



25 August 2014

Committee Secretary
Senate Economics References Committee
PO Box 6100
Parliament House
CANBERRA ACT 2600

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

Terms of Reference

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.

Submitted by the Jewellers Association of Australia

Dear Sir,

This submission is prepared by the Jewellers Association of Australia which represents the Australian jewellery industry. The industry includes 3100 retail jewellery stores with an annual turnover of \$4.6 billion and employing more than 25,000 people.

Jewellery retailers are represented in virtually every shopping centre in Australia. There are several dominant chains of jewellery shops but the vast majority of jewellers are family owned and operated small businesses.



Jewellery shops generally have a higher level of sales per square metre than other retailers due to the relatively high value and compact size of the jewellery products sold and the consequent need for a smaller shop size.

Due to the nature of their product and customer, jewellery sales are a discretionary purchase which requires comparative shopping. This means jewellery shops typically occupy corner locations in shopping centres with high levels of customer traffic to maximise exposure of their product. It is accepted that jewellers will pay a premium in rent per square metre for a well located jewellery shop than will be paid by other retailers for shops in less than prime locations. The problem faced by our members is that due to the methods of rent review and the high cost of jeweller's fitouts (which increases their need to renew leases rather than lose the value of their fitout) there is now a vast increase in the difference between rent paid by jewellers and rent paid by virtually every other retailer in a shopping centre.

We believe this imbalance can be rectified if market forces are allowed to prevail and Retail and Commercial Leases Legislation around Australia is changed to provide a level playing field giving landlords and tenants equal access to the same facts and figures needed to negotiate a fair market rent for a lease renewal. It is important to eliminate the ability for either party to take advantage of the other as a result of unfair or biased legislation.

The First Right of Refusal for Tenants to Renew their Lease

Unlike other retailers, it is a rare circumstance where a landlord would not wish to renew a jewellers lease and change the use of the shop.

There are rules in several states in Australia which require landlords to negotiate with sitting tenants before going to the market. This process has generally evolved into one whereby many of our members are now



on holdover after leases have expired as landlords refuse to acknowledge reductions in market rent and would rather keep a jeweller on a monthly tenancy at a high rent than accept market rent at a reduced level and enter into a new long term lease. The only state which has addressed this issue is Tasmania which has implemented legislation which commits landlord and tenant to a rent determined by an independent valuer if both parties agree that the lease is to be renewed but cannot agree on the level of rent to be paid. It is a system which has great merit and should be implemented Australia wide.

Affordable, Effective and Timely Dispute Resolution Processes

A dispute resolution process which is embedded in legislation and cannot be over turned by lease contracts is essential. The process needs to be absolute (in the same way as a valuers' determination of market rent is absolute) and not subject to appeal or the ability to take it to Court if either party is dissatisfied with the outcome. The process needs to be cost efficient and timely so that it is available for all.

One of the major issues concerning our members relates to the disruption to business caused by development activity as shopping centres are expanded or refurbished. Most leases include clauses which prevent tenants from claiming damages as a result of landlord's works. This needs to be remedied to enable all retailers who are affected by development works to be compensated for their losses.

Another area of significant concern to our members is the way in which landlords overload the jewellers category in centres.

For example, a jeweller may negotiate terms for a new lease in a shopping centre to occupy a prime corner location and pay a premium in rental for it believing the amount of jewellery retail business which can be generated in that centre will justify the level of rent negotiated. If the landlord then adds additional jewellers who pay progressively lower levels of rent per square metre as more are added, the first jeweller who



agreed to pay the higher level of rent is now disadvantaged with greater cost of occupancy than the last jeweller to come into the centre. If there has been no commensurate increase in customer traffic, all that has happened is for the total volume jewellery sales to be more thinly distributed. A legislated mechanism which allows this situation to be independently reviewed and rent adjusted accordingly is an essential requirement which needs to be addressed.

A Fair Form of Rent Adjustment

In the past when the Australian economy has grown significantly and retail sales have performed well, annual rent increases of up to 5% have been accepted as an affordable impost of entering into new leases to occupy prime locations in shopping centres.

Over the past five years this situation has changed and growth in shopping centre turnover, retail sales and customer traffic has remained virtually flat and has not kept pace with movement in the Consumer Price Index. Over the past five years CPI has grown by about 10% on a cumulative basis, and rent has increased by between 15% and 20% over the same period.

Any attempt to vary the mechanism for rent review during negotiations for new leases are generally not accepted by landlords. They simply suggest that the commencing rent be negotiated to take into account the likely increases in rent which will occur as a result of the rent review mechanism in the lease.

Legislation which limits growth in rent to match growth in specialty shop sales per square metre would be fair, measurable and keep rent as a percentage of turnover at a constant level for the term of the lease.



Implications of Statutory Rent Thresholds

Statutory rent thresholds are evident in the lease legislation in several Australian States and are set at levels which are meant to be high enough to ensure all small businesses enjoy the protection of the relevant Retail Commercial Lease Legislation for that state.

Unfortunately, as rents increase as a result of the method of rent review used in leases, leases which start with rent under the threshold and are therefore in the Act can be outside of the threshold at the end of the lease and lose all of the most important benefits of preferential rights at the end of the lease. The threshold either needs to increase at the same rate as rent is reviewed (which means that it will vary from lease to lease, centre to centre and state to state) or a ruling made that if a lease is inside the Act when it is negotiated, it remains inside the Act and vice versa.

Bank Guarantees

Bank guarantees used to be equal to the amount of rent for one month only. That has changed over the years and our members are now being asked to provide bank guarantees equal to a minimum of three months gross rent up to as much as twelve months worth of gross rent. This is on top of the cost of a jewellers fitout, costing anywhere between \$250,000 and \$350,000, and stocking their shop with between \$200,000 to \$500,000 worth of stock. Bank guarantees have the effect of reducing the amount of working capital available to tenants in addition to costing between 2% and 4% per annum in bank fees.

Providing an expensive bank guarantee becomes just another impost which works against the development of new business. The other issue our association has with bank guarantees is that our members are being asked to guarantee the very highest levels of rent paid in a centre. They are levels of rents which no other retailer could afford to pay and if a jeweller is unable to pay the rent it forfeits the lease which will result in the bank guarantee being called up. There is no chance of the landlord paying back any of the bank guarantee as it will all be consumed in the



landlord's futile attempt to have another retailer pay the same level of rent as was paid by the failed jeweller.

Bank guarantees should be limited by legislation to equal a maximum of one month's gross rent. This step alone would free up billions of dollars of capital for small business across Australia, resulting in a significant boost to economic activity and GDP. One of the main challenges confronting small business is access to sufficient capital. Having such large amounts tied up in term deposits, bank accounts, and reduced borrowing capacity in order to support a three month (and longer) rental bank guarantee is an unreasonable impost, and detrimental to the Australian economy.

A Need for a National Lease Register

If information contained in lease documents was as easy to understand as information provided by companies such as RP Data on residential sales, it would be useful.

However, leases are complex documents often running to 100 pages of legal jargon with difficult to understand schedules, no reference to tenancy area, rates per square metre, quality or shape of shop location and whether there are incentives provided to secure the deal.

In addition to providing an overview of each lease which covers all of these aspects and the ability to search leases based on location, use, commencing date, lease term, shop size and quality of location.

Full Disclosure of Incentives

We have many examples within our association of jewellers who have negotiated new leases including substantial incentives by way of rent free periods, reduced rentals or fitout contributions to enable leases to



be recorded with a much higher “face rent” than the level of rent actually paid.

Our members are sworn to secrecy and are required to sign confidentiality agreements by landlords which, if breached by them, would enable the landlord to claw back the benefit given.

Even when our members talk to each other and discuss their recent dealings with landlords, they are unable to discuss the reality of their situation and disclose the benefits they have received to commit to the “face rents”. The net result of this deception is for other retailers to be persuaded to pay higher levels of rent than is truly indicated by the market. In addition, it could be argued that this practice results in artificial inflation of the gross rent of a shopping centre, with the potential to mislead investors and financiers. Legislation should be implemented to require the mandatory inclusion of incentives in the lease document which, even if not registered, are deemed to be a publicly available document which may be disclosed to anyone at the option of the lessee or lessor without seeking the approval of the other.

Another option would be for the front page of each lease document to show a single net annual lease cost (ie Net Annual Lease Value or “NALV”). The NALV would comprise the total rent payable under the lease, less all incentives and landlord contributions, divided by the lease term. This system would allow easy comparison of market values between leases.

Provision of Sale Results

It is clearly obvious from information provided by our members that the jewellers who disclose their sales to landlords end up paying higher rent than those who do not disclose their sales. Landlords take advantage of the high level performance of some jewellers to greatly increase the amount of rent they must pay to retain their shops. All too often it seems the landlord lets slip to competing jewellers the level of sales which can be generated from jewellery shops in the centre which means more jewellers are attracted to it or, in a worst case scenario, a competing



jeweller will offer to pay a much higher level of rent and the sitting jeweller with the high performing business is forced to either match the offer or vacate the tenancy.

Our members acknowledge the requirement for landlords to gauge the performance of their centres but this can be provided without retailers giving absolute sales data. Variations in sales movement should be all a landlord requires to know whether or not the centre is performing well.

The provision of monthly sales figures dates back to the 1960s and 1970s when the vast majority of shopping centre rentals were based on a percentage of sales. During the 1980s and 1990s the increases in base rentals in shopping centre outstripped sales growth to such an extent that today, almost no retail shops pay percentage rent. The average rentals for jewellery stores averaged 5% of sales in the 1970s, 10% in the 1980s and 15% in the 1990s. current jewellery store rentals average 19% of sales with many paying 20% or more.

Contractual Obligations Relating to Store Fitouts and Refits

Jewellery shop fitouts are among the most expensive of any shop due to the high quality of jewellery display cabinets, the intensity of lighting required, extensive signage and high levels of security. A jewellery shop fitout will typically fall within the range of \$250,000 to \$350,000 for a 60 square metre to 85 square metre shop. Jewellery shop fitouts are designed to last at least 10 years before a major refurbishment is required and up to 20 years before a complete refit is necessary.

This does not prevent landlords from issuing a list of upgrades required at the end of the lease if the jeweller wishes to renew their lease. There is often no logic behind their request for variations to the fitout and more often than not results from a change in personnel within the design department of the shopping centre who has been "enlightened" as to the latest trends in shopping centre design.



There is no recourse to an independent expert to determine whether or not the request for upgrade, change or complete refit is justified. This would be a welcome addition to retail and commercial lease legislation.

Any Related Matters

Landlords at present are immune from the consequences of their actions regardless of the extent to which they impact on the commercial viability of their retail tenants businesses. This is unfair, unreasonable and unjust. If, as a result of landlords action or inaction, their retail tenants business suffers there should be an instant, automatic and indisputable legislated process which sets the amount of compensation to be paid by the landlord to the tenant. This would enable landlords to measure the likely cost to them of whatever action or inaction they are about to embark on (refurbishment, expansion, redevelopment, introducing competitors) to ensure the full cost to the landlord is known before they make the decision to embark on that particular course of action.

At present there is no such legislation and it seems that if a landlord is simply doing what landlords do, there is no penalty to be paid by them.

Further Comments

We will be pleased to answer any questions you may have concerning any of the matters raised in this submission either by personal representation or in writing.

Yours sincerely

Toby Bensimon

On behalf of the Jewellers Association of Australia