act and that 88% of all formal cases are successfully resolved. Further, they report that 98% of disputes are resolved prior to mediation.

The Senator also asked about the potential for a "sting in the tail" or a "cost penalty for a party that behaves unreasonably in the mediation". As we stated in our submission, we have no problem with mediation being mandated, but we disagree with the premise of the Senator's line of thought. We also refer to the evidence provided by Mr Paul Giugni regarding the practical steps taken following a mediation attempt (page 10 of draft Hansard transcript).

A mediator is not necessarily a legal professional and would not necessarily have the relevant skills and experience to judge whether a party has been "unreasonable" (whatever the Senator intends that term to mean) in the context of the mediation. As is outlined in a fact sheet on the NSW Small Business Commissioner's website, *Small Business Info Kit – 2, Avoiding and Dealing with Disputes,* a "mediator is a neutral third party and will not decide whether one party is right or wrong, nor do they decide the outcome or provide legal advice". Changing a mediator's role to one of arbitrator or decision maker will fundamentally change the nature of mediation.

6. Rent movement relative to sales growth, and relationship with gross and semi-gross leases (Senator Xenophon, pg. 12)

Our members that are publicly listed companies generally report the overall nature of sales growth and rental growth. This provides a mechanism to determine a relationship between rent and sales (although this can ignore other factors such as occupancy rates). It is worth noting that such reporting on sales (including sales growth) can only be achieved where sales information (generally monthly) is provided by tenants to the landlord.

When we reviewed our members' last annual results (reported in mid-to-late 2014), it highlights the variation across different companies. The Novion Property Group, for instance, reported a negative leasing spread of 6.1%, whereas speciality store turnover growth was a positive 2.7%. Stockland reported a positive leasing spread of 2.5% with specialty store turnover growth 4.2%.

The issue of gross and semi-gross leases is a matter for negotiation with the landlord and tenant. If a net lease is chosen, governments have imposed certain protections for tenants, such as in relation to the apportionment and payment of outgoings.

Some landlords and tenants prefer gross leases or, more usually, semi-gross leases. Some prefer net leases. Each methodology has advantages and disadvantages. The advantage of a gross lease arrangement, from a tenant's perspective, is the greater certainty in estimating future total occupancy costs over the period of the lease. However, this approach removes transparency in relation to, for instance, audited outgoing statements. We do not believe it is the place of governments to make a judgement as to which method should apply.

7. Preferential renewal system, with specific reference to Tasmanian system (Mr Nardi, pg. 11)

As far as we are aware Tasmania does not have a 'right of renewal' of leases. Tasmania does not have retail tenancy legislation and retail leasing arrangements in that state are governed by a code of practice made by regulation under the *Fair Trading Act*. The *Fair Trading (Code of Practice for Retail Tenancies) Regulations 1998* is silent on the issue of a right of renewal of leases. This is confirmed by reference to the *Compendium of Australian Retail Tenancy Legislation* published by Gadens Lawyers.

The Tasmanian Code of Practice does require that if a retail property owner offers to renew a lease, the rent under the renewed lease is to be "the market value rent for those premises determined in accordance with [the provisions for determining market rent] *unless there is agreement to the contrary*".

It is our understanding that major shopping centres and other retail landlords do not agree to such market rent determinations for renewed leases and this is accepted by retailers. Tasmania is always a tough retail leasing environment for property owners and vacancy levels are much higher than they are in states such as Victoria and NSW, where retail competition is more intense. Lessors and lessees are therefore confident that, through negotiation, they can reach a market rent without utilising the services of a retail valuer.

We contacted one of our members with significant investments in Tasmania. Our member has advised: "In our experience tenants do not seek to rely on the Code and are happy to negotiate a new lease with us. Market reviews can be quite risky for tenants as they may not necessarily give them the result they want (not to mention, at an additional cost). Having the ability to freely negotiate the rent with the landlord appears to be the preferred approach."

'Third-party rent determination' on lease renewal is simply not practical. This can be demonstrated by taking NSW as an example. The Productivity Commission estimated in 2008 that there were around 96,000 retail leases on foot in NSW. (There would be many more now.) Assuming each lease is, on average, for five years this means around 19,000 leases come up for renewal in NSW each year. Even if we assume that in only around one-third of renewals would a landlord and tenant agree to a market rent review to determine the rent under the renewed lease, this means there would be around 6,400 *additional* market rent reviews required each year in NSW. This means an *additional* 123 market rent reviews added to the workload of retail valuers in NSW each week. Since each market rent review takes around 30 to 40 days to complete, this suggests NSW would require around 600 additional retail valuers. (If we assume that such a provision applied around Australia, the additional number of retail valuers required in Australia would be around 1,800.)

The Australian Property Institute has advised that there is already a *chronic* shortage of retail valuers in NSW to undertake the existing workload of mid-term market rent reviews and reviews under options leases. (We understand there are also shortages in other states.) Even if it was possible to find or train an additional 1,800 retail valuers, which we strongly doubt, such valuers then require a minimum of 5 years' experience in valuing retail shops, so the chronic shortage would last for at least five years and, more likely, for much longer. In the meantime, of course, the cost of retail valuations – which can already be a significant imposition on landlords and tenants – would skyrocket as owners and tenants bid for the services of scarce valuers.

Because of the continuing chronic shortage of retail valuers, leases would inevitably expire before the determination of the new rent can be completed. This means tens of thousands of retail tenants would be in 'holdover' (without the protection of a lease) for indefinite periods while the rent is being determined. Many landlords could not wait that long to have the rent determined. Since the landlord would not be able to seek a higher rent while these processes are in train, he would most likely terminate the 'hold over' – by giving 30 days' notice – and begin negotiations with a new tenant.

One reason why landlords would take such 'protective action' is because the landlord knows the tenant is free to "walk away" at the end of the market rent determination process if they are unhappy with the outcome. Landlords would face the prospect of paying thousands of dollars in expenses to the retail valuer, as well as losing tens of thousands of dollars in foregone rent, only to find themselves back where they started and looking for new tenants for the retail premises.

8. Landlord response to impact of a regulatory change on a specific sector (eg. Pharmacy) (Mr Nardi, pg. 12)

The Pharmacy Guild contacted us to draw attention to issues in their sector, relating to the 'price disclosure' changes under the Federal Government's Pharmaceutical Benefits Scheme (PBS), which were scheduled to commence in October 2014. We were advised that these changes would adversely impact pharmacy income. In this regard, the Pharmacy Guild wanted to bring these changes, and their impact, to the attention of our industry when negotiating leases.

In this example, a decision made under the PBS is obviously an external factor that a shopping centre owner cannot control.

We met with the Pharmacy Guild, and subsequently advised our members and also distributed an information booklet to our members (the *Pharmacy Rental Report 2014: Price Disclosure Impact Edition*) that the Guild produced for the industry.

We have not seen any industry data that is available in relation to the impact of PBS changes on pharmacy turnover (or, for example, occupancy costs) as a result of the changes which commenced on October 2014. This will likely be available, including the ability to draw comparisons with previous financial years, at the end of 2015. We will, however, seek to continue to engage with the Pharmacy Guild on relevant industry issues.

9. Rental movements over the past five years (Senator Ketter, pg. 12)

As noted above, our members that are publicly listed companies generally report on key operational issues such as leasing information.

Given the diversity of the shopping centre (and retail) sector, it is difficult to generalise about the overall nature of rental movements over the past five years. However, Stockland reported their 2014-15 first half-yearly results recently and reported average rental growth on all lease deals of 3.6% (compared with 0.2% growth in the 2013-14 first half). This compared with total moving annual turnover growth of 1.2% (although smaller specialty stores experienced 3.8% sales growth; department stores and discount department stores experienced negative 1.8% growth).

10. Average difference between a larger tenant's rental costs compared with an average smaller tenant (Senator Ketter, pg. 12)

We do not have access to such information since the *Shopping Centre Benchmarks*, produced annually by the independent research firm Urbis, only record average rents per square metre (and occupancy cost ratios) for specialty tenants (according to sales categories). However, in dollar terms, the major tenants obviously pay vastly more rent than specialty stores because they occupy so much more space. (The average department store in a regional shopping centre occupies more than 18,000 square metres while the average specialty store occupies just slightly more than 100 square metres.)

It is true that when the rents paid by major stores and specialty stores are converted to a dollar per square metre basis, majors usually pay a lesser figure. There is nothing unusual about large purchasers being able to negotiate a better deal than smaller purchasers. A major law firm, in a city office building, usually pays a much lower rent per square metre than a small firm occupying a much smaller amount of space in that building. A major advertiser generally negotiates a much lower advertising rate from a media company than a small advertiser because of the volume of business they bring. These 'economies of scale' are common in business everywhere. This is no different to the principle of collective bargaining in industrial relations where a trade union is able to negotiate a better deal for employees than an individual or small group negotiating on their own. Only in retail leasing, however, does this become a matter of discussion and controversy.

The Committee should also be aware that, for a variety of reasons, the space occupied by department stores and discount department stores is less efficiently used - that is, is less 'productive (as measured by sales per square metre) - than the space occupied by specialty retailers. This is another reason why the rent per square metre for these department stores is less than that for specialty retailers. Specialty retailers in Australian regional shopping centres are almost twice as productive as their counterparts in US shopping centres.

There is no law that requires department stores, discount department stores or supermarkets to locate in shopping centres. Many of these retail formats operate from free-standing stores outside shopping centres. Indeed, without a pre-commitment from a major retailer to lease space, investors contemplating new shopping centres would find such projects too risky to undertake. This obviously puts these major retailers in a powerful negotiating position. (Again the need for such pre-commitments from prospective tenants for proposed buildings is not unique to the shopping centres).

For this reason these major retailers are sometimes referred to as 'anchor tenants'. In order to gain commitments from these 'anchor tenants' to lease space in shopping centres, rather than opening a store elsewhere, shopping centre developers have to offer a rent that is competitive to the costs or rents the anchor tenant would face in establishing in alternative locations. This is always a long and protracted negotiation between the owner and the anchor tenant. (In recent years we have seen instances where the major department store chains have closed stores in major shopping centres because they would not pay the rent the owner sought for a new lease.)

The most important point, however, is that these major retailers are draw cards in shopping centres and the specialty retailers profit from the pedestrian traffic they generate. That is why so many specialty retailers seek space in shopping centres rather than in, say, main street locations. Once again there is no law forcing specialty retailers to do so. Specialty retailers seek locations in shopping centres because, among other things, they want to take advantage of the customer pulling power of the major retailers. The statistical evidence indicates the superiority of such locations in terms of turnover achieved – both gross and net of rent and other occupancy costs.

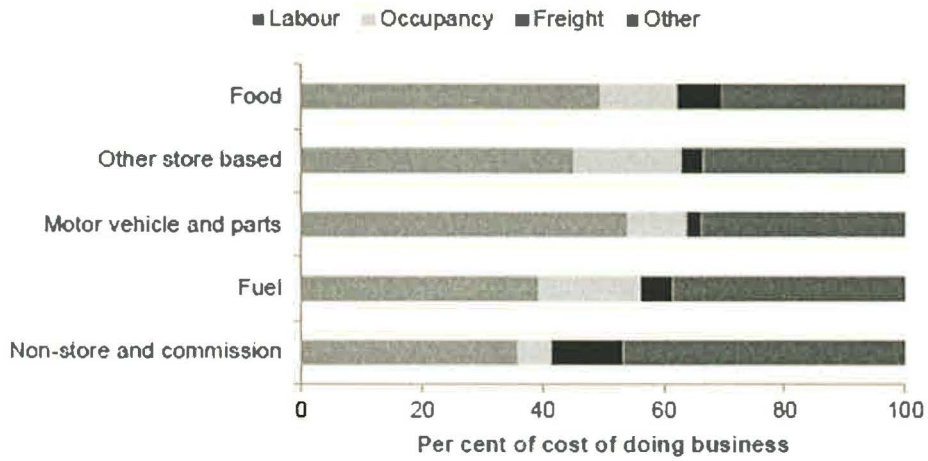
Most retailers understand this economic fact. An article by an adviser to small retailers, for *Inside Retailing*, made the same point: *"There is a very good reason that Woolworths [per square metre] rent is lower. It's pulling power. The number one determinant in supermarket shopping market share is location. Woolworths can (and does) self develop mini-centres in local areas or stand alone supermarkets at very low cost. Landlords actually have to price rent to lure them into their centres as – unlike many speciality retailers like butchers – Woolworths pulls foot traffic to wherever it locates. The other retailers around Woolworths pay for the right to exploit the foot traffic generated by the retail 'anchors' like Woolworths. The rent is higher for this very reason and – just like Woolworths – any retailer has the choice to locate somewhere else where the rent is cheaper."*

Obviously landlords would love to charge the same rent per square metre for the major retailers as they do for specialty retailers but, if they did, they would not have any anchor tenants and the specialties would have far fewer customers and the shopping centre would struggle to survive. (In reality, as noted above, without an anchor tenant the shopping centre would not be built.) If landlords charged the specialty retailers the same rent per square metre that they charge the anchor tenants then the shopping centre would be uneconomic and would be forced to close. In both cases the ultimate losers would be the specialty retailers. That's why this argument, with its implication that specialty retailers are actually subsidising the rent of the major retailers, is such a circular one and ultimately leads nowhere.

11. Percentage of a retailers overall operating costs that is rent (Senator Ketter pg. 13)

The Productivity Commission's *Final Report into the Relative Costs of Doing Business in Australia: Retail Trade*, which was released in October 2014, provided a 'breakdown' of costs in 2012-13 (refer to page 59). It should be noted, however, that the Commission noted diversity in cost structures across the retail sector. In the summary, 'Occupancy', which includes rent, represented the third highest of four categories at 15%. The highest category was reported as 'Labour' (47%); the second highest was 'Other' (33%) such as utilities, warehousing and distribution; and the lowest was 'Freight' (5%). The Commission also provided (at page 61) a summary of the relative shares of the costs of doing business across different retail types; as reflected in the following chart.

Figure 3.3 **The relative shares of the costs of doing business differ across types of retail 2012–13[a]**



[a] 'Other' relates only to costs of doing business and so do not include the 'cost of goods sold'.

Source: ABS (Cat no. 8622.0, 2014).

12. Lease incentives and perceived distortion of the rental and investment market (raised by Senator Xenophon during the evidence of Mr Brian Scarborough, pg. 17)

As noted above, our members that are publicly listed companies generally report on operational issues, including key leasing information. As an example, Federation Centres last annual results (reported in August 2014) highlighted a 7.3 month equivalent rental incentive on new leases across the group's activities; and a 1-2 month incentive on lease renewals. This had an overall reported value of $13.9 million. In relation to incentives in general, we refer to our written submission.

ATTACHMENT 3 - Responses to questions on notice from Senator Nick Xenophon, provided via email on Monday 16 February

1. **The Productivity Commission's 2011 report concluded that planning and zoning regulation 'appears to be the root cause of many of the problems that arise in retail tenancy' and that 'further refinements to retail tenancy regulation are unlikely to result in significant improvements to the operation of the retail tenancy market given the distortions and constraints arising from planning and zoning regulation'.**

    - **What is your view with regards to the Productivity Commission's conclusion that 'appears to be the root cause of many of the problems that arise in retail tenancy'. Are you aware of any reforms to planning and zoning regulation at the state and territory level? Do you think that these reforms will be effective?**

    The Senator would be aware that the issue of planning and zoning in the context of retail development and retail leasing has been considered over and over by the Productivity Commission and the subject of numerous recommendations. We have participated in the *2008 Retail Tenancies in Australia* inquiry, the 2011 inquiry into the *Economic Structure and Performance of the Australian Retail Industry*, the 2011 *Planning, Zoning and Development Assessment Study*, and the *2014 study into the Relative Cost of Doing Business: Retail Trade*.

    Most recently, the Competition Policy Review Panel also considered the issue of planning and zoning in both its review Issues Paper and draft Report. In our submission to the Competition Policy Review Panel's Issues Paper we offered the critique that many competition-related inquiries or reviews of land-use planning can be simplistic and narrow in public policy terms.

    While recommending to the Review Panel that it recognise the Productivity Commission's previous findings and recommendations in relation to the competition in Australia's planning systems, and endorsed these as the basis for reforms to be progressed at the relevant State and Territory levels, we have consistently maintained that reform to the planning and zoning systems should not come at the expense of competitive neutrality and should provide a timely level playing field for investment and give due recognition to broader public policy and other benefits such as productivity and maximisation of infrastructure.

    We would refer the Senator to our submissions to these various inquiries, which are publically available, to understand our broader views on planning and zoning. Our submission to the Competition Policy Review Panel also provides an overview of the relevant planning and zoning reforms that have been undertaken by the States and Territories, including the most comprehensive reform program in Victoria throughout 2013-14.

2. **Could provide the committee with an update on the progress of the "Draft Code of Practice on the Reporting of Sales and Occupancy Costs in Australian Shopping Centres" that is being developed with retail bodies?**

    Please see response to Item 2 in Attachment 2.

3. **Why was retailer associations' support for the shopping centre code of practice reduced after they realised that it would replace retail tenancy legislation? (submission 17, p. 6)**

On several occasions retailer association officials have advised us that they prefer retail tenancy legislation to a retail tenancy code of practice. This is supposedly based on their experience in NSW when, prior to the introduction of the *Retail Leases Act* in 1994, retail leasing arrangements were governed by a Code of Practice. It is their view that there were widespread breaches of this Code of Practice and this lead to NSW introducing the *Retail Leases Act*. This was prior to the formation of the Shopping Centre Council of Australia so we have no knowledge of whether this is an accurate assessment or not. We would note, however, that the retailer associations have since accepted that self-regulation, in the form of codes of practice, are useful in regulating specific aspects of retail tenancy, such as the Code of Practice on Casual Mall Leasing and the (proposed) Code of Practice on Sales and Occupancy Cost Reporting. This was referred to in Mr Nardi's evidence on page 13 of the transcript.

We have noted, and welcome, the support of the National Retail Association (NRA) at the hearing on 13 February for a more harmonised approach to retail tenancy regulation and its general support for the Productivity Commission recommendations to achieve national consistency. Retailer representation in Australia, however, is fragmented and state-based retailer associations still exist in some states. Such associations, because they are state-based, prefer state-based legislation and oppose any move that would result in the repeal or downgrading of such legislation. We are also aware of reluctance among some state government officials to surrender responsibility in this area of regulation.

4. **Definitions of 'retail premises' vary across jurisdictions, and are based on factors such as rent thresholds, ownership structure (ie public companies) and floor space. If a harmonised approach were taken, what would be your preferred definition of 'retail premises' for the purposes of retail tenancy regulation?**

The exclusions from coverage by state/territory retail tenancy legislation are currently contained in the definitions of 'retail premises' and/or in the definition of 'retail shop' and/or in the definition of 'retail lease'. As the question notes, these differ widely from state to state.

We believe the principle that should apply is that the coverage of retail tenancy legislation should be strictly confined to small retail businesses which may need regulatory protection and should not be extended to those businesses which are capable of looking after themselves in negotiations with landlords. This will minimise unnecessary business red tape on both lessors and lessees.

We recommend that a harmonised definition of 'retail premises' be largely based on the definition contained in section 3 of the NSW *Retail Leases Act*. This refers to premises used or proposed to be used wholly or predominantly for the carrying out of a business listed in a schedule to the Act. (The definition in the Queensland *Retail Shop Leases Act* is similar). These definitions are superior to those in other legislation because the legislature keeps control of the business premises covered by the Act whereas in other States, particularly Victoria, court decisions are continually expanding the scope of the definition. (A Guide published by the Small Business Commissioner in Victoria on "What are retail premises?", for example, runs to 23 pages).

The NSW RLA also excludes a range of retail premises from coverage of the Act:

- premises that have a lettable area of 1,000 square metres or more;
- premises used wholly or predominantly for the carrying on of a business on behalf of a landlord;
- cinemas, bowling alleys, skating rinks;
- premises in an office tower that forms part of a retail shopping centre where these are not used for retail purposes;
- businesses exempted by regulation.

In addition, state governments are increasingly deciding to exclude other premises from the definition of a 'retail premise' or a 'retail lease' because they believe that such premises do not require the protection of Parliament in dealings with their landlords or because such regulation makes little sense. These include:

- premises leased by a listed corporation or a subsidiary;
- premises leased by federal, state or local governments;
- premises such as ATMs; telecommunications equipment; vending machines; information, entertainment, community or leisure facilities;
- storage premises;
- parking facilities.

We would be happy to explain our reasoning in supporting these various exclusions if the Senate Committee wishes.

5. SCCA considers that incentives and side deals agreed to as part of negotiations between landlords and tenants should remain confidential (Submission 17, p. 22). How can retailers know if they are getting a fair price when the true cost of leasing arrangements is not being provided?

Please see response to Item 11 in Attachment 2.

6. How successful/effective are Small Business Commissioners (in the jurisdictions where they operate) in resolving leasing disputes?

See response to Item 5 in Attachment 2.