2 Retail tenancy

> ... it is war out there between the retailers and the owners and managers.[1]

Introduction

Overview of the evidence

2.1 The idea there is a 'war' going on in shopping centres around Australia, between retail tenants and property owners and managers, conveys accurately the tenor of evidence given to the Fair Trading inquiry on retail tenancy issues.

2.2 Retail tenants who gave evidence to the inquiry consider they have lost most of the battles to date. A significant proportion of the written and oral evidence from retail tenants was required to be received *in camera* because of fears of victimisation by landlords and property managers. Indeed, the examples of combative behaviour by property managers documented both in confidential evidence and on the public record suggest fears of victimisation are well founded.

2.3 Retail tenancy accounted for the vast bulk of submissions made to the inquiry and more than half the evidence given at public hearings. The urgency of the retail tenancy situation was conveyed in the first of numerous submissions from the United Retailers Association, a Victorian association representing small retail tenants,[2] informing the Committee:

> *The situation ... is appalling, many of our members just walking and losing everything. ... The small business person has had **enough** and we will band together to have this oppressive conduct addressed.*[3]

1 Yvonne Valentin, Commercial Manager, Laubman and Pank Optometrists (WA). *Transcript of evidence*, p. 442.

2 Ms Lisa Michael, President of the United Retailers Association, gave evidence that the association was 'run by small businesses for small businesses'. The association had representatives in all major shopping centres in Melbourne and membership of the association was increasing. *Transcript of evidence*, p. 749.

3 United Retailers Association Incorporated, *Submission No. 111*.

2.4 Indeed, this statement was prophetic. Towards the end of the Fair Trading inquiry, the United Retailers Association announced plans to 'go national'[4] and Independent Retailers of Australia was set up under the umbrella of the Council of Small Business Organisations of Australia Ltd (COSBOA) to represent small specialty retailers at the national level. These moves reflected concern that the traditional retail associations - which include in their membership the major retail chains such as Coles Myer and Woolworths - have not adequately addressed the dilemmas confronting specialty retail tenants who have little or no clout in lease negotiations.

2.5 The Fair Trading inquiry, in line with its terms of reference, has specifically dealt with the plight of small specialty retailers.

2.6 The major business conduct issues raised by small retail tenants in the Fair Trading inquiry concern:

- lack of security of tenure, and attendant problems - particularly the inability to sell businesses close to the expiry of a lease term and the loss of goodwill;
- the calculation of rent and the practice of reviewing rent to 'market value' during the term of a lease;
- the calculation of variable outgoings and whether or not it is appropriate for tenants to be paying the salaries and expenses of shopping centre management;
- lack of disclosure or misleading information given to lessees during lease negotiations;
- changes in tenancy mix during a lease term; and
- lessors' exercise of their considerable discretion to redevelop shopping centres and compulsorily relocate tenants, causing damage to small retail businesses.

2.7 The Committee examines each of these issues in turn. A brief outline of retail leasing practices and issues - explaining industry jargon - appears in Box 2.1 overleaf.

2.8 At the outset, the Committee sees a need to set these business conduct issues in context with a brief discussion of the broad trends in retailing that have exacerbated the problems of retail tenants. Also at the outset, before making any recommendations about specific strategies to address retail tenancy problems, the Committee outlines the existing protection for retail tenants under State and Territory retail tenancy legislation, and identifies the 'gaps' in protection.

4 Lisa Michael, United Retailers Association, *Transcript of evidence*, p. 749.

Trends in retail tenancy environment

2.9 The Property Council of Australia and some of its members suggested some retail tenants complaining to the Committee about harsh treatment may, in fact, simply have been victims of circumstances and their own lack of business acumen. For example, Mr Ian Newton, General Manager, Leasing Division, Westfield, gave evidence that:

> *... we believe it is necessary to understand why retailers are in trouble. This may have occurred from a series of factors, some personal, some financial. Common personal facts are the split-up of a husband and wife partnership, alcohol, poor health et cetera. Financial problems may occur from paying too much for the business; from paying too high franchise fees, which means they are highly leveraged; or from a downturn in trading, with the consequence that the business expenses, including original agreed rent, make the business uneconomical.*[5]

2.10 No doubt this is true to some extent. However, it does not account for all the evidence to the Fair Trading inquiry, much of which came from merchants who had been trading successfully for many years before suffering serious commercial damage at the hands of property managers.

2.11 That there are problems inherent in the disparity in bargaining power between shopping centre landlords and small retail tenants has long been recognised. This is why there is already retail tenancy legislation in place in Australian States and Territories.

2.12 The Committee has been left in no doubt the relationship between property owners/managers and merchants is deteriorating. Ms Soula George, representing the Micro Business Consultative Group, told the Committee:

> *I have been in small business, mainly in the retailing of food, which is the fastest growing sector in the industry, for approximately 20 years. Seventeen of these years have been in a major regional shopping centre. Consequently, I have witnessed first-hand the changes within the industry. I have also seen the deterioration of business relations between landlords, managers and their tenants to such an extent that the malpractice has led to our industry being in crisis.*[6]

5 Ian Newton, Westfield, *Transcript of evidence*, p. 818.
6 Soula George, Micro Business Consultative Group, *Transcript of evidence*, p. 299.

Box 2.1: Glossary of terms and overview of key issues

RETAIL TENANCY - TERMS AND ISSUES

Categories of shopping centres

In Australia, the major categories of retail floorspace are:

- Central Business District (CBD) shopping space in city centres;
- **regional shopping centres** or department store centres;
- **sub-regional shopping centres**, or discount department store centres;
- supermarket shopping centres; and
- traditional strip shopping centres in a town or suburb.

Many retail tenancy complaints to the Fair Trading inquiry concerned leasing practices in regional shopping centres. Regional centres accounted for 21.9% of retail floorspace and 28.4% of retail turnover in Australia in 1993-94. Specialty stores in regional shopping centres generate more sales per square metre than those in other locations, but their occupancy costs - as a percentage of turnover - are much higher.

Property owners and managers

The regional shopping centres in Australia are owned by the major superannuation and investment trusts, but developed and managed by **property managers** such as Westfield, Lend Lease and AMP. Throughout this report, 'Westfield' refers to **Westfield Shopping Centre Management Co. Ltd**, a subsidiary of Westfield Holdings Ltd with responsibility for managing the retail property portfolio; 'Lend Lease' refers to **Lend Lease Property Management (Australia) Pty Limited** which manages the retail property holdings of unit trusts such as General Property Trust; and 'AMP' refers to **AMP Shopping Centres Pty Ltd**, a wholly owned subsidiary and the property management arm of the Australian Mutual Provident Society. Together, these three property managers are responsible for most of the regional shopping centres in Australia.

Although the property managers operate the shopping centres on behalf of the owners, their salaries and expenses are paid by the retail tenants (also known as **merchants**).

Anchor tenants and specialty tenants

When a new shopping centre is developed, it is important to secure **anchor tenants**, such as Coles Myer (Grace Bros, Target, Coles Supermarkets etc), David Jones or Woolworths/Big W, since these major retailers will attract customers to the centre. Surveys have shown up to 80% of **foot traffic** in a shopping centre is made up of customers who have come to the centre to shop at a department store or discount department store. Anchor tenants will typically occupy about 75% of the available retail space in a shopping centre, known as the **gross lettable area (GLA)**, but pay as little as 20% to 25% of the total rents collected in the centre, owing in part to the lower margins in supermarkets and lower turnover per square metre in large department stores. As an added incentive, anchor tenants may also be offered **rental holidays** - up to five years occupation rent-free. Anchor tenants are said to have considerable influence in determining the tenancy mix of shopping centres.

The remaining 25% of the gross lettable area is leased to **specialty merchants**, who, collectively, will account for up to 75% or 80% of the rental income for the centre.

Retail leases for specialty tenants

The terms and conditions in leases for small retail tenants (generally defined in terms of premises less than 1000 square metres) largely reflect the requirements of retail tenancy legislation in States and Territories. The maximum lease period that can be negotiated by most small retailers is five years. This compares to leases of 25 years for anchor tenants.

When the lease is negotiated, the most important consideration is **occupancy costs**, which have a number of components:

- **base rent**;
- **variable outgoings** (charged to each tenant on the basis of the proportion of gross lettable area occupied, to recover the costs of running the shopping centre, including management, electricity and water rates, insurance, maintenance of equipment and so on);
- **promotions levy** (charged to cover advertising of the centre); and
- (possibly) **turnover rent**, based on a percentage of sales revenue.

For anchor tenants, the most significant component of rent is turnover rent - providing an automatic mechanism for rent to fall when there is a downturn in retail sales.

By contrast, the principal component of rent for smaller retailers is base rent and the lease will usually provide for annual indexation of base rent (usually to the Consumer Price Index) as well as for **market rent review** midway through the lease. Rent reviews to 'market value' estimate the level of rent expected to be paid if the shop were vacant and let to a new tenant, having regard to the rents paid by tenants in similar premises. There is a high level of secrecy attached to rental negotiations and tenants do not have access to the **Tenancy Schedules** for a shopping centre which disclose the rents paid by other tenants. Property managers, on the other hand, generally have access to the tenant's turnover figures pursuant to a requirement in most leases, so they can assess how much tenants can afford to pay. Market rent review not uncommonly results in increases in base rent of 30% to 50%.

Merchants are responsible for the **fitout** of their shops, which will include shopfront fittings (windows, signs), floor coverings, light fittings, display units and so on. The fitout for fresh food outlets will tend to be higher because of the need to install electrical equipment such as refrigeration and ovens. Basic fitout of a small specialty shop will cost in the order of $100 000 to $150 000 and small businesses typically borrow this amount, using the family home as security.

Lessors' discretion

Retail leases reserve to the property owners and managers considerable discretion to change the trading environment of the merchant during the term of the lease. For example, managers can change the **tenancy mix** (or merchandising mix) of the centre - perhaps introducing new competitors into a particular line of trading - without consulting **sitting tenants**.

During **redevelopment,** extensions and renovations of a Centre, it is common practice for the managers to require that small retail tenants **relocate**, often to a less desirable location. It has been suggested retail leases could more appropriately be termed 'trading licence agreements' since tenants do not have freehold tenure over the shop premises in respect of which the lease is negotiated.

Sources: ***Submissions Nos. 141, 175; Exhibits Nos. 70, 71, 179, 188, 222, 223 ,233; and Transcript of evidence, p. 621 (Professor Alan Millington) and p.720 (Dr Clyde Croft).***

2.13 The position of small retail tenants has been affected over the last decade by the following trends in retailing:

- the increasing concentration of the retail sector and, in particular, the move of the major retail conglomerates into areas traditionally the preserve of specialty retailers;
- the deregulation of trading hours around Australia, increasing the 'head on' competition between smaller retailers and the major retail chains;
- weak growth and periodic decline in retail sales, resulting from a downturn in general economic activity and changing patterns of income distribution and expenditure that have seen household disposable income directed away from retail goods to recreation and leisure; [7]
- changing patterns of retailing, including the popularity of warehouse retailing, open air markets, catalogue and electronic retailing;
- the expansion of retail shopping space around Australia, resulting in more and more retailers competing for the shrinking shopping centre dollar; and, in particular
- the focus on regional and sub-regional shopping centre developments, which create regional 'monopolies' in shopping centre floorspace. [8]

2.14 Mr Graeme Maher, Corporate Merchant Relations Manager for Westfield, gave evidence that the retail market had changed more dramatically in the last two to three years than at any other time in his 34 years in retailing.[9]

2.15 It was suggested to the Fair Trading inquiry that trends in retailing have put pressure on the value of retail property also, and that property owners and managers have sought to offset any deterioration in retail property values by demanding higher and ever increasing rentals from small specialty tenants. This matter is examined in detail later in the context of rent issues.

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7 The Australian Retailers Association submitted:

> *Issues related to retail tenancy, particularly in integrated shopping centres, have been of major concern to retail tenants for a number of years. However, problems were exacerbated following the recession in Australia in the early 1990's. While growth in retail sales fell during this period, longer term commercial leases with '80's boom escalation clauses resulted in occupancy costs rising at these higher rates. This resulted in some fundamental shifts in the basic relationships between turnover figures for stores and occupancy costs* (*Submission No. 44)*

8 Access Economics reported that shopfront retail floorspace (average of the five mainland capital cities) had increased by 37.4% in the period from 1979-80 to 1993-94, but that real retail turnover per square metre had declined by roughly 6.5% over the same period, indicating that the supply of retail shopping space was being used less and less intensively (*Exhibit No 70).*

9 Graeme Maher, Westfield, *Transcript of evidence,* p. 824.

2.16 Professor Alan Millington has pointed out the retail property market is at a turning point. If property owners and managers do not work together in partnership, they run the risk of stimulating the pace of change in retailing away from shopping centres to rival methods of selling.[10] Merchants with a sound track record will be forced out of business, never to return, and customers will be 'put off' by rapid changeover of merchants and empty shops between tenancies.[11] Professor Millington warned:

> *Above all, there is a need for retail property owners to accept that the success of their investments, and their shopping centres in particular, is ultimately completely dependent upon the success of tenants trading from them. Without successful retail tenants there will not be successful shopping centres. To have successful retail tenants owners must allow and assist them to prosper by working in partnership with them, rather than seeking to punish them for their success by ... persistent demands for ever higher rents irrespective of the ability of retailers to pay such rents.*[12]

2.17 It is the firm view of the Committee that the problems in the retail tenancy area will not be resolved until the escalating tension on retail tenancy issues between property managers and tenants is replaced by a 'partnership approach'. As one witness put it:

> *I ... believe that it would be preferable if retailers and management could form some sort of partnership. At the moment it is a real them and us situation. It would be much better if we could both try to work towards a win-win situation. At the moment it is very one-sided. The property owners and managers are in it for themselves with little regard for the retailer.*[13]

2.18 The Committee was encouraged to see, towards the end of the Fair Trading inquiry, a recognition of the need for property owners and managers to work together with their merchants to resolve problems in the industry.

2.19 In particular, the Committee was impressed by the willingness of the Property Council of Australia to concede there are serious problems in relation to security of tenure for retail tenants, market rent reviews and certain other matters.[14]

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10 Professor Alan Millington, *Submission No. 162.*
11 Professor Alan Millington, *Exhibit No. 179.*
12 Professor Alan Millington, *Exhibit No. 179.*
13 Yvonne Valentin, Laubman and Pank Optometrists (WA), *Transcript of evidence*, p. 439.
14 Alan Briggs, Property Council of Australia, *Transcript of evidence*, pp. 776-77.

2.20 The Committee acknowledges initiatives taken by property managers to improve their relationships with merchants.[15]

Existing legislative protection for retail tenants

2.21 The terms of reference for the Fair Trading inquiry require the Committee to take into account existing State and Commonwealth legislative protection, in considering whether or not there is a need for further Government action to address the business conduct issues affecting small business.

2.22 An outline of the existing protection available to retail tenants under State and Territory retail tenancy legislation and codes is at Appendix VI.

State and Territory retail tenancy legislation

2.23 Basically, State and Territory retail tenancy legislation covers the following areas:

- alternative dispute resolution;
- mandatory disclosure requirements prior to signing of lease;
- minimum term of lease (five years in most States and the ACT);
- outlawing of 'key money' and payments to lessors for goodwill;
- procedural requirements for rent reviews;
- definition of expenses allowed to be charged to tenants as 'outgoings' and requirement for audited statement of outgoings to be provided to tenants;
- compensation to tenants for disturbance during shopping centre redevelopments and/or in case of compulsory relocation;
- right of lessor to refuse approval for assignment of a retail lease;
- notice to be given of renewal or termination of a lease; and
- right of tenants to form traders associations in shopping centres.

Gaps in State and Territory retail tenancy legislation

2.24 Although it is arguable retail tenancy legislation is better in some States than in others, there are certain weaknesses in retail tenancy legislation generally. [16]

2.25 The Australian Retailers Association submitted State retail tenancy legislation falls short in one particular area:

15 These initiatives include: education on retail leasing (the property industry generally), consultation with tenants over merchandising mix (Lend Lease), empowerment of merchants' associations (AMP) and the appointment of a special adviser on merchant relations (Westfield).

16 The Committee received the most retail tenancy submissions from Victoria and Western Australia, and it was submitted that the retail tenancy legislation in these States was particularly lacking.

> *This is the so-called 'sitting tenant' issue ie. the substantial imbalance of power that exists between landlord and tenant at the expiration of an existing lease.*
>
> *This can apply by way of a substantial increase in rental in return for the right to stay in a particular site, given that the cost of relocating (or, in most cases, a lack of alternative site to relocate to) is considerable.*
>
> *Alternatively, a landlord has an unfettered right not to renew a lease, thus effectively ending that particular store's business. This is bad enough for a chain store business, but it is devastating to a single store business. It effectively ends the business without any compensation or return through goodwill.*[17]

2.26 The Property Council of Australia acknowledged the 'sitting tenant' issue requires attention.[18]

2.27 Based on the evidence presented to the Fair Trading inquiry, the other 'gaps' in retail tenancy legislation in Australia appear to be in relation to the following areas:

- rent review provisions in retail tenancy legislation provide ample scope for hefty and unpredictable rent increases affecting the viability of retail tenants;
- retail tenancy legislation does not address the information asymmetry in the lessor/lessee relationship:
  - ⇒ tenants are in a weak bargaining position because they have very limited market information - due to secrecy clauses in relation to rentals paid by other tenants, but
  - ⇒ property managers have a 'window' into the tenant's profitability because merchants are required to provide turnover figures;
- retail tenancy legislation does not give tenants any control over outgoings and the promotional budget - tenants are simply entitled to an audited statement;
- there is not a standard form 'plain English' retail lease, resulting in the use of complex contracts with 'small print' tenants do not understand;
- retail tenancy legislation does not cover the important issue of tenancy mix in shopping centres, beyond a requirement that the existing tenancy mix be disclosed in lease negotiations;
- retail tenancy legislation does not give tenants adequate protection in relation to redevelopments; and
- the requirements of retail tenancy legislation in relation to relocation of tenants are not particularly stringent and afford landlords considerable potential to damage a tenant's business.

17 Australian Retailers Association, *Submission No. 44.*

18 Geoff Deakin, Property Council of Australia, *Transcript of evidence*, p. 776.

2.28 Not surprisingly, most of the submissions to the Fair Trading inquiry from retail tenants concerned one or other of the above issues.

Uniform retail tenancy legislation

2.29 Retail tenancy legislation has traditionally been a State matter. However, there is a groundswell of support for harmonised retail tenancy legislation around Australia. The Micro Business Consultative Group argued:

> *You might well say that retail shop lease issues are governed by state legislation. I would bring to your attention that the crisis in our industry is not centres in just one state but is a nation-wide crisis. I believe that, because it affects small businesses and microbusinesses Australia-wide, because it affects the unemployed Australia-wide, it should be an issue taken up by the federal government.*[19]

2.30 That a Committee of the Commonwealth Parliament has been given a reference to examine and report on retail tenancy is a recognition of the national significance of the issue.

2.31 Many of the major stakeholders in the retail tenancy area - property owners, property managers, retail chains, franchise chains - operate on a national basis and would benefit from consistency in legislative provisions.

2.32 Not surprisingly, the Property Council of Australia strongly supports harmonised retail tenancy legislation around Australia. Mr Alan Briggs, Chairman of the Australian Council of Shopping Centres in the Property Council of Australia, said:

> *We believe firmly that harmonised best practice legislation across the country would best serve the needs of all parties. At the moment we have seven different laws governing all of us in seven different states, which is not good either for the landlord or for the merchant.*[20]

> *Inconsistencies in the retail lease legislation in each state and territory are an impediment to good business practice for retailers and retail property. The Property Council strongly advocates harmonised lease legislation.*[21]

19 Soula George, Micro Business Consultative Group, *Transcript of evidence*, p. 301.
20 Alan Briggs, Property Council of Australia, *Transcript of evidence*, p. 346.
21 Alan Briggs, Property Council of Australia, *Transcript of evidence*, p. 778.

2.33 There are high administrative costs to property managers to ensure lease documentation complies with the differing requirements of State and Territory retail tenancy legislation. AMP advised the Committee that each time a change in retail legislation occurs in any one state, it results in costs to AMP, inclusive of external legal advice of around $50 000. The (additional) ongoing costs to AMP of administering lease documentation to comply with differing retail tenancy legislation around Australia are in the order of $35 000 per year. In this context, AMP supported uniform retail tenancy legislation.[22]

2.34 Towards the end of the Fair Trading inquiry, the Property Council of Australia advised the Committee of the creation of the Retail Industry Liaison Forum, a joint initiative of the Property Council of Australia and the Australian Retailers Association. The Forum will take responsibility for developing harmonised retail tenancy legislation. In particular, the Forum intended to tackle the 'sitting tenant' issue, identified in the Fair Trading inquiry as requiring special attention.[23] The Committee recognises the need for uniform retail tenancy legislation around Australia.

2.35 Recommendation 2.1

The Committee recommends the drafting of a Uniform Retail Tenancy Code, by the Australian Competition and Consumer Commission in consultation with industry participants including:

(a) the Property Council of Australia;

(b) the Australian Retailers Association;

(c) the Australian Chamber of Commerce and Industry;

(d) the Council of Small Business Organisations of Australia and its constituent retail bodies, including Independent Retailers of Australia;

(e) other retail associations, including the United Retailers Association Inc;

(f) the Australian Institute of Valuers and Land Economists; and

(g) the Australian Institute of Business Brokers.

The Committee recommends that the Uniform Retail Tenancy Code be submitted to the Council of Australian Governments with a view to the adoption of uniform retail tenancy legislation around Australia.

22 AMP, *Submission No. 189.1.*

23 Geoff Deakin, Property Council of Australia, *Transcript of evidence,* p. 776; Property Council of Australia, *Submission No. 119.3.*

Remedies for retail tenants in the Trade Practices Act

2.36 The Committee took evidence to the effect that section 51AA of the Trade Practices Act (Unconscionable conduct in commercial transactions) provided little or no protection for retail tenants.[24] Indeed, the Australian Competition and Consumer Commission (ACCC) informed the Committee that, notwithstanding it had made enforcement of section 51AA of the Trade Practices Act a priority, it had not been able to build a case that would stand up in Court in relation to complaints from retail tenants in shopping centres.[25] The Committee discusses this issue in detail in Chapter 6 of this report. The Committee is recommending a new section 51AA, making 'unfair' business conduct unlawful.[26] The Committee is also recommending that industry codes of conduct approved by the ACCC be taken into account by the courts in determining whether or not conduct is 'unfair'.[27]

2.37 The Committee considers the Uniform Retail Tenancy Code should be underpinned in the Trade Practices Act along with other industry codes of conduct.

2.38 The effect of underpinning the Uniform Retail Tenancy Code in the Trade Practices Act would be that, in relation to actions under Part IVA of the Act (Unfair conduct):

- the courts would be directed to take account of the provisions of the Code in determining the fairness of business conduct in the retail tenancy area; and
- the ACCC would be able to take representative actions on behalf of retail tenants against property owners or managers operating in breach of Code provisions.

2.39 Underpinning the Code would allow for the ACCC to take effective action against any widespread and particularly pernicious practices in the retail tenancy environment.

2.40 Recommendation 2.2

The Committee recommends that the Minister request the Australian Competition and Consumer Commission to approve the Uniform Retail Tenancy Code for underpinning in the *Trade Practices Act 1974,* thus providing for the courts to take into account provisions of the Uniform Retail Tenancy Code in determining whether or not business conduct in the area of retail tenancy has been 'unfair' and thus unlawful.

24 This point was argued strongly by the United Retailers Association in *Submission No. 111.2* and related *Exhibits Nos. 205-07.*

25 ACCC, *Submission No. 62,* pp. 7-10.

26 Recommendation 6.1.

27 Recommendation 6.2.

Dispute resolution mechanisms

2.41 The Committee does not see such underpinning as a substitute for quick, low cost resolution of individual disputes through State and Territory retail tenancy dispute resolution processes.

2.42 Mr Allan Asher, Deputy Chairman of the ACCC, pointed out that litigation (under the Trade Practices Act) would not assist small businesses to trade successfully:

> *It only takes a moment's thought to see that for any small business, if it has some continued dealing with a large business ... the idea of litigation is just not relevant. That is only after a business relationship has ended and you are trying to sweep up the pieces. It does not help, in my view, to focus all the attention on [legal provisions in the Trade Practices Act].*[28]

2.43 Indeed, an overarching concern of retail tenants in the inquiry concerned mechanisms for dealing with retail tenancy disputes outside the courts.

2.44 A detailed outline of retail tenancy dispute resolution procedures in each State and Territory is at Appendix VI.

2.45 It was submitted to the Fair Trading inquiry that retail tenancy dispute resolution procedures in some State legislatures are inadequate. The key factors determining whether or not retail tenants found dispute resolution procedures to be effective were:

- the costs involved in pursuing a dispute;
- delays inherent in dispute resolution; and
- the limits on lessors' rights to appeal to the court (since tenants incur costs to respond to any action).

2.46 Dissatisfaction amongst retail tenants with dispute resolution procedures was particularly evident in Victoria and Western Australia. It is significant that neither of these States have special shop lease tribunals.

2.47 In Victoria, retail tenancy disputes are taken to commercial arbitration. The Committee took evidence from Dr Clyde Croft, Vice-President of the Australian Centre for International Commercial Arbitration which is responsible for administering the dispute resolution procedures in the Victorian retail tenancy legislation.[29] The Committee was impressed with the evident flexibility and efficiency of the arbitration procedures, but concerned at the high costs involved for retail tenants.

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28 Allan Asher, ACCC, *Transcript of evidence,* p. 375.

29 Dr Clyde Croft, Australian Centre for International Commercial Arbitration, *Transcript of evidence,* pp. 710-24.

2.48 Dr Croft informed the Committee that arbitration or conciliation costs $200 to $250 per hour. This means conciliation of a relatively minor dispute would cost in the order of $500 to $700, whereas arbitration of a dispute with a written determination could cost $5 000.[30] The Committee heard of cases where arbitration costs were many times this amount.[31] The Committee was also informed that tenants could be required to enforce arbitration decisions in their favour through the courts (with the additional legal costs this would involve).[32] A further concern with the Victorian system was that arbitration determinations are not on the public record - retail tenants thus remain unaware of some unfair practices occurring in shopping centres and cannot assess their chances of success when contemplating action against lessors.[33]

2.49 The United Retailers Association, representing small specialty tenants in Victorian regional shopping centres, considered Victoria needed a low cost shop leases tribunal.[34]

2.50 In Western Australia (WA), the chief criticisms of retail tenancy dispute resolution procedures concerned delays and the lack of ultimacy of decisions of the Commercial Tribunal.

2.51 The Committee took evidence at the public hearing in Perth that mediation/dispute resolution procedures in the WA Commercial Tribunal were being hindered by legal delaying tactics adopted by property owners and that property owners would not accept the rulings of the Commercial Tribunal:

> *The Commercial Tribunal is a forum in which the smaller retailer can be heard and can present legitimately his feelings on the situation that exists. Many cases now exist, and I have sat through those particular proceedings, in which no sooner than the verdict is made - possibly in favour of the tenant; in more cases than not they are that way - they are immediately challenged and put into the District Court.*

30 Dr Clyde Croft, Australian Centre for International Commercial Arbitration, *Transcript of evidence*, p. 719.

31 Ms Lisa Michael, President of the United Retailers Association gave evidence that one of the Association's members had gone to arbitration and it had cost $40,000. Mr Richard Rogalsky, also representing the United Retailers Association pointed out that there could be additional hefty fees for the services of an accountant to provide preparatory documentation for an arbitration. *Transcript of evidence*, p. 731.

32 Dr Clyde Croft, Australian Centre for International Commercial Arbitration, *Transcript of evidence*, pp. 715-16.

33 The United Retailers Association was concerned about this aspect of the system. Richard Rogalsky, United Retailers Association, *Transcript of evidence*, p. 732.

34 Paul Russo, United Retailers Association, *Transcript of evidence*, p. 728.

> *Once you go into the District Court, it becomes a legal fest. It becomes a situation where lawyers can joust and be expensive in their whole approach such that the smaller retailer has no way whatsoever of being able to sustain the financial pressures that are imposed on them. The owners and the centre managers know this only too well - they are only too happy to admit it to people like me - so that this is exactly the way in which they will conduct the proceedings because they can last longer than those tenants can.*
>
> *The existing system through the Commercial Tribunal is grossly unfair to the tenants because the commercial registrar does not have the power to make a judgment that cannot be challenged. At the moment the process is treated very light-heartedly, as I know only too well. I have often heard a lawyer in the court challenge the chairman of the tribunal by saying, 'Thank you very much, your Honour. The verdict is against us, but this is only the beginning'...*[35]

2.52 Mrs Donna Clark, proprietor of Gifts R Us in Farrington Fayre Shopping Centre in Leeming, WA, told the Committee of action taken by tenants at that centre against the property manager, alleging gross overcharging in relation to variable outgoings and promotions levies.[36]

2.53 This serious matter was referred to the WA Commercial Tribunal in January 1996. When the Committee took evidence in Perth in November 1996, the Tribunal proceedings had not been finalised. The tenants eventually won their case in the Tribunal, but the matter was appealed - first to the District Court and then to the Supreme Court. At the time of writing, this matter was still unresolved and tenants in the centre continued to be billed for disputed expenses.

2.54 The Committee has serious concerns about the efficacy of the WA Commercial Tribunal to handle retail tenancy disputes. Indeed, in his 1996 report to the WA Attorney-General, the Chairman of the Tribunal stated the Tribunal was not operating satisfactorily as far as commercial tenancy disputes were concerned and that quick solutions to such disputes were not being achieved because of 'massive costly pettifogging lawyer or non-lawyer created obstruction and delaying tactics'.[37]

35 Len Rathmann, WA Council of Retail Associations, *Transcript of evidence,* p. 406.

36 Donna Clark, Gifts R Us, *Submission No. 70.*

37 R H Burton, Chairman, Commercial Tribunal of Western Australia. *Report to the Attorney-General for the year ended 30 June 1996,* p.14 (*Exhibit No. 122).*

Best practice dispute resolution

2.55 The Property Council of Australia advised the Committee that NSW and Queensland retail tenancy legislation formed 'best practice' for the industry.[38] The Committee sought detailed advice on the operation of the NSW retail tenancy dispute process (described in Box 2.2) - which is closely comparable to the Queensland and ACT shop lease tribunal processes.

Box 2.2 NSW dispute resolution process

NSW DISPUTE RESOLUTION PROCESS

1. Retail tenant contacts Registrar of Retail Tenancy Disputes to seek help in settling a dispute with a lessor. Disputes examined concern matters covered in the NSW Retail Leases Act, including lease renewals and options, terms of the lease and misrepresentations, rent and outgoings, assignment of the lease, and other matters.

2. Staff of the Retail Tenancy Disputes office (a government body) visit the shopping centre to discuss the dispute with the tenant, and with the lessor if possible. Advice is given and the dispute may be resolved at this stage.

3. If the dispute cannot be resolved informally, either party to a dispute may lodge a Dispute Resolution Application Form with the Registrar. There is a filing fee of $150. The Registrar will then arrange for mediation of the dispute, usually within one month. Parties pay the mediation fees ($250 per hour).

4. Notice of the mediation is given to both parties and both parties are invited to present their cases, documented if possible. The mediator has no jurisdiction to give directions; however, if agreement is reached in the course of mediation, then a mediation agreement is signed and is binding on both parties.

5. If the mediation fails, this is certified by the Registrar and the matter may be referred to the Commercial Tribunal. A separate fee is payable to the Registrar for access to the Tribunal. In some cases, the matter may be listed for hearing in Court.

6. The Commercial Tribunal comprises a Chairperson, two Deputy Chairpersons, and two part-time members (but can be constituted to hear cases by, for example, a Deputy Chairperson sitting alone). Parties will be called to a 'pre-hearing' to clarify the issues in dispute. Then there will be a formal hearing at which parties can be represented by legal practitioners, if they wish. The Tribunal will decide the dispute.

7. Decisions of the Commercial Tribunal are final and can only be appealed to the Courts on the grounds of a denial of natural justice or a claim that the Tribunal has exceeded its jurisdiction. Decisions of the Tribunal are public.

Source: Property Council of Australia, 'Don't sign that lease', Exhibit No.75.

38 Dale McDermid, Property Council of Australia, *Transcript of evidence*, p. 780. The NSW legislation had been based on a code of conduct negotiated between the Retail Traders Association (NSW) and the former BOMA (now the Property Council of Australia).

2.56 Mr Ken Carlsund, NSW Registrar for Retail Tenancy Disputes, informed the Committee the success rate of resolving disputes through the mediation process (that is, Steps 1-4 above) was in the range of 75% to 80%. To December 1996, 370 retail tenancy disputes had been registered, of which 213 had been settled by informal mediation and 157 by formal mediation.[39]

2.57 The Committee considers there should be low cost retail tenancy dispute resolution procedures in all jurisdictions around Australia. The Committee's brief examination of the dispute resolution procedures in place around Australia suggests the most effective schemes are those that provide for:

- initial advice and assistance on how to handle a dispute - at low cost or no cost to the tenant;
- mediation and conciliation of disputes in a timely fashion;
- specialist shop lease tribunals; and
- limited rights of appeal to the Courts.

2.58 The Committee also considers that parties to a retail tenancy dispute should not be allowed to be represented by lawyers unless the matter is ultimately appealed to the courts on a point of law. The NSW dispute resolution procedure provides for legal representation before the Commercial Tribunal. The Committee does not favour this option.

2.59 In the course of the Fair Trading inquiry, Committee members met a number of lawyers with a sincere concern for their retail clients and a passion to see the law in this area improved. Nonetheless, the evidence, especially from Western Australia, suggests that the involvement of lawyers can thwart the effectiveness of dispute resolution procedures since some legal advisers may have a vested interest in protracting a dispute.

2.60 Recommendation 2.3

The Committee recommends that the Uniform Retail Tenancy Code provide for:

(a) low cost mediation and conciliation of retail tenancy disputes; and

(b) retail lease tribunals around Australia with jurisdiction to make binding decisions on retail tenancy disputes and affording limited rights of appeal to the courts.

The Committee further recommends that the Code explicitly exclude the option of legal representation for parties to a retail tenancy dispute, short of any eventual appeal to the courts.

39 Ken Carlsund, NSW Registrar of Retail Tenancy Disputes, *Transcript of evidence,* p. 858.

Specific business conduct issues

Committee's approach

2.61 The Committee examined copies of retail leases provided by Westfield, Lend Lease and AMP, and believes it is fair to say the lease terms in those documents reflect minimal compliance with the provisions of retail tenancy legislation.[40]

2.62 Certainly, there is concern amongst retail tenants that property managers have an attitude of minimal compliance and the Committee notes evidence that:

- property managers are adept at exploiting loopholes in retail tenancy legislation - for example, by putting tenants on temporary leases that are not subject to the provisions of retail tenancy legislation;[41]
- unfair lease provisions outlawed in some States are still enforced on tenants in other States;[42]
- property managers have put pressure on tenants to forego their rights under retail tenancy legislation;[43] and
- retail tenants often do not pursue disputes for fear of retaliation by property managers.[44]

2.63 Mr John Brownsea, representing the Small Retailers' Association of South Australia (SA) - where retail tenancy legislation has recently been reviewed - gave evidence he had heard a group of landlords talking to a member of the State Parliament in the following terms:

> *They said straight out, 'You can do what you like. We will find a way around it.' There is the warning. They have no respect for the law.*[45]

40 The Committee requested the property managers to provide copies of leases used at regional shopping centres named in evidence to the inquiry, namely:
- ⇒ AMP, Garden City Booragoon, WA, *Exhibit No. 191;*
- ⇒ Lend Lease, Charlestown Square, NSW, *Exhibit No. 209;* and
- ⇒ Westfield, Marion Shoppingtown, SA, *Exhibit No. 184.*

41 Max Baldock, Small Retailers Association of South Australia Inc, *Transcript of evidence,* p. 482 and Sandra Lazari, *Submission No. 18.*

42 Mrs Josephine Grieg, Chicken Feast gave evidence that 'ratchet' clauses in leases (providing that rent cannot decrease, regardless of the rental formula used) - outlawed in most States - are still imposed on retail tenants in Western Australia (*Transcript of evidence,* p. 421).

43 Professor Alan Millington gave evidence that, within weeks of the *Retail Leases Act 1994* (NSW) coming into effect, tenants had been told that they could have a lease as long as they were prepared to sign away their rights to the minimum five year term. The Retail Leases Act provides that the five year term can be waived if tenants sign a form to the effect that the matter has been discussed with a lawyer (*Transcript of evidence,* p. 627).

44 Pieter and Robyn Willems, *Submission No. 32* and David Roskell, *Submission No. 141.*

45 John Brownsea, Small Retailers Association of SA, *Transcript of evidence,* p. 498.

2.64 Since retail tenancy legislation effectively determines retail leasing practice, it is essential such legislation be comprehensive, fair and enforceable. The Committee considers retail tenancy legislation should be drafted to minimise the discretion allowed to property owners to alter the trading environment of the merchant during the term of the lease.

2.65 The Committee has not attempted to draft a uniform retail tenancy code. The Committee has recommended that the ACCC conduct a consultative process to this end.[46] The Australian Retailers Association and the Property Council of Australia are presently engaged on this task and the Committee applauds their initiative. A uniform tenancy code will no doubt draw together all the proven effective elements of existing State and Territory legislation. The Committee's concern in this report is to give guidance about 'plugging the gaps' in retail tenancy legislation to address the serious business conduct issues brought to light in the Fair Trading inquiry.

2.66 The Australian Retailers Association provided the Committee with a Proposed Model for National Legislation, drafted in February 1997.[47] This model sets out general matters to be covered in retail tenancy legislation, but also sets out additional requirements for shopping centres. The Committee sees considerable merit in this approach.

2.67 The bulk of evidence to the Fair Trading inquiry from retail tenants concerned the business conduct of the major property managers in relation to regional shopping centres. It follows that some of the Committee's recommendations - for example on relocation, redevelopments and changes in tenancy mix - have particular relevance for major shopping complexes and perhaps less relevance to strip shopping centres. In the process of consultation with stakeholders proposed in Recommendation 2.1 above, the Committee considers the needs of different classes of retail tenants should be taken into account.

Security of tenure for retail tenants

Issues raised

2.68 Retail tenants in Australia have no security of tenure beyond the term of their lease. Most small tenants are only able to negotiate a five year lease. Retail tenancy legislation in most, but not all, jurisdictions provides only that leases be offered for minimum five year terms and that adequate notice be given of termination or renewal of the lease. The Property Council of Australia provided the Committee with a summary of statutory provisions applying to lease terms in different jurisdictions and this has been reproduced as Table VI.1 in Appendix VI.

46 Recommendation 2.1.
47 *Exhibit No. 260.*

2.69 The practical effect of tenants having no rights beyond the term of the lease is illustrated vividly by the experience of Glasshouse, a retail tenant in the Garden City Shopping Centre in Booragoon, Western Australia. Glasshouse gave evidence to the Committee that a dispute-free tenancy of 13 years duration had been terminated at the absolute discretion of the property manager:

> *On March 12th 1996 I received Notice from AMP to terminate my business, I could not believe this had happened. ... I was told there was no reason as to why my lease would not be renewed except I was to make way for new tenants coming in from the Eastern States. ... I proposed a 20% rent increase and new fit out and change of merchandise to suit their ideas. They admitted that there would be a void in giftware with Glasshouse going and finally offered me another shop in the centre, but would not allow me to stay in Shop 73. I could not accept their offer to move to the other shop because it was just not a good position ... I was evicted on May 31st 1996 and sadly this shop is still vacant today, 30th August 1996.*[48]

2.70 The concern about security of tenure goes far beyond retailers just wanting to stay in their shops. The inability of most specialty retailers to obtain a longer lease term than five years results in the following significant commercial difficulties:

- some retail tenants cannot recoup their investment in a retail business - including fitout costs of, say, $100 000[49] - over the term of an initial lease;[50]
- 'sitting' tenants are vulnerable in lease renegotiation, especially in relation to the rent they may be prepared to pay to stay in business;[51] and
- businesses can only be sold for the value of the anticipated cashflow over the remaining term of the lease, rather than as a going concern with 'goodwill'.

48 Bruce Paull, Glasshouse, *Submission No. 103.*

49 Laubman and Pank Optometrists (WA), *Submission No. 77.*

50 The Australian Newsagents' Federation Ltd submitted that its members were typically only able to obtain retail leases for up to five years - with no right of renewal. It was submitted that this had a serious economic impact on the operation of newsagents. In particular, banks require that the term of a business loan not extend beyond the lease tenure of the business and the cost of a shop re-fit needs to be recouped over the balance of the lease term. The initial investment in a retail newsagency not unusually exceeds $300 000 (*Submission No. 92).*

51 The Small Business Development Corporation of Western Australia argued that sitting retail tenants are 'economic captives' when it comes to renewing leases because of the goodwill and investment in the business, all of which will be lost if the lease is terminated (*Submission No. 67).*

2.71 Garden City News, a tenant in the Garden City Shopping Centre in Booragoon, summed up these concerns in its submission to the Fair Trading inquiry:

> *It is about time something was done to protect the small businesses in shopping centres. We live in constant fear that if we don't toe the line our lease will not be renewed, and as a result they can move you when your lease comes up, because they know that without a lease your investment is zero. We have been in a situation where we were told by the centre manager our investment of $1.2 million is worth zero and we should have recouped it in the five years that we were trading. ... We have a very good business, but we are on a one month lease and to be told that your investment is worth "0" I find a bit rich.*[52]

2.72 The Committee notes the Property Council of Australia recognised towards the end of the Fair Trading inquiry that the present position in relation to sitting tenants required attention.[53]

Goodwill

2.73 The issue of goodwill was one of the most debated issues in the inquiry. Property managers argued that retail businesses should be sold at a price reflecting the anticipated cashflow of the business over the remaining term of the lease.[54]

2.74 Some tenants were obviously resigned to this proposition. Mrs Donna Clark, the proprietor of a gift shop in a major shopping centre in Western Australia, was asked at a public hearing if there was goodwill at the end of the lease. Mrs Clark replied:

> *No, because at the end of the lease, my managing agent might say to me, 'Look, I really don't like your face any more. We've decided not to renew your lease'. That happened to a good friend of mine ...*[55]

2.75 Unfortunately, not all the retailers who appeared before the Committee understood the implications of having no security of tenure beyond the term of the lease. AMP noted that the NSW Retail Traders Association had taken action to warn its members that goodwill does not extend beyond the term of the lease.[56]

52 H Ben-Pelech, Garden City News, *Submission No. 78.*
53 Alan Briggs, Property Council of Australia, *Transcript of evidence*, p. 777.
54 Alan Briggs, Property Council of Australia, *Transcript of evidence*, p. 786.
55 Donna Clark, Gifts R Us, *Transcript of evidence*, p. 461.
56 AMP, *Submission No. 189.*

2.76 Other witnesses insisted that small businesses were entitled to recover their financial and personal investment - even at the end of a lease - in the form of a payment for goodwill. The United Retailers Association submitted a formula for the calculation of goodwill based on the maintainable earnings of the business in question.[57] Mr Garth Griffiths, President of the Australian Institute of Business Brokers, was asked at a public hearing if there was goodwill at the end of a lease. He replied:

> *I have heard the argument that goodwill does not exist. I do not know what business brokers sell around Australia, but every day they transact goodwill. It is fair to say that goodwill in shopping centres is a thing that is diminishing at a rapid rate, but it is not diminishing outside shopping centres.*[58]

2.77 Mr Max Baldock, representing the Small Retailers Association of SA, told the Committee that AMP requires information on the sale of every business within its centres, including a breakdown of the sale price into goodwill, fixtures and stock at valuation. Mr Baldock saw this as an acknowledgment that goodwill in retail tenancies does exist and that it has a definite value.[59]

2.78 AMP relied on a definition of goodwill taken from Californian property law. AMP submitted that:

> ***Goodwill*** *consists of the benefits that accrue to a business as a result of its location, reputation for* ***dependability, skill*** *or* ***quality*** *and any other circumstances resulting in probable retention of old or acquisition of new* ***patronage****.*[60]

2.79 AMP noted that tenure (length of the lease) is the most important factor for determining dependability and that a retail business has 'zero' goodwill at the expiration of the lease.[61]

2.80 The Committee's recommendation about security of tenure will have an impact on the 'goodwill' in retail businesses. However, the Committee considers it is still important for retail associations and other groups educating merchants to ensure tenants understand there is no goodwill beyond their secure tenure.

57 United Retailers Association, *Submission No. 111.2.*
58 Garth Griffiths, Australian Institute of Business Brokers, *Transcript of evidence,* p. 668.
59 Max Baldock, Small Retailers Association of SA, *Transcript of evidence,* p. 500.
60 AMP, *Submission No. 189.*
61 AMP, *Submission No. 189.*

Options and recommendations

2.81 Independent Retailers of Australia submitted the basic principle underpinning retail tenancy laws should be that relationship between retailer and property owner is capable of subsisting on a long term basis. Longer lease terms and rights of renewal were considered to be fundamental to this partnership relationship. As one merchant stated: 'It cannot just be a cut and dried issue of, "I'm sorry. I am not renewing your lease; bye-bye" '.[62]

2.82 The Property Council of Australia, on the other hand, opposed regulation, arguing that the matter of lease terms beyond five years, including options to renew, should remain a matter for negotiation by the parties to the lease.[63]

2.83 Professor Alan Millington drew the Committee's attention to the *Landlord and Tenant Act 1954* (UK) which provides retail tenants in the United Kingdom with considerable security of tenure at the end of a lease term. This legislation provides that:

- commercial tenancies cannot be terminated except in accordance with the Act;
- tenants may apply to the Court for the renewal of a tenancy, with the grounds for landlords opposing lease renewals being strictly limited under the Act;[64]
- the Court can grant a new lease of up to 14 years duration and, in the absence of agreement between the parties, the Court can determine the terms of the lease;
- the rent applicable for such a lease would be market rent excluding any element of rental value applicable to improvements done by the tenant or to the goodwill of the tenant's business; and
- where the tenancy is terminated through no fault of the tenant, the tenant is entitled to recover 'compensation for disturbance' and also compensation for improvements.[65]

2.84 Professor Alan Millington pointed out to the Committee this legislation had been in place in the United Kingdom for many years with no perceivable adverse effects on the property development market or the property investment market.[66] However, the Property Council of Australia did not consider the UK model to be appropriate for the Australian property market, noting there were very restrictive planning and zoning requirements in the UK.[67]

62 Donna Clark, Gifts R Us, *Transcript of evidence*, p. 462.
63 Property Council of Australia, *Submission No. 119.3.*
64 Such grounds include a tenant's persistent delay in paying rent or failure to repair premises. Australian Retailers Association, *Submission No. 44.1.*
65 Professor Alan Millington, *Submission No. 162.*
66 Professor Alan Millington, *Submission No. 162.*
67 Dale McDermid, Property Council of Australia, *Transcript of evidence*, p. 787.

2.85 The Property Council of Australia also pointed out lessors and lessees have the right to contract out of the UK legislation.[68] The Australian Retailers Association noted the courts must authorise any such agreement to exclude the tenant's right to lease renewal.[69]

2.86 Other options suggested to the Committee included:

- retail tenants should be offered the first right of refusal at the end of a lease period with compensation paid when the lease is not renewed if the tenant has observed all lease conditions;[70]
- tenants whose occupancy is terminated at the end of the lease without fault on the part of the tenant should be entitled to some compensation;[71]
- the standard term of a retail lease should be ten years with lessors precluded from refusing to grant a ten year lease;[72]
- longer lease time frames should be provided to reflect the high level of capital investment small businesses have in shopping centre premises;[73] and
- retail tenants should have a statutory right to renew a lease (for a further five year term).[74]

2.87 Independent Retailers of Australia proposed an amalgam of the above options to provide a retail tenant with ongoing secure tenure. It was proposed there be a mandatory five year initial lease term, followed by a statutory five year option (exercisable at the tenant's discretion), followed by a right of first refusal at the end of year ten.[75] The Committee endorses this proposal as an eminently workable compromise between the interests of tenants and the rights of property owners.

2.88 Giving effect to such a proposal would require attention to matters such as:

- statutory exemptions to allow property managers to remove underperforming tenants;
- how rent will be determined for the initial and subsequent lease terms (since the right to a subsequent lease term is worthless without a mechanism for determining a fair rent for the subsequent term); and
- how compensation will be determined if it is necessary to relocate or terminate the tenant to allow redevelopment of the shopping centre or changes in tenancy mix.

68 Property Council of Australia, *Submission No. 119.3.*
69 Australian Retailers Association, *Submission No. 44.1.*
70 Micro Business Consultative Group, *Submission No. 74.*
71 Professor Alan Millington, *Submission No. 162.*
72 Australian Institute of Business Brokers, *Submission No. 175.1.*
73 Micro Business Consultative Group, *Submission No. 74.*
74 United Retailers Association, *Submission No. 111.2.*
75 Independent Retailers of Australia, *Submission No. 192.*

2.89 These issues would need to be settled as part of the consultative process proposed in Recommendation 2.1. The Committee considers it would be fair for rent to be reviewed to market value at the time of lease renewal for second and subsequent five year terms. This vexed issue is discussed later in the section on rent and rent reviews.

2.90 The Committee considers retail tenancy legislation should not provide for tenants to contract out of their right to a minimum five year term, but tenants should be allowed to surrender leases before the end of the five year period on pre-determined terms and conditions.

2.91 The Committee also considers there should be some provision for casual leasing. However, such a provision should not be drafted so widely as to allow scope for permanent retailers to be kept on temporary leases indefinitely. The Committee took evidence that this commonly happens during redevelopments and that some Westfield tenants had been held on temporary leases for up to eight years.[76] The Committee considers that it is not appropriate for permanent tenants to be denied lease renewal and to remain in a shopping centre on a casual basis.

2.92 The Committee recognises that there are some merchants - for example, mobile phone retailers trading in shopping malls from temporary booths - who would not wish to be bound by a five year lease. The Committee considers that casual leasing should be allowed only at the request of a lessee, and in clearly circumscribed situations. This matter could be addressed in the consultative process recommended above.[77] The Committee considers that the Uniform Retail Tenancy Code should draw a clear distinction between permanent tenants and casual tenants.

2.93 Recommendation 2.4

The Committee recommends that the Uniform Retail Tenancy Code provide:

(a) for minimum lease terms of five years;

(b) for sitting tenants to have the option of lease renewal for a further five year term;

(c) for sitting tenants to have a right of first refusal of the lease for subsequent five year periods; and

(d) for the option of casual leasing in clearly defined circumstances but only at the request of the lessee.

The Committee further recommends that parts (b), (c) and (d) of this recommendation extend to tenants under existing leases.

76 Alan Briggs, Property Council of Australia, *Transcript of evidence*, p. 786.
77 Recommendation 2.1.

2.94 The above recommendation is a recognition that merchants - as well as property owners - have an investment in shopping centres in Australia.

Lease assignment

2.95 A related concern was the restrictions imposed on the sale of retail businesses, involving the transfer of leases. Retail leases typically reserve to the lessor the right to approve (or veto) the transfer of a lease (without which a retail business cannot be sold).

2.96 The most disturbing evidence on the issue of lease assignment came from proprietors, or former proprietors, of small businesses in the Box Hill Central Shopping Centre in Victoria in relation to difficulties encountered in selling their businesses:

- the former proprietors of the Centre Mall Cafe in Box Hill Central gave evidence that centre management had rejected 8 potential buyers for their business and that the business was eventually sold at less than 40% of the original purchase price and at a loss in excess of $100 000;[78]
- Mr Toni and Mrs Clare Hofmann, who had paid $230 000 to take over an existing business, eventually lost this entire amount when the property manager refused consent for the sale of the business; the property manager is alleged to have gone to the Hofmann's proposed purchaser and signed that purchaser up for another shop in the centre;[79]
- Mrs Mary Caruana gave evidence she had secured a purchaser for her restaurant in the centre, but the purchaser had retrieved his $70 000 deposit and walked away from the deal because of the 'run around' the property managers gave him;[80] and
- the proprietor of Central BarBQ also gave evidence of difficulty in obtaining approval from centre management for the sale of the business.[81]

78 R & D Sammut Pty Ltd, *Submission No. 110.*
79 Clare and Toni Hofmann, *Transcript of evidence*, pp. 151-53.
80 Mary Caruana, *Transcript of evidence*, p. 181.
81 Frank Huber, Central BarBQ, *Submission No. 131*.

2.97 These serious cases raised two business conduct issues:

- first, whether or not the witnesses to the Fair Trading inquiry had been 'burned' in the sense that they had paid too much for their businesses in the first place, possibly because of inadequate information provided at the time of purchase;[82] and
- second, whether or not the actions of the property manager in refusing permission for assignment of the leases were fair and reasonable.

2.98 The Property Council of Australia was particularly concerned about the first of these issues and urged the Committee to recommend mandatory disclosure statements to be provided to prospective purchasers by the existing tenants, having learned from bitter experience that many of the merchants who have difficulties in shopping centres are those who have paid excessive amounts to purchase existing businesses, often on the basis of false information provided by the former tenant.[83] The Committee endorses this proposal.

2.99 The Committee was also concerned about the second issue - especially in light of allegations that property managers often 'signed up' prospective purchasers for other shops in a centre. The Committee considers it is necessary for retail tenancy legislation to balance the interests of property managers (who must have some discretion to veto the sale of shops where this would damage the image or success of the shopping centre as a whole) against the interests of tenants (who have a right to liquidate their businesses).

2.100 The Committee notes retail tenancy legislation in some jurisdictions (for example, NSW, SA and the ACT) achieves a fair balance by providing guidance on the range of circumstances in which a lessor could reasonably withhold consent for the assignment of a lease - for example, if the proposed lessee intends to change the use of the shop or has retailing skills inferior to the sitting tenant.

2.101 One further issue was raised with the Committee in relation to lease assignment. Retail leases may provide that the original lessee continues to be liable under the lease, even after it is transferred to a new operator. The WA Council of Retail Associations submitted no continuing liabilities should be placed on outgoing lessees when leases are assigned or a shop is sub-let.[84]

2.102 Mr Len Rathmann, Executive Director of the Council, told the Committee the retailers were trying desperately to remove this clause in standard leases, citing the following case:

82 In fact, the proprietors of the Central Mall Cafe informed the Committee they had not been provided with a disclosure statement, despite a specific request, and that the manager had given verbal assurance of a rent reduction within 6 months - a promise that was not kept. (R & D Sammut Pty Ltd, *Submission No. 110).*

83 Alan Briggs, Property Council of Australia, *Transcript of evidence,* p. 779.

84 WA Council of Retail Associations, *Submission No. 139.*

> *I refer to an example of a couple who, after four months in their existing lease, assigned it. It was subsequently reassigned on two other occasions and on the last occasion, three months before the five-year period of the lease, the building was suspiciously destroyed by fire. The insurance company went back through the assignees and found that the best option they had was to go back to the original lessee with something like an $180,000 claim through the Supreme Court. At this point in time, they look like winning. The original lessee knew nothing about what had transpired.*[85]

2.103 The Committee considers it is inappropriate for the original lessee to be held liable for any matters covered in the lease once the lessee ceases to be in control of the premises.

2.104 The Committee's preferred option would be for the original lease to be cancelled, and the purchaser of a retail business to be awarded a new lease by the property manager. The Property Council of Australia gave evidence that this is, in fact, common practice. The granting of a new lease does not prejudice the rights of the selling tenant, who is still able to obtain a payment for the goodwill of the remaining lease term. Mr Dale McDermid, representing the Property Council of Australia, convinced the Committee that this was the fairest option for all concerned:

> *In many cases, when a retailer comes to us and says that they have got someone that wants to run their business, we in fact encourage them to surrender their lease, and we enter into a new lease with the purchaser. This is because it is not in the purchaser's best interests - or in the vendor's - to have two years to run on a lease. In fact it is in our own best interest for our industry to protect quality businesses and to help them develop. So, if someone wants to invest substantial amounts of money in purchasing a business, we want to give them the longest tenure that we can.*
>
> *... I am saying that we are getting involved in the process to help both the vendor and the purchaser to complete a transaction which is going to have a win-win situation for all three parties.*[86]

2.105 The Committee considers the Uniform Retail Tenancy Code should encourage this practice. Since lessors will retain a (circumscribed) right to refuse assignment of a lease and since, as the Property Council of Australia pointed out, property managers want to give their tenants the best chance to succeed, the Committee can see no difficulty in adopting this best practice.

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85 Len Rathmann, WA Council of Retail Associations, *Transcript of evidence*, p. 408.
86 Dale McDermid, Property Council of Australia, *Transcript of evidence*, p. 789.

2.106 Recommendation 2.5

The Committee recommends that the Uniform Retail Tenancy Code:

(a) require lessees assigning their leases to provide a disclosure statement to prospective purchasers showing all relevant information on the financial position of the business and the rights and obligations of the business as a tenant, including information on rental rebates, rental holidays, and any other financial incentives applying at the time of assignment or in the previous five years;

(b) specify the grounds on which a lessor can withhold consent to the assignment of a retail lease; and

(c) provide that:

(i) purchasers of a trading retail outlet be given a new lease by the property management, when all parties agree; or

(ii) (as a fallback option) all rights and responsibilities pursuant to a retail lease pass to the new tenant on assignment of a lease, unless otherwise agreed in writing between the assignor and assignee.

Rent

2.107 Not surprisingly the next most important issue for specialty retail tenants after security of tenure was rent. Rent has become the major operating expense for small retail tenants over the last decade. The Committee's attention was drawn to ABS statistics showing, for small retail businesses, rent had increased as a proportion of turnover from 10% in 1989 to 15% in 1996 at the expense of wages and salaries.[87]

2.108 The 1996 National Occupancy Cost Survey of Regional Centres[88] reported occupancy costs for specialty retailers in regional centres were continuing to increase as a percentage of sales - to a national average of 14.37% - and were considered to be unsustainable.[89] South Australia was the only State to record a reduction in occupancy costs. The survey showed average occupancy costs in NSW, Victoria and the ACT exceed $1000 per square metre.

87 Max Baldock, Small Retailers Association of SA, *Transcript of evidence,* p. 481.

88 Australian Retailers Association, *Exhibit No. 225.*

89 The Property Council of Australia, responding to the survey, noted that an independent census of retailers in regional shopping centres had shown a lower rate of increase in occupancy costs than that reported by the Australian Retailers Association. The Property Council of Australia submitted that occupancy costs had risen from 13.7% of sales in June 1994 to 14.4% in June 1996. *Submissions Nos. 119.2 & 119.3.*

2.109 McKinsey & Company, consultants, reported in 1995 that average rents for specialty retailers in Australia were more than three times those in the United States.[90]

2.110 Several business conduct issues were raised in relation to retail rents:

- whether or not retail rents had been artificially inflated with a potentially destabilising effect on retail property values;
- why there are disparities in rents paid by different retailers in the same shopping centre;
- the fairness of market rent reviews;
- the vulnerability of sitting tenants in rent reviews; and
- whether or not specialty retailers should pay 'turnover' rent.

2.111 Each of these issues is discussed below, in turn.

Is retail property overvalued?

2.112 The issue of whether or not retail property (ultimately owned by superannuation funds and other investment trusts) was overvalued and, moreover, whether or not a dramatic correction in values was imminent, attracted more media attention than any other matter examined by the Fair Trading inquiry. From the Committee's point of view, the valuation of retail property was a significant but secondary issue that pointed to the primary business conduct issue of whether or not the procedures for setting and reviewing rentals for small retail tenants are fair.

2.113 The Australian Institute of Business Brokers was the first witness to raise with the Committee the real possibility of a crash in retail property values, submitting:

> *... shopping centre rents could be artificially inflated by as much as 50%. The consequences of this statement are that the value of some property trust shares and superannuation funds whose property portfolios include regional shopping centres could soon fall by as much as 50%. ... It is a very real possibility that the impending losses and correction in the marketplace could result in the country losing billions of dollars.* [91]

90 McKinsey & Company attribute this differential to the limited supply of retail space in Australia compared to the United States. *Exhibit No. 233*.

91 Australian Institute of Business Brokers, *Submission No. 175.*

2.114 Professor Alan Millington and the Australian Institute of Business Brokers gave evidence Australian retail property owners and managers simply refused to accept retail rents should fall, despite the weight of economic evidence pointing in that direction.[92] Professor Millington reported, with evident dismay:

> *Retail property investments are not immune to the vagaries of the investment markets in general, and yet there appear to be some in the retail property investment and management sectors who consider that constantly rising retail rents and constantly rising retail property values on a universal scale are realistic expectations and achievable objectives.*[93]

2.115 The Australian Institute of Business Brokers claimed the instability in the retail property market had been caused by:

- tenants being forced to pay rents that were unsustainable (in the sense that rents were out of alignment with retail turnover and profitability);[94]
- property managers hiding the high level of vacant shopping spaces that had resulted from uneconomic rents by plugging gaps with casual leasing;[95]
- tenants being given rebates or discounts off nominal rents or given 'rental holidays' with the result 'market rents' were not actually paid; [96] and
- tenants being assisted with fitout costs or promotions to enable them to pay high 'book' rents.[97]

2.116 Merchants gave evidence 'book' rents are not paid. The proprietors of a take away food shop in WA told the Committee that, in the course of rent negotiations, they had been able to negotiate a compromise rent 'on condition that [they] accepted the proposed rent increase as being market rent', commenting:

> *On paper they can write and say that the market rent is whatever - $920 a square metre or whatever it is. So they have that rent increase on paper but, in real terms, they do not have the money, and that is what is happening.*[98]

2.117 The Committee raised all of these issues with property valuers and property managers at public hearings.

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92 Australian Institute of Business Brokers, *Submission No. 175* and Professor Alan Millington, *Exhibit No. 179.*

93 Professor Alan Millington, *Exhibit No. 179.*

94 Australian Institute of Business Brokers, *Submission No. 175.*

95 Garth Griffiths, President, Australian Institute of Business Brokers, *Transcript of evidence,* p. 671.

96 Australian Institute of Business Brokers, *Submission No. 175.*

97 Australian Institute of Business Brokers, *Submission No. 175.*

98 Josephine Grieg, Chicken Feast, *Transcript of evidence,* p. 427.

2.118 Mr Denis Lovell, a practising valuer of retail property with the Australian Institute of Valuers and Land Economists was asked to comment on the claims retail property was overvalued and a correction was imminent. Mr Lovell replied:

> *Mark Twain said forecasting was difficult, particularly about the future - and he was right. There will be an Armageddon. It is a question of how landlords deal with their rent negotiations with their existing tenants as to how and when it comes and whether we have a soft landing or a hard landing.*[99]

2.119 Rebutting this view, the Property Council of Australia pointed to low vacancy rates in regional shopping centres - under 2% - as an indication that retail tenants were prepared to pay, and could afford to pay, prevailing rents.[100]

2.120 The Property Council of Australia,[101] and Westfield,[102] acknowledged anchor tenants would often be given assistance with fitout and that smaller retailers had been assisted to remain viable with rent abatement, but pointed out that any such rebates off 'market rents' would affect the 'bottom line' of earnings from a shopping centre and would be automatically taken into account by valuers.

2.121 Lend Lease acknowledged that the retail industry is cyclical, that Lend Lease was only developing further retail space in growth areas (such as the south west corridor of Sydney) and that, across the Lend Lease portfolio of retail property in Australia, rents were falling in real terms. Ms Louise Martin, Chief Executive, explained:

> *In terms of rents, across our portfolio we are finding a flattening of rents because as retail sales flatten, obviously retail rents cannot increase. In fact in the 1996-97 year increases at rent review time and lease renewals were flat. They were at 0 per cent increase. Given that CPI was running at 1.6 per cent, that means there was an actual negative in real terms.*[103]

2.122 AMP also gave evidence of rents falling as a result of market rent reviews in certain shopping centres where trading was weak.[104]

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99 Denis Lovell, Australian Institute of Valuers and Land Economists, *Transcript of evidence,* p. 696.

100 Alan Briggs, Property Council of Australia, *Transcript of evidence,* p. 781 and Ian Newton, Westfield, *Transcript of evidence,* p. 818.

101 Alan Briggs, Property Council of Australia, *Transcript of evidence,* pp. 783 & 796.

102 Ian Newton, Westfield, *Transcript of evidence,* pp. 818 & 828.

103 Louise Martin, Lend Lease, *Transcript of evidence,* p. 783.

104 Neil Fagg, AMP, *Transcript of evidence,* p. 835.

2.123 The Committee is not in a position to make a judgement on the stability of the retail property market. On the balance of evidence before the Fair Trading inquiry, the Committee considers it likely specialty retail rents have been held at a higher level than would prevail in a market with freely available information about rents paid. This issue has drawn attention to a matter which the Committee believes should be addressed by regulators - namely, the availability of market information.

Should rental information be more readily available?

2.124 Merchants were concerned about the information asymmetry in rent negotiations, whereby:

- lessors have access to tenants' turnover or sales figures, and can estimate the maximum rent tenants can afford to pay; but
- lessees have limited information about rents paid by other tenants in the shopping centre.

2.125 Hamiltons, Valuers and Property Consultants, advised the Committee that the typical procedure for determination of market rents is for the lessor and lessee each to appoint a valuer, and for the two valuers to arrive at a joint determination of the market value of a shop. The lessor's valuer would have access to all tenancy and sales information. The lessee's valuer would request access to relevant information which may, or may not, be provided with the consent of the lessor.[105]

2.126 It was argued the market for retail tenancies might operate more effectively if there were a compulsory register of rentals, or public display of the total occupancy cost schedules, in all retail developments[106] and the Committee does not doubt for one moment that this is so. However, property managers submitted to the Committee that rent negotiations were highly commercially sensitive.

2.127 The Australian Institute of Valuers and Land Economists called for information on rents paid in shopping centres to be more readily available.[107]

2.128 The Committee considers professional valuers should have access to comprehensive details of occupancy costs - on a confidential basis - to carry out informed valuations for investors and market rent valuations. The Committee considers this information should comprise more than nominal market rents and should include details of any rebates or concessions granted. It would not be appropriate for valuers to disclose such information to their clients or otherwise make the information public.

2.129 The Committee also considers retail tenants should **not** be bound to secrecy in relation to rents paid.

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105 The advice from Hamiltons was provided to the Committee by the Property Council of Australia, *Exhibit No. 269.*

106 COSBOA, *Submission No. 105.*

107 Stephen Garmston and Denis Lovell, Australian Institute of Valuers and Land Economists, *Transcript of evidence*, pp. 689-90.

2.130 Recommendation 2.6

The Committee recommends that the Uniform Retail Tenancy Code provide for accredited retail property valuers to have access - on a non-disclosable basis - to relevant Tenancy Schedules of shopping centres, showing the total occupancy costs for each tenant in the centre and the value of any concessions or rebates given, for the purposes of valuing retail property or providing advice on market rent reviews.

Why is there gross disparity in rents paid in shopping centres?

2.131 Another cause of anguish for small retailers was the claimed marked disparity in rents - especially between 'anchor tenants' (notably Coles Myer, Woolworths) and specialty shops.

2.132 Ms Soula George, representing the Micro Business Consultative Group, told the Committee:

> *We are all aware that small business, especially in the retail sector, subsidises the rentals of big supermarkets by [paying rentals] up to 1,000 times more. In fact, in some instances, supermarkets do not pay any rentals for up to as many as four years.*[108]

2.133 The Committee requested that Westfield, AMP and Lend Lease provide copies of Tenancy Schedules - showing the occupancy costs paid by each tenant - in respect of particular shopping centres about which the Committee had received complaints. These documents were received in confidence and the Committee examined issues raised at *in camera* hearings.

2.134 The Tenancy Schedules confirmed there is massive disparity in rents paid per square metre, notably between anchor tenants and specialty tenants,[109] but also amongst different classes of specialty tenants.

108 Soula George, Micro Business Consultative Group, *Transcript of evidence*, p. 300.

109 Dale McDermid, Property Council of Australia, *Transcript of evidence*, pp. 783-84. Evidence was given that property managers need to secure one of a very small number of anchor tenants into a centre to make it work and that anchor tenants are able to negotiate vastly lower rents per square metre, assistance with fitout and other financial incentives.

2.135 The property managers explained specialty retail rents are determined by a complex series of factors, including:

- the position of a shop and the amount of foot traffic passing through this area of the shopping centre (so tenancies in or near the 'Food Hall' in a shopping centre attract a premium rent as do positions in close proximity to anchor tenants);[110]
- the size of the specialty shop leased (with a 'quantum allowance' applying);[111]
- the layout of the shop and, in particular, the amount of frontage;[112]
- the anticipated profitability of the merchant, based on margins in that line of trade;[113] and
- supply and demand - that is, what other retailers are prepared to pay.[114]

2.136 In short, specialty rents are the maximum amounts that can be obtained from the retailer in rent negotiations; retail shopping spaces have no intrinsic 'price'.

2.137 Specialty retailers were not persuaded rents are determined fairly and various options were proposed for changing the fundamental basis of determining retail rents. One submission proposed a prohibition on rent differentials per square metre within a shopping centre - which would have the effect of providing for the anchor tenants to negotiate on behalf of all tenants in the centre.[115] Alternatively, it was suggested that rent differentials should be 'capped' at 20%.[116]

2.138 The principal proposal for changing the basis on which rents are calculated was that specialty retailers should pay turnover rent.

Should specialty retailers pay turnover rent?

2.139 For anchor tenants, the principal component of rent paid is turnover rent - which automatically falls in times of economic downturn. Some associations representing the interests of small specialty retailers submitted the rents of specialty tenants should also be tied to retail turnover.

110 Ian Newton, Westfield, *Transcript of evidence,* pp. 814-15.
111 Property Council of Australia, *Submission No. 119.3.*
112 Property Council of Australia, *Submission No. 119.3*
113 Louise Martin and Graham Dreverman, Lend Lease, *Transcript of evidence,* pp. 807-09.
114 AMP, *Submission No. 189.*
115 David Roskell, *Submission No. 141.*
116 David Roskell, *Submission No. 141.1.*

2.140 The Micro Business Consultative Group considered shopping centre management should be made responsible for the viability of the centre by requiring for leases to be negotiated on a percentage of turnover basis for all tenants.[117] The Australian Institute of Business Brokers also considered turnover rent to be the fairest rental formula,[118] and proposed a sophisticated mechanism for determining and monitoring monthly rental payments on the basis of turnover.[119] There was enthusiastic support for the option of turnover rent at the public hearing in Melbourne on 20 February 1997.[120]

2.141 The chief rationale for turnover rent was that it would (re)align rents with tenants' ability to pay. Mr Rob Bastian, Chief Executive Officer of COSBOA, suggested property owners and managers should see themselves as being in the retail distribution trade in partnership with retail tenants and thus not aloof from economic trends in retailing:

> *To the extent that the landlord makes his of her money out of the rents of the tenant rather than out of the turnover of the tenant - that is, ... the throughput of the occupancy - then he is raping the tenant. ... The real issue is distribution of product down on the ground, but ... we have lost the plot on that. It is absolutely fundamental.*[121]

2.142 The Property Council of Australia claimed it was unviable to base all rental on turnover since such a formula would reward poor traders and would also make returns on retail property dependant on factors over which property managers had no control, namely the competence of merchants and the accuracy of turnover figures provided.[122] Ms Louise Martin, Chief Executive of Lend Lease, stated in evidence that property investors would not be prepared to sink money into shopping centres without an assurance of 'base rent' earnings:

> *If rental deals were based purely on turnover and there was no base rent, then I think you would be very unlikely to see any investment in retail property by property trusts or developers whatsoever. There must be surety of income, otherwise investment will not occur.* [123]

117 Micro Business Consultative Group, *Submission No. 74.*
118 Australian Institute of Business Brokers, *Submission No. 175.*
119 Australian Institute of Business Brokers, *Submission No. 175.1.*
120 The United Retailers Association supported the proposal and many observers at the hearing indicated their endorsement as well.
121 Rob Bastian, COSBOA, *Transcript of evidence,* p. 564.
122 Property Council of Australia, *Submission No. 119.3.*
123 Louise Martin, Lend Lease, *Transcript of evidence,* p. 811.

2.143 Some specialty retailers already pay turnover rent - but only as a premium. For example, specialty retailers may negotiate a base rent on the basis of market value, but be required to pay more rent if their turnover exceeds a certain level. Alternatively, in States where it is not illegal to have rental formulae framed in terms of an 'each way bet', rent may be specified to be base rent or turnover rent, whichever is the greatest.[124]

2.144 Laubman and Pank Optometrists (WA), a chain of 18 practices operating from retail tenancies in regional shopping centres, objected to the inclusion of turnover rent premiums in retail rental formulae.[125] Ms Yvonne Valentin, Commercial Manager, Laubman and Pank Optometrists (WA), argued turnover rent should be abolished:

> *I would like to see turnover rent abolished. I believe it is [a] completely unfair practice. In many cases you are paying what is considered by the owner to be the market rent - that is how he refers to it - and then he suggests that there should be percentage rent on top of this. In many cases, I believe it is not because they want to actually obtain that additional rent from you; it is because they want access to your sales figures to use against you at a later time, perhaps when there is a market rent review or when your lease is coming up for renegotiation.*[126]

2.145 Certainly, the effect of requiring tenants to disclose turnover figures is that the lessor has all the information necessary to determine the maximum rent that can be 'negotiated' in a rent review whereas the lessee is completely ignorant of everything about the lessor's business, including rents paid for other shops in the centre.

2.146 The Committee considers a turnover rent premium on top of 'market rent' to be unfair. It would, nonetheless, be fair for specialty rents to be calculated on the same basis as anchor rents - that is, largely based on turnover but with a component of base rent. The advantage of this formula is that it would provide automatic adjustment of rents to trading conditions. In particular, it would provide for rent reductions - hitherto unavailable to specialty tenants, from what the Committee has heard.

2.147 The Committee does not accept the arguments of the Property Council of Australia that such a method of charging rents would put rental income beyond the control of property managers. Indeed, if rental income was dependent on the overall trading success of tenants, there would be an incentive for property managers to pay more attention to the tenancy mix of the centre and also to the skills and potential of

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124 *Exhibit No. 186.*

125 Laubman and Pank Optometrists (WA), *Submission No. 77.* The WA Council of Retail Associations also submitted that 'turnover rent' should be outlawed and that retailers should not be required to provide financial results except to the extent necessary to prove they can pay the rent (*Submission No. 139).* Mrs Josephine Grieg, Chicken Feast, also called for the abolition of turnover rents (*Transcript of evidence,* p. 421).

126 Yvonne Valentin, Laubman and Pank Optometrists (WA), *Transcript of evidence,* p. 439.

each tenant, rather than signing up anyone who is prepared to pay the rent. The Committee also does not accept that there would be a problem with the accuracy of turnover figures provided. Indeed, as Ms Valentin pointed out above, managers have been obtaining this information for some time. The Australian Institute of Business Brokers proposed a mechanism to protect shopping centre owners against understatement of turnover.[127]

2.148 The Committee does not accept that charging specialty tenants turnover rent plus a nominal base (not market) rent, as for anchor tenants, would undermine the property market. Instead, the retail property market might become more attuned to the retail market.

2.149 The Committee does not believe it would be appropriate to legislate a formula for rent calculations at this stage. The Committee would prefer retail tenancy legislation simply to set a framework in which fair rent negotiations can take place. However, the Committee considers it is high time for property owners and managers to review the fundamental basis for setting specialty rents.

2.150 Suffice it to say the Committee is not convinced that all specialty retailers are paying fair rents. The Committee considers specialty retailers have been charged maximum achievable rents.

Are market rent reviews fair?

2.151 It is clear from submissions to the inquiry that a major concern of small retail tenants is the ability of the landlord to review the base rent during the term of a lease on the basis of 'market value' which the tenant can neither predict nor verify. In the words of one of the witnesses at the public hearing in Perth:

> *... when a tenant signs that lease, basically they are signing everything over to the owner. It is almost like an open cheque. ... The owner can guarantee his return regardless of the economic situation. ... If you go into a contract where you buy yourself a vehicle, you know what you are getting yourself in for. When you go into a five-year lease, circumstances change and you do not always know that. That is where the problem comes in. We were successful operators but I cannot reconcile a 33 per cent increase with retail trade at the moment. That is something where you can ask, 'How could we even anticipate that?'.*[128]

127 Australian Institute of Business Brokers, *Submission No. 175.1.*

128 James Grieg, Chicken Feast, *Transcript of evidence,* p. 430.

2.152 One small business gave evidence to the inquiry that, in a five year lease, the rent increased at the end of the first year by CPI plus three percent; the second year, the rent increase would be to 'market value' - around 30% or more.[129] Other evidence to the inquiry suggested 'market value' rent increases could be as high as 150%.[130]

2.153 The Australian Institute of Valuers and Land Economists advised the Committee that 'market rent' is defined as follows:

> *Market Rental Value is the estimated amount for which premises should rent, as at the relevant date, between a willing lessor and a willing lessee in an arm's length transaction, wherein the parties had each acted knowledgeably, prudently and without compulsion, and having regard to the usual market terms and conditions for leases of similar premises.*[131]

2.154 Hamiltons, Valuers and Property Consultants, pointed out that, in applying the above definition, valuers ignore the lessee's goodwill and investment in fitout, take into account the terms and conditions of the lease and assume that the premises may only be used for the purpose permitted in the lease.[132]

2.155 Hamiltons further advised that, in market rent reviews:

- lessors place greater emphasis on the rents per square metre derived from new leasings or market rent reviews of shops in the vicinity of the shop under review or of shops in the same retail category elsewhere in the centre; whereas
- lessees place greater emphasis on industry average gross occupancy costs.[133]

2.156 When retail tenants seek independent advice from valuers on market rent reviews, this will not necessarily put them in a stronger bargaining position with the lessor.[134]

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129 M. Breheny, *Submission No. 26.* Mrs Josephine Grieg, Chicken Feast, gave evidence that rent levels in her lease were increased, in alternate years, by CPI indexation and market rent review (of 33%). *Transcript of evidence,* p. 420.

130 Jean M Sietzema-Dickson, Poetica Christi Press, on behalf of the traders in Box Hill Central Shopping Centre and the Public Justice Committee of the Reformed Churches of Australia, *Submission No. 29.*

131 Stephen Garmston, Australian Institute of Valuers and Land Economists, *Transcript of evidence,* p. 687.

132 *Exhibit No. 269.*

133 *Exhibit No. 269.*

134 Mrs Josephine Grieg, Chicken Feast, gave evidence that the independent valuer she engaged had disagreed with the 'market value' rental calculated by the lessor's valuer, but that there was no compromise on the rental increase (*Transcript of evidence,* p. 425). Mrs Sandra Lazari, proprietor of a hairdressing salon at Marion Shopping Centre, gave evidence that she had employed a land valuer to assist in rental negotiations but that the valuer could only negotiate 'so far' (*Transcript of evidence,* p. 508).

2.157 Mr Len Rathmann, Executive Officer of the WA Council of Retail Associations, suggested market rents were like the share values on the stock market.[135] He gave an example of how market rent would be calculated for coffee lounges:

> *Coffee lounges down in Fremantle are very much the vogue, very attractive - al fresco arrangement and so on. It is great. All visitors here should go to Fremantle. The point is that the rents negotiated down there in the environment are such that they can be put at a higher level. Once that level or that plateau is achieved, that is used for consideration for other coffee lounges in Armadale or wherever - all the various locations. The interesting point is, once all those other coffee lounges were brought up to that same level, guess what? They started back in Fremantle again.*[136]

2.158 Retail tenancy legislation in most jurisdictions sets down rules for market rent reviews, including provision for arbitration of disputed market rent assessments by independent valuers. In fact, the Committee was asked to consider options for improving market rent reviews that have already been implemented in parts of Australia.[137] For example, a serious concern amongst WA tenants concerned the backdating of rental increases to the contract review date (notwithstanding the tenant may not have been advised of the higher rent until six months later and notwithstanding the rental increase may be in dispute). [138]

2.159 The Committee does not consider market valuations to be an inherently unfair method of determining rent in an informed market, provided the retail tenant can walk away if the price is too high. Problems arise when market rent reviews are imposed on sitting tenants who are not able to walk away.

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135 Len Rathmann, WA Council of Retail Associations, *Transcript of evidence,* p. 415.

136 Len Rathmann, WA Council of Retail Associations, *Transcript of evidence,* p. 415.

137 For example, Laubman and Pank Optometrists (WA), operating in Western Australia, proposed the following safeguards be built into retail tenancy legislation:

- that 'market rent' be redefined to also provide for rent reductions; and
- that property owners be required to provide rent review evaluations within a month of the contract review date (*Submission No. 77).*

Retail tenancy legislation in some other States already addresses such matters.

138 Laubman and Pank Optometrists (WA), *Submission No. 77.* Ms Yvonne Valentin, representing Laubman and Pank Optometrists (WA), gave evidence that, where there is a dispute in a market rent review, lessees are obliged to pay the increased amount proposed by the lessor until a lower amount is negotiated - at which time the lessee is eligible for a credit. The lessor then has an incentive to allow the dispute to drag on (*Transcript of evidence,* p. 440). Mrs Josephine Grieg, proprietor of Chicken Feast in the Belmont Forum Shopping Centre, Western Australia, also objected to this practice. Mrs Grieg and her business partners had been presented with a 33% rental increase three months after the rent review date, the backdated increased rental payment had been demanded in full and the lessor had threatened legal action - when the increase was still in dispute (*Transcript of evidence,* p. 421).

Are sitting tenants 'sitting ducks'?[139]

2.160 It was suggested to the Committee market rents were distorted by holding sitting tenants 'to ransom', particularly at the end of a lease period.[140] One 'sitting tenant' gave evidence that:

> *When an existing tenant is forced to pay an unrealistic rental increase, as in our case, he would be doing so under duress. This increased rental is then used as a yardstick for further rent reviews, thereby inflating true market value which should be based on decisions in a free and open market.*[141]

2.161 The Australian Institute of Business Brokers submitted its members had witnessed instances of sitting tenants walking out of their shops because they couldn't afford to pay rent increases of, say, 30% resulting from market rent review, only to be replaced by new tenants on rents that represent a 10%, 20% or 30% reduction in the rent previously paid for the same shop.[142]

2.162 The Committee raised this issue with the Property Council of Australia who disputed the claim, citing independent research by Jebb Dimasi Holland, Economists and Property Advisers.[143]

2.163 The Jebb Dimasi Holland research on comparative rentals for new and 'sitting' tenants is not conclusive either way. For a start, the survey across 33 regional shopping centres defined 'old' or sitting tenants as those established for more than one year, compared to new tenants who had been established for less than one year. Since five year leases typically provide for market rent review no earlier than year three, it is not clear how a survey methodology that includes second year tenants as 'sitting' tenants can be useful.[144]

2.164 In any case, the report concluded 'there is no fixed rule that new tenants pay more or less rent than old tenants'. The survey found:

- in 23 of the 33 shopping centres in the survey, old tenants pay higher rents (per square metre) than new tenants;
- in 10 of the 33 shopping centres new tenants pay higher rents than old tenants;
- old tenants pay higher rents than new tenants in centres that have been over-extended relative to market capacity;
- new tenants pay higher rents than old tenants in successful centres that have been expanded in line with market demand;

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139 This question was posed by Professor Alan Millington, *Exhibit No. 179.*

140 Max Baldock, President, Small Retailers Association of SA, *Transcript of evidence,* p. 502 and Professor Alan Millington, *Transcript of evidence,* p. 620.

141 Josephine Grieg, Chicken Feast, *Transcript of evidence,* p. 421.

142 Australian Institute of Business Brokers, *Submission No. 175.*

143 *Exhibit No. 223.*

144 The comparison the Committee sought to make was between sitting tenants in their second lease term - say year six - and new tenants.

- across all 33 centres, the average rent for new tenants was $865 per square metre compared to $995 for old tenants; but
- rent for new tenants was 15.4% of turnover and for old tenants 13.9% of turnover.[145]

2.165 The Committee did not consider this research determinative of the question of the vulnerability of sitting tenants in market rent reviews, and has a remaining concern about the considerable body of evidence to the Fair Trading inquiry about sitting tenants facing exorbitant increases in rent at the time of market rent reviews.

Conclusions and recommendations

2.166 The Committee considers rent will always be the result of negotiation between the landlord and the tenant, and both parties should have access to all relevant information necessary to arrive at a mutually acceptable bargain. The Committee does not consider it would be appropriate for regulators to determine the appropriate method of calculating retail rent.

2.167 The Committee has, however, already indicated strong support for specialty tenants being charged turnover rent as for anchor tenants.

2.168 The Committee considers it would be appropriate for retail tenancy legislation to set down some procedural rules for fair rent negotiations. In particular, the Committee considers retail tenants have a right to know - before entering into a lease - approximately how much rent they will be paying for the term of the lease. Small retailers cannot otherwise assess their viability prior to going into business.

2.169 The Committee does not consider it to be acceptable for:

- lessors to require that tenants pay the greater of two or more amounts (however calculated);
- rent to be subject to 'ratchet' clauses stating base rent is increased by a certain amount or percentage each year; or
- rent to be reviewed to 'market value' during the term of the lease, (in light of the weight of evidence to this Committee that market rent reviews result in very high and unpredictable increases that cause significant hardship to small retailers).

2.170 In short, the Committee does not consider it acceptable for retail tenants, rather than their better informed lessors, to be carrying all the risk of fluctuations in retail property values and changes in general economic conditions.

145 *Exhibit No. 223,* pp. 10-11.

2.171 The Committee considers, if turnover rent is not charged, it would be appropriate for rent to be reviewed to market value on renewal of a lease. However, as indicated above, the Committee is concerned about the dubious manner in which 'market rent' has been calculated in the past. The Committee considers retail tenancy legislation should require that market rent on renewal of a lease be determined in the first instance by an independent accredited valuer with access to the Tenancy Schedule for the relevant shopping centre. The costs of this valuation should be shared between the parties and the valuation should be binding on both parties.[146]

2.172 Of course, tenants would have the option of walking away from the deal in the event that the market rent was beyond their capacity to pay. It would not be appropriate for the lessor to have the right to walk away from the deal as this would defeat the purpose of Recommendation 2.4 (Security of tenure) above.

2.173 Recommendation 2.7

Recognising rent will always be a matter for negotiation between landlord and tenant, the Committee recommends the Uniform Retail Tenancy Code provide that:

(a) the disclosure statement set out clearly the method by which rent is to be calculated for the term of the lease without provision for review or for unpredictable increases;

(b) market rent review only be permitted on renewal of a lease; and

(c) the level of market rent on lease renewal be determined by an independent accredited valuer, with costs shared between the parties.

Outgoings and promotions

2.174 The main concerns about variable outgoings and promotions were:

- the fairness of charging tenants for the running of a shopping centre;
- tenants' absolute lack of control over expenditure on outgoings and promotions with the attendant potential for profligacy on the part of managers; and
- alleged failures of managers to document the calculation of outgoings with potential for fraud.

146 AMP advised that a market valuation for a specialty retail shop would cost $1500 to $3000 (*Submission No. 189.1*).

Should retail tenants pay for the running of the shopping centre?

2.175 The Committee requested Westfield, Lend Lease and AMP to provide the most recent audited statements of outgoings and promotions for certain shopping centres named in evidence to the inquiry.[147] These statements showed the total annual bill for outgoings and promotions in a regional shopping centre is in the order of $4 million to $7 million and that tenants are charged for expenses incurred in operating the shopping centre such as:

Variable outgoings

- Council rates, State land tax
- water, electricity and garbage collection;
- property insurance and public liability insurance;
- operation and maintenance of
  - ⇒ air conditioning units,
  - ⇒ the public address system and music;
  - ⇒ escalators and travelators;
  - ⇒ plants and gardens;
  - ⇒ carparks;
  - ⇒ public amenities and facilities;
- management and administration
- cleaning; and
- security.

Promotions levy or marketing fund

- advertising on print and electronic media;
- promotions and displays in the shopping centre;
- courtesy/promotional staff;
- market research;
- consultants; and
- marketing management.

2.176 These costs are apportioned to each merchant on the basis of the proportion of gross lettable area occupied, although Westfield gave evidence that property owners may 'pick up the bill' for a component of the variable outgoings chargeable to anchor tenants.[148]

147 *Exhibits Nos. 186 &187* (Westfield), *190* (AMP) and *211* (Lend Lease).
148 Ian Newton, Westfield, *Transcript of evidence,* p. 821.

2.177 There was concern that retailers pay for management salaries and expenses even though the managers are engaged by, and work on behalf of, the property owner. There was also concern that tenants have no control over the level of service provided by managers and no control over management expenses.[149] Independent Retailers of Australia suggested that, since merchants are paying property managers, it would not be unreasonable to expect that managers could provide a range of services to support merchants, including:

- monitoring traffic flow and the performance of individual retailers, product categories, and the centre as a whole;
- updates on new methods and new innovations in retailing;
- market research and development;
- promotion and advertising;
- bulk purchasing (providing discounts to individual merchants); and
- management and financial advice to merchants.[150]

2.178 Tenants also pay for other expenses that protect the owner's investment rather than contributing to the trading success of the centre - including property insurance and security costs. It was also unclear to the Committee why permanent tenants are charged for the upkeep of common areas which managers can lease to casual tenants.

2.179 Showbits Joondalup raised concerns about the lack of tenant control over compulsory outgoings:

> *Variable outgoings is another area of contention. There is often no control over expenditure, we are not given proper audited copies of expenditure. We need to have more say on whether or not an expenditure is acceptable to us and it should be within our rights to contain variable outgoings if viewed as reasonable by the majority of small tenants.*
>
> *We are forced to contribute to a promotional fund of which there is limited benefit to the tenant.*[151]

2.180 State retail tenancy legislation presently requires that lessees receive an audited statement of outgoings. Retail tenancy legislation in all States also lays down basic requirements as to what can be charged to retail tenants as outgoings. For example, capital expenses cannot be charged to tenants. However, there was concern property managers failed to replace obsolete equipment (a capital expense to the owners) since repairs and maintenance are charged out to tenants.[152] In any case, the Committee took evidence that it is extremely difficult, costly and time consuming to take property managers to court over disputed outgoings.

149 WA Council of Retail Associations, *Submission No. 139.*
150 Independent Retailers of Australia, *Submission No. 192.*
151 M Dwight, Showbits Joondalup, *Submission No. 40.*
152 Laubman and Pank Optometrists (WA), *Submission No. 77.*

2.181 Managers thus have a relatively free hand in billing expenses to merchants, and there is significant potential for profligacy or fraud. The Committee took evidence of:

- miscalculation of gross lettable area on the basis of which outgoings are apportioned (for example, following a redevelopment in which a former common area might be fitted for occupation);[153]
- unexplained massive (50%) increases in management costs;[154]
- inclusion in outgoings of items which are properly capital expenses to the owner (for example, landscaping of new gardens, surfacing of carparks following redevelopments, painting or signage of new extensions);[155]
- inclusion in outgoings of expenses incurred outside the shopping centre or in relation to another shopping centre;[156]
- the inclusion in outgoings of owners' or managers' head-office administration costs and for the eventual replacement of the landlord's fixtures, fittings, plant and equipment; [157]
- the use of promotions funds in shopping centres to publicise a landlord's general activities rather than to promote the specific activities of the relevant shopping centre;[158] and
- alleged significant discrepancies between promotion costs charged to tenants, promotions budgeted and promotions actually run.[159]

2.182 The Committee considered it was unacceptable for shopping centre management to be given a 'blank cheque' to run the centre. The Committee considers management should be accountable to merchants for expenses to be charged as variable outgoings or promotions levies.

2.183 The Committee is concerned that the statements of outgoings and promotions which it perused (provided by Westfield, AMP and Lend Lease) provided only highly aggregated itemised accounts.[160] Indeed, it is not suprising that the first battle tenants have to fight if they wish to challenge the calculation of outgoings under retail tenancy legislation is obtaining access to all the documentation underpinning the calculation of outgoings and promotions, to find out where the money has gone. The Committee took evidence of reluctance by management to document the calculation of variable outgoings.[161]

153 Donna Clark, Gifts R Us, *Submission No. 70.*
154 Name withheld, *Submission No. 187.1.*
155 Name withheld, *Submission No. 187.1.*
156 Name withheld, *Submission No. 187.1.*
157 Professor Alan Millington, *Submission No. 162.*
158 Professor Alan Millington, *Submission No. 162.*
159 Donna Clark, Gifts R Us, *Submission No. 70.*
160 *Exhibits Nos. 186 (Westfield), 190 (AMP) & 211 (Lend Lease).*
161 Donna Clark, Gifts R Us, *Submission No. 70* and Name withheld, *Submission No. 187.1.*

2.184 The Committee considers retail tenants are entitled to better accountability for outgoings and promotions. The Committee believes tenants should be given quarterly breakdowns of expenditure on outgoings and promotions, broken down into specific items of expenditure - for example, particular promotions or particular maintenance jobs.

Could merchants' associations monitor outgoings?

2.185 Most retail tenancy legislation in Australia provides for the formation of a merchants' association, which has the potential to provide tenants with a forum for negotiations with centre management in relation to such vexed issues as promotions, the level of outgoings, changes in tenancy mix, and disturbances during redevelopments.

2.186 The Committee heard some disturbing stories about action taken by property managers to discourage the operation of effective merchants' associations:

- Mrs Sandra Lazari, Treasurer of the tenants' association at Marion Shopping Centre in South Australia was told by centre management that she was 'wasting her time and energy' and reported that membership of the association had fallen from 45 to 12 because tenants were 'really scared';[162]
- Mr Pieter Willems gave evidence that retailers were scared to be seen by centre management talking to each other, that retailers were bound by secrecy agreements in relation to (redevelopment) deals negotiated with management, and that the merchants' association in the Whitford City centre in WA had disbanded in 1990;[163] and
- Mrs Mary Caruana, proprietor of a restaurant in the Box Hill Central Shopping Centre in Melbourne, told the Committee that, on one occasion, centre management had reacted to a proposed tenants' meeting in the Food Court by ordering the security guards to lock the doors and turn off the lights at closing time, notwithstanding there were still customers in the centre who had to leave by a trade entrance.[164]

2.187 The Committee is concerned some property managers seem to see merchants' associations as a threat rather than as an effective means of consulting with tenants. The Committee considers property managers should foster the operation of merchants' associations.

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162 Sandra Lazari, *Transcript of evidence*, pp. 512-14. A retail tenant in Western Australia told the Committee that property managers applied the 'divide and rule' policy (Josephine Grieg, *Transcript of evidence*, p. 420).

163 Pieter Willems, *Transcript of evidence*, pp. 470-71.

164 Mary Caruana, *Transcript of evidence*, p. 183.

2.188 AMP gave evidence there has been a trend around the world away from merchants' associations, partly because of problems with voting power (anchor tenants being a formidable voting bloc) and partly because of 'aggro' between the manager and the merchants. However, it was acknowledged that, where there is a good committee and a good manager in charge, merchants' associations are of great benefit.[165]

2.189 The Committee does not see why merchants' associations could not operate in a similar way to Strata Title Bodies Corporate, with tenants having the right to approve, at an annual general meeting, a broad operational budget within which property managers would run the centre. This would provide tenant control over some of the more extravagant expenditure brought to the Committee's attention.

2.190 AMP submitted that such a model would be inappropriate:

> *Centre managers should not take instructions from merchants. Retailers are Lessees, they do not have ownership of the property (as in Strata Title) nor do they have the necessary skills in Property Management. In any event, many of the retailers are in competition with each other and conflicts of interest would arise between retailers.*[166]

2.191 The Committee is not convinced by this argument. If lessees are paying the levies, then it is the lessees to whom the manager must be accountable for expenditure. The Committee considers that Articles of Association for merchants' associations should be appended to retail leases, that all merchants should be required to be members, and that quorum and voting provisions in the Articles of Association should be determined with regard to the typical composition of anchor tenants and specialty tenants in shopping centres, to ensure that both groups are fairly represented in decisions of merchants' associations.

2.192 If property owners and managers are concerned about merchants' control over the running costs of the shopping centre, they have the option to fund these expenses themselves and to charge gross rents.

Options and recommendations

2.193 Options proposed to the Committee for dealing with unfair levies on tenants for variable outgoings and promotions were that:

- retail rents be 'grossed up' (that is, negotiated rents should include outgoings so the property managers have an incentive to contain costs);[167]
- retail tenants not have to pay for management of shopping centres since the managers protect the interests of the owners; or

165 Brian Harrison, AMP, *Transcript of evidence,* p. 837.
166 AMP, *Submission No. 189.1.*
167 Yvonne Valentin, Laubman and Pank Optometrists (WA), *Transcript of evidence,* p. 439.

- retail tenants have a greater say in how shopping centres are run and, in particular, be able to influence expenditure on outgoings and promotions.[168]

2.194 The Committee considers there are compelling arguments for all of these options. The Property Council of Australia was not averse to the idea of gross rents and submitted this was again 'on the agenda' in the industry.[169]

2.195 In the present situation where rents are not 'grossed up', the Committee favours a model of increased consultation between tenants and property managers over outgoings and promotions. The Committee considers it is completely inequitable for property managers to bill all expenses to merchants (including their own salaries and expense accounts) without being accountable to merchants. The potential for waste and fraud is enormous.

2.196 The Committee is vehement retail tenants must be given the right to approve the budget for expenditure to be charged to them as variable outgoings and promotions. This could take place at an annual general meeting of merchants. If actual expenditure were to be far in excess of budgeted expenditure without explanation, tenants would have a prima facie case to take to dispute resolution.

2.197 Recommendation 2.8

The Committee recommends that the Uniform Retail Tenancy Code provide:

(a) for the establishment of merchants' associations in shopping centres;

(b) that all tenants in a shopping centre belong to the merchants' association in that centre;

(c) for Articles of Association of merchants' associations to be appended to the standard retail lease;

(d) for the merchants' association to approve the annual budget of variable outgoings and promotions levies at an annual general meeting; and

(e) for each tenant to be provided with detailed quarterly statements of expenditure on outgoings and promotions and audited annual statements of expenditure on outgoings and promotions.

168 Laubman and Pank Optometrists (WA), *Submission No. 77.*
169 Property Council of Australia, *Submission No. 119.3.*

Lease documentation - terms and disclosure

The need for standard form leases

2.198 The Committee took a great deal of evidence from retail tenants who felt their legal advisers had let them down, by not providing adequate advice on the terms and conditions in retail leases. However, Dr Clyde Croft, an eminent barrister and arbitrator in the field of retail tenancies, pointed out that the complexity of retail leases is the underlying problem.

> *The Retail Tenancies Act in Victoria decided not to prescribe standard leases and you can see the arguments for and against that. But, as a practitioner, a barrister some time ago, I was presented with a lease in a large commercial development to advise a tenant on it. The document was inches thick. To advise someone as to their rights under that document really means that you have got to read it. How long is that going to take, if you are going to read it properly?* ***To advise properly on that sort of document, you need a good deal of legal knowledge and expertise, so you are entitled to some compensation for that. Who is going to pay for all this****? I have every sympathy for the poor tenant in that situation, but how does the system deal with that situation?*[170] *[emphasis added]*

2.199 Laubman and Pank Optometrists (WA) proposed the promulgation of a standard 'plain English' retail tenancy lease.[171] The Micro Business Consultative Group also proposed leases should be framed in 'plain English'.[172]

2.200 The Committee learned the Property Council of Australia has prepared a 'standard lease' for use in NSW[173] and Lend Lease provided the Committee with a copy of a 'plain English' lease drafted by its legal advisers, which is currently used in Lend Lease centres.[174] The Committee took evidence suggesting the leases in use by property managers are basically 'not negotiable'.[175]

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170 Dr Clyde Croft, Australian Centre for International Commercial Arbitration, *Transcript of evidence*, p. 720.

171 Laubman and Pank Optometrists (WA), *Submission No. 77.*

172 Micro Business Consultative Group, *Submission No. 74.*

173 *Exhibit No. 270.*

174 *Exhibit No. 209.*

175 Ms Yvonne Valentin, Commercial Manager for Laubman and Pank Optometrists (WA), gave particularly useful evidence on the ability of that business to negotiate lease terms. Laubman and Pank Optometrists (WA) operates a chain of 18 outlets in major shopping centres in Western Australia and might be considered to be in a stronger bargaining position than individual retailers. Ms Valentin told the Committee that lessors were 'not receptive' to changes in the standard lease (*Transcript of evidence*, p. 443).

2.201 The Committee considers that, once retail tenancy legislation is harmonised around Australia, it would be desirable and achievable for a standard retail lease to be used in major shopping centres around Australia.

Disclosure statements

2.202 Retail tenancy legislation in every jurisdiction provides for full disclosure by the lessor of information that is relevant to a lessee's decision about whether or not to enter into a lease (see Appendix VI).

2.203 For example, the standard disclosure statement prepared by the Property Council of Australia for use in NSW shows:

- the location and lettable area of the leased premises;
- the lease period and any options;
- requirements for fitout to be provided by the tenant;
- fixtures and fittings to be provided by the lessor;
- the rent and method for calculating rent;
- detailed estimates of variable outgoings chargeable to the tenant and the basis on which outgoings are apportioned amongst tenants;
- any contribution payable for the promotion of the centre;
- details of the shopping centre - including hours of access, core trading hours, parking facilities;
- any changes to the shopping centre proposed by the lessor;
- the tenancy mix of the centre (shown on a floorplan of the centre); and
- whether or not there is a merchants' association in the centre.[176]

2.204 The Committee received evidence that, even where mandatory disclosure applies, some property managers are failing to provide enough accurate information to allow sensible decisions on the part of prospective tenants.

2.205 Ms Jean Sietzema-Dickson, drawing attention to the problems faced by traders in the Box Hill Central Shopping Centre in Victoria, noted traders had entered into retail leases on the basis of inaccurate or incomplete information, namely:

- the traffic flow through the Centre was falsely represented;
- the impending closure of a major store was not mentioned;
- the returns were not as represented by the vendor; and
- the Post Office was unexpectedly relocated with a resulting loss in traffic.[177]

176 *Exhibit No. 270.*

177 Jean M Sietzema-Dickson, Poetica Christi Press, *Submission No. 29.*

2.206 Ms Roslyn Lanigan, the franchisee of a coffee muffin shop in a new shopping complex in the Brisbane area, submitted that tenants in her centre had been misled during lease negotiations - and subsequently - in relation to information about:

- tenancy mix and major tenants;
- proportion of the centre already leased;
- exclusivity of product; and
- traffic flow figures. [178]

2.207 The United Retailers Association submitted that many of its members were in the courts, taking action under the Fair Trading Act in relation to misleading information provided by property owners.[179]

2.208 Independent Retailers of Australia proposed that the best elements of disclosure documents in State retail tenancy legislation, together with some disclosure provisions from the Franchising Code of Practice, also elements of the Trade Practices Act approach to disclosure (proscribing misleading statements as well as misrepresentations) should be incorporated in a Code of Disclosure for retail tenancies.[180]

2.209 The United Retailers Association submitted a list of items considered essential in a mandatory disclosure statement,[181] but also submitted that, in view of the profound information asymmetry between property owners/managers and tenants, that a property owner/manager should have a statutory duty of care to disclose all information relevant to a tenant's decision to enter a lease - including all plans for the redevelopment of the centre (notwithstanding the lessor may not have finally decided to proceed with any redevelopment).[182]

2.210 The Property Council of Australia did not support the 'statutory duty of care' proposal but was supportive of disclosure statements and receptive to ideas for their improvement.[183]

Conclusions and recommendations

2.211 The Committee considers it is absolutely fundamental to fair dealings in the retail tenancy area that small specialty retailers be provided with documentation and information that enables them to understand their rights and obligations as retail tenants. The Committee considers this documentation should be standardised to allow tenants and their advisers to become familiar with important terms and conditions, and to reduce preparation costs for property managers.

2.212 The Committee further considers it is essential for mandatory disclosure statements to be enshrined in retail tenancy law, and for retail tenancy dispute

178 Roslyn Lanigan, *Submission No. 37.*
179 United Retailers Association, *Submission No. 111.*
180 Independent Retailers of Australia, *Submission No. 192.*
181 United Retailers Association Inc, *Submission No. 111.2.*
182 Professor Alan Millington, *Submission No. 162.*
183 Property Council of Australia, *Submission No. 119.3.*

resolution mechanisms to be equipped to provide immediate relief for tenants who have entered into leases on the basis of inadequate or misleading information by property managers.

2.213 The Committee has identified some desirable additions to mandatory disclosure statements in relation to tenancy mix and redevelopment/relocation. Such additions are incorporated in separate recommendations (2.10 and 2.11) below.

2.214 Recommendation 2.9

The Committee recommends that the Uniform Retail Tenancy Code provide:

(a) for a standard form 'plain English' retail lease, also published in community languages; and

(b) for mandatory pre-contract disclosure of all factors likely to affect the viability of lessees - including all items currently required to be included in a statutory disclosure statement under the NSW *Retail Leases Act 1994.*

Change in tenancy mix

Business conduct issues raised

2.215 Incumbent tenants are neither consulted, nor compensated, for significant changes in the store tenancy mix. There was concern that the tenancy mix is at the lessor's discretion because tenants' profitability is affected by the level of direct competition in the centre.[184]

2.216 The Committee received a submission on this matter from the proprietors of Great Cuts Hairdressing in the Lend Lease Charlestown Shopping Centre.[185] Great Cuts was two years into its second five year lease, with one competitor, when it discovered that two new hairdressing salons would be setting up in an addition to the centre. In its lease negotiations with Lend Lease, Great Cuts had been informed that one of the reasons a high rental was expected was that there were only two hairdressing salons in the Centre. Centre management refused to renegotiate the rent when the retail tenancy mix changed.

184 Laubman and Pank Optometrists (WA), *Submission No. 77.*

185 Dennis and Helen Cook, t/a Great Cuts, *Submission No. 10.* Mrs Sandra Lazari, proprietor of a hairdressing salon at Westfield Marion Shopping Centre in Adelaide, also drew attention to this problem (*Submission No. 18).*

2.217 Mrs Sandra Lazari, proprietor of a hairdressing salon in the Marion Shopping Centre in South Australia, went from being the sole retailer of hairdressing products in the centre (in 1980) to one of eight retailers in 1996, including Price Attack. At the public hearing in Adelaide, she told the Committee:

> *The marketing manager [of the complex] - not even the centre manager - came into my shop on a Thursday night and, in front of everybody in the shop, demanded to know why my figures were stationary ... whereas before I was having growth all the time. I said, 'Where are your brains? You have given me seven competitors. Of course the slice of cake is smaller.'* [186]

2.218 Mrs Marion Dwight, the former proprietor of a gift shop at the Belmont Shopping Centre in Western Australia, gave evidence at the public hearing in Perth that her hitherto successful business had failed after centre management introduced a direct competitor - part of an eastern states group - contrary to representations made during contract negotiations.[187]

2.219 Property managers submitted to the Committee that it is essential to the success of shopping centres that managers retain the right to change the tenancy mix to cater to changing customer demands and expectations.[188] Property managers insisted tenancy mix is not changed 'willy-nilly'[189] but on the basis of a well researched retail plan for each shopping centre.[190]

Options and recommendations

2.220 The United Retailers Association submitted that a property owner/manager has a duty of care not to take action contrary to the best interests of merchants already under lease - which, for example, would preclude changes in the tenancy mix of a centre that would damage the profitability of existing tenants.[191]

186 Sandra Lazari, *Transcript of evidence,* p. 509.
187 Marion Dwight, *Transcript of evidence,* p. 447.
188 Alan Briggs and Dale McDermid, Property Council of Australia, *Transcript of evidence,* pp. 790-91 and Graham Dreverman, Lend Lease, *Transcript of evidence,* p. 806.
189 Graham Dreverman, Lend Lease, *Transcript of evidence,* p. 807.
190 Lend Lease, *Transcript of evidence,* p. 807; Property Council of Australia, *Transcript of evidence,* p. 791.
191 United Retailers Association Inc, *Submission No. 111.2.*

2.221 The Property Council of Australia, addressing this and other proposals to restrict changes in tenancy mix, submitted:

> *... tenancy mix changes are an integral part of the viability of a shopping centre. The management of the tenancy mix by the shopping centre manager is a professional skill demanded by the other retailers in the centre. Unreasonable limitations on tenancy mix changes would ultimately harm the viability of the centre and all the retailers within it.*[192]

2.222 Independent Retailers of Australia proposed a compromise, whereby:

- there would be a business plan for each shopping centre, setting out the potential market for each retail sector (based on the population, income levels and spending patterns of the catchment area);
- property managers, in consultation with retail tenants would then discuss performance targets for each sector; and
- tenancy mix would be determined in the context of the business plan and this would prevent managers from simply accommodating whatever form of new business could afford to pay the rent.[193]

2.223 Ms Louise Martin, Chief Executive, gave evidence that Lend Lease had already adopted a policy of consulting with tenants in relation to proposed major changes in tenancy mix:

> *For instance, we are currently doing a development in Casuarina in Darwin which is a high growth area. We gave an undertaking to the existing tenants that they would be part of the retail mix process, and they have been. We have had a number of sessions on it. We have discussed all the market research, the availability of expenditure in the trade area, how many ice cream shops, how many T-shirts can be supported, et cetera. That has been debated with those retailers. That was our first one, Casuarina, and we will do it in any of our centres where there is a major remix or redevelopment going on.*[194]

2.224 The Committee applauds the Lend Lease initiative.

2.225 The Australian Institute of Business Brokers recommended changes in tenancy mix should be 'put to the vote' at a meeting of the merchants' association, or, alternatively, 'a method of compensation could be calculated whereby the landlord agrees to compensate affected tenants for its actions'.[195]

192 Property Council of Australia, *Submission No. 119.3.*
193 Independent Retailers of Australia, *Submission No. 192.*
194 Louise Martin, Lend Lease, *Transcript of evidence,* p. 805.
195 Australian Institute of Business Brokers, *Submission No. 175.1.*

2.226 The Committee agrees merchants suffering severe damage as a result of a change in tenancy mix should be compensated. Mandatory disclosure statements typically include information on the current tenancy mix of a centre. This is good as far as it goes, but the Committee does not consider it goes far enough. Tenants relying on the tenancy mix disclosed at the time of lease negotiations could well form an impression that they have exclusivity or limited competition when, in fact, their future competitive position is entirely uncertain. The Committee considers mandatory disclosure statements should indicate, quite clearly:

- the existing tenancy mix of the centre;
- if the tenancy mix can be changed during the term of the lease;
- if so, whether or not the lessor is prepared to reduce the rent in the event of the tenant losing sales owing to the introduction of a new direct competitor; and
- if so, the formula for rent reduction or rebate to apply.

2.227 The Committee considers retail tenants have a right to be able to assess their future viability before signing a lease. The present situation, where a tenant negotiates a rent on the basis of being a sole merchant in a particular line of business but faces four or five competitors midway through the lease is unfair.

2.228 Recommendation 2.10

The Committee recommends that the Uniform Retail Tenancy Code provide:

(a) for the merchants' association in a shopping centre to be consulted in relation to changes in tenancy mix; and

(b) for lessors to include in disclosure statements provided prior to the signing of a retail lease the tenancy mix of the shopping centre and whether or not there are any provisions for rent reduction to apply if the turnover of the lessee falls owing to the introduction of a new competitor, or new competitors.

Redevelopment and relocation

Business conduct issues raised

2.229 Two further issues of concern to retail tenants relate to lessors' exercise of their considerable discretion to extend or refurbish shopping centres and to relocate tenants. The issues arising are that:

- tenants are not consulted, nor compensated, in relation to redevelopments that affect foot traffic and sales;
- tenants can be relocated against their will to inferior positions, affecting the profitability of specialty retail businesses; and
- relocation is considered as a common strategy for getting rid of tenants that are in dispute with management.

2.230 The Committee sought detailed advice from the Property Council of Australia on the provisions in retail tenancy legislation applying to the redevelopment of shopping centres and the compulsory relocation of tenants. This advice is reproduced as Table VI.2 in Appendix VI of this report.

2.231 The Committee also examined the terms and conditions in leases provided by AMP, Lend Lease and Westfield, discovering that the lease clauses mirror the legislative provisions.[196]

Compensation for disturbance to trading

2.232 Retail tenants are entitled to compensation for disturbance to trading caused by the refurbishment or redevelopment of a shopping centre. The NSW legislation gives guidance as to the circumstances in which tenants are entitled to compensation. However, there is no guidance as to how compensation should be calculated and, in fact, the amount of compensation paid is a matter for negotiation between lessor and lessee after the event. For example, Lend Lease's standard lease provides:

> ***Part M: Repairs or building work***
>
> *40. We may do any repairs or building work. ...*
>
> *41. When we do repairs or building work:*
>
> *41.1 We must give you as much notice as is reasonably possible of any repairs, maintenance or building work. We must cause as little disruption to your use of the premises as is reasonably possible in the circumstances.*

196 *Exhibits Nos. 184* (Westfield), *191* (AMP) & *209* (Lend Lease).

> *41.2 If we do anything that is within our control and that you prove adversely affects your use of the premises, we must negotiate with you in good faith about reducing the rent or any other money by a reasonable amount.*[197]

2.233 The Committee is not critical of the Lend Lease lease, which simply reflects legislative requirements and industry practice (with admirable clarity of expression). However, these clauses illustrate that retail tenants are not guaranteed compensation for disruption to trading during building work; rather, they bear the onus of proof of damage and must then negotiate from a position of weakness with a powerful manager.

2.234 The Committee heard some horrific stories - including evidence given to the inquiry in confidence - about the disturbance to trading suffered by merchants during redevelopments of shopping centres, with inadequate compensation paid to cover trading losses.

2.235 For example, Mr Pieter and Ms Robyn Willems ran a successful automotive store for ten years before encountering problems after relocating to a new wing during a redevelopment. In 1995, after several claims for compensation against shopping centre management, they closed down with losses in excess of $300 000.[198] During the redevelopment, the Willems were obliged to pay full rent, despite serious disruption to trading caused by:

- the virtual closure of the car park - which was roped off or occupied by building workers for over two years (the Willems' business having formerly derived the bulk of its sales from customers entering the centre from the car park);
- difficulties for potential customers in accessing the Willems' new store (being required to walk through long, dark and often flooded passages with no directional signage);
- three metre high hoardings that obstructed visibility of the mall in which the Willems' store was located; and
- blocking of the external entrance to the mall in which the Willems' business was located with temporary access only through a narrow service passage.

197 *Exhibit No. 209.*

198 Pieter & Robyn Willems, *Submission No. 32* and Pieter Willems, *Transcript of evidence*, pp. 464-74.

2.236 In the Willems' case, they were awarded a token settlement and were not allowed to discuss this settlement with other tenants. The Willems understood that at least one of the anchor tenants in the shopping centre had been substantially compensated for disruption to trading during redevelopment, notwithstanding the impact on anchor tenants had not been as great as the disruptions for specialty tenants since property managers had ensured reasonable access to major stores throughout the redevelopment.[199]

2.237 The Committee considers retail tenancy law should be unambiguous about the eligibility of tenants to be compensated for disturbance to trading. The Committee also considers it would be appropriate for merchants' associations to be informed about proposed redevelopments and to be given an opportunity to make representations to owners about options for minimising disturbance to trading.

Compensation for relocation

2.238 The Property Council of Australia and its members argued at length for shopping centre managers to have the flexibility to redevelop shopping centres and, in the process, compulsorily relocate tenants.

2.239 Retail tenancy legislation usually provides for retail tenants to be compensated if they are compulsorily relocated, to cover pack-up costs, any required refit of new premises and other costs involved in transferring a shop to another location as set out in Table VI.2 in Appendix VI.

2.240 The total costs to a developer of paying out relocation compensation can be enormous and there is both incentive and scope for relocation allowances not to be paid. The Committee heard that it was common industry practice not to renew leases (or grant permanent new leases) when redevelopments were planned.

2.241 The Committee examined Westfield on its policy to retain permanent tenants on renewable short-term temporary leases during major redevelopments, to avoid liability for relocation costs. Mr Alan Briggs, General Manager of Westfield, noted that retail tenants at Westfield Shoppingtown Marion in South Australia had been kept on six month leases for six years or longer, and that retail tenants at Carousel Shoppingtown in Western Australia had been waiting for eight years for a proposed redevelopment to take place.[200]

199 Pieter & Robyn Willems, *Submission No. 32.*

200 Alan Briggs, Property Council of Australia, *Transcript of evidence*, p. 786.

2.242 Mr Ian Newton, General Manager, Leasing Division, explained that Westfield could not afford to pay the levels of compensation required under retail tenancy legislation and was therefore obliged to evade the provisions of the legislation in relation to Marion:

> *The economics of the situation is that if you take 90 merchants and you say the fitout costs of those 90 merchants is $100,000 each, that means - if the owner had to fund that $9 million additional cost - that the project would not go ahead.*[201]

> *I can only tell you that the motivation to avoid paying $9 million in additional capital costs is certainly very strong. We know for a fact that if we had had to absorb the additional cost of the $9 million the development would not have happened. It is a commercial decision that we conform with legislation where we always conform with it. But the fact is the legislation provided for us to step outside that legislation. As a result of that, we took the option to give six-monthly tenancies, which means we are not constrained by that $9 million - or it could have been $10 million or $12 million or $15 million.*[202]

2.243 The Committee can only conclude that the tenants at Marion subsidised the redevelopment of Westfield Marion Shoppingtown.

2.244 The Committee also took evidence that relocation can be used to 'punish' recalcitrant tenants. The story of Ms Linda Hewitt (Box 2.3 below) illustrates the use of relocation as a tactic for terminating a lease.

Are retail leases simply 'trading rights'?

2.245 As discussed above, the Committee examined the retail leases provided by AMP, Lend Lease and Westfield. It is clear from these leases that property owners/managers retain a broad discretion to relocate tenants during redevelopments. Tenants have very limited rights to remain in the premises for which they negotiate a lease and applicable rent.

201 Ian Newton, Westfield, *Transcript of evidence*, p. 819.
202 Ian Newton, Westfield, *Transcript of evidence*, p. 822.

2.246 Professor Alan Millington considered relocation of retail tenants to be completely unfair and to go against the concept of 'quiet enjoyment' which is fundamental to the lessor/lessee relationship:

> *I have seen instances where people have taken trading positions retailing clothes, and Just Jeans, Country Road and Sportsgirl - that group - have been in the same area of the shopping centre. Then either the smaller retailers have been moved to another shop, or the other people have been offered different shops, and the trading composition of an area is changed. I believe that to be unconscionable; it certainly would be in my book. To move tenants from a shop that you have originally leased to them because it suits your management objectives I believe to be unfair.*[203]

2.247 Similarly, Dr Clyde Croft, lawyer and arbitrator specialising in retail tenancy, suggested that retail leases were not really leases as such but, rather, trading rights - rights to retail goods in a particular shopping centre.[204]

2.248 The Committee considers there could be merit in renaming retail leases 'trading rights' and providing for rents to be negotiated in respect of the least favourable location to which the tenant could be compulsorily relocated during the term of the 'trading right'.

203 Professor Alan Millington, *Transcript of evidence*, pp. 622-23.
204 Dr Clyde Croft, *Transcript of evidence,* p. 720.

Box 2.3 Case study of relocation - Ms Linda Hewitt

CASE STUDY - RELOCATION

The case described below is summarised from Submission No. 114 to the Fair Trading inquiry by Linda Hewitt, the former proprietor of a toy shop in Macarthur Square, Campbelltown.

In June 1988, Ms Linda Hewitt purchased a toy shop at Shop 10, Macarthur Square, Campbelltown in NSW, with a five year lease ending in June 1993.

In 1993, many retailers at Macarthur Square were not being offered renewal packages but, rather, casual occupancy, in the context of a proposed redevelopment of the centre by Lend Lease.

Ms Hewitt, conscious of the expansion of Toys R Us and World 4 Kids, was not unhappy at the prospect of closing, or continuing on a casual basis until Christmas 1993. However, Lend Lease offered Ms Hewitt a further five year lease. Lend Lease suggested Shop 10 was too small for a toy shop. In any case, the position was required to entice Sportsgirl back into the centre. Lend Lease offered Ms Hewitt Shops 17 and 18, which were quite rundown, with messy shopfront, uneven floor covering, missing ceiling tiles, and light fittings that did not match. Shops 17 and 18 provided roughly twice the floorspace of Shop 10 and Ms Hewitt was informed by the managers that this would give her security against the entry of a large toy operator.

Ms Hewitt was required by Lend Lease to completely renovate the shops and took out a loan of $300 000 for this purpose, secured against her own home and the home of her parents-in-law.

The toy shop commenced trading from the new premises on 28 October 1993.

In October 1994, two of the project managers for the centre met with Ms Hewitt to inform her that Lend Lease wanted a mega toy store in the centre at the completion of the redevelopment in mid-1996. When Ms Hewitt asked where this left her, one of the managers allegedly replied:

> *Piss off, pack your bags and get out of here, I can't be any clearer than that. You're extinct, you're a dinosaur, you're not wanted anymore.*

Ms Hewitt was told to go 'quickly and quietly' by Christmas 1994, as her shops were needed to accommodate tenants who had been required to vacate their shops for refurbishment. When Ms Hewitt refused to go, the manager promised to bankrupt her by giving continual relocation notices until she ran out of money. The manager indicated Ms Hewitt would not be eligible for any payout for goodwill - since he could bankrupt her and bankrupt businesses have no goodwill.

Ms Hewitt was informed Lend Lease had various ways of getting rid of retail tenants it didn't want, including insistence on new carpet or shopfittings or paintwork (resulting in the cessation of trading and income for the period of the renovation). The manager promised to bring Ms Hewitt to her knees and said that, in time, she would be begging to be released from the centre.

Ms Hewitt noted that, at the time of lease renegotiation in 1993, she had been told that no larger toy store would be opening in the centre for the term of her lease. The manager allegedly replied: 'So! We lied'.

Ms Hewitt later learned that Lend Lease had signed with Coles Myer in March 1993 for the entry of World 4 Kids into Macarthur Square in 1996 at the completion of the redevelopment, and that Lend Lease had given an undertaking to Coles Myer that World 4 Kids would have no direct competition in the centre.

Ms Hewitt declined to close down, principally because of the large loan she had taken out to refurbish Shops 17 and 18.

In January 1996, centre management informed Ms Hewitt's husband that World 4 Kids would open in the centre in May 1996 and that Ms Hewitt was to close her store.

On 1 February 1996, Ms Hewitt received a relocation notice - to Shop 23 which provided less than half the floorspace of Shops 17 and 18. The base rental for Shop 23 was $802.90 per square metre compared to $314.68 for Shops 17 and 18. Ms Hewitt asked for an assurance that she would not be asked to relocate again in the near future if she relocated from Shops 17 and 18. The project manager laughed and said they could give another relocation notice the day after she started trading from Shop 23.

Ms Hewitt informed the project manager she would fight to stay in the centre and was told that Lend Lease was too big to fight, that Lend Lease always won, and that she would run out of money before she got to court. Ms Hewitt informed the manager she had contacted the Australian Competition and Consumer Commission (ACCC).

On 28 February 1996, Ms Hewitt received notice to vacate the centre no later than 30 April 1996. On 24 April 1996, the shop was closed.

Ms Hewitt requested from Lend Lease the return of her security deposit of $28 000 and for $20 000 'pack-up' expenses. In a conversation with Ms Hewitt's husband, one of the project managers said, 'You cannot expect to go to the ACCC and still get your money'.

When Ms Hewitt made her submission to the Fair Trading inquiry in September 1996, Lend Lease had not refunded the security deposit nor paid 'pack-up' costs.

Lend Lease was invited to comment on Ms Hewitt's story but had not lodged a response by the end of the inquiry.

Options and recommendations

2.249 Independent Retailers of Australia argued relocated tenants should be compensated for:

- the value of the existing business (including fitout, plant and equipment, goodwill and the unexpired term of the lease); and
- the cost of removal and 'making good' the old premises.[205]

2.250 Independent Retailers also considered the relocated tenant should be given a new lease on similar terms as the old lease - and for a similar retail space.[206]

2.251 The Australian Institute of Business Brokers argued relocation should only be permitted at the end of a (ten year) lease unless the lessor had negotiated the move with the tenant, after giving assurances to safeguard the tenant's trade and an offer of compensation should a decline in trade eventuate as a direct or indirect consequence of the relocation. The formulae proposed by the Australian Institute of Business Brokers for the calculation of relocation compensation was along the lines of that proposed by Independent Retailers of Australia.[207]

2.252 The Committee has a concern that retail tenancy legislation, as it stands, allows property managers a broad discretion to refurbish and redevelop shopping centres in a way that is inimical to the success of tenants in that centre. Moreover, although retail tenancy legislation recognises tenants' rights to compensation for disturbance and relocation, it is obvious from evidence to the Fair Trading inquiry (including the stories recounted above) that tenants suffer once a redevelopment takes place.

2.253 The Committee considers the conditions that will apply to tenants in the event of any redevelopment should be made abundantly clear to prospective tenants at the time they enter into a lease.

2.254 Accordingly, the Committee would like to see the industry - in the process of consultation recommended for the drafting of a Uniform Retail Tenancy Code - seek to develop tighter compensation provisions for disturbance and relocation, to be specified in the lease or mandatory disclosure statement.

2.255 The experience of Ms Linda Hewitt illustrates how capricious relocation of tenants can effectively undermine any security of tenure. Accordingly, the Committee strongly recommends that, where leases are surrendered in the course of a relocation, that there be a requirement for a lease of similar premises to be granted on similar terms to the surrendered lease. The tenant would then have a right to have a dispute over a relocation examined under the retail tenancy dispute resolution procedures in the Code.

205 Independent Retailers of Australia, *Submission No. 192.*
206 Independent Retailers of Australia, *Submission No. 192.*
207 Australian Institute of Business Brokers, *Submission No. 175.1.*

2.256 Recommendation 2.11

The Committee recommends that the Uniform Retail Tenancy Code provide for retail tenants to be compensated according to pre-determined formulae, specified in the lease or disclosure statement for:

(a) disturbance to trading caused by redevelopments carried out at the direction of the lessor; and

(b) any costs incurred as a result of a compulsory relocation, including pack-up costs, any new fitout requirements, and compensation for disruption to trading.

The Committee further recommends that the Uniform Retail Tenancy Code require a relocated tenant to be granted a lease over new premises comparable to those vacated on like terms and conditions to the surrendered lease.

Future retail property development

Economic and social impact statements

2.257 The Committee was urged to recommend that local governments require 'social and economic impact statements' for large shopping centre developments to stop overdevelopment of retail property.[208] Concern was expressed that local governments are enticing major retail developments into their areas to obtain increased rates and land taxes.[209]

2.258 The Committee took evidence to the effect that town planning tribunals and courts do not presently take into account the likely impact on small businesses when deciding applications for commercial developments.[210]

208 WA Council of Retail Associations, *Submission No. 139* and Tasmanian Independent Wholesalers, *Submission No. 155.*

209 Len Rathmann, WA Council of Retail Associations, *Transcript of evidence,* p. 410.

210 United Retailers Association, *Submission No. 111.5.*

2.259 On the basis of evidence to the Fair Trading inquiry, the Committee is concerned that:

- some existing shopping space in major urban centres is underutilised and retailers in existing centres have suffered serious commercial damage because new centres have been permitted to open in close proximity;[211] and
- there appears to be an emerging trend away from shopping in regional centres, and it would be preferable for the Australian landscape not to be littered with rundown or empty centres.[212]

2.260 In light of the serious social and economic concerns with retail developments raised in the Fair Trading inquiry, not to mention claims of an impending crash in the retail property market, the Committee considers it would be appropriate for local governments to consider in more detail the requirements of customers and small businesses within a community prior to granting approval for the expansion of retail floorspace. The Committee is aware some planning authorities already conduct comprehensive studies of this nature.[213]

2.261 Recommendation 2.12

The Committee is concerned about the proliferation of retail shopping space in Australia and recommends that the Commonwealth raise through the Council of Australian Governments the possibility of local planning authorities requiring 'social and economic impact statements' to be lodged with development applications for shopping centre developments, for consideration with a view to restricting oversupply of retail floorspace.

211 The Micro Business Consultative Group submitted that shopping centres are often established with inadequate infrastructure, do not attract adequate patronage and that traffic flow and advantages are often overstated in lease negotiations with tenants. The Group also considered that local government had not ensured that adequate market share would be available to sustain additional centres before approving new developments (*Submission No. 74).* In a recent article in *The Valuer & Land Economist*, Michael Lonie of the Australian Retailers Association spoke of this as 'cannibalism' of catchment areas and noted that there was no growth in traditional retail categories to support more shops. He observed that two big centres in Gosford (NSW) had felt the effects of 'cannibalisation' by centres at Erina and Tuggerah (*Exhibit No. 226).*

212 Michael Lonie's article also notes that shoppers 'have lost the thrill of the hunt', are bored with the sameness of shopping centres and fed up with crowded car parks. He concluded that 'black holes will come' - as at Sundale on the Gold Coast (*Exhibit No. 226).*

213 The Committee was provided with copies of consultancy reports commissioned by the NSW Department of Urban Affairs and Planning for the 1996 review of the Draft Retail Policy in that State. The reports covered retail trends, the implications for the retail industry of demographic patterns and the level and distribution of retail floorspace *(Exhibits Nos. 235 & 236).*

Regional or neighbourhood shopping centres?

2.262 Local governments (and State planning authorities) influence rents paid by tenants, and profits earned by property owners, by controlling commercial developments in a catchment area.

2.263 Throughout the inquiry the Committee was told that merchants had a 'choice' as to whether or not they occupied space in a particular shopping centre. In fact, specialty retailers do not have much choice at all, largely because of the shift away from strip shopping and neigbourhood shopping.

2.264 The management and ownership of regional centres is highly concentrated and there is no apparent competition between the major property managers in terms of specialty rents and conditions. Indeed, the Property Council of Australia and its members spoke as a united voice throughout the inquiry.

2.265 The Committee considers that future competition in the retail property market - with the potential to constrain the market power of the managers of regional shopping centres - could come from small scale developments.

2.266 Planning authorities should examine the potential for expansion of neighbourhood shopping centres as a means of overcoming some fundamental problems in the retail tenancy environment and the retail property market generally.

2.267 Queensland's draft retail industry strategy suggests that consideration be given to maintaining and enhancing strip shopping with the capacity for innovative and niche market developments.[214] This is an encouraging sign. The Committee considers there is a need for forward-looking innovative retail strategies around Australia, rather than the continued development of major regional shopping centres with attendant social and economic problems.

214 *Exhibit No. 257.*

Conclusions on retail tenancy

2.268 The recommendations the Committee has made above seek to re-establish the retail lessor/lessee partnership on a fair and sustainable foundation.

2.269 The Committee has not attempted to protect retail tenants from trading difficulties. As the Committee recognised at the outset, traditional retailers are facing increasingly tough times because of broad social and economic trends affecting retailing. The Committee has recognised the need to allow property owners and managers considerable flexibility in running shopping centres to adapt to these changing trends.

2.270 The recommendations for 'plugging the gaps' in retail tenancy legislation around Australia will provide lessors and lessees with increased certainty about their obligations to each other.

2.271 The Committee cannot stress strongly enough the need for action to be taken immediately to prevent a collapse in small business retailing. As one witness put it:

> *The organisations which advocate the 'softly, softly' approach are sadly out of touch with what the small retailers want and need. ... These people are bleeding to death and* ***for most of them this inquiry is the last throw of the dice****.*[215] *[emphasis added]*

215 David Roskell, *Submission No. 141.1.*