



August 28, 2014

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

Dear Senator Dastyari,

The National Retail Association (NRA) is a not-for-profit industry organisation providing professional services and critical information and advice to the retail, fast food and broader service industry throughout Australia. The NRA is Australia's largest and most representative retail industry organisation, representing more than 19,000 stores and outlets.

This membership base includes the majority of national retail chains, as well as independent retailers, franchisees and other service sector employers. Members are drawn from all sub-categories of retail including fashion, groceries, department stores, home wares, hardware, fast food, cafes and personal services like hairdressing and beauty.

The NRA has represented the interests of retailers and the broader service sector for almost 100 years. Its aim is to help Australian retail businesses grow.

The NRA appreciates the opportunity to make a submission to the Senate Standing Committees on Economics in relation to the need for a national approach to retail leasing agreements.

The association supports a national approach to retail leasing arrangements to create a fairer system and reduce the burden on small to medium businesses with associated benefits to landlords, with particular reference to the points as set down by the committee.

Overview

NATIONAL APPROACH TO RETAIL LEASING ARRANGEMENTS

This submission relates to the inquiry into the need for a national approach to retail leasing arrangements, as referred to the Senate Standing Committee on Economics, with a report to be handed down on October 30, 2014.

It is the NRA's view that current arrangements, which vary from state to state, are creating confusion and adding an unnecessary cost and regulatory burden to retailers – particularly those which operate in more than one state. The NRA supports a national approach to retail leasing arrangements to create a fairer system and reduce the burden on small to medium businesses (with associated benefits to landlords) with particular reference to the following points:

- The first right of refusal for tenants to renew their lease
- Affordable, effective and timely dispute resolution processes
- A fair form of rent adjustment
- Implications of statutory rent thresholds
- "True cost" pricing (gross or semi-gross leases)
- Bank guarantees
- A need for a national lease register
- Full disclosure of incentives
- Provision of sales results
- Contractual obligations relating to store fit-outs and refits
- Related matters.

Confidentiality

This submission is not confidential.

Implementation/key points

The NRA believes that many of the issues identified by the Productivity Commission's 2008 report into retail tenancies remain relevant and unresolved in the marketplace. In some areas these issues have become more difficult for business owners than was the case six years ago.

The NRA therefore advises that recommendations should be revisited and actioned by the government.

- The first right of refusal for tenants to renew their lease

There may be a multitude of reasons the landlord may wish to remove a tenant at the end of a lease agreement, such as under-performance or continued payment default. Landlords believe they have the right to make such a decision without interference – a view many tenants also support. However tenants also require a certain confidence that their lease agreements are assured in order to operate successfully.

The NRA has suggested at various reviews, that if a landlord offers to renew a lease and the retailer is of the opinion that the rent is in excess of true market value for the designated use, the tenant should have the right to ask for a rent review from a registered retail valuer.

However, we acknowledge that there is a high level of division among retailers on this subject, and for this reason the National Retail Association does not state that its view is representative of the wider retail trade community.

- Affordable, effective and timely dispute resolution processes

The existing dispute resolution procedures, which follow those outlined in the various state legislation, can generally be followed in an affordable, effective and timely manner. However the processes still vary from state to state. Some states are providing better service than others, and achieving a better success rate with either the formal mediation process or intervention between the parties by the relevant authority at an early stage.

Despite the long-standing nature of the processes, there are still parties who attempt to by-pass the system, resulting in delays and additional costs. The NRA has witnessed a number of cases in which legal practitioners have made little effort to resolve the issues between parties, thus prolonging the proceedings, despite the diminishing likelihood of successful prosecution of the case. This kind of undertaking adds an unnecessary cost burden to the client, particularly if the case involves a tenant challenging a major landlord, such as in a shopping centre.

There have been cases which have reached four to five days in a number of the tribunals which could have been resolved on mediation, with a more realistic and commercial approach by the parties' legal representatives.

The NRA recommends the implementation of further education measures, including more specific and streamlined educational materials.

- A fair form of rent adjustment/Implications of statutory rent thresholds

Retail shop leasing arrangements are highly regulated in Australia, almost to the extent of codification. Separate retail shop leasing legislation exists in each of the States and Territories. The retail leasing regimes in each jurisdiction are similar in many respects, but are certainly not identical. Key differences occur between the different state regimes, in many significant areas of leasing administration and operations.

The retail sector is not necessarily averse to a high level of regulation in the area of leasing and tenancy operations. There is a broad recognition that much of the regulation is based on the assumption that landlords and tenants begin in an uneven bargaining position. That assumption does not hold true in some instances, because there exists both small business landlords and large business tenants such as retail chains and franchise banner groups. However, almost every piece of real estate is unique in some respects and that poses policy challenges when considering factors such as bargaining and competition.

Nonetheless, there is significant consensus within the retail sector that there are benefits to be obtained through harmonisation of these laws. There is little doubt that public policy can therefore play a significant role in determining retailers' costs in this area.

The preamble to the terms of reference mentions the reduction of the burden on small and medium businesses with associated benefits to landlords.

Rent and occupancy charges are a major component of almost all retailers' costs of doing business. Within the regulated shopping centre market, a recurring theme in the concerns expressed by retailers is that the annual compounding escalation of rents has exceeded the growth in sales over many years.

The NRA's surveys and member feedback suggest that occupancy costs in this space currently average around 18 per cent in retail shopping centres, which is higher in most cases than the share of retailers' labour costs and on-costs. In some instances, in the shopping centre space, retailers' occupancy costs are at least partially determined by reference to their turnover or the broader performance of others in their product category.

The majority of strip shops use the Consumer Price Index as the method of annual increases in a lease. This may be combined with a mid-term review to market. Generally, tenants believe the CPI is a reasonable indicator but the All Groups Index can be distorted when applied to some retail categories. For example from 2011 until late 2013, apparel and footwear annual increases ranged from -2.7% to 2.7%, whereas the All Groups were in positive territory at all times and nearly always at the higher end of 2.5-3.0% due to the influence of other categories.

When sales increases have been below 3%, an additional 1 or 2% on top of the CPI, as demanded by shopping centres, can have a massive impact on the occupancy cost ratio over a five year term.

A newsagent is a business typically affected in such a way. ABS Retail Sales for June 2014 showed this particular area of retail has taken a significant revenue hit, dropping 11.2% nationally across the twelve month period in 2013. A newsagent in a shopping centre would have experienced a 21.5% increase in rent over the past five years, despite an estimated 17.5% decrease in sales over the same period. Therefore the state and category-specific Consumer Price Index would be a fairer form of rent adjustment for individual retailers.

- True cost pricing (gross and semi-gross leases)

The introduction of gross or semi gross leases by landlords, whereby all the costs associated with outgoings recoveries and marketing are included in the rent, would do away with the need for annual budgets and audits for both these charges. Landlords have continually fought such a change but from a tenant's perspective all they wish to know is how much the landlord requires to occupy the shop. A semi-gross lease would see the statutory charges of rates and taxes recovered in addition to the charge for occupying the store.

A gross lease would also remove a substantial portion of the Disclosure Statement that with the current legislation requires full details of the Outgoing budgets for the financial year. There would have to be substantial savings for the landlord and the same for the tenant as they pick up the administration costs in the outgoings. This position has been put to the various reviews but an agreement is yet to be reached.

The NRA wishes to maintain the banning of the ratchet clause, as it prevents the rent from going down on review when either the market has softened or the CPI is negative. The same position also applies to the provision of a landlord being able to nominate the higher of two methods that would give the landlord a higher rental return.

- Bank guarantees

The NRA suggests bank guarantees are generally the preferred form of security over a lease, and a successful solution to remedying the financial consequences of a retail tenant's default. Issues tend to arise, however, around the size of the bank guarantee when requested by landlords for periods that vary from three to six months. Longstanding tenants with no prior history of default can find the associated restriction on cash-flow costly.

The NRA appreciates the landlord's wish to implement a bank guarantee of such a time period with a new tenant when giving a long-term lease, but wishes to draw attention to potential problems which arise when a smaller landlord draws down on the bank guarantee without prior notice to alert the tenant, or to offer adequate time to remedy a default.

The NRA also suggests more clarification surrounding returning the bank guarantee following the termination of the lease and vacation of the premises, when the tenant has met all obligations as set out within the lease.

- A need for a national lease register

Retail leases are the domain of the states which oversee property rights with no national body operating in that jurisdiction, therefore the creation of such a register would not only be costly but would quickly become outdated due to the speed at which leases expire or are dissolved.

The NRA also questions where the responsibility for such costs and maintenance would eventually fall.

While there is potential for the NRA to operate such a registry for its members, it would take a large degree of development given the sensitivity of information stored. Confidentiality of financial arrangements must be respected, but could be compromised under such a register.

- Full disclosure of incentives;

Various elements determine the final inclusions in a lease agreement between a landlord and tenant, and the degree of difficulty involved in renting a premise will play a large role in the number and scale of incentives offered.

While the NRA supports the full disclosure of incentives to a prospective tenant, it does not support full disclosure to third parties. Due to the confidential nature of incentives as agreed between parties, it is not in the best interests of either landlords or tenants to be obliged to fully disclose incentives. Such incentives should be protected from public accessibility.

- Provision of sales results;

Following the recent reviews of the Retail Leases Acts in Queensland and New South Wales, the Shopping Centre Council of Australia and the NRA, together with other retail bodies have developed a "Draft Code of Practice on the Reporting of Sales and Occupancy Costs in Australian Shopping Centres", containing information relevant to both landlords and retailers.

The draft report, as applied to shopping centres, is in its final stages, and sets down guidelines, categories and definitions relating to areas such as gross leasable areas, sales productivity measures, occupancy cost measures and comparable growth calculations.

The NRA believes tenants whose rents are not based on percentage turnover should remain exempt from sales reporting obligations.

- Contractual obligations relating to store fit-outs and refits;

The contractual obligations relating to fit-out and refits relate mainly to shopping centres in which the landlord publishes a fit-out guide, with which the tenant must comply. Such fit-out guides will typically set down certain parameters relating to lighting, racks and shelving and the type and style of finishes. Guides will also include requirements relating to the shop frontage, entryway, display windows and flooring type. The quality and style guide will differ according to the type of shopping centre – a higher quality would be expected at a larger, regional shopping centre than that of a smaller, supermarket-based centre.

Problems generally tend to arise when the term of the lease has not given the tenant sufficient time to write off the large costs of a compliant fit-out, in line with tax requirements. It is not unusual for a tenant at the end of a three or five-year lease to still be bearing significant sums, some between \$30,000 to \$50,000 not depreciated, when the landlord renewing the lease requires a new fit-out, as a condition of a new lease agreement. Tenants who've invested in excess of \$100,000 on a compliant fit-out require a minimum term of seven years in order to fully depreciate such an outlay. It is not uncommon for a landlord to disregard this issue, citing they are only required to issue a lease for a term of five years as set down in many states' legislation.

The NRA suggests there is a consistent degree of difficulty among retailers in negotiating fair and reasonable fit-out terms. While the industry did enjoy a small reprieve during a period of marked decreases in retail spending, such demands for fully compliant fit-outs have returned as the sector recovers.

- Related matters.

In 2008, the Productivity Commission completed an investigation into the operation of the retail tenancy market in Australia. That inquiry examined the operation of the market, including the concept of "negotiating imbalance" between landlords and store owners. It also examined planning.

Inter alia, that report recommended Federal and/or State Government action to:

- Improve transparency and information accessibility in the retail tenancy market;
- Improve national consistency and administration of lease information in order to lower compliance costs;
- Reduce jurisdictional differences in the provisions for unconscionable conduct, as applying to retail tenancies;
- Work with stakeholders towards a voluntary national code of conduct for shopping centre leases, with enforcement by the ACCC;
- Remove restrictions in retail tenancy legislation that provide no improvement in operational efficiency;
- Develop model retail tenancy legislation to help move towards national consistency, and for this to be adopted in each jurisdiction; and
- Relax state controls that limit competition and restrict retail space and its utilisation.



Disappointingly, many of the recommendations in that report have not yet been actioned by the appropriate governments and/or agencies.

The NRA believes that many of the issues identified by the Commission in 2008 remain relevant and unresolved in the marketplace. In some areas these issues have become more difficult for business owners than was the case six years ago.

The NRA therefore recommends that the Commission's 2008 report be revisited and its recommendations be actioned by government.

Of the list of recommendations above, the NRA considers that all continue to be relevant and should be revisited. Each of the recommendations should be actioned, subject to the following updated comments:

- While the ACCC is not the only potential solution for the enforcement or administration of a national code of conduct for shopping centre leases, there remains a clear need for a national approach to facilitate harmonisation, with the involvement of both industry and government.
- The recommendation to remove restrictions in retail tenancy legislation that provide no improvement in operational efficiency remains relevant as a general principle, but many jurisdictions have since concluded a subsequent review of their own regimes. These subsequent reviews have, to various degrees, focused on the potential for cutting red tape. Future deregulatory gains are most likely to be realised through a national approach to facilitate harmonisation.

Contact information

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