Department of Jobs, skills, Industry and regions

retail leases regulations 2023 regulatory impact statement

FEBRUARY 2023

**Publication Information**

The Department of Jobs, Skills, Industry and Regions acknowledges the traditional owners of the land on which we work, and pays respect to their Elders past, present and emerging.

February 2023

Authorised by the Hon. Natalie Suleyman MP

Department of Jobs, Skills, Industry and Regions, 121 Exhibition Street Melbourne Victoria 3000

© Copyright State of Victoria,

Department of Jobs, Skills, Industry and Regions 2023

Except for any logos, emblems, trademarks, artwork and photography this document is made available under the terms of the Creative Commons Attribution 3.0 Australia license.

TABLE OF CONTENTS

 [**Executive summary *1***](#_Toc124943369)

[**1. Introduction *7***](#_Toc124943370)

[1.1. Requirement for a Regulatory Impact Statement *7*](#_Toc124943371)

[1.2. Consultation *8*](#_Toc124943372)

[**2. Legislative context *9***](#_Toc124943373)

[2.1. Retail Leases Act 2003 *9*](#_Toc124943374)

[2.1.1. Policy intent of legislation *9*](#_Toc124943375)

[2.1.2. Policy objectives of regulations *10*](#_Toc124943376)

[2.1.3. Definition of retail premises *11*](#_Toc124943377)

[2.1.4. Definition of small and medium businesses *11*](#_Toc124943378)

[2.2. Retail Leases Regulations 2003 *12*](#_Toc124943379)

[2.3. Retail Leases Amendment Act 2020 *13*](#_Toc124943380)

[**3. Nature and extent of the problem *14***](#_Toc124943381)

[3.1. Nature of the problem *14*](#_Toc124943382)

[3.1.1. Information asymmetry *15*](#_Toc124943383)

[3.1.2. Market power imbalances *16*](#_Toc124943384)

[3.1.3. Tenant behaviour and capability *17*](#_Toc124943385)

[3.2. Extent of the problem *18*](#_Toc124943386)

[3.2.1. Size of Victoria’s retail leases market *18*](#_Toc124943387)

[3.3. Key market participants *18*](#_Toc124943388)

[3.3.1. Small landlord-small tenant relationship *20*](#_Toc124943389)

[3.3.2. Large landlord-small tenant relationship *20*](#_Toc124943390)

[3.4. What evidence is available to support the problem? *20*](#_Toc124943391)

[3.4.1. Number of disputes *21*](#_Toc124943392)

[3.4.2. Cause of disputes *23*](#_Toc124943393)

[3.4.3. Problems that would exist if the Regulations were allowed to lapse *26*](#_Toc124943395)

[3.5. Rationale for government intervention *27*](#_Toc124943396)

[3.5.1. How effective is the existing regulatory regime? *27*](#_Toc124943397)

[3.5.2. Inadequate market based intervention *28*](#_Toc124943398)

[**4. Options identification *29***](#_Toc124943399)

*4.1* Base case *29*

[4.*2*. Prescribe an occupancy cost threshold to exclude large businesses *31*](#_Toc124943400)

[4.*2*.1. Background and current regulations *31*](#_Toc124943401)

[4.*2*.2. Alternative approaches considered *35*](#_Toc124943402)

[4.*2*.3. Viable options for analysis *35*](#_Toc124943403)

[4.*3*. Prescribe a formula to determine and apportion outgoings to reduce market imbalances](#_Toc124943404) *36*

[4.*3*.1. Background and current regulations *36*](#_Toc124943405)

[4.*3*.2. Alternative Options Considered *39*](#_Toc124943406)

[4.*3*.3. Viable options for analysis *39*](#_Toc124943407)

[4.*4*. Prescribe a disclosure statement to reduce information asymmetries and transaction costs](#_Toc124943408) *41*

[4.*4*.1. Background and current regulations *41*](#_Toc124943409)

[4.*4*.2. Alternative Options Considered *45*](#_Toc124943410)

[4.*4*.3. Viable options for analysis *45*](#_Toc124943411)

[4.*5*. Silent regulations *46*](#_Toc124943412)

[**5. Impact analysis *47***](#_Toc124943413)

[5.1. Approach to impact assessment *47*](#_Toc124943414)

5.1.1 Reference cases *48*

[5.1.*2*. Multi-criteria analysis *48*](#_Toc124943415)

[5.2. Impact analysis – Occupancy costs *50*](#_Toc124943416)

[5.2.1. Base case *50*](#_Toc124943417)

[5.2.2. Criterion 1: Protect small and medium-sized retail business tenants *50*](#_Toc124943418)

[5.2.3. Criterion 2: Protect small and medium-sized retail business landlords *53*](#_Toc124943419)

[5.2.4. Criterion 3: Cost to tenants *54*](#_Toc124943420)

[5.2.5. Criterion 4: Cost to landlords *55*](#_Toc124943421)

[5.2.6. Summary *57*](#_Toc124943422)

[5.3. Impact analysis – Formula to determine and apportion outgoings *58*](#_Toc124943423)

[5.3.1. Base case *58*](#_Toc124943424)

[5.3.2. Criterion 1: Protect small and medium sized retail business tenants *58*](#_Toc124943425)

[5.3.3. Criterion 2: Protect small and medium sized retail business landlords *60*](#_Toc124943426)

[5.3.4. Criterion 3: Cost to tenants *60*](#_Toc124943427)

[5.3.5. Criterion 4: Cost to landlords *61*](#_Toc124943428)

[5.3.6. Summary *62*](#_Toc124943429)

[5.4. Impact analysis – Disclosure statements *62*](#_Toc124943430)

[5.4.1. Base case *62*](#_Toc124943431)

[5.4.2. Criterion 1: Protect small and medium sized retail business tenants *64*](#_Toc124943432)

[5.4.3. Criterion 2: Protect small and medium sized retail business landlords *65*](#_Toc124943433)

[5.4.4. Criterion 3: Cost to tenants *65*](#_Toc124943434)

[5.4.5. Criterion 4: Cost to landlords *66*](#_Toc124943435)

[5.4.6. Summary *68*](#_Toc124943436)

[**6. Summary of the preferred optiom *68***](#_Toc124943437)

[6.1. Small business and competition impacts *70*](#_Toc124943439)

[6.2. Implementation *71*](#_Toc124943447)

6.2.1 What needs to be done? *72*

6.2.2 When will it be done? *72*

6.2.3 Who will do it? *72*

6.2.4 Who will monitor implementation, enforcement and compliance? *72*

6.3. Evaluation *72*

7. Reference list *74*

 Appendix A *75*

 [Appendix B *7*](#_Toc124943448)*6*

# Executive summary

**Purpose of this document**

Small Business Victoria (SBV) has prepared this Regulatory Impact Statement (RIS) for the remaking of the Retail Leases Regulations 2013 (the current Regulations), which expire on 16 April 2023.

Under section 7 of the Subordinate Legislation Act 1994, a RIS must be prepared for proposed regulations unless an exemption is issued by the responsible Minister or Premier. In general terms, a RIS is required for any subordinate legislation that imposes a ‘significant economic or social burden’ on any sector of the community. The proposed Regulations (the Retail Leases Regulations 2023) would impose a significant burden, so a RIS has been prepared.

The proposed Regulations largely remake the current Regulations with no substantive changes. This RIS analyses the benefits and costs of the proposed Regulations as well as alternative options. The analysis shows that the benefits of the proposed Regulations in terms of protecting small and medium size tenants (as well as small and medium size landlords) outweigh other costs. The analysis also shows that the proposed Regulations are superior to alternative options.

**Background and problem analysis**

The retail sector is a large and important part of the Victorian economy, comprising over 40,000 retail businesses and employing about 350,000 people, as defined by the ABS, in Victoria. Many retail businesses are small businesses but the retail sector also includes several large chains of supermarkets and retailers. The nature of competition in the retail sector varies from highly competitive small businesses to oligopolistic supermarkets and large retailers. Most retail businesses lease their premises from a landlord rather than own their own premises. Leases are contractual agreements between a landlord and tenant which outlines the legal and financial obligations of both parties.

The Retail Leases Act 2003 (the Act) defines a ‘retail premise’ as a premise that is wholly or predominately used for the sale or hire of goods or the retail provision of services. ‘Retail leases’ refer to leases that are covered under the Act. Some retail businesses are on commercial leases, not covered by the Act.

All leases are governed by Commonwealth property law; however, all State governments have some form of retail leasing legislation or regulation. In Victoria the retail leasing legislation and its subordinate regulations provide greater legal protection to small and medium sized businesses who fall within the scope of the Act. The Act aims to ensure the fairness and clarity of retail leasing arrangements between landlords and tenants and ensure an effective dispute resolution process is available for both parties. Without the Victorian regulatory framework (the Act and the Regulations), small and medium sized tenants would be disadvantaged because of information asymmetry (landlords having more information than tenants about premises) and market power imbalances. This could result in inequitable and inefficient outcomes.

The Act’s provisions include:

* the conditions of a retail lease – including minimum lease periods, options to renew, fit outs, acceptable payments (e.g. rent and outgoings) and the means by which such payments should be calculated and/or reviewed, and specific requirements for shopping centre tenants;
* the provision of information between landlords and tenants including notification periods, and the requirement to provide tenants with a disclosure statement;
* damages, repairs, refurbishments and relocations – and the respective roles and responsibilities of landlords and tenants; and
* dispute resolution – and the role of the VSBC.

The Act is enabled by the Regulations. If the current Regulations were allowed to expire (the ‘base case’), the threshold to exclude retail premises from the Act would be equal to zero (as the Regulations would not exist to prescribe an occupancy cost threshold). This would essentially render the Act null and void as all retail premises in Victoria would fall outside the scope of the Act. With all retail businesses falling outside the scope of the Act, all retail businesses would be managed on a commercial lease. As a result, no retail tenant or landlord would be required to adhere to the Act’s provisions.

It is thus reasonable to expect that, under the base case, the Act’s provisions, as stated above, would cease to provide the protection that small and medium sized business require.

It is uncertain how the market for retail businesses would operate in the base case, particularly given the Regulations and regulatory framework are longstanding, however, there is a strong likelihood that the market would operate as the commercial leasing market does currently.

**Objectives**

Three objectives are stated in the current Regulations:

1. to make provision with respect to the amount of occupancy costs for the purpose of excluding certain retail premises;
2. to make provision with respect to the amount of outgoings payable by a tenant; and
3. to prescribe the form of the landlord’s disclosure statement.

These three objectives aim to address problems that would occur in the absence of regulations.

1. Prescribing an occupancy cost threshold excludes large tenants from coverage under the legislation as these tenants do not need the protections of the Act;
2. Prescribing a formula to fairly determine and apportion outgoings reduces market power imbalances; and
3. Prescribing the content and form of disclosure statements reduces information asymmetries.

**Options identification**

The Department has considered a broad range of options to address the problems above. Non-regulatory options, such as a code of practice to promote fair leasing practices, were considered unviable because regulations are required for there to be retail leases and tenants covered by the Act.

Viable options were identified for further analysis for each of the three areas/objectives of the Regulations.

The Department analyses three options for setting occupancy cost thresholds:

* Option 1 (OC1): Retain the current threshold of $1 million per year.
* Option 2 (OC2): Increase the current threshold in line with inflation to $1.3 million per year, meaning more retail businesses would be covered by the Act.
* Option 3 (OC3): Decrease the threshold to $500 000 per year, meaning fewer retail businesses would be covered by the Act.

The Department analyses two options for apportioning outgoings:

* Option 1 (F1): Retain the current formula to determine and apportion outgoings where tenants pay in proportion to their lettable area.
* Option 2 (F2): Prescribe a performance standard requiring a fair and equitable determination and apportionment of outgoings.

The Department analyses two options for disclosure statement requirements:

* Option 1 (DS1): Retain the current approach which has four distinct disclosure statements (for shopping centre tenants, non-shopping centre tenants, renewed leases and tenant assignment).
* Option 2 (DS2): Revert to the single nationally harmonised disclosure statement for all types of tenants (which was in place in Victoria prior to 2013).

**Impact analysis**

Each set of options is analysed using multi-criteria analysis (MCA). MCA is used because the impacts of these options (especially benefits) cannot be precisely or reliably quantified (due to data being unavailable or the nature of the impacts). Chapter 5 of this RIS provides further explanation on how the MCA was conducted.

Each option is analysed against a ‘reference case’ (a point of comparison) rather than the base case. This is because it is not clear what protections would be available to tenants in the absence of the Regulations.

The criteria and weightings in the MCA are:

* Protect small and medium-sized retail business tenants (40 per cent), by reducing information asymmetries and market power imbalances.
* Protect small and medium sized retail landlords (10 per cent), by making the rights and responsibilities of landlords clear and reducing the potential for disputes.
* Costs to tenants (25 per cent), which include administrative and compliance costs for tenants covered by the regulatory framework, as well as other economic costs such as reduced flexibility to negotiate terms and conditions for some tenants covered by the framework.
* Costs to landlords (25 per cent), which include administrative and compliance costs for landlords whose tenants are covered by the regulatory framework, as well as other economic costs, such as reduced flexibility, for landlords whose tenants are covered by the framework.

Each option is scored against each criterion on a scale of -10 (much worse than the reference case) to +10 (much better than the reference case). The reference case is scored 0, so if an option has a positive score it is preferred to the reference case.

Analysis of options in the RIS draws heavily on the 2013 RIS (prepared for the current Regulations) because:

* The market for retail leases is an established market. While there have been considerable changes in retailing over the past decade, such as more online retail, retail leases have not fundamentally changed. This means that the analysis in the 2013 RIS remains relevant. In particular, the analyses by the Productivity Commission and PwC of retail leases used in the 2013 RIS remain relevant.
* Estimates of the distribution of occupancy costs from the 2013 RIS have been used in the current RIS. This distribution is relevant to estimating the impacts of different occupancy cost thresholds. Recent analysis by Invest Victoria (Q3 2022) suggests that occupancy costs have not changed significantly in recent years and analysis of current Australian Taxation Office data suggests that average commercial rents in almost all industries are well below the thresholds considered in each option.
* The pandemic has had a significant impact on many retail businesses and landlords. The Department has been heavily engaged with businesses, for example, through the Commercial Tenancy Relief Scheme. Stakeholders (both tenant and landlords) have expressed a clear preference for stability in retail leases regulations given the pandemic and other challenges. For these reasons, the Department has been reluctant to undertake a significant data collection exercise from retailers and landlords, given that the 2013 analyses remain relevant.
* The requirement to notify the Victorian Small Business Commission on entry or renewal of a retail leases was removed at the end of 2012 to reduce the regulatory burden on landlords. As a result, there is limited data on the precise size and scope of retail leasing market in Victoria.
* It avoids the significant expense of gathering and analysing privately held data about occupancy costs.

The Department invites feedback from stakeholders on the assumptions made and analysis in the RIS.

*Analysis of occupancy cost thresholds*

Options for setting occupancy cost thresholds are analysed against a reference case under which the Regulations expire and no leases are covered by the Act. It is assumed that businesses on retail leases would continue to operate but under a commercial lease.

All options are preferred to the reference case because under each option more than 90 per cent of retail businesses would fall under the threshold and be covered by the Act. The benefits of these protections to small and medium size tenants outweigh the compliance costs and loss of flexibility for landlords and large tenants.

Option 1 (OC1) is the preferred option for setting occupancy cost thresholds because it would cover almost all small and medium size tenants and have lower costs than Option 2 (OC2) because it would cover fewer large tenants. Option 3 (OC3) has a much lower threshold, so many medium size tenants would not be covered, resulting in it being the least preferred option.

**See table 13: Occupancy costs threshold options – MCA summary**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
|  | ***Weighting*** | ***Reference Case*** | ***Option OC1*** | ***Option OC2*** | ***Option OC3*** |
| Protect small and medium sized retail business tenants | 40% | 0 | 8 | 8 | 5 |
| Protect small and medium sized retail business landlords | 10% | 0 | 4 | 4 | 2 |
| Cost to tenants  | 25% | 0 | -1.5 | -4 | -1 |
| Cost to landlords  | 25% | 0 | -4.5 | -6 | -4 |
| **Weighted score** |  |  | **2.1** | **1.1** | **1.0** |

*Analysis of options for apportioning outgoings and disclosure statements*

Options for apportioning outgoings and disclosure statements are analysed against a separate reference case which assumes that an occupancy cost threshold of $1 million remains in place. This is because without an occupancy cost threshold in place (the base case), there would be no retail leases, so the options for apportioning outgoings and disclosure statements would have no impact.

Option 1 (F1) is the preferred option for determining and apportioning outgoings. This is because Option 1 will better protect small and medium size tenants by providing clarity and certainty about how outgoings will be determined and apportioned. It will also provide some protection to small and medium landlords. Option 1 will impose costs on landlords and large tenants by limiting landlords’ ability to provide discounted outgoing costs and recovering the shortfall from smaller tenants. Overall, the protection to small and medium tenants and landlords outweighs the greater costs imposed on large landlords and tenants.

**See table 14: Apportionment formula options – MCA summary**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | ***Weighting*** | ***Reference Case*** | ***Option F1*** | ***Option F2*** |
| Protect small and medium sized retail business tenants | 40% | 0 | 6 | 4 |
| Protect small and medium sized retail landlords | 10% | 0 | 2 | 1 |
| Cost to tenants | 25% | 0 | -3 | -2 |
| Cost to landlords | 25% | 0 | -2 | -1 |
| **Weighted score** |  | 0 | **1.35** | **0.95** |

Option 1 (DS1) is preferred for disclosure statement requirements because it offers stronger protection to both small and medium-sized tenants and landlords when compared to the reference case and Option 2 (DS2). Option 1 provides stronger protection than Option 2 due to having distinct disclosure statements for different types of leases, meaning they are easier to understand. Option 1 is also less costly than Option 2 because distinct disclosure statements are shorter and less burdensome to prepare.

**See table 16: Disclosure Statements – MCA summary**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | ***Weight-ing*** | ***Reference Case*** | ***Option DS1*** | ***Option DS2*** |
| Protect small and medium sized retail business tenants  | 40% | 0 | 9 | 7 |
| Protect small and medium sized retail business landlords | 10% | 0 | 6 | 2 |
| Cost to tenants  | 25% | 0 | -1 | -1.5 |
| Cost to landlords | 25% | 0 | -4 | -7 |
| **Weighted score** |  | 0 | **3.0** | **0.9** |

It is difficult to quantify the full extent of the regulatory burden. However, the regulatory burden imposed by the disclosure statement requirements for new, renewed and assigned leases can be quantified and provides an indication of the total regulatory burden. In producing the estimates utilised in this RIS, the Department has relied upon certain data sources from the previous RIS. These data sources have been updated where practicable with current data, and the Department is satisfied with their adequacy. Through this process, it is estimated that the total cost imposed on Victorian businesses, primarily landlords of retail premises in Victoria, over the 10 years during which the proposed Regulations would be in place, is $47.9 million.

**Preferred option**

The preferred option and proposed Regulations have three elements:

1. The preferred option is to retain the $1 million occupancy cost threshold. This option would bring any business with yearly occupancy costs of under $1 million into the scope of the Act. This option represents continuity with the 2013 Regulations and would provide certainty to landlords and tenants.
2. The preferred option is to retain the current formula to determine and apportion outgoings. Landlords would be required to use the prescribed formula for all tenants covered by the Act. This option would provide landlords and tenants with certainty about how outgoings should be determined and apportioned. Conversely, it would also reduce the flexibility of landlords and tenants in their commercial negotiations.
3. The preferred option is to retain the current four disclosure statement model. Under this model there will be separate disclosure statements for shopping centre tenants, non-shopping centre tenants, renewed leases, and tenant assignment. This provides a streamlined disclosure statement system where businesses and landlords deal with forms specifically tailored to the disclosure requirements of their circumstances.

The proposed Regulations largely remake the current Regulations with no substantive changes. The minor changes mainly involve grammatical adjustments and the reformatting of certain regulations to improve ease of understanding. For further information on the changes see Appendix A.

**Implementation and evaluation**

The proposed Regulations remake the current Regulations, so implementation will be relatively straightforward. The proposed Regulations will commence in April 2023, before the current Regulations expire on 16 April 2023. In April 2023, the Victorian Small Business Commission will hold information sessions about the remaking of the Regulations and undertake targeted stakeholder consultation.

As noted above, analysis in this RIS draws heavily on the 2013 RIS. The Department invites feedback from stakeholders on the assumptions made and analysis in this RIS.

The Department is committed to undertaking a mid-term review of the effectiveness of the Regulations within five years (by April 2028). This review will require updated data and additional analysis. The Department anticipates that additional data sources will be available that will be able to inform future analysis and decisions. This includes additional analysis on data collected by the Victorian Small Business Commission’s new customer management system, which will be able to provide more insights on the nature of disputes than has previously been possible. In addition, the Department’s close work with other government agencies throughout the pandemic has highlighted opportunities for developing new data sources, particularly on occupancy costs. Section 6 of this RIS further expands on this commitment.

Potential indicators for evaluating the effectiveness of the Regulations include, VSBC data on the number of disputes and the nature of those disputes, the percentage of businesses falling within the scope of the Act and continued stakeholder engagement.

**Public consultation**

The RIS will be published on 14 February 2023. Public comments and submissions are invited on the proposed regulations, in response to information provided in this RIS. All submissions will be treated as public documents unless specified otherwise. Written comments and submissions should be provided no later than 5pm on 14 March 2023. Further details on public consultation can be found in section 1.2 of this RIS.

# Introduction

This chapter outlines why a Regulatory Impact Statement (RIS) has been prepared and the consultation undertaken to date for the RIS.

## Requirement for a Regulatory Impact Statement

The Regulations sunset on 16 April 2023 and Small Business Victoria (SBV) has prepared this RIS to determine the form of the re-made Regulations. SBV is a branch of the Department of Jobs, Skills, Industry and Regions (DJSIR) which is the government department that administers the Act and the Regulations. While the Act does not require any items to be prescribed in the Regulations, in reality certain items must be prescribed to support the operation of the Act. Therefore, the Regulations must be re-made to some degree and the RIS considers options to amend the current Regulations.

Under section 7 of the *Subordinate Legislation Act 1994,* a RIS must be prepared for the proposed regulations unless an exemption is issued by the Premier or the responsible Minister. In general terms, a RIS is required for any subordinate legislation that imposes a ‘significant economic or social burden’ on any sector of the community. An indicative threshold of $2 million per annum can be used to assess whether burden is significant.[[1]](#footnote-2)

Based on an initial analysis, it was concluded that the re-made Regulations will impose a significant burden and a RIS is therefore required. This analysis is primarily based on the disclosure statement, which is expected to be prescribed in the proposed Regulations. The requirement to provide a disclosure statement imposes a burden by requiring a substantial amount of information to be disclosed, which is costly to gather and collate in a statement. It can be safely assumed that for the purposes of the *Subordinate Legislation Act 1994* the proposed Regulations will impose a significant burden.

A RIS forms an essential part of the regulatory development process as it considers the appropriateness of regulation in comparison to other non-regulatory options available to Government and the costs and benefits of all regulatory and non-regulatory options. It should also consider the sectors of the community where the costs and benefits will be attributed. The RIS process should ensure that:

* the implementation of regulation only occurs where this is a justified need;
* only the most efficient forms of regulation are adopted; and
* there is an adequate level of public consultation in the development of regulatory measures.

To adhere to the requirements of the *Subordinate Legislation Act 1994*, the purpose of this RIS is to:

* identify, establish and determine the nature and extent of the problem that the Government is seeking to address as well as specifying the objectives of regulations (Chapter 2 & 3);
* identify a set of feasible options for Government to address the identified problems (Chapter 4)
* assess the costs and benefits of these options, and the effectiveness of each option in addressing the problem before establishing a preferred option for Government action (Chapter 5); and
* summarise the preferred options and proposed regulations, develop an implementation plan and evaluation strategy (Chapter 6).

## Consultation

SBV, has undertaken initial consultation with key government and industry stakeholders to inform the development of the proposed regulations prior to release for public comment. Consultation has been ongoing with stakeholders throughout the lifetime of the regulations, particularly throughout the development of the *Retail Leases Amendment Act 2020* and during the *Commercial Tenancy Relief Scheme*. Further information was provided by stakeholders to test some of the costing assumptions in this RIS.

Public comments and submissions are invited on the proposed regulations, in response to information provided in this RIS. All submissions will be treated as public documents unless specified otherwise. Written comments and submissions should be provided **no later than 5pm on 14 March 2023** by:

**Email**

ylva.carosone@ecodev.vic.gov.au

**Post**

Ms Ylva Carosone

Executive Director, Small Business Victoria

Department of Jobs, Precincts and Regions

GPO Box 4509

MELBOURNE VIC 3001

# Legislative context

This chapter provides an overview of Victoria’s retail leases legislation, the policy intent of the legislation and key definitions that determine coverage of the legislation.

1.

## Retail Leases Act 2003

Retail leases legislation was enacted in most States and Territories between 1984 and 2003.[[2]](#footnote-3) State based legislation imposes regulation aimed at ensuring the efficient and equitable operation of the retail leases market. Retail leases regulation in Australia takes a number of forms, including substantive restrictions on lease terms and general provisions to prohibit unconscionable conduct.[[3]](#footnote-4)

The Act regulates the commercial relationship between the landlord and tenant of a retail premises in Victoria. A retail lease is a type of commercial lease. All commercial leases in Australia are governed by property laws but retail leases are also subject to State/Territory retail leases legislation, which have more stringent lease requirements and tenant protections.

Retail leases legislation was introduced in Victoria in 1987 (*Retail Tenancies Act 1986*). The legislation has since been reviewed and amended six times: 1995 (*Retail Tenancies (Amendment) Act 1995*); 1998 (*Retail Tenancies Reform Act 1998*); 2003 (when a new Act was introduced – the *Retail Leases Act 2003*); 2005 (*Retail Leases (Amendment) Act 2005*); 2012 (*Retail Leases Amendment Act 2012)*;and 2020 (*Retail Leases Amendment Act 2020)*. Each amendment has sought to clarify the law and implement practical improvements to retail leases legislation. As a result, the quantity of legislation has increased and become quite prescriptive, with some stakeholders believing it is now too prescriptive.

To ensure that small business tenants and landlords are well informed about the extent of their obligations, the Victorian Small Business Commission[[4]](#footnote-5) (VSBC) and Business Victoria[[5]](#footnote-6) website contains information about particular aspects of the Act.

## Policy intent of legislation

The Act originally came into operation as a result of a comprehensive review in 2001 (2001 Review) to ensure Victoria’s retail tenancy laws better protect small and medium sized retail tenants. The Act aimed to “establish a new regulatory framework for retail tenancies that promotes greater certainty, fairness and clarity in the commercial relationship between landlords and tenants of retail premises.”[[6]](#footnote-7) The main objectives of the legislation are to enhance the:

* certainty and fairness of retail leasing arrangements between landlords and tenants; and
* mechanisms available to resolve disputes concerning leases of retail premises.

The legislation is intended to encourage an environment of fairness during the negotiation and duration of the lease, so that landlords and tenants mutually benefit. The Government “developed legislation that represents a fair balance between the interests of tenants and landlords.”[[7]](#footnote-8) The Government has legislated to ensure that one party does not unfairly take advantage of its superior information and negotiating power to the detriment of the other party. Usually, the landlord has superior information. The Act contains minimum provisions that cannot be overridden through lease negotiations.

The following five policy principles were used to guide the development of the current retail leases legislation.[[8]](#footnote-9) These principles aim to address the market failures described later in section 3.1.

1. Retail leases legislation should only protect small and medium sized retail businesses.
2. Government regulation of retail leases should focus on addressing information imbalances and the misuse of market power.
3. Government involvement in retail leases matters should aim at ensuring that prospective tenants have sufficient knowledge to make an informed business decision.
4. While a landlord has a fundamental right of control over the use of its property, this right does not extend to engaging in unfair business practices.
5. Landlords and tenants should be able to access a low-cost informal dispute resolution forum prior to any grievances proceeding to formal litigation.

## Policy objectives of regulations

The *Subordinate Legislation Act 1994* requires a RIS to include a statement of the proposed regulations’ objectives. These objectives should be closely related to the objectives of the Act authorising the proposed regulations. Some proposed measures may have several objectives and where this is the case, a RIS will explain whether there is a primary objective. The objectives should be stated in terms of the ends to be achieved and must be specified in relation to the underlying problems discussed in chapter 3. The objectives are important as they help to assess whether the proposed regulations have been appropriately selected as a means of addressing the underlying problems.

The relevant objective of the Act is to “enhance the certainty and fairness of retail leasing arrangements between landlords and tenants”.[[9]](#footnote-10) Overall, the Regulations aim to provide for successful relationships and more efficient arrangements than would otherwise be achieved between landlords and tenants.[[10]](#footnote-11) Three objectives are stated in the current Regulations:

* to make provision with respect to the amount of occupancy costs for the purpose of excluding certain retail premises;
* to make provision with respect to the amount of outgoings payable by a tenant; and
* to prescribe the form of the landlord’s disclosure statement.

These objectives aim to address three market failures or problems over and above the Act:

* prescribe an **occupancy cost threshold** to exclude large businesses from coverage under the legislation;
* prescribe a **formula** to fairly determine and apportion outgoings to reduce market power imbalances; and
* prescribe the content and form of the **disclosure statement** to reduce information asymmetries.

The underlined sections of the problems above represent the primary objectives of the Regulations. The **bolded** sections of the above problems represent the measures by which these objectives are achieved. These measures are dictated by the Act. The identification of feasible options in Chapter 4 and the analysis of these options in Chapter 5 is structured around these three measures (i.e. occupancy cost threshold, outgoings formula and disclosure statement) and examines variations of each measure.

## Definition of retail premises

‘Retail premises’ is defined in section 4 of the Act. Premises are ‘retail premises’ if, under the terms of the lease, the premises are used or are to be used wholly or predominantly for the sale or hire of goods by retail or the retail provision of services.

The Act does not define ‘retail’. The ordinary meaning or dictionary definition of retail means the provision of goods or services, which generally involves a sale to an ultimate consumer. It is implicit in the concept of ‘sale’ that goods are sold at a price, which involves the payment of money.[[11]](#footnote-12)

Section 4 of the Act also provides that certain premises are not ‘retail premises’. Broadly, retail premises will be excluded from coverage under the Act if the tenant has occupancy costs greater than the prescribed amount or is a publicly listed company. Certain types of premises are also specifically excluded from coverage under the Act via Ministerial Determination.[[12]](#footnote-13) These exclusions aim to ensure that only small to medium sized retailers are covered by the Act.

## Definition of small and medium businesses

There is no consistently used definition of ‘small business’. Common definitions categorise businesses based on the number of employees as used by the Australian Bureau of Statistics (ABS), Fair Work Commission and several small business surveys or annual revenue as used by the Australian Taxation Office.

SBV uses the ABS definition, which defines a small business as a business with zero to 19 employees and a medium sized business as a business with 20 to 199 employees. The *Retail Leases Act 2003*, however, does not expressly define small business or medium sized business.

Including or excluding businesses from coverage under the Act based on the number of employees is considered inappropriate as there are practical difficulties with such criteria. For instance, the number of employees can vary significantly over the course of a lease. It may also be difficult for the landlord to verify the number of employees a tenant has to determine whether the legislation applies.[[13]](#footnote-14)

Instead, the Act uses other criteria to ensure that large businesses are not captured by the legislation. Section 4 of the Act lists exclusions to the definition of ‘retail premises’ and those exclusions relating to business size include:

* premises with occupancy costs greater than the amount prescribed in the Regulations (currently $1 million per annum);
* premises the tenant of which is a listed corporation (as defined by the *Corporations Act 2001*) or a subsidiary of such a corporation; and
* premises the tenant of which is a body corporate whose securities are listed on an international stock exchange or a subsidiary of such a body corporate.

The 2001 Review of the retail leases legislation gave extensive consideration to which criteria should be used as a suitable basis for defining a small business to ensure the Act provided suitable protection of smaller tenants of retail premises. This is discussed further in section 4.2.

## Retail Leases Regulations

Regulations were first made under section 99 of the Act to facilitate the Act’s operation and commenced operation on 1 May 2003 to accompany the Act. The objectives of the Regulations are guided by the policy principles underpinning Victoria’s retail leases legislation (discussed above). The stated objectives of the Regulations were to:

* make provision with respect to the amount of occupancy costs for the purpose of excluding certain retail premises;
* make provision with respect to the amount of outgoings payable by a tenant; and
* to prescribe the form of the landlord’s disclosure statement.

Amendments to the Regulations came into effect on 1 January 2011 to introduce a new disclosure statement based on a core model national disclosure statement that was developed in 2010. The model disclosure statement was developed by the National Retail Tenancy Working Group to facilitate national harmonisation of retail leases legislation across jurisdictions.

In 2013, the Regulations replaced the 2003 Regulations and the key changes made were to replace the former singular disclosure statement with four separate disclosure statements. These disclosure statements were to be used in connection with retail leases in retail shopping centres; new leases of premises not located in retail shopping centres; renewals of lease; and assignments of leases that involve the sale of the business operating from the retail premises.

Further amendments to the model disclosure statement came into effect on 1 December 2022. These amendments are aimed at improving transparency for tenants in the lease renewal and negotiation process.

The Act gives power for a number of matters to be prescribed in the Regulations. However, not all powers to prescribe are utilised, with the Regulations remaining silent in a number of areas. For example, the following sections of the Act refer to the Regulations and the sections marked with an asterisk (\*) do not prescribe relevant items in the current Regulations:

* section 4 Meaning of ‘retail premises’ (occupancy costs);
* section 17 Provision of Landlord’s disclosure statement and proposed lease;
* section 26 Landlord’s disclosure on renewal of lease;
* section 30 Alterations to premises to enable fit out\*;
* section 35 Rent reviews generally\*;
* section 39 Recovery of outgoings from the tenant;
* section 40 Liability to contribute to non-specific outgoings;
* section 47 Statement of outgoings;
* section 61 Procedure for obtaining consent to assignment (disclosure statement);
* section 72 Unspent advertising and promotion contributions\*;
* section 84 Functions of the Small Business Commission\*;
* section 86 Referral of retail tenancy disputes for alternative dispute resolution\*; and
* section 99 Regulations.

## Retail Leases Amendment Act 2020

The Retail Leases Amendment Act 2020 (‘Amendment Act’) commenced on 23 September 2020. The Amendment Act amended the 2003 Act and clarified that landlords can pass on the cost of repairs and maintenance of Essential Safety Measures to retail tenants as outgoings where provided for in the lease, after a Victorian Civil and Administrative Tribunal (VCAT) advisory opinion[[14]](#footnote-15) created uncertainty on this matter.

Secondly, amendments to section 17 of the Act extend the minimum timeframes by requiring landlords to provide the proposed lease (including rent, tenant particulars and the term) and a disclosure statement to the tenant at least 14 days before entering a lease. The section 17 of the Act amendments also require landlords to notify tenants of any changes made to the proposed copy of the lease since the previous version to ensure tenants are aware of any changes. The Schedules to the Retail Leases Regulations 2013 have consequently been updated to comply with the new legislative requirements.

Lastly, amendments to sections 26 and 28 of the Act require landlords to give up-to-date information to tenants with options to renew retail premises leases. The amendments ensure that tenants are provided with all relevant price and non-price terms and changes to the previous disclosure statement within a reasonable time before they must decide whether to exercise an option to renew the lease. Landlords will be required to provide notice to tenants at least three months before the last date that an option to renew the lease may be exercised containing: the last date by which the option to renew may be exercised, the rent payable for the first twelve months of the new term, the availability of an early rent review process and a cooling-off period and any changes to the most recent disclosure statement provided to the tenant. Schedule 3 of the Retail Lease Regulations 2013 has consequently been updated to comply with the new legislative requirements.

The Amendment Act makes retail leases fairer and easier to understand by improving the information tenants receive to facilitate more informed decisions on retail leases.

# Nature and extent of the problem

This chapter explains the nature of the problems in the retail lease market in the absence of government regulation. These problems are examined in the context of economic efficiency and equity. In the absence of regulations for retail leases, several inefficiencies can occur, caused by market failures. Economic equity issues would also be exacerbated between landlords and tenants in the absence of regulation. This chapter also examines the size of the retail leases market and key relationships in the market between landlords and tenants. Finally, this section considers the extent of the problem by looking at the number and type of retail lease disputes between landlords and tenants.

1.

## Nature of the problem

Most small retailers lease premises. The cost of rent payable and other terms of the lease (along with staff costs) are usually the retailer’s greatest expense and can have a major impact on a tenant’s business. Occupancy costs as a proportion of turnover varies greatly with businesses in houseware and hardware retailing having far lower occupancy costs as a percentage of turnover than clothing retailing businesses.[[15]](#footnote-16) This result is likely to reflect the prime retail locations (e.g. Bourke Street mall or Chadstone shopping centre) and associated high rents in which clothing stores are located.

If all parties to a lease adopted good and fair business practices, there would be little need for the regulation of retail leases. Governments across Australia have recognised that this is not always the case and have introduced retail leases legislation that establishes minimum requirements to promote fair outcomes.[[16]](#footnote-17) The legislation should encourage successful relationships and more efficient arrangements than would otherwise be achieved between landlords and tenants, without imposing additional and unnecessary burden on the parties.[[17]](#footnote-18)

The basis of the commercial relationship between the landlord and tenant is the mutual pursuit of profit from the retail premises under lease. For the landlord, this is sought through rent from the premises, and for the tenant this is achieved through retail sales and possibly the sale of the business.[[18]](#footnote-19) Factors such as the location, rent and other costs payable are fundamental to the success of the business. The negotiation of appropriate lease arrangements is therefore a crucial aspect of ensuring a mutually successful business relationship between a landlord and tenant.[[19]](#footnote-20)

The lease is the commercial contract that reflects this relationship and is negotiated between two consenting business owners. The lease will outline the legal and financial obligations of both the landlord and the tenant and a lack of understanding of these obligations may have significant repercussions.

A lease is legally binding and defines the legal relationship between the landlord and the tenant.[[20]](#footnote-21) Both parties to the lease, and particularly prospective tenants, should ensure they understand all provisions of the lease they are about to enter into and their legal obligations. Even a well-drafted lease may be difficult for some parties to understand, particularly small landlords, small tenants, and people with limited English skills.

A lease is also a financially binding document. Rent is only one of the costs payable and other significant costs are associated with the lease such as fit out, repairs and maintenance, and outgoings. A well-drafted lease should clearly detail whether the landlord or tenant is liable for particular costs and provide a breakdown of those costs.

Efficiently functioning markets will generally provide the best means of ensuring that goods and services are delivered at least cost. Government regulation is justified where market failure or other problems occurs and regulation provides for a more efficient outcome than non-regulatory alternatives.[[21]](#footnote-22) A market failure is when a free market fails to efficiently distribute goods and services and where normal behaviour does not lead to total benefits being maximised. Examples include public goods, externalities, information asymmetry or market power. Without government intervention, tenants, particularly smaller retailers, will face higher costs during the negotiation of the lease and throughout the duration of the lease due to information asymmetry.

There are also economic equity concerns regarding retail leases. As larger landlords often have better information about the leased premises, a better understanding of leases in general, and greater market power, larger landlords are more likely to be able to negotiate unfairly favourable lease agreement at the expense of retailers. Equity concerns also need to be addressed by retail lease regulation.

There are certain characteristics of the market for retail leases that result in two specific and interrelated problems or market failures: information asymmetry and market power imbalances. Another related problem is also evident; tenant capability and behaviour. How each problem manifests in the retail leases market is explained in the sections below.

## Information asymmetry

Information asymmetry occurs when relevant information is known to some but not all parties in a market giving an advantage to the more knowledgeable party involved in the transaction. Information asymmetry causes markets to become inefficient since at least some market participants do not have access to the information they need to inform their decision making, and this may result in them not transacting or making poor decisions.

In the retail leases market both parties have incentives to ensure that they base their decision on as complete information as possible and conducting their own due diligence.

The current regulations precludes landlords from providing *false* information to prospective tenants. However, the landlord (particularly large shopping centre landlords) may have information that prospective tenants do not and in some circumstances this may constitute an advantage for the landlord during lease negotiations. A tenant could obtain some of this information by conducting due diligence and obtaining specialist advice. However, engaging specialist advice from a lawyer, property consultant or other advisor is often a significant cost, particularly for small tenants (Average cost is approximately $684).[[22]](#footnote-23) Further, some information will not be publicly available due to its ‘commercial in confidence’ nature, such as foot traffic, annual turnover of the shopping centre, the landlord’s future intentions in relation to refurbishment, or changes to the tenancy mix.[[23]](#footnote-24) Tenants, particularly smaller retailers, may find it difficult to access the necessary information to enable them to make an informed decision when considering entering a lease. As a result, prospective tenants may not be adequately informed as to certain matters regarding the leasehold interest, which could have a major impact on the success of the business.

However, as further explained in section 4.4.1 of this RIS, there are incentives for landlords to share information with prospective tenants. Tenants who enter into a lease fully informed of the legal and financial obligations from the start are more likely to become stable, long-term tenants. The likelihood of future disputes is also reduced, saving the landlord time and money in the future.

Business disputes are costly and take valuable resources away from the business, government and economy more broadly. Disputes also reduce goodwill and affect the ability of the parties to maintain their commercial relationship, which may result in ongoing conflict throughout the lease period.

An important principle of the Act is that the parties know what they are getting into before entering into a lease. In general, asymmetric information can justify the provision of information which would not ordinarily form part of the lease or could not otherwise be ascertained through basic due diligence.[[24]](#footnote-25) Well-informed decision making in this context has broader economic benefits, as landlords compete to attract retailers with high consumer appeal and efficient, profitable retailers are able to secure tenancies from which they may better meet customer demand.[[25]](#footnote-26)

## Market power imbalances

Market power imbalances, in terms of uneven negotiating or bargaining power, relates to the relative abilities of parties in a situation to exert influence over each other. If both parties are on an equal footing, then they will have equal bargaining power. If one party has greater power than the other to choose not to take the deal, then that party is more likely to gain favourable terms.

In the retail leases market the landlord often has greater bargaining power than the tenant when negotiating a lease. Landlords have a monopoly on the specific location where their property is located, and thus have more power to set the price of a lease for their property. Landlords still compete for tenants, but each landlord has a monopoly over their specific location, giving them market power. The tenant’s negotiating position is affected by internal factors (e.g. level of business experience, type of good or service being sold) and external factors (e.g. the retail location and retail format) that they may have limited ability to control. A tenant may be able to improve their negotiating position by seeking specialist advice (e.g. a lawyer) but this is often a significant expense, particularly for small tenants.

This imbalance in market power is particularly evident when the landlord is a shopping centre. Such landlords are often very large companies and possess a strong negotiating position when setting the terms of a lease and determining who it will permit to operate there.[[26]](#footnote-27) An individual small business is usually not in a position to significantly affect the terms and conditions of the lease offered by the landlord of a shopping centre. In some instances, a shopping centre may also have localised market power and the retailer may have little choice but to locate in the shopping centre in line with consumer expectations.[[27]](#footnote-28) Such localised market power is more common in non-metropolitan centres where there are a limited number of shopping precincts.

Uneven market power is also highlighted upon renewal of a lease. A substantial portion of a retailer’s goodwill or custom is location specific and moving location often means a loss of trade as well as a loss of investment in the fit-out of the premises. In effect, the landlord has the power to determine whether the tenant can stay by offering an option to renew the lease. If the landlord does offer an option to renew the lease, this does not guarantee a tenant can stay, as the new rent may be unaffordable. Furthermore, the lease length and conditions will impact the tenant’s ability to sell the business, with a longer lease term more favourable for sale. These situations place the tenant in a vulnerable negotiating position, reliant on the legal framework to provide a minimum level of protection.

The potential imbalance in bargaining power between landlords and tenants adds further weight to the argument for government intervention through disclosure requirements. In the absence of such power imbalances, it might be assumed that competitive market forces would lead parties to disclose more information of potential value to prospective tenants.[[28]](#footnote-29) To the extent that competitive pressures are insufficient to bring about voluntary disclosure, this supports the case for a mandated approach.[[29]](#footnote-30)

## Tenant behaviour and capability

The above sections focused on problems caused by landlord behaviour, however, it should be acknowledged that problems evident in the market for retail leases are exacerbated by tenant behaviour and capability. Ultimately, the tenant is responsible for its decision to enter into a retail lease and the tenant should ensure they have sufficient information (as far as is reasonably practicable) on which to base this decision by conducting due diligence. As explained in more detail below, tenants sometimes have limited capability (skills/experience) to negotiate a lease.

Information provided by the landlord about the lease, (e.g. in the disclosure statement) should complement and not substitute due diligence. For instance, the disclosure statement requires a landlord to disclose the tenant mix and foot traffic of the shopping centre. However, this does not mean a prospective tenant should not visit the shopping centre and directly experience customer flow, the layout of the shopping centre, whether casual mall leasing is allowed (i.e. use of common areas of a shopping centre for casual trading or promotional activities) and other easily observable items. Similarly, a prospective tenant could visit the local neighbourhood and monitor the media for any indication of future developments in the area that may affect the viability of the business. For example, the opening of a major hardware store in the area may have a positive impact on some retailers (e.g. create increased customer traffic for a nearby café or furniture store) but a negative impact on other retailers (e.g. create competition for the local hardware store).

Unfortunately, due to the limited resources and/or inexperience of many small businesses this due diligence may not be conducted or not conducted thoroughly. This lack of capability similarly affects the ability of a tenant to understand the terms of a lease and affects the position of the tenant in lease negotiations disadvantageously. As a result, a tenant may enter into a lease without fully understanding their legal and financial obligations and the impact on the success of their business. This raises the question of how much information should be prescribed to ensure that tenants have a minimum amount of information to use in decision-making, without placing excess burden on landlords. This argument to date has justified the inclusion of a disclosure statement in the Regulations.

## Extent of the problem

## Size of Victoria’s retail leases market

Retailing is the sale of final or finished goods and services to consumers rather than intermediate inputs used to produce other goods and services.[[30]](#footnote-31) Retailing is a vital part of the Victorian economy. Victoria has a diverse and vibrant retail sector ranging from world-class shopping centres to specialist stores in laneways. The retail sector is a major employer and contributor to the economic activity of the State. The market for retail leases exists to provide space for the provision of all manner of final goods and services in a retail format to the public, including individual households and business customers. Retail space may be owned by the retailer but is usually provided by landlords in many formats including stand-alone premises, neighbourhood shops and shopping centres.[[31]](#footnote-32)

The size of the market for retail leases is difficult to determine due to the broad range of businesses that lease premises. As discussed in section 2.2, retail premises are broadly defined as premises from which goods or services are sold or hired to an ultimate consumer, usually an individual. Thus, the market for retail leases comprises a broad range of businesses including typical retailers such as supermarkets, department stores, clothing chains, cafes, restaurants, petrol stations, and florists.

The requirement to notify the VSBC on entry or renewal of a retail leases was removed at the end of 2012. As a result, there is limited data on the total amount of retail leases in Victoria. In 2012 there were around 33,000 retail businesses as defined by ABS figures, however, it was estimated that there were between 69,000 to 72,000 retail leases. This large deviation in numbers is because the definition of a retail premises under the Act is much broader than the definition of retail used by the ABS. Many professional services such as hairdressers and doctors are captured by the definition under the Act.

Current ABS data shows that there has been around a 43.6 per cent increase in the number of retail businesses (47,392) over the past ten years.[[32]](#footnote-33) However, it is not possible to conclude that the number of retail leases would have also increased by this percentage.

## Key market participants

Table 1 below outlines the key types of participants in the retail leases market and the relationships between them. It is the perceived imbalance between large landlords and small tenants (Relationship B) that has formed the basis for government intervention in the retail leases market. Most retail leases legislation has been introduced to deal with this relationship. In this relationship the landlord is usually considered to be a shopping centre landlord. ‘Retail shopping centre’ in defined in section 3 of the Act and broadly means five or more retail premises owned by the same person and located in the same building or adjoining buildings.

However, retail lease legislation also plays an important role in regulating the relationship between a small landlord and a small tenant (Relationship A) which is a more common relationship than Relationship B.[[33]](#footnote-34)The tenant’s large size in the other two scenarios (Relationship C and Relationship D) means these relationships are generally excluded from coverage under the legislation.

Table 1: Interaction of participants in the retail leases market

|  |  |  |
| --- | --- | --- |
|  | **Small low-resourced tenants**e.g. small business | **Large well-resourced tenants**e.g. supermarket, department store |
| **Small low-resourced landlords**e.g. private investor | ***Relationship A***Most common relationship, with both parties required to seek advice on the lease. The negotiating position of each party is likely to be similar and will be influenced by factors such as business experience. | ***Relationship C***Uncommon relationship, due to the substantial investment required to provide retail space for larger tenants. |
| **Large well-resourced landlords**e.g. shopping centre | ***Relationship B***Common relationship, with the tenant in particular required to seek advice on the lease. The negotiating position of the tenant is generally weaker and will be influenced by factors such as business acumen, retailing format/location and the type of product retailed. | ***Relationship D***Common relationship, with both parties expected to have the resources and experience to look after their own interests. |

*Source: Productivity Commission (2008).[[34]](#footnote-35)*

Relationship A and relationship B are discussed in more detail below, since they are the focus of retail leases legislation.

## Small landlord-small tenant relationship

As stated in Table 1 the small landlord-small tenant relationship (Relationship A) is the most common. This relationship type also has the potential to be the most problematic and has the highest number of disputes (see section 3.4.1). In this scenario the landlord is less likely to have superior information and bargaining power compared to the tenant and this acts to level the playing field. However, both parties are less likely to understand adequately their rights and obligations imposed by the lease and Act resulting in a higher likelihood of non-compliance with the legislation and dispute. The VSBC plays an important role in helping resolve disputes between small business tenants and landlords through the facilitative services it provides.

While the Act aims to protect smaller tenants it also provides protection for smaller landlords by providing a legal framework within which leases are to be negotiated and stating the rights and responsibilities of both landlords and tenants.

## Large landlord-small tenant relationship

As stated above, retail leases legislation has generally been introduced to regulate this relationship (between large landlords and small tenants - Relationship B in the figure). There is a common perception that large landlords take advantage of small tenants. It is acknowledged that large landlords, such as a shopping centre landlord, typically have superior information and a stronger negotiating position as described in section 3.1, which favours the landlord during lease negotiations.

As large landlords are usually well-resourced they are better able to understand and comply with the legislation and lease. Anecdotal evidence from the VSBC indicates that shopping centres rarely breach the provisions in the lease and Act. Nevertheless, this is not to say that some shopping centre landlords do not take advantage of small tenants due to their lack of understanding or awareness of the provisions of the Act.

This market power imbalance in this relationship has led to governments putting in place regulatory frameworks to provide appropriate protection for smaller tenants. This imbalance also highlights the need to educate tenants about the different costs, benefits and risks associated with locating in a shopping centre versus a non-shopping centre. A shopping centre location is likely to have higher costs (e.g. rent, outgoings, fit out requirements) and stricter lease conditions but may also represent greater profit, and a prospective tenant should be aware of the trade-off.

## What evidence is available to support the problem?

There is limited empirical evidence available to demonstrate the key problems or market failures described in section 3.1. This is due to a number of reasons, such as;

* The retail leasing market size has not been tracked since notification requirements were removed.
* The scope of the Act goes beyond most definitions of retail business and regulates the leases of other specialist small and medium sized businesses.

However, due to the large number of retail premises in Victoria, the impact of any market failures is likely to be significant. Data on business disputes is available from the VSBC and this helps illustrate the nature of these market failures.

## Number of disputes

The Act requires that retail lease disputes go to the VSBC for mediation before they can progress to the VCAT for determination. From 2003, at the establishment of the VSBC, the number of applications for assistance received the VSBC in relation to retail lease disputes steadily increased each year until 2013. The number of disputes was relatively stable and showed no trend from 2013 until the Covid-19 pandemic. The number of disputes during Covid-19 decreased due to many of the disputes made under the Act being absorbed into the dispute statistics that were made under the *Commercial Tenancies Relief Scheme Regulations 2020* and *2021.[[35]](#footnote-36)* Disputes are anticipated to return to pre-pandemic levels with the ending of the scheme. (see Table 2 and Figure 1 below)

The initial increase in the number of applications for assistance between 2003 to 2013 appears to have been due to increasing awareness in the business community of the low cost and efficient dispute resolution services provided by the VSBC.

This low level of disputation suggests that the regulatory framework is effective (about 1 percent of the total leases per year).[[36]](#footnote-37) Further, in 2011-12 approximately half of the retail lease dispute applications proceeded to mediation. The other half were predominantly resolved through preliminary assistance conducted by the VSBC. This suggests that many disputes are minor in nature and a key role of the VSBC is to help clarify the rights and responsibilities of the parties to the lease using a ‘light touch’ (e.g. a telephone call or letter to the respondent).

Table 2: Retail lease disputes

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Year** | **Total** **disputes under the Act** | **Yearly change (Act disputes)** | **Total** **leasing disputes\*** | **Shopping centre disputes** |
| **Total shopping centre disputes** | **Landlord****applicant** | **Tenant applicant** |
| **#** | **%\*\*** | **#** | **%\*\*** |
| **2013-14** | 910 | - | 915 |  69 | 23 | 33 | 46 | 67 |
| **2014-15** | 977 | 67  | 986 | 86 | 24 | 28 | 62 | 72 |
| **2015-16** | 970 | -7  | 979 | 83 | 32 | 39 | 51 | 61 |
| **2016-17** | 904 | -66  | 929 | 47 | 19 | 40 | 28 | 60 |
| **2017-18** | 919 | 15  | 949 | 33 | 11 | 33 | 22 | 67 |
| **2018-19** | 1,040 | 121  | 1,056 | 19 | 8 | 42 | 11 | 58 |
| **2019-20** | 843 | -197  | 1,784 | 42 | 24 | 57 | 18 | 43 |
| **2020-21** | 788 | -55  | 4,482 | 54 | 24 | 44 | 30 | 56 |
| **2021-22** | 920 | 132  | 2,452 | 77 | 47 | 61 | 30 | 39 |
| **Total** | **8,271** |  | **14,532** | **510** | **212** | **42%** | **298** | **58%** |

*Source: VSBC Annual Reports*

*\* Disputes made under RLA, Commercial Tenancies Relief Scheme and the Small Business Commission Act*

*\*\* Percentage of total shopping centre disputes*

Figure 1: Retail lease disputes – total disputes made under the *RLA* vs. other leasing disputes

Figure 2: Retail lease disputes – total disputes vs. shopping centre disputes

*Source: VSBC Annual Reports*

Table 3 and Figure 2 above demonstrate that a relatively low proportion of all retail lease disputes handled by the VSBC have involved a shopping centre. In total, the VSBC has received 510 applications involving a shopping centre since 2013, representing 6.2 per cent of all retail lease applications. This result may indicate that the legislation effectively regulates the relationship between a large landlord and a small tenant.

Table 3 above and Figure 3 below also show that the shopping centre landlord was the respondent (i.e. the tenant submitted the application for VSBC assistance) in 58 per cent of all retail lease applications involving a shopping centre (see column 8 of Table 2). This suggests that both tenants and Landlords see the VSBC as an effective way to resolve a dispute. The relatively low percentage of disputes overall may also suggest that some tenants in shopping centres do not pursue disputes with their landlord because they perceive that they may be at a disadvantage due to an imbalance in market power.

Figure 2: Shopping centre disputes – Shopping centre as applicant vs. respondent

*Source: VSBC Annual Reports*

The low proportion of retail lease disputes involving shopping centres as shown in Table 2and Figure 2 also suggests that the majority of applications for assistance are for disputes between a small landlord and a small tenant. This supports the argument in section 3.3 that the small landlord-small tenant relationship is the most common and the most problematic and requires the protection provided by the legislation and the facilitative services offered by the VSBC.

## Cause of disputes

The VSBC categorises retail lease applications by topic or issue. The top three causes of retail lease disputes over the 2021-22 financial year were: communication issues; financial capacity and COVID-19.[[37]](#footnote-38) It should be noted that a dispute may fall under several categories as disputes often involve more than one issue.

There are three dispute categories of particular relevance to the Regulations: the failure to understand the legislation, power imbalances and communication issues.

A party’s failure to understand the legislation or regulations caused 14 disputes in 2021-22. This shows that although the legislation and regulations are reducing the total number of disputes, there are still a small number of disputes that could be avoided. SBV and the VSBC aim to further reduce this cause of dispute in the future with improvements made to the regulations that are easily understood.

The Regulations promote a level playing field for landlords and tenants, and to reduce power imbalances between parties. In the previous financial year only 18 (2.4 per cent) disputes handled by the VSBC were due to this category of issue.[[38]](#footnote-39) This is a strong indication that the regulations are currently acting in the manner intended and supports the argument that only minor technical amendments are required for the remake.

Communication issues were a cause of 62.7 per cent (478 total) of all RLA disputes in 2021-22.[[39]](#footnote-40) The VSBC has reported that there is strong compliance with disclosure statement requirements. The high level of disputes related to communication issues displays the continued need for strong disclosure regulations, as without them, transparency would diminish, resulting in increased communication issue disputes.

The 2003 Act as currently in force, has strengthened sanctions on the landlord for failure to provide a disclosure statement or for providing an incomplete or inaccurate statement. A landlord may face significant financial consequences for non-compliance with subsection 17(1) of the Act, which requires a landlord to provide the tenant with a disclosure statement at least 14 days before entering into the lease. For example, a tenant is able to withhold rent until a disclosure statement is provided (subsection 17(3)(a)) of the Act and the tenant is not liable to pay rent for the period between notice of non-disclosure and disclosure (subsection 17(3)(b) of the Act). Therefore, it is expected that landlords would comply with the requirement to provide a disclosure statement as it is in their interests to do so and this is consistent with the low percentage of disputes.

The following case study illustrates the information asymmetries and market imbalances faced by tenants and how this has contributed to a retail lease dispute. Other examples provided by the VSBC include a matter where the tenant alleged that the lease commencement date of an anchor tenant (i.e. major tenant in a shopping centre such as a supermarket or department store) in the disclosure statement was misleading, and as a result sought an extension of a rent-free period. These examples illustrate the importance of accurate, transparent information in decision making.

|  |
| --- |
| **Case study 1: Owner’s corporation fees**A tenant lodged a dispute with the VSBC regarding the amount of owner’s corporation fees charged by the landlord. The disclosure statement estimated the tenant would be charged $3,500 per annum. However, the tenant was charged owner’s corporation fees of $11,500 for the first year of the lease and invoiced $19,000 for the second (current) year of the lease.The tenant claimed s/he would not have entered into the lease if they knew the estimate was so inaccurate. The landlord claimed the disclosure statement included the best estimate at the time and provided evidence to support the actual fees charged.Mediation found that while the disclosure statement included an estimate of owner’s corporation fees as an outgoing the lease did not state which outgoings the tenant was liable for as required under section 39(1)(a) of the Act. Further, a breakdown of the owner’s corporation fees indicated a number of items that the tenant was not liable for (e.g. fire service maintenance). As a result the tenant and landlord agreed on a reduced fee for the current year and on a new amount for the remaining years of the lease.This case study demonstrates the need to ensure that the estimate of outgoings is reasonably accurate and that the items to be payable as outgoings are specified in the lease as well as the disclosure statement. This case study also highlights the need for transparency in relation to outgoings to ensure that tenants are only charged for outgoings that they benefit from. |

The second case study highlights the important role that disclosure statements (and the underlying legislation) can play in resolving disputes and ensuring the costs are distributed between landlords and tenants in a fair and equitable manner.

|  |
| --- |
| **Case study 2: Repair of hot water service** A landlord and tenant negotiated the rental on a lease of a small shopfront. The tenant wished to use the premises to run a cafe. The landlord provided the tenant with a lease and disclosure statement outlining both parties' obligations. The lease commenced and all was going well until the breakdown of the hot water service on which the tenant depended. The landlord stated to the tenant that, notwithstanding the fact that landlords are responsible for repairs and maintenance under section 52 of the Retail Leases Act 2003, he was not responsible for fixing the hot water service as it had been the previous tenant who had installed it therefore it was the new tenant's responsibility to fix it. The tenant contacted the VSBC and was advised to refer to his lease and disclosure statement. The tenant found that the landlord had ticked that the hot water service was an existing piece of equipment or fixture provided by the landlord. The tenant pointed this out to the landlord who acknowledged his error and replaced the hot water service. |

The third case study provides a snapshot on the importance of accurately disclosing all negotiated costs and outgoings in the disclosure statement. The below example is also another instance where there is at times a significant power imbalance between parties, where in this case, it is apparent that at the commencement of the lease, the tenant was unable to have specific provisions added into the lease due to lack of assistance in adding important conditions into the lease.

|  |
| --- |
| **Case study 3: Failure to accurately disclose outgoings in the disclosure statement**A landlord and tenant negotiated the lease on a small shopfront to be used by the tenant to run a café. The tenant advised the landlord that it was willing to pay for the fit-out, so long as their investment in the premises was factored in at the end of the lease.The landlord provided a lease and disclosure statement outlining the parties’ obligations. The disclosure statement was incomplete and did not state whether the landlord would contribute to the fit-out costs because the landlord’s agents made verbal assurances that any work done would be factored into any discussions at the end of the lease. The fit-outs were undertaken at a significant cost, and the tenant operated the cafe successfully until the pandemic disrupted the tenant’s operations. At the end of their five-year term, the tenant had significant debts to the landlord and other creditors, which caused them to close their business. The tenant attempted to negotiate with the landlord to have debts waived based on the dollar value of the fit-out, but the landlord’s new agent stated that the fit-out needed to be removed and the premises returned to the condition it was in prior to the commencement of the lease. They advised that any investment that the tenant had made in the premises would not be considered in end-of-lease negotiations.Because the disclosure statement did not accurately summarise the tenant’s costs and the verbal assurances given by landlord’s agent were not documented or followed, the tenant was not able to recuperate any costs for their fit-out at the end of the lease at mediation. |

The next case study illustrates the need for full transparent disclosure from landlords and tenants when providing the actual amount of outgoings that is associated with the lease.

|  |
| --- |
| **Case study 4: Underestimation of outgoings**A landlord and tenant negotiated the lease on a retail shop in a suburban High Street.Before the commencement of the lease, the landlord provided a lease and a disclosure statement containing an estimate of $7,000 in outgoings per annum. The tenant’s accountant factored in this cost when supporting the tenant to organise their finances prior to opening the business.Within the following year, and after paying all invoices, the tenant’s accountant realised that the tenant was paying far more than the estimated amount. The tenant contacted the VSBC for advice and it was suggested that they first attempt to resolve the matter directly with the landlord. When the parties could not come to an agreement the tenant filed an application for dispute resolution with VSBC. At mediation, the landlord agreed that it had underestimated the amount for outgoings per annum.  Following negotiations facilitated by the VSBC the landlord agreed to cap the outgoings at $7,000 per annum.  |

## Problems that would exist if the Regulations were allowed to lapse

In the absence of the Regulations the market for retail tenancy leases in Victoria would experience:

* An increase in inefficient decision-making, leading to sub-optimal outcomes. Disclosure statements have generally been effective in “encourag[ing] better informed decision making and contracting.”[[40]](#footnote-41) In the absence of a requirement for landlords to provide tenants with a disclosure statement the information asymmetries described in Section 3.1.1 would remain unaddressed. This would increase the chances that prospective tenants may make a decision about a lease agreement (either accepting or declining) that would be different to the decision they would have made if they had had access to complete and/or better information. Such inefficient decisions can impose costs on both tenants and landlords (through business failures or foregone revenue from a business opportunity that was not progressed).
* An increase in disputes – in the absence of the Regulations the information asymmetries, market imbalances and transaction costs described in section 3.1 would increase the potential for:

a) tenants and landlords to be uncertain, and not have a shared understanding, about the terms and conditions of a lease; and

b) larger landlords (or tenants) to act in a manner that is not fair and equitable. For instance, in the absence of a prescribed formula to determine and apportion outgoings, there would be potential for shopping centre landlords to pass any shortfall in outgoings from major tenants onto the speciality retailers in shopping centres, as was the case prior to the Act.

* A reduction in efficient dispute resolution – as the Productivity Commission notes:

*Prior to the introduction of retail tenancy legislation, disputes between landlords and tenants were handled as commercial tenancy disputes. For small retailers who were unable to settle disputes via direct negotiation, the only other options were either a tribunal or court with its associated formality, expense and delay. The cost of these options had the potential to act as a barrier to efficient dispute resolution. Also, the use of the courts to settle disputes had the potential to jeopardise ongoing commercial relationships between parties.[[41]](#footnote-42)*

Many of these problems have been addressed through the Act and Regulations – particularly the legislated role of the Victorian Small Business Commission in dispute resolution.

## Rationale for government intervention

## How effective is the existing regulatory regime?

The Productivity Commission thoroughly examined Australia’s retail leases market in 2008 and considered that the market was working reasonably well overall. While the Productivity Commission’s work is 15 years old, it is the most comprehensive publicly available piece of research on retail leases.

The Retail Leases Act and Regulations have been amended over the years since the Productivity Commission report was published to ensure that the retail leasing market continues to work reasonably well. The Productivity Commission stated that retail leases regulations should maintain those parts of the State and Territory legislation that are working effectively. In particular, the Productivity Commission stated that “dispute settlement and information disclosure have effectively addressed market impediments related to transaction costs and information differences, and should remain part of the regulatory framework.”[[42]](#footnote-43) The Productivity Commission also stated that “lease disclosure provisions have effectively reduced the information gap between retail tenants and landlords”.[[43]](#footnote-44) The low level of disputes in the retail leases market, as discussed in Section 3.3, supports these findings.

Further, the Productivity Commission noted that there is not a strong case for further detailed regulation of the retail tenancy market as the market is already heavily regulated. The regulatory approach has been to add detailed prescriptive provisions to the legislation governing the relationship between retail landlords (especially shopping centres) and tenants. This approach aimed to reduce potential abuses of bargaining power by landlords and information imbalances.

Overall, the legislative framework appears to work well and has been amended over the years to reduce over-prescriptive sections. The repeal of section 25 of the Act, which requires a landlord to inform the VSBC of new or renewed retail leases is an example of the removal of unnecessary regulation. The amendments to the regulations in 2020 requiring increased disclosure obligations for landlords were criticised by stakeholders as being too burdensome, however, SBV is confident that the current legislative requirements are necessary to create a fair and balanced playing field for both tenants and landlords.

## Inadequate market based self-regulation

In the absence of regulation industry bodies in the retail leases market may develop industry standards to regulate the landlord-tenant relationship. However, industry led self-regulation is likely to be inadequate for two main reasons.

Firstly, industry association membership does not adequately reflect the membership of the retail leases market. Several prominent industry associations operate in the retail leases market and these groups represent different market participants such as:

* large landlords (e.g. Shopping Centre Council of Australia, Property Council of Australia);
* tenants (e.g. Australian Retailers Association); and
* property specialists including lawyers, valuers and real estate agents (e.g. Australian Property Institute, Real Estate Institute of Victoria).

Small landlords are generally not represented by relevant industry associations. Small retailers, while represented by the Australian Retailers Association (ARA) and other associations, may find it difficult to exert influence to the same degree as large retailers. As a result, large landlords and large tenants would likely influence any industry led self-regulation in their own self-interest, and potentially to the detriment of small landlords and small tenants. Consequently, industry led self-regulation is unlikely to protect the market participants that need the most protection.

Secondly, industry initiatives rely on voluntary compliance. For example, an industry developed code of conduct or disclosure statement would be voluntary and is unlikely to be enforced by an industry body. A voluntary code or statement is likely to have a lower compliance rate than regulations, which will decrease the level of protection afforded to tenants, particularly small retailers. This would result in higher costs for tenants to overcome information asymmetries and market imbalances.

There appears to be agreement among industry stakeholders that in the absence of regulation an industry code of practice or similar instrument may be developed for shopping centre landlords but this code would not be effective because it: would not cover all landlords; would not have the same substance as the legislation; and would be voluntary and unenforceable.

In addition, in the absence of regulation, industry bodies are likely to be expected to expand their advisory function or new advisory bodies may emerge in the market. Industry associations tend to focus on information/education and advocacy, with advisory services, if provided, available to members at a cost. While an industry association such as the ARA may provide its members with useful information about changes to retail leases legislation, it is unlikely to have the capacity to provide specific advice on individual retail lease negotiations, particularly on a large scale.

The absence of regulation would likely to reduce legal certainty which would essentially transfer the cost of acquiring legal certainty from government to the market, with the cost likely to be ultimately borne by tenants. Considering the number of retail leases in the market and the diversity of retail tenants/premises, regulation is likely to be the more efficient approach to achieving legal certainty.

Overall, market based self-regulation is likely to advantage large landlords in their negotiations with tenants and this would fail to fulfil a fundamental policy principle underpinning retail legislation which is to provide protection to smaller retailers. As a result, a non-regulatory option such as a voluntary disclosure statement has not been considered in the options analysis.

# Options identification

This chapter analyses what would likely happen in the ‘base case’ where the current Regulations are allowed to expire and the government takes no further action to regulate retail businesses. It is critical to analyse the base case in a RIS to assess whether the Regulations should be allowed to expire or replaced with new Regulations. The base case also provides a point of comparison to assess the impact of different regulatory and non-regulatory options.

This chapter also identifies options for further analysis for the three areas of the current Regulations:

* Prescribe an occupancy cost threshold to exclude large businesses (section 4.2)
* Prescribe a formula to determine and apportion outgoings to reduce market imbalances (section 4.3)
* Prescribe a disclosure statement to reduce information asymmetries and transaction costs (section 4.4)

For each of these three sections, background is provided to the current Regulations, alternative options are discussed and a set of viable options for further analysis (in chapter 5) is described.

## Base case

As noted in earlier chapters in the RIS, the Act aims to better protect small and medium sized retail businesses while reducing the regulatory burden on larger retail businesses. The rationale underlying for this objective is that:

* Larger retail businesses generally have sufficient resources, information and bargaining power to navigate the landlord-tenant relationship in an efficient and effective manner.
* Consequently, such businesses do not require protection under the Act. Nor would it be effective to cover such businesses – as coverage would impose costs on larger businesses (e.g. reduced flexibility in commercial negotiation) that would not be offset by the same type or level of benefits enjoyed by small and medium sized businesses.

To achieve the above objective, section 4(4)(a) of the Act states that the Regulations will prescribe an occupancy cost amount or threshold. Retail businesses that have occupancy costs greater than this prescribed threshold are not covered by the Act.

Under the base case, the threshold to exclude retail premises from the Act would be equal to zero (as the Regulations would not exist to prescribe an occupancy cost threshold). This would essentially render the Act null and void as all retail premises in Victoria would fall outside the scope of the Act. As noted in section 1.2, the Retail Leases Act regulates commercial relationships on retail premises. With all retail businesses falling outside the scope of the Act, all retail businesses would be managed on a commercial lease. As a result, no retail tenant or landlord would be required to adhere to the Act’s provisions relating to:

* the conditions of a retail lease – including minimum lease periods, options to renew, fit outs, acceptable payments (e.g. rent and outgoings) and the means by which such payments should be calculated and/or reviewed, and specific requirements for shopping centre tenants;
* the provision of information between landlords and tenants ‑ including notification periods[[44]](#footnote-45), and the requirement to provide tenants with a disclosure statement;
* damages, repairs, refurbishments and relocations – and the respective roles and responsibilities of landlords and tenants; and
* dispute resolution – and the role of the VSBC.

In this environment, most landlords and tenants would only undertake activities (such as providing certain types of information) and agree to lease conditions where they:

* were required to do so under other legislation (e.g. the *Crimes Act 1958*, the
*Fair Trading Act 1999* and the *Competition and Consumer Act 2010*); and/or
* believed the benefit of doing so would be greater than the cost.

It is thus reasonable to expect that, under the base case, the following outcomes would result:

* Landlords and tenants would agree to lease periods that were mutually acceptable to both parties (potentially less than a five year minimum currently stipulated in the Act).
* The type of outgoings to be passed on to tenants would not be centrally prescribed, but rather agreed on a case-by-case basis between landlords and prospective tenants during lease negotiations. Landlords and prospective tenants could agree as part of these negotiations for the tenant to pay an amount for tax for which the landlord or head landlord is liable under the *Land Tax Act 2005*.
* Landlords would apportion outgoings based on standard industry practice and in a manner that would be agreed by prospective tenants.
* The scope and associated costs of fit-outs would not be centrally prescribed but would be agreed on a case-by-case basis between landlords and prospective tenants during lease negotiations.
* The process by which rent reviews would be conducted would not be centrally prescribed but would be agreed on a case-by-case basis between landlords and prospective tenants during lease negotiations.
* Almost all landlords would not provide information about the terms and conditions of a lease agreement (e.g. in the form of a disclosure statement) over and above the information outlined in the lease agreement. It is likely that landlords would deal with retail tenants similarly to commercial tenants.
* The roles and responsibilities of landlords and tenants with respect to alterations, refurbishments and interference that adversely affect the tenant’s business (including notification and payment of compensation) and the repair of damaged retail premises would not be centrally prescribed. Rather, these would be determined during lease negotiations and/or ongoing negotiations between the landlord and tenant at the time of an incident.
* Landlords and tenants would not be required to refer disputes to the VSBC for alternative dispute resolution before progressing their dispute to the VCAT.

Furthermore, under the base case, retail tenant costs would likely increase as current and prospective tenants would seek specialist advice (e.g. from retail consultants, valuers and lawyers) to obtain information about the operating environment of a rental property and/or the terms and conditions of a lease. It is estimated that the price of a tenant obtaining specialist advice would be similar, or potentially higher,[[45]](#footnote-46) to the costs landlords experience when preparing a disclosure statement. This cost has been calculated to be approximately $684 on average.[[46]](#footnote-47)

It is uncertain how the market for retail businesses would operate in the base case, particularly given the Regulations and regulatory framework are longstanding, however, there is a strong likelihood that the market would operate as the commercial leasing market does currently.

## Prescribe an occupancy cost threshold to exclude large businesses

As discussed above in the problem chapter, problems that retail leases regulation are intended to address are most acute for small and medium tenants. For this reason, the current regulations have an occupancy cost threshold to exclude larger tenants, which is currently $1 million per annum. Section 4.1.1 provides background and describes the current regulations. Section 4.1.2 discusses alternative options that are considered unviable for analysis in this RIS. Section 4.1.3 and Table 6 set out the viable options that are analysed further in chapter 5 of the RIS.

## Background and current regulations

The Act aims to maximise the coverage of small and medium sized retail businesses under the legislation through the setting of an appropriate occupancy cost threshold. Section 4(4)(a) of the Act states that the Regulations may prescribe an occupancy cost amount or threshold.

The Act introduced “major improvements to how the coverage of the legislation is determined, so that small and medium-size tenants are not unfairly excluded”.[[47]](#footnote-48) A threshold issue in the design of a retail leases regulatory framework is to determine which businesses should be covered by the legislation. From a policy perspective, the legislation should focus on protecting small retail businesses as they are the parties most likely to be at a disadvantage in the marketplace in terms of negotiating position and being in possession of relevant information.[[48]](#footnote-49) Until 2003 the key means by which Victoria’s retail leases legislation distinguished between small and medium sized retailers and large retailers was by the floor area of the retail premises. Premises larger than 1,000 square metres were excluded from coverage under retail legislation. The 2001 Review determined that there was no strong conceptual link between the floor area rule and the financial resources of the tenant. The 1,000 square metre rule focused on the characteristics of the premises rather than the financial capacity of the tenant, meaning that it is possible for the same businesses to come under the protection of the Act in some retail locations but not others.

The rule also unfairly excluded small retail businesses that operate from large premises such as motels, caravan parks or nurseries. Further, the 1,000 square metre rule created practical difficulties of how the measurement of retail premises should be undertaken.[[49]](#footnote-50) The meaning of the term ‘floor area’ was the subject of significant litigation.

The 2001 Review considered a number of alternatives to the 1,000 square metre rule and determined that coverage under the Act should be determined by an occupancy cost threshold. It was concluded that “a prescribed threshold is a fairer means of determining coverage”.[[50]](#footnote-51) . The term ‘occupancy cost’ is defined in section 4(3) of the Act and includes the rent payable, outgoings, and any other prescribed costs that the tenant is liable for. A broad definition of occupancy costs was preferred because it ensured that coverage under the legislation is not circumvented by artificially minimising the rent payable and inflating the outgoings.[[51]](#footnote-52)

The way in which the Act is worded states the Regulations *may* prescribe an occupancy cost amount or threshold but in reality, the Regulations *must* prescribe an amount. If the Regulations remained silent and prescribed no amount then all retail leases would be excluded from the legislation as all retail leases would have occupancy costs greater than zero (as discussed above in the base case section).

Therefore, the key question for this RIS to consider is what occupancy cost threshold can be most appropriately prescribed in the re-made Regulations. As previously stated, the occupancy cost threshold is one of the key means by which coverage under the Act is determined. If the prescribed threshold is too high the Act may capture large businesses that do not require the protection afforded by the Act. Conversely, if the prescribed threshold is too low, the Act may not cover businesses that require protection and fail to achieve the objectives of the legislation.

The current Regulations prescribe the occupancy cost amount or threshold as $1 million per annum and this amount has remained unchanged since the Regulations’ introduction in 2003. A threshold of $1 million per annum was chosen to:

* ensure to the greatest degree possible that small and medium sized tenants currently protected by the legislation would continue to be covered, while minimising the extent that major retailers are covered;
* provide the industry with long-term stability, as the higher threshold provides for natural growth in occupancy costs over the ten year term of the 2003 Regulations; and
* promote legal certainty, as the higher threshold means there are less marginal cases where the proposed occupancy cost under the lease is close to $1 million per annum. Legal certainty is particularly important as coverage under the Act imposes various rights and obligations on landlords and tenants.

The 2003 RIS acknowledged, and the 2013 RIS confirmed, that prescribing the occupancy cost at $1 million per annum, as opposed to a lower figure, imposes some costs in the form of coverage of some significant retail groups that are not publicly listed corporations. These costs are borne by landlords and potentially by those retail groups. However, this scenario would occur in limited circumstances and arguably both the landlord and tenant are of sufficient size to bear any costs imposed.

**Occupancy cost distribution**

In both 2003 and 2012 an analysis of occupancy costs in Victoria was undertaken to determine the most appropriate occupancy cost threshold.[[52]](#footnote-53) Table 3 demonstrates that although the $1,000,000 threshold remained unchanged between 2003-2012, businesses being excluded by the Act only increased by 0.5 per cent.[[53]](#footnote-54) Furthermore, evidence shows that throughout the 2003-2012 period, despite an increase in cost-of-living expenses, only an extra 3.5 per cent of retail businesses reached the $400,000-500,000 occupancy cost range and in 2012 93.5 per cent of all retail businesses remained under this threshold.

Current ANZSIC retail industry figures show that companies considered small and medium sized, through employee numbers, consist of 99.7 per cent of the retail market.[[54]](#footnote-55) Consequently, it is reasonable to only exclude a very small percentage of business from protection under the Act.

Analysis of ATO data found that only eight industry groups average rent expenses (occupancy costs[[55]](#footnote-56)) of above $1 million. Of these industry groups, department stores (32.80 per cent), supermarket and grocery stores (19.49 per cent) and depository financial intermediation (14.88 pre cent) are the only industries with percentage of small businesses over ten per cent.[[56]](#footnote-57) SBV believe that the mean occupancy cost in these industries has been skewed by large businesses occupying part of the market. It is likely that many smaller businesses within the market would have far lower occupancy costs than the median price found within these industries.

The ten industries with the largest number of small businesses, such as, cafes, restaurants and takeaway food services, which account for over 60,000 businesses, all have average rent expenses of under $360,986.[[57]](#footnote-58) This gives SBV a strong indication that the vast majority of small and medium sized businesses will remain protected by the Act.

Since 2013, retail rental prices have remained relatively stagnant. Colliers report on the Australian retail sector provides insight into the retail rental market. The report analyses a range of retail precincts, such as regional shopping centres, neighbourhood shopping centres and CBD retail.[[58]](#footnote-59)

A lack of current retail lease market data, relating to the specifics of occupancy cost market averages exists. SBV has engaged with stakeholders over the life of the regulations and has not received feedback that an increased number of retail businesses are falling outside the scope of the Act. The unsubstantial rise in retail lease prices along with stakeholder feedback and ATO data gives SBV confidence that a similarly high percentage of businesses will be protected by the Act and the $1,000,000 threshold will remain an efficient threshold to achieve the Act’s objectives.

Table 3: Comparison of occupancy costs 2003-2012

|  |  |  |  |
| --- | --- | --- | --- |
| **Gross rent range (occupancy cost)** | **Per cent of retail premises 2003** | **Per cent of retail premises 2012** | **Cumulative difference in percentage** **2003 - 2012** |
| 0-100,000 | 83.5 | 83.5 | 37.5 | 37.5 | 46.0 |
| 100,000-200,000 | 10.7 | 94.2 | 33.0 | 70.5 | 23.7 |
| 200,000-300,000 | 1.8 | 96.0 | 14.5 | 85.0 | 11.0 |
| 300,000-400,000 | 0.6 | 96.6 | 5.6 | 90.6 | 6.0 |
| 400,000-500,000 | 0.4 | 97.0 | 2.9 | 93.5 | 3.5 |
| 500,000-1,000,000 | 0.7 | **97.7** | 3.7 | **97.2** | **0.5** |
| 1,000,000+ | 2.3 | 100.0 | 2.8 | 100.0 |  |

 *Source: Savills reports 2003 and 2012[[59]](#footnote-60)*

**Relationship with the publicly listed corporation rule**

It is important to note that the occupancy cost rule operates in tandem with the publicly listed company rule to exclude certain retailers from coverage under the Act. The 2001 Review determined that a readily identifiable means of distinguishing between small and large businesses is by whether they are a listed corporation as defined under the *Corporations Act 2001*. There is a close correlation between listed companies and big businesses. Companies that are listed on the Australian Stock Exchange, or any recognised stock exchange have the financial capacity to make informed business decisions and do not require protection under retail leases legislation.[[60]](#footnote-61)

Using multiple exclusions from the definition of retail premises helps to maintain legal certainty. For example, if a company de-listed from the Australian Stock Exchange it could still be captured by the Act because its occupancy costs may be less than the prescribed threshold.

**Other regulations about occupancy costs**

Section 4(3)(c) of the Act states that occupancy costs include “any other costs of a prescribed kind that the tenant is liable to pay under the lease”. Regulation 7 of the 2013 Regulations states that for the purposes of section 4(3)(c) of the Act, advertising and promotional services, including marketing fund contributions, is prescribed as another kind of cost.

A broad definition of occupancy costs was adopted to ensure that coverage under the legislation is not circumvented by artificially minimising the rent payable and inflating the outgoings.[[61]](#footnote-62) Outgoings are costs that the tenant is liable for because it receives a benefit from the outgoing. A tenant would benefit from advertising and promotional services, including marketing fund contributions, thus it appears reasonable for such costs to be prescribed as an outgoing and included in the definition of occupancy costs.

Stakeholder feedback has not indicated that any other costs should be prescribed as an outgoing for the purposes of section 4(3)(c) of the Act and it is therefore proposed to re-make the current Regulation 7.

##  Alternative approaches considered

A range of approaches addressing the problem have been considered including an occupancy cost threshold, a rent threshold, and a floor space threshold. Several of these options would require amendments to the Act and are hence beyond the scope of this RIS.

South Australia is the only jurisdiction with a similar exclusion from coverage under the retail leases legislation, albeit using a narrower definition. In South Australia, the legislation does not apply to a retail lease if the rent payable under the lease exceeds $400,000 per annum. This is opposed to Victoria’s occupancy cost approach which includes rent + outgoings + any other costs of a prescribed kind.[[62]](#footnote-63) It has been previously noted that the actual cost of some outgoings for the year is not known at the time the lease is entered into, therefore, there may be some uncertainty as to whether a lease is captured by the Act if its occupancy costs are close to the threshold, although this circumstance is rare. Nonetheless, legal certainty should be achieved where possible and a rent threshold approach should be considered. However, to change to such an approach in Victoria would require an amendment to the Act which is beyond the scope of this RIS, so a rent threshold has not been considered as a viable option.

Several other states use a floor size base rule in conjunction with a list of prescribed businesses to overcome the problem of small businesses such as a nursery from being excluded from the Act due to their large premises, as discussed in section 4.2.1. Some stakeholders have commented that Victoria should revert back to the 1,000 square metre rule as they believe this approach is more straightforward. However, as noted in section 4.2.1 there were problems with this approach and numerous stakeholders agree the 1,000 square meter rule is not appropriate. In any event, changing to a 1,000 square metre or similar area based approach would involve an amendment to the Act which is beyond the scope of this RIS, so this approach has not been considered as a viable option.

## Viable options for analysis

In light of the above discussion, this RIS analyses three different options for setting the occupancy cost threshold (relative to the reference case) (Table 4).

**Table 4: Occupancy cost threshold options**

|  |  |
| --- | --- |
| **Option**  | **Description**  |
| Reference case  | The reference case for analysing options for different occupancy cost thresholds is the base case, where the threshold to exclude retail premises from application of the Retail Leases Act 2003 would be equal to zero – thus excluding all retail premises in Victoria. It assumed that under this reference case, retail businesses currently on a retail lease would continue to operate under a commercial lease.  |
| Option OC1  | ***Retain the current threshold of $1 million per year***Under this option the occupancy cost threshold would be set at the current $1 million per year. This option represents continuity with the 2013 Regulations and would provide certainty to landlords and tenants. It is also assumed that the current formula to apportion outgoings and the current disclosure statement would be in place.  |
| Option OC2 | ***Increase the current threshold in line with inflation ($1.3 million per year)***As noted above, the current occupancy cost threshold of $1 million per year was introduced in 2003. Under this option, the current threshold would be increased to $1.3 million per year to account for inflation between the years of 2013-2022. It is also assumed that the current formula to apportion outgoings and the current disclosure statement would be in place. |
| Option OC3 | ***Decrease the threshold to $500,000 per year***Under this option, the occupancy cost threshold would be set at $500,000, or half the current threshold. The intention of this option is to focus the Act on smaller retail businesses; assuming that larger businesses have access to sufficient resources, information and bargaining power and thus do not require protection under the Act. It is also assumed that the current formula to apportion outgoings and the current disclosure statement would be in place. |

## Prescribe a formula to determine and apportion outgoings to reduce market imbalances

As highlighted in the previous chapters, there is the potential for imbalance of market power in the retail tenancies market. More specifically, it is perceived that small business tenants are at a disadvantage due to their limited resources, and therefore have a lower bargaining power in the market compared to landlords. This chapter looks at possible solutions to even out the playing field for tenants and landlords. 4.2.1 provides a background to the current regulations, and how the outgoings are defined and determined. 4.2.2 gives insight to alternative options and 4.2.3 describes viable options for further analysis in chapter 5.

## Background and current regulations

As highlighted in section 2.2, one of the key features of the retail leases market is the potential imbalance in market power between the landlord and tenant. If the determination and apportionment of outgoings was left to the negotiation of each individual lease, it would be expected that larger tenants may be able to negotiate a lower proportion of the expenses as outgoings because of their superior bargaining power. It is inequitable for tenants to be charged a disproportionate amount of the outgoings or for expenses incurred by the landlord for which the tenant derives no direct benefit.[[63]](#footnote-64)

Section 39 of the Act states that outgoings are only recoverable from a tenant under a retail premises lease if the lease specifies:

1. the outgoings that are to be regarded as recoverable,
2. in a manner consistent with the regulations and how the amount of outgoings will be determined and apportioned to the tenant, and
3. how those outgoings or any part of them may be recovered by the landlord.

Section 39(2) of the Act also states that the regulations may prescribe the manner in which the amount of outgoings may be determined and apportioned to the tenant. Regulation 9 of the 2013 Regulations states that for the purposes of section 39(2) of the Act, "the amount of an outgoing may be determined and apportioned to a tenant by multiplying the total amount of the outgoing by the relevant fraction”. ‘Relevant fraction’ is defined in the Regulations as A (the lettable area of the retail premises) divided by B (is the total of lettable areas of all the premises which receive the benefit of the outgoing).

This formula was introduced in the 2003 Regulations and a minor technical amendment was included in the 2013 Regulations at the request of stakeholders. The principle of proportionality was a feature of Victoria’s retail leases legislation prior to 2003 and the formula seeks to provide greater clarity and fairness regarding how outgoings should be determined and apportioned. The 2001 Review of the Act found there should be greater transparency and accountability in relation to outgoings and other costs paid by the tenant under the lease. The 2003 RIS considered that the formula represents a reasonably equitable approach to apportioning expenses or outgoings, as premises that comprise a larger proportion of the building would be required to make a commensurate contribution to the outgoings. As a result the Regulations provide a means by which a landlord and tenant can resolve liability for payment of outgoings and operating expenses relating to the lease. This ensures that tenants are not charged a disproportionate amount of the expenses of outgoings.[[64]](#footnote-65)

This formula is particularly pertinent to tenants of a retail premise located in a shopping centre or other non-standalone premises. There is a large range of expenses that the landlord has responsibility to manage but which benefit all tenants in the shopping centre such as security, gardening and landscaping, car parking and cleaning. Therefore, a method that easily and fairly apportions such expenses to individual tenants is necessary.

The Act provides discretion for the Regulations to prescribe a manner by which to determine and apportion outgoings. Therefore, the key questions for the RIS to consider are:

* should the Regulations continue to prescribe a formula to determine and apportion outgoings?; and
* if so, is the formula currently prescribed the most appropriate formula for determining and apportioning outgoings?

Stakeholders have not indicated any concern with the intention of the formula. Indeed, the prescribed formula appears to codify industry practice and it was suggested that the prescribed formula was useful because it provides legal certainty. As highlighted in section 3.4, communication issues are one of the largest causes of disputes and a specified formula creates certainty. A mechanism (i.e. the prescribed formula) that provides legal certainty, either by avoiding disputes in the first place or helping to clarify disputes when they occur, is generally considered to provide benefit with little, if any, cost.

**Other regulations about outgoings**

The Regulations include three other regulations in relation to determining and apportioning outgoings: maximum outgoing; statement of outgoings; and prescribed outgoings (other kinds of outgoings). These regulations are examined below.

**Maximum outgoing**

Section 40(2) of the Act states that “a tenant is not liable to contribute towards an outgoing of the landlord…in excess of an amount calculated as prescribed by the regulations”. For the purposes of section 40(2) of the Act, regulation 10 of the 2013 regulations states that “a tenant is not liable to contribute towards an outgoing of the landlord in excess of an amount calculated by multiplying the total amount of the outgoing by the relevant fraction”.

The ‘maximum outgoing’ regulation was introduced in the 2003 Regulations and appears to have a similar intent to regulation 9 of the 2013 regulations ‘Determination and apportionment of outgoings’, that is, to ensure that tenants are not charged a disproportionate amount of the outgoings. However, section 40 only applies to a tenant of retail premises that are located in a retail shopping centre, whereas section 39 is of broader application to a tenant under a rental premises lease (not limited to a shopping centre). There does not appear to be any reason to remove this regulation and no stakeholder feedback has so far been received to indicate it should be removed. Similar to regulation 9, regulation 10 of the 2013 regulations provides the benefit of legal certainty without imposing any costs. It is therefore proposed to re-make regulation 10. This regulation is proposed to be made as regulation 10.

**Statement of outgoings**

Section 47 of the Act requires the landlord to provide the tenant with a written statement of outgoings detailing all expenditure by the landlord for each of the landlord’s accounting periods during the lease. The statement must be accompanied by an audit report that verifies it correctly states the total amount of outgoings for the accounting period. If the cost of any individual outgoing is more than the prescribed percentage of the total outgoings to the specific leaseholder, the audit report must also verify the cost of the individual outgoing. For the purposes of section 47(5)(b)(i) of the Act, regulation 12 of the 2013 regulations states that the prescribed percentage is 10 per cent. Therefore, an individual outgoing that is more than 10 per cent of the total outgoings must be independently verified.

The requirement for the landlord to prepare a statement of outgoings was a feature of Victoria’s retail leases legislation prior to 2003. This prescribed percentage was introduced in the 2003 legislation to provide greater transparency and accountability in relation to expenses for which the tenant is liable for.

The Act requires that a percentage *must* be prescribed in the Regulations. Therefore, the key question for the RIS to consider is whether the prescribed percentage should change or remain the same. In theory, if the prescribed percentage is increased (decreased), less (more) individual outgoings would fall into this category which may decrease (increase) the transparency of the statement of outgoings. As a result, this may decrease (increase) the regulatory burden imposed on the landlord, because the statement of outgoings would take less (more) time and money to complete and would be verified by an auditor.

Previous stakeholder feedback indicates that there will be little, if any, difference in practice if the prescribed percentage changed. Industry practice is to verify all costs regardless of the amount. This means the prescribed percentage could be any amount and it would make no practical difference in the base case. This element of the legislation appears to have had good intentions when first introduced but is essentially redundant and unnecessary. Due to the way in which the Act is worded, this regulation cannot be repealed as a percentage must be prescribed. It is also not possible to prescribe ‘nil’ or ‘zero’ as the percentage. It is therefore proposed that this regulation prescribe 0.1 as the prescribed percentage. This approach will have the same practical effect as repealing the regulation but do so within the limitations of the Act.

To maintain legal certainty and to provide stability within the market, it is therefore proposed to re-make regulation 12 of the 2013 regulations in the same form. This regulation is proposed to be made as regulation 11(1) in the proposed 2023 regulations.

**Prescribed outgoings**

Section 47(6) of the Act states that the statement of outgoings, discussed above, does not need to be accompanied by an auditor’s report if the statement relates to certain outgoings only. These outgoings are GST, water, sewage and drainage rates and charges, municipal council rates and charges, and insurance. Section 47(6)(a)(v) of the Act allows ‘any other outgoing of a kind prescribed by the regulations’ to be included in this list.

During the 2013 review of the Regulations, two “other kinds of outgoings” were identified and prescribed under section 47(6)(a)(v) of the Act through the construction of regulation 11. The prescribed outgoings under regulation 11 are:

1. Fire services property levy; and
2. Owners corporation fees.

The fire services property levy was prescribed as an ‘other kind of outgoing’ because of the change in the way the fire services levy was charged. The *Fire Services Property Levy Act 2012* imposed a levy on all properties that is collected through Council rate notices. To maintain consistency and ensure that the fire services property levy does not trigger the requirement for an audit report, it was prescribed as an ‘other outgoing’ for the purposes of section 47(6)(a)(v) of the Act.

It was argued by stakeholders in 2012 that owner’s corporation fees are similar to council rates or insurance premiums in that it is a necessary cost imposed by a third party at a set amount. Section 47(6)(b) of the Act states that the outgoings under section 47(6)(a) of the Act are only exempt from the auditor report requirement if they are accompanied by proof of payment (e.g. invoice, receipt) for expenditure by the landlord. Proof of payment for owner’s corporation fees should provide sufficient transparency to a tenant and further verification regarding the cost of the outgoing by an auditor seems an unnecessary compliance burden that imposes a cost without a corresponding benefit. As a result, owners corporation fees were also prescribed as an ‘other kind of outgoing’ under Regulation 11 of the 2013 regulations.

It is therefore proposed to re-make regulation 11 of the 2103 regulations. This regulation is proposed to be remade as regulation 11(2) of the proposed 2023 regulations.

## Alternative Options Considered

No alternative options have been considered for this regulation. The prescription of a formula to apportion outgoings has a narrow scope which limits potential options. Two viable options are considered below in 4.3.3.

## Viable options for analysis

In light of the above discussion, this RIS analyses two different options for determining and apportioning outgoings (relative to a reference case) (Table 5).

**Table 5: Options for determining and apportioning outgoings**

|  |  |
| --- | --- |
| **Option**  | **Description**  |
| Reference case  | For the purpose of analysing options (chapter 5), a ‘reference case’ has been constructed which assumes that an occupancy cost threshold of $1 million is in place (the current Regulations). This reference case has been used as a point of comparison for other options because without an occupancy cost threshold there would be no retail leases within the scope of the Act, so requirements for apportioning outgoings would have no impact. Under this reference case, there would be no prescribed manner in which the amount of outgoings would be determined and apportioned to a tenant. Consequently, landlords would determine and apportion outgoings based on standard industry practice and in a manner that would be agreed by prospective tenants.  |
| Option F1 | **Prescribe the current formula to determine and apportion outgoings**Under this option, the Regulations would prescribe the current formula to determine and apportion outgoings. Table 6 provides an example of how the prescribed formula could work in practice. Landlords would be required to use the prescribed formula for all tenants covered by the Act (e.g. those that meet the occupancy cost threshold and are not a publicly listed company). This option would provide landlords and tenants with certainty about how outgoings should be determined and apportioned. Conversely, it would also reduce the flexibility of landlords and tenants in their commercial negotiations – though noting that landlords and tenants are not prohibited under the Act or Regulations from reaching a separate agreement about how costs could be distributed between the parties (e.g. through an increase in rent). It is also assumed that under this option an occupancy cost threshold of $1 million would be in place. |
| Option F2 | **Prescribe a performance standard to determine and apportion outgoings**Under this option, the Regulations would not prescribe a formula to determine and apportion outgoings. Rather, the Regulations would require landlords to determine and apportion outgoings in accordance with a performance standard (e.g. ‘the amount of an outgoing must be determined and apportioned to a tenant in a fair and equitable manner’). It would be left to landlords and tenants to agree what constitutes a ‘fair and equitable’ determination and apportion of outgoings. In practice it is likely under Option F2 that landlords and tenants would determine and apportion outgoings in manner similar to that outlined in Table 6 (i.e. based on the lettable area of the tenant relative to total lettable area). However, a landlord and tenant may agree that a tenant should pay a smaller or larger share of total outgoings based on contextual factors. For instance, both parties may agree that a tenant should pay a smaller share of total repair costs because the tenant occupies a newer part of the building that requires less maintenance. Landlords would be required to use the performance standard for all tenants covered by the Act (e.g. those that meet the occupancy cost threshold and are not a publicly listed company).This option would provide landlords and tenants with greater flexibility in their commercial negotiations; though it would reduce certainty about how outgoings should be determined and apportioned. It is also assumed that under this option an occupancy cost threshold of $1 million would be in place. |

Table 6 : Example of application of prescribed formula for outgoings under Option F1

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Outgoing type** | **Total cost of outgoing to Landlord**  | **Lettable area of tenant****(sqm)** | **Lettable area of all the premises which receive the benefit of the outgoing****(sqm)** | **Relevant fraction** | **Outgoing payable by tenant** |
| Air-conditioning  | $1,000 | 75 | 1,000 | 7.5% | $75 |
| Repairs  | $2,000 | 75 | 1,000 | 7.5% | $150 |
| Customer information services  | $500 | 75 | 500[[65]](#footnote-66) | 15.0% | $75 |
| ***Total*** | ***$3,500*** |  |  |  | ***$300*** |

## Prescribe a disclosure statement to reduce information asymmetries and transaction costs

As discussed in section 2.2, information asymmetries and transaction costs reduce the ability of a tenant to gain the necessary information on which to base their business decisions about the lease. An effective and relatively inexpensive means by which a tenant can access basic relevant information about the lease is through a disclosure statement provided by the landlord.[[66]](#footnote-67) Section 4.4.1 provides a background on the current regulations. Section 4.4.2 discusses the alternative options that are not considered viable for the scope of the current project. Section 4.4.3 sets out the viable options that are analysed further in chapter 5 of the RIS.

## Background and current regulations

Disclosure statements are an important part of the regulatory approach to retail leases in all Australian States. By requiring disclosure of relevant information, retail leases legislation attempts to reduce the complexity of lease conditions and improve the basis for the commercial decisions of the parties to the lease.[[67]](#footnote-68)

“The government considers that the most effective way of minimising retail tenancy disputes is to ensure that the parties have sufficient information to make a sound business decision about entering into and renewing a lease.”[[68]](#footnote-69) “One of the key issues to emerge from the industry consultations is the need for improved education of both tenants and landlords on the implications of a lease before it is entered into, to help prevent disputes arising during the term of the lease”.[[69]](#footnote-70) The disclosure statement is a key means of achieving this as it is a critical element of the legislative framework, given that it seeks to promote informed decision-making by prospective tenants.

Section 17 of the Act states that a landlord must give a prospective tenant a disclosure statement in the form prescribed in the Regulations at least fourteen days before entering into a retail premises lease. A disclosure statement must also be provided by the landlord to the tenant on renewal of the lease (section 26) and on assignment of the lease (section 61). A tenant (in the capacity of assignor) must also give a new tenant (the assignee) a disclosure statement under section 61(5A). The way in which the Act is worded means that a disclosure statement *must* be prescribed in the Regulations. The form of the disclosure statements is prescribed in Schedules 1 to 4 of the Regulations.

Importantly, the Regulations prescribe the content of the disclosure statements and this helps ensure the quality of the information provided to the tenant. If the content of the disclosure statements was not prescribed, the level of detail and the information provided by the landlord could vary dramatically across leases. In this context, a tenant may be at a relative disadvantage in lease negotiations with a landlord as they will be reliant on the landlord to determine the appropriate information to provide and then provide it in a helpful format. Prescribing the form and content of the disclosure statement ensures that tenants receive a minimum amount of information about a retail lease in a consistent and understandable format.

A disclosure statement has always been a feature of Victoria’s retail leases legislation. However, the 2013 remake of the Regulations divided the singular disclosure statement into 4 separate disclosure statements to streamline the process. Each revision of the legislation has sought to improve the quality of information provided by landlords to tenants. Key items for disclosure include:

* lease details;
* rent and rent reviews;
* options for renewal; outgoings;
* and declarations by the landlord and tenant.

In addition, specific information has always been sought in relation to retail premises located in a shopping centre to reflect the different operating environment of these premises compared to non-shopping centre premises.

Since Victoria introduced disclosure statement requirements in 1986 there have been a number of changes that have gradually increased the regulatory burden. A chronological list on these changes can be found in the 2013 retail leases regulatory impact statement. There has been very little change to the disclosure statement requirements over the past 10 years.

* 2013 Regulations: The singular disclosure statement is divided into 4 disclosure statements that are specific to the requirements for the disclosure required. The 4 types of disclosure statement are for:
	+ Retail premises not located in retail shopping centres (schedule 1) (13 pages)
	+ Retail premises located in retail shopping centres (schedule 2) (18 pages)
	+ Renewal of a lease (schedule 3) (4 pages)
	+ Assignment of lease where a business is ongoing (schedule 4) (5 pages).
* 2022 Amendment Regulations: did not alter the four disclosure statement model. The *Retail Leases Amendment Act 2020* increased the timeframe in which a landlord must provide a tenant with a disclosure statement and requires a landlord to disclose changes to the previous disclosure statement when renewing a lease.

The recent amendments to the format of disclosure statements came into effect on 1 December 2022.

**Benefits and costs of disclosure**

There are both costs and benefits of disclosure. The benefits come in the form of more informed tenants and ultimately a more efficient allocation of scarce resources across the retail sector. While the direct benefits accrue mainly to tenants, landlords also benefit from having well informed retailers operating within their premises.[[70]](#footnote-71) These benefits include:

* less churn in retail leases (as tenants base their decision to sign a lease agreement on an adequate understanding of future occupancy costs and/or the operating environment of the rental property) and a reduction in associated costs (e.g. foregone rent from vacant premises and the cost of attracting and negotiating with new tenants); and
* a reduction in disputes and associated costs (such as fees for legal advice).

The costs come in the form of an administrative burden on landlords to complete the disclosure statement. The Regulations impose a compliance burden consistently across all landlords operating in the retail leases market. However, it is acknowledged that small landlords are likely to be impacted disproportionately.

While the costs and benefits of disclosure have not been quantified, there appears to be a general consensus between stakeholders that the benefits of disclosure to tenants outweigh the cost of disclosure to landlords. However, in 2009 Price Waterhouse Coopers (“PwC”) noted in its development of a core model national disclosure statement that there is a point at which the disclosure statement becomes too long, and each additional question imposes costs but actually reduces the benefit to the tenant by making the statement too long and complex.[[71]](#footnote-72) This was a major reason as to why the regulations were amended in 2013 to include four disclosure statements that are specific to the situation and type of disclosure required. This reduced the length and complexity of the disclosure statements.

Importantly, the requirement for landlords to provide a disclosure statement to prospective tenants is the primary means by which the Regulations help to address the market failures described in section 2.2. How provision of a disclosure statement helps to overcome information asymmetries, potentially high transaction costs, and in some cases an imbalance in market power between landlords and tenants is described below.

**Reduce information asymmetries**

The policy rationale for disclosure statements is to improve the efficiency and equity of the market for retail leases through better informed decision making.[[72]](#footnote-73) The notion of providing disclosure statements is based on the sound proposition that both parties to a legally binding arrangement should have the maximum available relevant information to assist their making an informed decision prior to executing any formal binding instrument.[[73]](#footnote-74) The disclosure statements aim to highlight key information contained in the proposed lease and presents it in a format that is easier for a tenant, particularly a tenant of a small business, to read and understand.

Furthermore, the disclosure statements require the landlord to provide information that will often be readily accessible to them but difficult or impossible for the tenant to acquire. In effect, this information provides the potential tenant with valuable commercial information that is not easily accessible by other means which can, in turn, help in assessing the viability of the tenant’s business plan.[[74]](#footnote-75)

**Reduce transaction costs**

Disclosure statements reduce both short term and longer term transaction costs associated with entering into and maintaining a retail lease. A disclosure statement reduces initial transaction costs incurred by a tenant by decreasing the cost to conduct due diligence before entering into a lease. Some information that is readily accessible to the landlord (e.g. customer foot traffic) would require a tenant to pay a property or other specialist to acquire.

In the longer term, disclosure statements also reduce the likelihood of disputes between landlords and tenants. Disclosure statements can reduce transaction costs by providing clarity at the outset as to the respective legal obligations of the parties to the lease.[[75]](#footnote-76) This can help to minimise costly legal proceedings at a later date, which might occur in the event that the parties were unsure of their legal standing after entering into a retail lease .[[76]](#footnote-77) A reduction in the incidence of business disputes has potentially significant cost savings for business, government and the economy more broadly.

Further, some information that is readily accessible to the landlord (e.g. the intention of an anchor tenant to vacate the shopping centre) may not be able to be acquired by the tenant, even for a fee. Such events may have a significant impact on the tenant and the financial success of the business. In this instance, disclosure helps to reduce the likelihood of business failure by improving decision making from the outset.

Disclosure helps to ensure that tenants enter into retail leases which are likely to prove commercially advantageous and profitable. This has a positive flow on effect for landlords by increasing the security of the tenancy and rental income. Thus, disclosure requirements improve the likelihood of mutually advantageous retail tenancy agreements.[[77]](#footnote-78)

**Reduce market imbalances**

Market imbalances in the retail leases market occur due to the superior knowledge and information about the premises held by the landlord. A disclosure statement helps to ‘level the playing field’ in regard to lease negotiations by improving the knowledge, and consequently the negotiating position, of the tenant. The disclosure statement plays a key role in assisting the tenant to acquire power by improving knowledge.

**National harmonisation**

In 2011, Victoria implemented the nationally harmonised model disclosure statement. At this time, it was found that using the model disclosure statement would save Victorian retail businesses $0.8 - $1.7 million if all states implemented the same system. However, only Victoria, New South Wales and Queensland ever implemented the model (80 per cent of national retail leasing market).

In 2013, Victoria moved away from the nationally harmonised model and implemented its current four disclosure statement system. The overall savings for retail businesses was found to be greater than using the nationally harmonised model.[[78]](#footnote-79)

Furthermore, the nationally harmonised model suffers from inflexibility due to NSW and Queensland having disclosure statement requirements set out within state legislation. Thus, making amendments harder to achieve.

## Alternative Options Considered

There are number of additional disclosure statement options that this RIS has not considered due to their lack of viability. These include:

* Not prescribing a disclosure statement for renewed leases and tenant assignment – one approach to address stakeholder concern about the disclosure statements in the context of renewed leases and tenant assignment would be for the new Regulations not to prescribe a disclosure statement for sections 26(1) and 61(5A) of the Act. However, the Regulations are required to prescribe some form of disclosure statement for all relevant sections of the Act. This option is thus not considered viable.
* Introducing a mechanism where a landlord would not provide a tenant with a disclosure statement if both parties agreed that a disclosure statement was not needed. Such an ‘opt out’ mechanism would, in theory, limit the provision of disclosure statements to those situations where tenants believed that a disclosure statement was required to improve their decision-making. Though safeguards would need to be developed to prevent landlords from using their market power to compel tenants into agreeing that they did not require a disclosure statement. Nonetheless, the introduction of an ‘opt out’ mechanism would involve amendment of the Act and is thus outside the scope of this RIS.

## Viable options for analysis

This RIS considers two disclosure statement options (relative to the reference case).

**Table 7: Disclosure statement option**

| **Option**  | **Description**  |
| --- | --- |
| Reference case | For the purpose of analysing options (chapter 5), a ‘reference case’ has been constructed which assumes that an occupancy cost threshold of $1 million is in place (the current Regulations). This reference case has been used as a point of comparison for other options because without an occupancy cost threshold there would be no retail leases within the scope of the Act, so disclosure statement requirements for retail leases would have no impact. Under this reference case, there would be no prescribed disclosure statement for the purposes of sections 17(1)(a), 26(1), 61(5) and 61(5A) of the Act. Consequently, landlords would not be required to provide prospective tenants (or renewing tenants) with a disclosure statement. Likewise, tenants seeking to assign a lease (e.g. as part of a sale of a business) would not be required to provide the prospective tenants with a disclosure statement. |
| Option DS1 | ***Retain the four current disclosure statements - for shopping centre tenants, non-shopping centre tenants, renewed leases and tenant assignment*** This option would retain the system currently in use. No significant changes would be made.As discussed, disclosure statements play a crucial role in maintaining a fair retail leasing market.Stakeholders have requested stability within the retail leases market and are satisfied with the current disclosure statement requirements.It is also assumed that under this option an occupancy cost threshold of $1 million would be in place. |
| Option DS2 | Returning to the pre 2013 nationally harmonised disclosure statement. The nationally harmonised model could provide savings of up to $1.7 million for Victorian retail businesses that operate across borders with other states that also operate the same disclosure statement model.The singular disclosure statement was considered inappropriate for all situations and was hence separated into 4 distinct disclosure statements in 2013. There has been no stakeholder feedback to suggest a return to the previous option is advisable.It is also assumed that under this option an occupancy cost threshold of $1 million would be in place. |

## Silent regulations

As highlighted in Section 2.2, the Act contains several powers to prescribe certain information that are not utilised, which are:

* section 30 of the Act Alterations to premises to enable fit out;
* section 35 of the Act Rent reviews generally;
* section 72 of the Act Advertising or promotion adjustment;
* section 84 of the Act Functions of the Small Business Commission; and
* section 86 of the Act Referral of retail tenancy disputes for alternative dispute resolution.

The RIS process provides the opportunity to utilise these powers to prescribe if considered appropriate. Stakeholder feedback does not indicate that any of these powers should be utilised and further regulations prescribed.

# Impact analysis

This chapter assesses the impacts of the options for each of the three parts of the Regulations (occupancy cost threshold, apportioning of outgoings and disclosure statements) relative to the reference case. The purpose of this analysis is to inform stakeholders about the costs and benefits of each option. The sections below detail:

* The approach to impact analysis in this RIS (5.1);
* Impact analysis of options for each of the three parts of the Regulations (sections 5.2 to 5.4).
1.

## Approach to impact analysis

Impact analysis in this RIS draws heavily on the 2013 RIS for the following reasons:

* The market for retail leases is an established market. While there have been considerable changes in retailing over the past decade, for example, more online retail, retail leases have not fundamentally changed, so analysis in the 2013 RIS remains relevant.
* Analysis by the Productivity Commission and PwC that was used in the 2013 RIS remains relevant to the current retail leases market.
* Estimates of the distribution of occupancy costs from the 2013 RIS continue to reflect the current retail leases market. Other data sources support this conclusion (discussed in more detail in section 5.2.1). Using estimates from the 2013 RIS also avoids the expense of gathering and analysing privately held data.
* The pandemic has had a significant impact on many retail businesses. The Department has been heavily engaged with businesses, for example, through the *Commercial Tenancies Relief Scheme*. Stakeholders (both tenant and landlords) expressed a clear preference for stability in retail leases regulations given the pandemic and other challenges. For these reasons, the Department was reluctant to gather significant data from stakeholders and burden them.
* The requirement to notify the VSBC on entry or renewal of a retail leases was removed at the end of 2012. As a result, there is limited data on the total amount of retail leases in Victoria.

There is a range of different decision-making tools that can be used to rank different options and assess which will yield the greatest net benefit to society, including cost-benefits analysis[[79]](#footnote-80)

This RIS uses multi-criteria analysis (MCA) as the decision-making tool for impact analysis. Options for each of the three parts of the Regulations are analysed against a ‘reference case’ (explained below).

## Reference cases

For each of the three parts of the Regulations, a ‘reference case’ has been used as a point of comparison to analyse the impact of options rather than the base case. Reference cases have been constructed for each of the three parts of the Regulations for the following reasons.

* It is uncertain how the market for retail businesses would operate under the base case, particularly given the Regulations and regulatory framework are longstanding. Retail businesses currently covered by the Act would operate under commercial leases and it is uncertain what conditions would be in these leases (see section 4.1 for more detail).
* There are interactions between the three parts of the Regulations. For example, an occupancy cost threshold is needed for requirements to apportion outgoings and disclosure statements to have any impact, so the base case is not a useful point of comparison.

Reference cases for each of the three parts of the Regulations are discussed in more detail in chapter 4 and below.

## Multi-criteria analysis

MCA is a tool that brings a degree of structure, analysis and openness to decision-making. As the *Victorian Guide to Regulation* states, MCA can be used when:

*… It is not possible to quantitatively estimate the effects of, many or most of the impacts of an option. However, you are able to define the objectives and their relative importance, as a basis for comparing options. [The process] will assign and aggregate scores to decision criteria and compare across options. [[80]](#footnote-81)*

This RIS uses MCA as its primary means to assess the impacts of the options because these impacts (especially benefits) generally cannot be precisely or reliability quantified (due to either data unavailability or the nature of the impacts themselves). This notwithstanding, this RIS does draw on a limited range of quantitative analysis to support the MCA, particularly with reference to the time and other costs associated with disclosure statements. The criteria against which the options are assessed are outlined below. The criteria (and their weightings) were chosen to represent the objectives of the Act and of the Regulations and to cover the spectrum of likely costs and benefits associated with the options.

Each option is scored on a scale from -10 to +10 relative to the reference case. A score of zero reflects no change compared to the reference case, whereas a positive (negative) score reflects a benefit (cost) to society compared to the reference case. The scale from -10 to +10 also allows the relative performance of the options to be illustrated. For instance, a score of 10 indicates that an option would have “twice the impact of an option with a score of 5 (and five times the impact of an option with a score of 2 etc).”[[81]](#footnote-82)

**Table 10 : Criteria for options analysis**

|  |  |  |
| --- | --- | --- |
| ***Criteria***  | ***Description***  | ***Weighting***  |
| 1. Protect small and medium sized retail business tenants
 | * Do the options protect small and medium size retail businesses from the potential misuse of market power that otherwise may hinder efficient bargaining between prospective tenants and landlords?
* Do the options address information asymmetries or deficiencies that can lead to unequal bargaining power?
* Do the options reduce the potential for disputes between tenants and landlords relating to retail lease agreements?
* Many of these benefits represent costs that are avoided with regulations in place.
* If an option provides protection to larger tenants, these benefits are not captured in this criterion or the MCA.
 | 40% |
| 1. Protect small and medium sized retail landlords
 | * While the Act aims to protect smaller tenants it also provides protection for smaller landlords by providing a legal framework within which leases are to be negotiated and stating the rights and responsibilities of both landlords and tenants.
* Do the options reduce the potential for disputes between tenants and landlords relating to retail lease agreements?
 | 10% |
| 1. Cost to tenants
 | * Includes administrative and compliance costs to tenants associated with specific regulations or retail leases being brought into the regulatory framework.
* Includes other economic costs to tenants such as reduced flexibility to negotiate terms and conditions as a result of retail leases being brought into the regulatory framework.
 | 25% |
| 1. Cost to landlords
 | * Includes administrative and compliance costs to landlords associated with specific regulations or retail leases being brought into the regulatory framework.
* Includes other economic costs to landlords such as reduced flexibility to negotiate terms and conditions as a result of retail leases being brought into the regulatory framework.
 | 25% |

## Impact analysis – Occupancy costs

## Reference case

For the purpose of this analysis, options for occupancy cost thresholds have been analysed against a ‘reference case’ which assumes that the Regulations would expire and leases currently covered by the Act would fall outside the Act, and would therefore operate like commercial leases.

For each option it is assumed that the Regulations operate in the same form that they currently operate in (aside from the occupancy cost threshold). This assumption is made because the costs and benefits of an occupancy cost threshold depend on whether an apportionment formula and disclosure statement are prescribed.

As discussed above, without an occupancy cost threshold in place, no businesses would be covered by the regulatory framework. Setting an occupancy cost threshold would determine which businesses are captured under the regulatory framework (Act and Regulations). Therefore, the impacts of each option are determined by the impacts of regulatory requirements in the Act as well as the apportionment formula and disclosure statement requirements.

The primary purpose of the occupancy cost threshold is to ensure that the Act covers resource poor small and medium business tenants while not capturing well-resourced large tenants. Therefore, the RIS analyses the impact of three different thresholds relative to this reference case:

* Option OC1 – Retain the current threshold of $1 million per year;
* Option OC2 – Increase the current threshold in line with inflation ($1.3 million per year); and
* Option OC3 – Decrease the threshold to $500,000 per year.

Greater detail about each of these options is provided in section 4.3.2.

## Criterion 1: Protect small and medium-sized retail business tenants

Relative to the reference case, all three options would provide greater protection to small and medium sized business tenants. These protections include:

* the conditions of a retail lease – including minimum lease periods, options to renew, fit outs, acceptable payments (e.g. rent and outgoings) and the means by which such payments should be calculated and/or reviewed, and specific requirements for shopping centre tenants;
* the provision of information between landlords and tenants ‑ including notification periods[[82]](#footnote-83), and the requirement to provide tenants with a disclosure statement;
* damages, repairs, refurbishments and relocations – and the respective roles and responsibilities of landlords and tenants;
* and dispute resolution – the requirement to take disputes to the Victorian Small Business Commission.

Each option would prescribe a threshold that would ensure the Act applies to a significant proportion of retail businesses in Victoria (Table 8). These options are compared to the reference case, under which the Act would not protect any retail business tenants (small, medium or large). The options vary on how much of the retail lease market they protect.

**Table 8: Proportion of retail businesses estimated to be covered under each option in 2023**

|  |  |
| --- | --- |
|  | ***Estimated proportion of total retail businesses*** |
| Option OC1: $1 million or less in annual occupancy costs  | 97% |
| Option OC2: $1.3 million or less in annual occupancy costs  | at least 98% |
| Option OC3: $500,000 or less in annual occupancy costs  | 94% |

*Source: DJSIR analysis based on Invest Victoria (Retail Leasing Snapshot) 2022 and Savills reports 2012*

Recent retail research reports, provided by Invest Victoria[[83]](#footnote-84), display a stable retail rental market over the past 10 years. Fluctuations in rental price were observed throughout lockdown periods, especially in Melbourne where lockdowns were longest. However, in the past year rental prices have reverted to the trends seen pre-covid.

As noted in section 4.2.1, ATO data also shows that only a very small percentage of industries have average occupancy costs over $1 million and those that do have large occupancy costs are generally not associated with retail business. The industry codes most aligned with small and medium sized retail businesses have average occupancy costs of significantly below the $1 million threshold (estimated average $181,267).[[84]](#footnote-85)

Due to a relatively stable retail leasing market and ATO data related to occupancy costs the Savills’ estimates on the distribution of occupancy costs in 2012 are used in this RIS and assumed to reflect the distribution of occupancy costs in 2023. Estimates from 2012 have also been used because it avoids the significant expense of gathering and analysing privately held data about occupancy costs.

The stable rental market, ATO data and continuous discussion with stakeholders has informed SBV that it is likely that over the past 10 years occupancy costs and the percentage of businesses covered by the Act have remained relatively stable.

Currently:

* small retail businesses are likely to pay annual occupancy costs of no more than $500,000; and
* medium retail business are likely to pay annual occupancy costs of no more than $1.2 million.[[85]](#footnote-86)

Table 9 provides SBV’s definition of small and medium sized businesses, which is based on number of employees, and provides up-to-date ABS data on the proportion of businesses falling into these categories. The table also draws on analysis from the previous RIS about occupancy costs provided by Savills. The table illustrates that an occupancy cost threshold of $500,000 will cover almost all small businesses and higher occupancy cost thresholds will cover almost all small and medium size businesses. It is important to note the limitations of the analysis outlined in the table; particularly:

* inferences are drawn between two different datasets based on number of employees and occupancy costs. Number of employees and occupancy costs are likely to be positively correlated, but the strength of this correlation has not been estimated; and
* the relative simplicity of the underlying datasets ‑ e.g. the Savills data has not been subject to statistical analysis to determine the mean or standard deviation and the ABS data only provides the number of businesses by broad employment categories (such as ‘non-employing’, ‘1-19 staff’, ’20-199’ staff and ‘200+ staff’).
* the age of the Savills analysis.

Nonetheless, in the absence of alternative data, the analysis in Table 9 provides an estimate of the small and medium sized business makeup of the retail industry in Victoria.

Table 9: Application of different definitions of ‘small business’ and ‘small and medium sized business’ to the Victorian retail sector

|  |  |  |
| --- | --- | --- |
|  | ***Employment-based data*** | ***Implication in terms of occupancy costs and coverage of retail businesses in Victoria*** |
| **Small business** |
| *As defined in terms of employment (0-19 staff)* | **97 per cent** of retail businesses in Victoria employ less than 20 staff.[[86]](#footnote-87)  | In 2012Savills estimated that around 94 per cent of retail businesses in Victoria pay $500,000 or less in annual occupancy costs, it is reasonable to assume that **$500,000** is an appropriate threshold to capture small retail businesses (in terms of the employment definition).  |
| **Medium business**  |
| *As defined in terms of employment (20-199 staff)* | **99.8 per cent** of retail businesses in Victoria employ less than 200 staff.[[87]](#footnote-88)  | In 2012 Savills estimated that around 98 per cent of retail businesses in Victoria pay $1.2 million or less in annual occupancy costs, it is reasonable to assume that **$1.2 million** is an appropriate threshold to capture small and medium retail businesses (in terms of the employment definition).  |

*Source: ABS (2022); Savills reports 2003 and 2012; IBISWorld (2012), various industry reports, relating to relevant ANZSIC codes, available at: http://www.ibisworld.com.au/industry/home.aspx*

Based on these findings it is reasonable to conclude that:

* Option OC1 would prescribe a threshold that would protect mainly small and medium sized business tenants (as $1 million aligns closely to the range of between $780,000 and $1.2 million);
* Option OC2 would prescribe a threshold that would protect close to 100 percent of all small and medium sized retail business tenants in Victoria but would also potentially capture some larger retail business tenants that were not originally intended to be covered by the Act; and
* Option OC3 would prescribe a threshold that would protect small retail business tenants in Victoria but very few medium sized retail business tenants.

As explained in section 4.2.3 there is a strong correlation between higher occupancy costs and publicly listed corporations. Although no up-to-date data is available that demonstrates the number of leases with occupancy costs greater than $1 million which are also publicly listed corporations, it is unlikely that raising the cost threshold above $1 million would greatly increase the coverage of the Act, as a large proportion of such businesses would be excluded from the Act under the publicly listed corporation rule.

Over the lifetime of the current regulations (since 2013), SBV has received a range of feedback from stakeholders regarding the occupancy cost threshold. Some have suggested increasing the threshold, while others have suggested decreasing it. The majority of stakeholders are satisfied with the current threshold and believe that the $1 million threshold ensures that small and medium sized businesses are covered by the protections of the Act and larger businesses are excluded. Tenants whose occupancy costs are around the $1 million mark have significant resources, information and bargaining power – sometimes more than the landlord. SBV has not received any feedback to suggest that tenants of premises with occupancy costs of over $1 million are suffering from the sort of imbalances in information and bargaining power that the Act was designed to address.

Recently, the overwhelming request from stakeholders has been for stability in the market. Amendments in 2020 to the Act have provided extra protections to tenants, and stakeholders appear content with the current protections.

On this basis, this RIS has given Options OC1 and OC2 the highest ranking with a score of **8** as both thresholds cover small and medium retail businesses. Option OC3 is ranked last (a score of **5**) as it would apply the Act to a smaller proportion of businesses than Options OC1 and OC2 and would not protect all the retail tenants requiring protection, particularly medium sized tenants.

## Criterion 2: Protect small and medium-sized retail landlords

Through the protection the Act offers tenants it also indirectly extends some protection to landlords. Each of the options would ensure more than 90 per cent of leases are covered by the Act and provide much greater protection than the reference case where no retail leases are covered. At a minimum Option 3 would protect the lowest proportion of tenants at approximately 94 per cent. The Act imposes various requirements, which although are mainly targeted for the benefit of tenants, also provide protection for landlords. These protections are highlighted below:

* Ensures prospective tenants (through the disclosure statement requirements) have access to information necessary for them to make a reliable judgment about the costs and benefits of a retail tenancy, promoting more efficient decision-making about retail lease agreements. This will reduce the possibility of a tenant defaulting, thus protecting landlord interests.
* Provides both landlords and tenants with clarity and certainty about key elements of a lease agreement (e.g. the determination and apportionment of outgoings, the length of lease periods, the process for rent reviews, and the roles and responsibilities of landlords and tenants with respect to alterations, refurbishments, interference and damages). This reduces:

a) the transaction costs for both parties associated with negotiating a lease agreement (as there is less need to engage specialist advice and/or negotiate over key elements of a lease agreement); and

b) the potential for disputes, thus avoiding costs involved in resolving disagreements (as both parties should have a similar understanding about issues that are likely to drive disputes, such as the nature and scope of costs to be borne by tenants). Chapter 3 highlighted the relationship between the Act and the number of retail lease disputes in Victoria over the past decade.

Similar to criterion 1, criterion 2 has scored options OC1 and OC2 equally (Scored **4**), as these options bring the greatest amount of small and medium sized landlords within the scope of the Act. Option OC3 (scored **2**) is ranked lowest, as it would apply the Act to a smaller proportion of businesses than Options OC1 and OC2, thereby not providing protection under the Act to as many retail landlords

## Criterion 3: Cost to tenants

Each of the options impose compliance costs on tenants that have annual occupancy costs below the relevant thresholds. As displayed below in table 11, the costs borne by tenants are minimal. These would primarily involve the costs associated with preparing a disclosure statement under Section 61(5A) of the Act.

**Table 10: Costs to tenants of preparing a disclosure statement, Occupancy Costs options (present value over 10 years)[[88]](#footnote-89)**

|  |  |  |  |
| --- | --- | --- | --- |
|  | ***% of retail businesses covered*** | ***Estimated number of lease agreements that would be subject to the Act each year*** | ***Cost to tenants*** |
| Option OC1 | 97% | 850 | $0.8 million |
| Option OC2 | 98% | 860 | $0.8 million |
| Option OC3 | 94% | 820 | $0.75 million |

*Source: DJSIR analysis based on information supplied by stakeholders in 2013 and PwC analysis*

The assignment of a lease (transferring from one tenant to another) requires the tenant assigning the lease to provide a disclosure statement to the landlord and the proposed assignee. As with the costs to landlords considered in section 5.2.3, Option OC2 would impose the highest costs on tenants, followed by Option OC1 and Option OC3. This is due to a higher percentage of businesses being captured by the Act with a higher occupancy cost threshold.

In addition to compliance costs, Option OC2 creates other economic costs for larger tenants who would prefer not to be captured by the Act. As discussed throughout this RIS, large tenants do not require the same protections as small and medium sized tenants. These tenants have a stronger market position and therefore favour the flexible negotiations seen in the commercial leasing market. If these larger tenants are captured by the Act, it is reasonable to assume they may suffer economic costs due to the prescriptive nature of the Act.

Option OC3 has been scored the highest (least costly) compared to reference case with a score of **-1**. This is due to the least number of tenants being brought within the scope of the regulations therefore producing the lowest compliance costs to tenants. Option OC1 has been scored **-1.5** as it captures a greater percentage of retail businesses but is unlikely to capture many large tenants and cause them economic costs. Option OC2 has been scored **-4** as it captures the largest percentage of businesses and would also capture substantially more large tenants and cause them economic losses..

## Criterion 4: Cost to landlords

By stipulating an occupancy cost threshold, each of the options would apply the Act to differing proportions of retail businesses in Victoria (Table 10). These businesses (as well as the relevant landlords) would thus be required to adhere to the Act and its provisions relating to:

* the conditions of a retail lease;
* information disclosure and landlord-tenant communication more broadly;
* damages, repairs, refurbishments and relocations; and
* dispute resolution.

**Table 11: Coverage of the Act under the three Occupancy Cost options**

|  |  |  |
| --- | --- | --- |
|  | Assumed proportion of retail businesses covered by the Act in 2023 | Estimated number of lease agreements that would be subject to the Act each year |
| Option OC1 | 97% | 16,055 |
| Option OC2 | 98% | 16,220 |
| Option OC3 | 94% | 15,558 |

*Source: DJSIR analysis based on information supplied by stakeholders in 2013 and PwC analysis*

Relative to the reference case, each option would impose compliance costs on landlords that enter into lease agreements with tenants that have annual occupancy costs below the relevant thresholds. Four types of costs would be imposed:

* Education ‑ landlords would have to educate themselves about the requirements of the Act and Regulations. New landlords would likely be required to spend more time on educating themselves than landlords familiar with the current regulatory arrangements. Disclosure statement requirements are one of the larger burdens for landlords within the regulations and these on average take 0.9-1.8 hours to complete.[[89]](#footnote-90) General understanding on other requirements would increase a landlord’s initial education on the requirements of the Act and Regulations.
* Reviewing practices – landlords would need to either dedicate staff time or procure external advice to ensure their internal processes and documents (e.g. lease agreements) are aligned with the requirements of the Act.
* Revising practices – The costs associated with implementing the advice given regarding internal processes and documentation would vary across businesses. Businesses with strong internal processes would have minimal costs associated with revising their practices.
* Publication and documentation – landlords would need to dedicate staff time and, in most cases purchase legal or other specialist advice, to complete a lease, disclosure statement and other necessary documentation for tenants.

The compliance costs to business outlined above would vary across the options, driven by the number of retail businesses (and associated lease agreements) captured by different occupancy cost thresholds. More specifically, Option OC2 would impose the highest costs on landlords, followed by Option OC1 and Option OC3.

This RIS does not have access to sufficient data that would allow it to quantify the full compliance costs associated with the Occupancy Cost options. However, analysis based on 2013 work done by PwC and updated with current data showed only a minimal variation across the 3 options. The 2013 modelling is displayed below in Table 11.

**Table 12: Costs to business of preparing a disclosure statement, Occupancy Costs options (present value over 10 years)[[90]](#footnote-91)**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | ***% of retail businesses covered*** | ***Cost to landlords*** | ***Cost to tenants*** | ***Total costs*** |
| Option OC1 | 97% | $47.1 million | $0.8 million | $47.9 million |
| Option OC2 | 98% | $47.6 million | $0.8 million | $48.4 million |
| Option OC3 | 94% | $45.6 million | $0.75 million | $46.4 million |

*Source: DJSIR analysis based on information supplied by stakeholders in 2013 and PwC analysis*

The findings in Table 11 suggest that:

* all of the options would impose compliance costs on business;
* the level of these costs would vary across the options (increasing from Option OC3 to Option OC1 to Option OC2); and
* the variance in costs across the options is slight (Option C2, for instance, is only 5 per cent more costly than Option C3) – reflecting the small difference in the proportion of retail businesses covered by each of the options.

There is no reason to expect that the relative costliness of the options would diverge from Table 11 if all the costs associated with each option could be fully quantified.

In addition to compliance costs, the options are likely to increase other costs borne by landlords and decrease costs borne by tenants. More specifically, there are a range of costs associated with running and maintaining a retail property (e.g. costs associated with government taxes, space conditioning, utilities, repairs and maintenance and marketing). Under the reference case, it is reasonable to expect that large landlords would use their superior resources, information and bargaining power relative to small and medium retail businesses to:

* pass on a greater range of operational costs to tenants than is currently allowed under the Act (e.g. land tax and/or “shortfall[s] in outgoings from … major tenants”); and
* limit payments to tenants and pay less than currently allowed under the Act (e.g. relating to compensation for interference and/or rent reductions due to damaged premises).

Each of the options would limit the extent to which large landlords could misuse their potential market power. This is achieved by prescribing the costs that can be passed on to a tenant (and the method of determining these costs) and the roles and responsibilities of landlords and tenants with respect to alterations, refurbishments, interference and damaged premises. Consequently, the distribution of costs between landlords and tenants under the options would favour tenants relative to the reference case.

Lastly, option OC2 may have other economic costs to large landlords due to a lack of flexibility in lease negotiations. Option OC2 is more likely to capture larger tenants who are likely to have larger landlords. The ability for large landlords and large tenants to have a free and fair ability to negotiate a lease on the terms they see fit in line with commercial practice is an important feature of the leasing market. Bringing these businesses within the scope of the Act may cause unnecessary burdens and costs on both parties.

The degree to which the options would increase costs borne by landlords would be driven by the proportion of retail businesses that are covered by each option. More specifically, Option OC2 would increase landlord costs to the greatest extent as it covers the largest percentage of the retail leasing market and would capture large tenants and landlords who prefer flexible leasing negotiations as seen in commercial leasing practices. As a result, OC2 has been scored **-6**. Option OC1 has been scored **-4.5**, whilst option OC3 has been scored **-4** as it would capture the fewest number of landlords within the confines of the Act.

## Summary

Based on the analysis outlined above, this RIS has scored each of the Occupancy Cost options against the three criteria as summarised below:

After the relevant weightings have been applied, Option OC1 – retain the current threshold of $1 million per year - has been identified as the preferred option (Table 12).

**Table 13: Occupancy costs threshold options – MCA summary**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
|  | ***Weighting*** | ***Reference Case*** | ***Option OC1*** | ***Option OC2*** | ***Option OC3*** |
| Protect small and medium sized retail business tenants | 40% | 0 | 8 | 8 | 5 |
| Protect small and medium sized retail business landlords | 10% | 0 | 4 | 4 | 2 |
| Cost to tenants  | 25% | 0 | -1.5 | -4 | -1 |
| Cost to landlords  | 25% | 0 | -4.5 | -6 | -4 |
| **Weighted score** |  |  | **2.1** | **1.1** | **1.0** |

## Impact analysis – Formula to determine and apportion outgoings

## Reference Case

For the purpose of this analysis, options for apportioning outgoings have been analysed against a ‘reference case’, which assumes that an occupancy cost threshold of $1 million is in place (the threshold in the current Regulations and preferred option in section 5.2 of this RIS). This reference case has been used because without an occupancy cost threshold there would be no retail leases, so any regulatory requirements about apportioning outgoings would have no impact. It is also assumed that an occupancy cost threshold of $1 million would be in place in both options.

Under the reference case, there would be no prescribed manner in which outgoings are determined or apportioned to a tenant. Rather, landlords would determine and apportion outgoings based on standard industry practice and in a manner that would be agreed by prospective tenants. It is reasonable to expect that outgoings would be determined and apportioned in a manner similar to the formula currently prescribed in the Regulations. Stakeholders have noted that it was common practice for landlords to apportion outgoings on an area basis prior to the introduction of the Regulations in 2003.

Despite landlords being broadly familiar with an area basis approach to determining and apportioning outgoings, there would still be room for interpretation on how this could be applied in practice, particularly with reference to the choice of the relevant denominator. In the absence of a prescribed formula, these issues would be left to landlords and prospective tenants to decide when negotiating a lease agreement.

Stakeholders have previously noted that, in the absence of a prescribed formula, there would be potential for “shopping centre landlords to pass any shortfall in outgoings from major tenants onto the speciality retailers in shopping centres”, as was the case prior to the Act coming into force.[[91]](#footnote-92) On a similar point, other stakeholders noted that “the opportunity to manipulate and include capital expenditure items would arise again as was the case prior to the introduction of the Act.”[[92]](#footnote-93)

This RIS considers two options relative to this reference case:

* Option F1 – Prescribe the current formula to determine and apportion outgoings (amended to reflect industry practice); and
* Option F2 – Prescribe a performance standard to determine and apportion outgoings.

Greater detail about each of these options is provided in Section 4.3.

## Criterion 1: Protect small and medium sized retail business tenants

Option F1 would protect a greater amount of small and medium sized retail business tenants relative to the reference case. By prescribing a formula in the Regulations, it would provide tenants with clarity and certainty about how outgoings will be determined and apportioned. This would, in turn, reduce:

* the need for small and medium sized business tenants to purchase specialist advice (average cost of approximately $650-800)[[93]](#footnote-94) about the best way to determine and apportion outgoings and/or negotiate over key elements of a lease agreement (reducing transaction costs) and less potential for larger businesses to misuse their market power during lease negotiations; and
* the potential for larger businesses to misuse their market power relative to small and medium sized businesses during lease negotiations to secure a more favourable means of determining and apportioning outgoings.
* disputes – tenants and landlords would have a similar understanding about how outgoings under a lease agreement would be determined and apportioned leading to less frequent disputes.
* poor decision making by providing prospective tenants with a firm basis on which to judge the future costs and benefits of a retail tenancy – promoting more efficient decisions about retail lease agreements.

In the circumstance of shopping centres, which are estimated to comprise of 20 per cent of the total market for retail tenancies,[[94]](#footnote-95) there is however a possibility that small and medium sized tenants are charged higher rent in lieu of landlords being able to charge them disproportionately high outgoings (to cover an anchor tenant) under the regulations. Landlords could do this by lowering the small and medium sized tenants’ apportioned outgoings to be in line with major tenants, and then charge the small and medium sized tenants higher rent to make up the shortfall.

This RIS does not assume this is a universal practice under the regulations, however it can be assumed that a large proportion of shopping centre landlords would be aware of this work-around. This work-around cannot be used any time an outgoing needs to be paid for, as landlords can only institute a potential rent increase through a rent review[[95]](#footnote-96) at the time and basis specified in the lease.[[96]](#footnote-97) Stakeholder feedback has not suggested that landlords are using this work around and for these reasons, it is assumed to be used infrequently by landlords and only affect a small proportion of leases. Option F2 would protect a greater amount of small and medium businesses relative to the reference case, but less so than Option F1. On the one hand, the performance standard would provide guidance to tenants and landlords that outgoings should be determined and apportioned in a fair and equitable manner. This would prompt both parties to seek further information about best practice and to query and test proposed approaches to determining and apportioning outgoings during negotiations.

However, Option F2 does not provide the same black-and-white certainty on the issue of outgoings as Option F1. Consequently:

* there would be a greater potential for some tenants to make inefficient decisions about retail lease agreements – as they may not have a complete or accurate picture of what constitutes the future costs and benefits of a retail tenancy;
* there would be a greater need for some tenants to purchase specialist advice about the best way to determine and apportion outgoings on an area basis
* there would be a greater potential for larger businesses to misuse their market power during lease negotiations; and
* there would be a greater potential for disputes – as tenants and landlords may not have a common understanding about how outgoings under a lease agreement should be determined and apportioned.

Due to the certainty, avoided specialist costs and lower risk of disputes option F1 has been scored **6** relative to the reference case. Option F2 has been scored **4** as it provides less certainty and would potentially require specialist advice, creating the potential for more disputes than option F1, but is still considered positive in comparison to the reference case.

## Criterion 2: Protect small and medium sized retail landlords

Both options provide greater protection to retail business landlords than the reference case similarly to the protection provided to tenants. Any protection provided to landlords is more important for smaller and medium sized landlords. This is because some small landlords often face similar issues to small tenants. As a result, the main protections that are provided to landlords are:

* there would be less need for landlords to purchase specialist advice and/or negotiate over key outgoing-related elements of a lease agreement (reducing transaction costs); and
* there would be less potential for disputes – as tenants and landlords would have a similar understanding about how outgoings under a lease agreement would be determined and apportioned.

It should be highlighted that the benefits derived by small to medium sized landlords are far lower than those derived by small to medium sized tenants. This is because small to medium sized landlords do not have property holdings large enough to lease to both an anchor tenant and small to medium sized tenants at the same time. If a small to medium sized landlord was to have multiple properties sharing outgoings, then it would be expected that tenants would not have bargaining power over each other, thus making outgoing apportionment negotiations and the disputes arising from them far less likely.

Similarly, to the discussion in 5.3.2 option, F2 would perform similarly to option F1 but would provide less certainty. This provides parties with a stronger bargaining position to misuse their power. As discussed, this generally benefits landlords, however this is not regarded as a desired benefit for landlords. The flexibility that option F2 provides can be viewed as beneficial to landlords, however, this could create uncertainty and lead to increased disputes.

After analysis, this RIS considers the stability benefits provided by option F1 (scored 2) to outweigh the flexibility benefits of option F2 (scored 1).

## Criterion 3: Cost to tenants

Option F1 and Option F2 would decrease the total costs of outgoings for small and medium tenants, relative to the reference case, because landlords would have less scope to offer discounted outgoings to large tenants to attract them (under recover) and then over recover outgoings from small and medium tenants. Landlords would also be restricted in terms of which outgoings they could pass on to tenants.

Both options would increase outgoing costs to large tenants. This is because, relative to the reference case, the decrease in outgoings paid by small to medium sized tenants must be accounted for elsewhere. This could occur in 3 separate ways:

* recovery from large tenants,
* increasing rent for small and medium size tenants, or
* absorption by the landlord.

These impacts (transfers of costs) are likely to be small.

Benefits to small and medium tenants from lower outgoings are captured in criterion 1. Costs to large tenants from higher outgoings are captured in this criterion.

Option F2 would have a similar impact on the shifting of costs from small and medium tenants to large tenants as Option F1. However, this impact would be smaller as Option F2 allows greater flexibility in how landlords and tenants agree to determine and apportion outgoings, so there is more scope for landlords to offer discounted outgoings to large tenants and recover the shortfall from small and medium tenants.

Option F1 has been scored **-3**, whilst option F2 has been scored **-2**.

## Criterion 4: Cost to landlords

Under both options, relative to the reference case, some costs would be transferred from small and medium tenants to landlords (as discussed in 5.3.4).

Stakeholders have previously stated that without an apportionment formula there is potential for landlords to:

* pass shortfalls in outgoings from major tenants onto the speciality retailers in shopping centres;[[97]](#footnote-98) and
* manipulate and include capital expenditure items, as was the case prior to the introduction of the Act.[[98]](#footnote-99)

By prescribing a formula for how outgoings should be determined and apportioned, Option F1 would limit the extent to which landlords could provide discounted outgoings to large tenants and recover the shortfall from small and medium tenants as well as limit the extent to which landlords could pass on non-prescribed costs to tenants. This imposes costs on landlords. These costs would likely be slightly lower than the costs to large tenants from these options (discussed in 5.3.4) because it should be assumed that more landlords are passing the costs onto the tenants than absorbing the costs themselves. As explained in 5.3.4,

Option F2 allows greater flexibility in how landlords and tenants agree to determine and apportion outgoings, and is less costly to landlords.

As a result, option F1 has been scored lower at **-2**, whilst option F2 has been scored **-1**.

## Summary

Based on the analysis outlined above, this RIS has scored each of the options against the four criteria as summarised below.

After the relevant weightings have been applied, Option F1 – prescribe the current formula to determine and apportion outgoings - has been identified as the preferred option (Table 13).

**Table 14: Formula options – MCA summary**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | ***Weighting*** | ***Reference Case*** | ***Option F1*** | ***Option F2*** |
| Protect small and medium sized retail business tenants | 40% | 0 | 6 | 4 |
| Protect small and medium sized retail landlords | 10% | 0 | 2 | 1 |
| Cost to tenants | 25% | 0 | -3 | -2 |
| Cost to landlords | 25% | 0 | -2 | -1 |
| **Weighted score** |  | 0 | **1.35** | **0.95** |

## Impact analysis – Disclosure statements

## Reference case for analysis

For the purpose of this analysis, options for disclosure statements have been analysed against a ‘reference case’, which assumes that an occupancy cost threshold of $1 million is in place (the preferred option in section 5.2 of this RIS). This reference case has been used because without an occupancy cost threshold there would be no retail leases, so disclosure statement requirements for retail leases would have no impact. It is also assumed that an occupancy cost threshold of $1 million would be in place in both options.

Under the reference case, landlords would not be required to provide prospective tenants (or renewing tenants) with a disclosure statement. The lease agreement itself would be the primary means by which landlords would inform prospective or renewing tenants about the terms and conditions of a lease. In addition, tenants seeking to assign a lease (e.g. as part of a sale of a business) would not be required to provide the prospective tenants with a disclosure statement.

Under the reference case, retail tenant costs would likely increase, as more current and prospective tenants would seek specialist advice (e.g. from retail consultants, valuers and lawyers) to obtain information about the operating environment of a rental property and/or the terms and conditions of a lease. It is estimated that when specialist advice is purchased it costs on average approximately $650-800.[[99]](#footnote-100)

This RIS analyses two options relative to this reference case:

* Option DS1 – Retain the current four disclosure statements – for shopping centre tenants, non-shopping centre tenants, renewed leases and tenant assignment.
* Option DS2 – Prescribe one disclosure statement for all relevant sections of the Act.

Greater detail about each of these options is provided in Section 4.4.3.

#### Theoretical approach to an optimal level of disclosure

The benefits of disclosure come in the form of better information to tenants and landlords, resulting in more efficient agreements and less disputation. The most important disclosures provide large additional benefits. However, beyond a point, the disclosure statement can get so large that new additions detract from its usefulness. This is akin to saying that the marginal benefit of disclosure starts high and declines as new elements are added, ultimately falling below zero (i.e. new additional disclosure provisions beyond a point are counter-productive).

Each new disclosure requirement comes at a cost; the administrative burden associated with gathering and providing the information. This means that the *total* cost of complying with disclosure requirements rises as new disclosures are added.

The *marginal* cost of new disclosures (that is the additional cost associated with an extra disclosure requirement) will depend on the nature of the disclosure. Clearly some pieces of information cost more to provide than others. However, it is unlikely that there is any systematic relationship between those items of disclosure which bring the highest marginal benefits and those which have higher or lower costs. For that reason, it cannot be assumed that the marginal cost of disclosure necessarily rises as new (less marginally beneficial) items are added. These basic assumptions are summarised in the diagram below.

Figure 5 : The marginal costs and benefits of disclosure



*Source: PwC (2009), Retail Tenancy Disclosure Statements: Proposals for harmonisation – Final report, January.*

The optimal level of disclosure occurs at point A where the marginal benefits of new disclosures are no more or less than the marginal cost. This broadly reflects the trade-off between the benefits of disclosure to tenants with the cost of disclosure to landlords.

If, on the other hand, a State was concerned only with the protection of tenants, it might choose to increase disclosure to point B – the point at which any further additional disclosure requirements would have negative effects even for tenants – owing to the length and complexity of disclosure statements. However, at point B landlords are incurring considerable costs associated with disclosure which exceed the benefits to tenants or the broader economy. This RIS considers the impacts of the Disclosure Statement options in the context of this theoretical framework.

## Criterion 1: Protect small and medium sized retail business tenants

Relative to the reference case, both options protect much stronger protection to small and medium sized retail business tenants. The requirement to provide a disclosure statement ensures prospective and renewing tenants have access to basic, relevant and comprehensible information about the key terms and conditions of a lease agreement. Consequently:

* prospective tenants would have a firmer basis on which to judge the future costs and benefits of a retail tenancy – increasing the probability that efficient decisions will be made about retail lease agreements;
* there would be less need for tenants to expend additional resources conducting due diligence (including the purchase of specialist advice); and
* there would be less potential for disputes – as tenants and landlords would have a shared understanding about the key elements of the lease agreement.

Stakeholder feedback has also been generally supportive of disclosure statements and the role they can play in enhancing decision-making around the agreement of retail leases. A stakeholder forum was held for the 2013 RIS. While this feedback is a decade old, SBV considers that these statements are broadly reflective of current views about the purpose and worth of disclosure statements. This is because the regulatory requirements have remained unchanged since then, while SBV has also received ad hoc feedback over the past decade consistent with that from 2013. Previously stakeholders have stated that:

* disclosure statements make tenants “aware of the initial and ongoing expense involved in leasing their retail premises, and nature of the expense. This means the preparation of a tenant’s business plan is likely to be more realistic”; and
* the disclosure statements were “useful for tenants as they rely heavily on the documents and don’t do the research”;[[100]](#footnote-101)
* “the disclosure statement does serve a useful purpose. It alerts the tenant to certain information. It’s the wrong approach to say we’ll give them less information”;[[101]](#footnote-102) and
* “the [disclosure statement] is critical to [Victorian Association for Newsagents’] members. Many do research and the [disclosure statement] adds to their research.”[[102]](#footnote-103)

SBV invites stakeholder feedback on whether these views expressed in 2013 reflect stakeholder views in 2023.

Whilst the single disclosure statement system was in operation up until 2013, stakeholders commented that the disclosure statement included too much information – “given the voluminous nature of the information being disclosed … it is possible that some tenants do not digest or bother to comprehend the information being provided.”[[103]](#footnote-104) Other stakeholders noted that the single disclosure statement system included information that was not relevant for non-shopping centre tenants;[[104]](#footnote-105)SBV’s view is that a single disclosure statement, relative to four disclosure statements, would impede efficient decision making and lead to small and medium tenants making worse decisions and being less protected.

Both options greatly protect retail lease tenants, however, the streamlined approach of Option DS1 provides greater protection as it is more readily understandable and reduces other costs (scored **9**). Option DS2 has been scored **7**.

## Criterion 2: Protect small and medium sized retail business landlords

Relative to the reference case, both options protect a greater number of small and medium sized landlords of retail businesses. The protection that landlords receive stems from the protections provided to tenants. The tenant protection, discussed in 5.4.2, consequently protects landlords in three main ways:

* By providing prospective tenants information about a tenancy and the expense involved in operating a retail business, the tenant can make an informed decision about whether to enter a retail premise lease. This results in a lower chance of businesses defaulting.[[105]](#footnote-106)
* It allows landlords to obtain a better understanding of a prospective tenant’s financial position and capability to perform its obligations under the lease, thereby minimising risk.
* There is less potential for disputes – as tenants and landlords would have a shared understanding about the key elements of the lease agreement.

A nationally harmonised model, as would be possible under option 2, may protect some landlords within state border communities. This type of protection would benefit landlords who owned property in multiple states, as harmonised disclosure statement requirements would reduce the work required to learn and understand multiple different disclosure statement requirements. However, these benefits relate to only a very small percentage of landlords and are much smaller than the benefits from option 1 resulting from more efficient decision making.

Both options protect retail lease landlords, however, the streamlined approach of Option DS1 provides greater protection, as it is more readily understandable and reduces other costs. Option DS1 has been scored **6** and option DS2 has been scored **2**.

## Criterion 3: Cost to tenants

Each of the options would also impose compliance costs on tenants that have annual occupancy costs below the relevant threshold and assign a retail lease to a new tenant. These costs would primarily involve the costs associated with preparing a disclosure statement under Section 61(5A) of the Act. But would also include the more minor costs associated with the comprehension of disclosure statements received from landlords.

Option 1 has the lowest compliance cost due to the streamlined nature of this option. The singular disclosure statement model, provided in option 2, has been found to create confusion, thus causing greater staff time requirements or specialist expertise.

Nevertheless, the requirements under section 61(5A) of the Act for tenants are minimal and therefore the compliance costs involved would also be minimal (see Table 14) for both options in comparison to the reference case. Option DS1 has been scored **-1**, whilst Option DS2 has been scored **-1.5**

## Criterion 4: Cost to landlords

Relative to the reference case, each of the options would impose compliance costs on landlords that enter into lease agreements with tenants that have annual occupancy costs below the relevant threshold. These costs would primarily involve those associated with preparing a disclosure statement under the relevant Sections 17(1)(a), 26(1) and 61(5) of the Act.

Stakeholders have highlighted the high compliance costs associated with preparing a disclosure statement under the Act. They noted that it is “a nightmare for both the landlord and tenant. It is time consuming and expensive for the landlord to complete.”[[106]](#footnote-107)

The total market cost to landlords is hard to estimate. As discussed in section 3.2.1 retail leases in Victoria are no longer required to be registered with the VSBC. As a result, there is limited data on the total number of retail leases in Victoria, so analysis from the 2013 RIS has been drawn upon. In 2012 there were around 33,000 retail businesses according to the ABS definition; however, it was estimated that there were between 69,000 to 72,000 retail leases.[[107]](#footnote-108) This large deviation arises because the definition of a retail premises under the Act is much broader than the definition of retail used by the ABS. Many professional services such as hairdressers and doctors are captured by the definition under the Act.

Current ABS data shows that there has been around a 43.6 per cent increase in the total number of retail businesses as defined by the ABS, over the past ten years. However, it is not possible to conclude that the number of retail leases would have also increased by this percentage. It is estimated that the current size of the Victorian retail leasing market has remained in between 65,000-80,000.

Without current data on the size of the Victorian retail leasing market, analysis from the 2013 RIS has been drawn upon heavily.

The types of compliance costs associated with disclosure statements are noted below.

* Shopping centre landlords would be able to dedicate specialist staff to preparing disclosure statements. The key costs they would face would thus be staff time.
* Non-shopping centre landlords would generally lack the institutional knowledge and resources to prepare disclosure statements themselves. Consequently, they would purchase the services of a lawyer or other third party to prepare a disclosure statement on their behalf. In addition to these costs, non-shopping centre landlords would also incur time costs in collating information at the request of the lawyer/third party.[[108]](#footnote-109)

Table 14 outlines the quantified compliance costs associated with the options. For further detail refer to Appendix A. Several assumptions have been made to enable the cost analysis. These are discussed below:

* As discussed in section 3.2.1, lease notification requirements ended in late 2012. As a result, no precise data exists on the number of retail leases. DJSIR has estimated growth in the number of leases based on the percentage increase in the number of employing retail businesses between 2012 and 2022 using ABS data.
* The proportion of leases that would require each type of disclosure statement (based on whether the lease is classified as new, renewed or assigned) was calculated using onlynew business entries in the ABS Retail Division **excluding** non-employing businesses. This differs from PwC’s original methodology, which included all businesses within the Retail Division. There are two reasons for the exclusion of non-employing businesses:
	+ Non-employing businesses are much less likely to enter into retail leases, as the category largely covers sole traders and independent contractors
	+ The latest ABS data on business numbers shows a significant increase in non-employing businesses between 2021 and 2022, largely for Covid-19 related reasons[[109]](#footnote-110).
* The removal of non-employing businesses from the updated analysis results in a reduced proportion of new leases compared with the original PwC framework. Because the estimates of total costs of disclosure statements rely on the three categories of lease types covering 100% of the retail leasing market, the shares of renewed and assigned leases have been adjusted proportionally upwards[[110]](#footnote-111).

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | ***Cost to shopping centre landlords*** | ***Cost to non-shopping centre landlords*** | ***Cost to tenants*** | ***Total costs*** |
| Option DS1 | $2.2 million | $44.9 million | $0.8 million | $47.9 million  |
| Option DS2 | $4.4 million | $80.0 million | $1.2 million | $85.6 million |

* Staff time spent on preparing disclosure statements, under the current 4 disclosure statement model, has been adjusted downwards based on the assumed reduction in time in PwC’s original analysis. PwC estimated a reduction in time preparing disclosure statements due to the streamlined process of the current model. The estimated time saved varied based on the type of disclosure statement being prepared.

**Table 15: Costs to business of preparing a disclosure statement, Disclosure Statement options, assuming a threshold of $1 million in annual occupancy costs (present value over 10 years).**

Table 14 : Costs to business of preparing a disclosure statement, Disclosure Statement options, assuming a threshold of $1 million in annual occupancy costs (present value over 10 years)

Table 14 indicates that the compliance costs to landlords are greatest under option 2, but still substantial under option 1. As a result, Option DS1 has been scored **-4** and Option DS2 has been scored **-7**.

## Summary

Based on the analysis outlined above, this RIS has scored each of the options against the three criteria as summarised in Table 15 below.

After the relevant weightings have been applied, Option DS1 – retain four disclosure statements - has been identified as the preferred option (Table 15).

**Table 16: Disclosure Statements – MCA summary**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | ***Weight-ing*** | ***Reference Case*** | ***Option DS1*** | ***Option DS2*** |
| Protect small and medium sized retail business tenants  | 40% | 0 | 9 | 7 |
| Protect small and medium sized retail business landlords | 10% | 0 | 6 | 2 |
| Cost to tenants  | 25% | 0 | -1 | -1.5 |
| Cost to landlords | 25% | 0 | -4 | -7 |
| **Weighted score** |  | 0 | **3** | **0.9** |

# Summary of the preferred option

A RIS is required to address seven key questions. The fifth of these questions is “What are the characteristics of the preferred option, including small business and competition impacts?” The Victorian Guide to Regulation[[111]](#footnote-112) explains that the characteristics of the preferred option are discussed in the impact analysis (chapter 5 of this RIS). The Guide also explains that to answer this question a RIS might go further and:

* Provide more detail than in the impact analysis chapter on specific design issues for the preferred options
* Compare the preferred option with the status quo
* Link to the exposure draft
* Provide a summary for stakeholder who may not read the impact analysis

The preferred option (the proposed Regulations) is to remake the current Regulations, which have been in place for a decade. No substantive changes have been proposed and the minor changes are summarised below:

* Regulation 8(4) of the current Regulations no longer required
	+ Transitional provision, no longer applied after 22 July 2013.
* Schedule 3 – 4.1 amended.
	+ Grammatical amendment to avoid confusion related to disclosure requirements for other monetary obligations and charges.
* Regulation 12 provides further detail on the procedure for obtaining consent to assign a lease.
* Grammatical changes to all schedule notes.
* Structural changes:
	+ Consolidation of regulations 6 and 7 of the current Regulations into a single regulation 6
	+ Consolidation of regulation 12 into regulation 11.
	+ Splitting of regulation 8 of the current Regulations into regulations 7, 8 and 12.

There have been several amendments to the Act and the Regulations over the past decade. There are no specific design issues related to the preferred option. The preferred option is the status quo, so comparing them is not applicable. The exposure draft of the proposed Regulations has been published with the RIS.

The preferred option involves three components:

1. setting an occupancy cost threshold of $1 million per annum, which enables the Act. Without an occupancy cost threshold there would be no retail leases. This threshold ensures that small and medium sized tenants are covered by the Act and its protections, but excludes large tenants who do not need these protections and in many cases would prefer the flexibility that comes from not being covered by the Act;
2. prescribing an apportionment formula, where retail tenants pay for shared outgoings in proportion to their floor space; and
3. prescribing four separate disclosure statements for different types of leases (for shopping centre tenants, non-shopping centre tenants, renewed leases and tenant assignment). Tenants and landlords must complete disclosure statements prior to signing a retail lease.

The preferred option enables small and medium sized retail tenants to receive the following protections in the Act:

* the conditions of a retail lease – including minimum lease periods, options to renew, fit outs, acceptable payments (e.g. rent and outgoings) and the means by which such payments should be calculated and/or reviewed, and specific requirements for shopping centre tenants;
* the provision of information between landlords and tenants including notification periods, and the requirement to provide tenants with a disclosure statement;
* damages, repairs, refurbishments and relocations – and the respective roles and responsibilities of landlords and tenants; and
* dispute resolution – and the role of the Victorian Small Business Commission.

Chapter 5 contains detailed analysis of the impacts of the preferred option and alternative options considered. In summary, relative to the base case of the Regulations expiring, the preferred option:

* Provides significant protection to small and medium sized tenants and promotes more efficient and equitable outcomes. The Regulations will reduce the need for smaller tenants to gather information and seek professional advice and reduce the likelihood of disputes;
* Provides some protection to small and medium sized tenants in part by smaller tenants making more informed decisions, reducing the likelihood of disputes;
* Imposes minimal compliance costs on small and medium sized tenants covered by the Act as well as imposing other economic costs through reduced flexibility for a minority of tenants who would prefer not to be covered by the Act; and
* Imposes compliance costs on landlords covered by the Act, particularly from preparing disclosure statements. Compliance costs on landlords are much higher than on tenants. Other economic costs will be imposed on landlords through a loss of flexibility.

The benefits of protections to small and medium sized retail tenants outweigh the compliance costs and other economic costs to large tenants and landlords.

## Small business and competition impacts

This section assesses the small business and competition impacts of the preferred option.

As noted in the Victorian Guide to Regulation, small businesses may experience disproportionate effects from regulatory requirements for a range of reasons, including limited resources to interpret compliance requirements, or to keep pace with regulatory changes and the cumulative effect of different requirements. For these reasons, it is best practice to examine small business impacts in a RIS[[112]](#footnote-113).

Overall, the proposed Regulations support small businesses and do not impose disproportionate regulatory burdens relative to larger businesses.

As explained in chapter 5, the proposed Regulations provide much stronger protections to small and medium sized tenants relative to the base case as well as providing protection to smaller landlords. While the Regulations do impose compliance costs on small tenants these costs are more than offset by avoided costs. For example, disclosure statements require landlords to provide prospective tenants with information about lease terms and conditions, which reduces the need for tenants to gather information and obtain specialist advice as well as reducing the likelihood of disputes.

RISs are required to analyse competition impacts. Regulation in Victoria is required to include a competition assessment under the Competition Principles Agreement. Under the Competition Principles Agreement, any new primary or subordinate legislation should not restrict competition except where:

* restriction of competition is required to meet the objectives of the legislation; and
* the benefits of the restriction outweigh the costs[[113]](#footnote-114).

Restrictions on competition occur when there will be changes to the way a market functions due to the implementation of the proposed regulation. Restriction can occur when:

* the number or range of suppliers is limited
* the ability of suppliers to compete is limited
* the incentive of suppliers to compete vigorously is reduced.

If the answer is “yes” to any of the following questions, then the proposed Regulations are considered to restrict competition.

|  |  |  |
| --- | --- | --- |
| **Test question**  | **Answer** | **Explanation**  |
| Is the proposed measure likely to limit the numbers of producers or suppliers to: only one producer?only one buyer?Less than four producers? | No.  | Based on ABS data, there are tens of thousands of retail businesses in Victoria. These businesses enter into leases with a similarly large number of retail landlords. The proposed Regulations protect tenants, relative to the base case, so will not reduce the number of tenants. While the proposed Regulations impose costs on landlords, these are relatively small and are not expected to reduce the number of landlords, particularly the number of large landlords.  |
| Would the proposed measure discourage entry into the industry by new firms/individuals or encourage existing providers to exit the market?  | No.  | As noted above, the proposed Regulations impose costs on landlords relative to the base case, but these costs are not expected to discourage entry into or encourage exit from the market. These costs are small relative to landlords’ rental income and are partially offset by the market functioning more efficiently as a result of the Regulations.  |
| Would the proposed measure impose higher costs on a particular class of business or type of service (e.g. small business?  | No.  | The proposed measures are unlikely to impose higher costs on a particular type of business. Although tenants with occupancy costs above the $1 million threshold would be excluded from coverage under the Regulations, this reflects a preference for flexibility by large tenants with the resources and market power to negotiate leases suited to their individual needs.  |
| Would the proposed measure affect the ability of businesses to innovate, adopt new technology or respond to the changing demands of consumers?  | No. | The preferred options are unlikely to significantly impact innovation or the adoption of new technology. This is due to the stable and established nature of the market and other statutory and regulatory requirements which prescribe many of the terms and conditions of commercial leases more broadly.  |

The Competition Principles Agreement also states that if there is a restriction on competition it is necessary to explain the objective that is achieved through restricting competition and assess other reasonable means of achieving the objectives without restricting competition.[[114]](#footnote-115) As noted above, the proposed Regulations do not significantly restrict competition.

## Implementation

RISs are required to include implementation plans. As explained in the Victorian Guide to Regulation, the key questions that should be considered for implementation are:

* What needs to be done?
* When will it be done?
* Who will do it?
* Who will monitor implementation, enforcement, and compliance?

##  What needs to be done?

As part of the implementation of the Regulations a number of key tasks must be completed. These are displayed below:

|  |  |
| --- | --- |
| **Task** | **Timing** |
| Public consultation on the RIS | Released for 28 day period as required under the Subordinate Legislation Act 1994 |
| Provide feedback to all parties who expressed interest during public consultation | After public consultation period has closed |
| Regulations made by Governor in Council | 11 April 2023 |
| Update existing guidance materials | April 2023 |
| VSBC information session with key stakeholders | April 2023 |
| Targeted stakeholder education/communication | April 2023 |

As the proposed regulations are in the same form as the sunsetting regulations there will not be further requirements to implement the regulations.

## When will it be done?

The current regulations sunset on 16 April 2023. The proposed regulations will come into effect on 15 April 2023.

## Who will do it?

DJSIR will be responsible for the implementation of the Regulations. DJSIR will collaborate with VSBC regarding stakeholder engagement.

## Who will monitor implementation, enforcement and compliance?

Monitoring of implementation, including identification and management of implementation risks, will be undertaken by DJSIR.

## Evaluation

RISs are required to include an evaluation strategy. Evaluation is important to understand how the preferred option works in practice and to drive continuous improvement of regulatory arrangements over time. An evaluation strategy needs to be clear on:

* + what will be evaluated;
	+ how it will be done;
	+ who will do it; and
	+ when it will be done.

The proposed Regulations will be evaluated by the DJSIR/Small Business Victoria. Evaluation will be ongoing and will involve a mid-term review within five years of commencement. The Regulations are part of the regulatory framework (the Regulations enable protections in the Act). Evaluation of the Regulations will invariably touch on the Act.

After commencement, the Department will continue to monitor the effectiveness of the proposed Regulations in protecting small and medium size tenants. Small Business Victoria will continue to engage with small businesses including smaller retail businesses.

As noted above, this RIS has relied heavily on analysis and data from the 2013 RIS. Once the Regulations have been remade the Department will consider gathering updated data and undertaking further analysis to assist in evaluating the Regulations. This would assist in developing a baseline for the mid-term review.

The Department is committed to undertaking a mid-term review of the effectiveness of the Regulations. This review will require updated data and additional analysis. The Department anticipates that additional data sources will be available that will be able to inform future analysis and decisions. This includes additional analysis on data collected by the Victorian Small Business Commission’s new customer management system, which will be able to provide more insights on the nature of disputes than has previously been possible. In addition, the Department’s close work with other government agencies throughout the pandemic has highlighted opportunities for developing new data sources, particularly on occupancy costs.

Indicators to assess the effectiveness of the Regulations could include:

* The number of disputes, and further analysis on the nature of those disputes
* Compliance costs for tenants
* Compliance costs for landlords
* Satisfaction by tenants with protections in the Act
* Improved occupancy cost data collection.

# References

**Legislation:**

Retail Leases Act 2003 (Vic)

**Government sources:**

Department of Treasury and Finance (2016), Victorian Guide to Regulation, August 2016

Productivity Commission (2008), The Market for Retail Tenancy Leases in Australia, Inquiry Report, March 2008

Productivity Commission (2011), Economic Structure and Performance of the Australian Retail Industry, Inquiry report, November 2011

Victorian Civil and Administrative Tribunal (2015), In the Matter of s11A of the Small Business Commissioner Act 2003; In the Matter of the referral of matters to VCAT for an advisory Opinion pursuant to section 125 of the Victorian Civil and Administrative Tribunal Act 1998 (Vic), VCAT Reference R115/2014.

Victorian Government (2001), Retail Tenancies Legislation: Discussion paper, October 2001.

Victorian Government (2001), Review of the Victorian Retail Tenancies Legislation: Issues paper, January 2001.

Victorian Government (2003), Proposed Retail Leases Regulations 2003: Regulation impact statement, March 2003.

Victorian Government (2003), Second Reading Speech, Retail Leases Bill (2003), Victoria, Legislative Assembly, 27 February 2003.

**Statistical Data:**

Australian Bureau of Statistics (2022), Data cube 2: Businesses by main state by industry class by employment size ranges, June 2022

Australian Taxation Office (2020), Taxation statistics 2019–20 Companies: Selected items and financial ratios for micro1 businesses by taxable status, profit status, broad industry and state/territory, August 2020

Australian Taxation Office (2022), Taxation statistics 2021-2022 Companies: Selected items and financial ratios for micro1 businesses by taxable status, profit status, broad industry and state/territory, December 2022

**External reports**

Colliers (2022), Australian Retail Snapshot Q3 2022, Colliers International Group Inc.

PwC (2009), Retail Tenancy Disclosure Statements: Proposals for harmonisation – Final report, January.

Savills Australia (2012), Report for Department of Business and Innovation, September 2012

Victorian Small Business Commission (2016), ‘What are “retail premises”?’, November 2016, available at:  [Retail Premises Guidelines - Amended 14 June 2016.docx (vsbc.vic.gov.au)](https://www.vsbc.vic.gov.au/wp-content/uploads/2016/06/vsbc-Retail-Premises-Guidelines-June-2016.pdf)

Victorian Small Business Commission (2022), Victorian Small Business Commission: Annual Report 2021-2022. December 2022

# Appendix A: Proposed changes to the regulations

|  |
| --- |
| **Proposed changes to the regulations** |
| **2013 Regulations** | **2023 Regulations** | **Reason for change** |
| Regulation 8(4) | Struck out | Transitional provision, no longer applied after 22 July 2013 |
| Schedule 3 – 4.1 - Outline any other costs arising under the renewed lease not including costs that are referred to in the statement of outgoings under section 47 of the Act and are not referred to in the **lease**.\* | Schedule 3 – 4.1 - Outline any other costs arising under the renewed lease not including costs that are:* referred to in the statement of outgoings under section 47 of the Retail Leases Act 2003: or
* referred to elsewhere in this **disclosure statement**.\*
 | Grammatical amendment to avoid confusion related to disclosure requirements for other monetary obligations and charges.Formatting changes for clarity purposes.\***Bolded** section highlights substantive change. |
| Regulation 8(3) - For the purposes of section 61(5A) of the Act, the form of tenant's disclosure statement is in Schedule 4. | Regulation 12 – 1. For the purposes of section 61(5) of the Act, the form of landlord's disclosure statement is—
2. if the retail premises are not located in a retail shopping centre, in Schedule 1
3. if the retail premises are located in a retail shopping centre, in Schedule 2.
4. For the purposes of section 61(5A) of the Act, the form of tenant's disclosure statement is in the form prescribed if it contains the information [and material] specified in Schedule 4
 | Provides further detail on the procedure for obtaining consent to assign a lease. |

|  |
| --- |
| **Consolidated regulations** |
| **2013 Regulation** | **2023 Regulation** |
| Regulation 6 – Excluded retail premises | Regulation 6 – Meaning of retail premises |
| Regulation 7 – Occupancy costs |
| Regulation 11 – Prescribed outgoings | Regulation 11 – Statement of outgoings |
| Regulation 12- Statement of outgoings |

|  |
| --- |
| **Expanded regulations** |
| **2013 Regulations** | **2023 Regulations** |
| Regulation 8 – Disclosure Statements | Regulation 7 - Provisions of landlord’s disclosure statement and proposed lease |
| Regulation 8 – Landlord’s disclosure on renewal of lease |
| Regulation 12 – Procedure for obtaining consent to assignment |

|  |
| --- |
| **Changes to regulation title** |
| **2013 Regulation** | **2023 Regulation** |
| Regulation 9 – Determination and apportionment of outgoings | Regulation 9 – Recovery of outgoings from the tenant |
| Regulation 10 – Maximum outgoings | Regulation 10 – Liability to contribute to non-specific outgoings |

# Appendix B: Costing assumptions

The tables below outline the data and assumptions that underpinned the costs estimates of preparing a disclosure statement associated with the Occupancy Costs options and the Disclosure Statement options.

General assumptions

| ***Data / assumption*** | ***Value*** | ***Basis/Source*** |
| --- | --- | --- |
| ***Period of analysis***  | ***10 years (April 2023 - April 2032)*** | ***Proposed timeframe of new Regulations (SBV)*** |
| ***Discount rate***  | ***4 per cent*** | ***DTF Guidance on discount rates*** |
| ***Number of retail leases agreed each year that would require the preparation of a disclosure statement***  | ***16,055*** | ***Inflated using percentage increase of retail businesses from 2012 to 2022 based on ABS 8165.0 Counts of Australian Businesses (excluding non-employing businesses) - Increase of 16.34% in Retail Division*** |
| ***Proportion of retail leases that involve shopping centre tenants***  | ***20 per cent*** | ***The Productivity Commission estimated in its 2008 inquiry into The Market for Retail Tenancy Leases in Australia that shopping centre tenants comprised 20 per cent of the total market for retail tenancy leases.***  |
| ***Proportion of retail leases that are new leases***  | ***10 per cent*** | ***ABS business count data (cat. no. 8165.0) indicates that 10 per cent of retail businesses in Victoria in the 2022 financial year were new businesses.*** |
| ***Proportion of retail leases that are renewed leases***  | ***84.7 per cent*** | ***Based on discussions with SBV*** |
| ***Proportion of retail leases that are assigned leases***  | ***5.3 per cent*** | ***Based on discussions with SBV*** |
| ***Cost of preparing a disclosure statement***  |  |  |
| ***Shopping centre landlords*** | ***Staff time – 0.9 hours*** | ***Based on the estimated staff time saved from 2013 RIS***  |
| ***Non-shopping centre landlords*** | ***Staff time - 0.72 hours (for new lease)******Staff time - 0.603 hours (for renewed lease)******Staff time - 0.72 hours (for assigned lease)*** | ***Based on the estimated staff time saved from 2013 RIS.***  |
|  | ***Fees to external parties - $684*** | ***Initial amount from 2013 RIS is inflated by using 2012-2021 CPI - total change in fees is 18.2% over 9 years at annual inflation rate of 1.9%*** |
| ***Tenants***  | ***Staff time - 1.206 hours*** | ***Based on the estimated staff time saved from 2013 RIS.***  |
| ***Cost estimates - staff time***  |  |  |
| ***Average weekly earnings (full time, Victoria)*** | ***$1,807.00*** | ***ABS (2023), Average Weekly Earnings, Australia, May 2022, cat. no. 6302.0*** |
| ***Earnings per week worked per annum after taking away leave*** | ***$2,135.55*** | ***DJSIR*** |
| ***Hours worked per week*** | ***40*** | ***DJSIR*** |
| ***Oncost and overhead multiplier***  | ***1.75*** | ***Victorian Guide to Regulation***  |
| ***Average hourly wage (including oncosts and overheads)*** | ***$93.43*** | ***Derived from assumptions above.***  |
| ***Data / assumption*** | ***Value*** | ***Basis/Source*** |
| Period of analysis  | 10 years (April 2023 - April 2032) | Proposed timeframe of new Regulations (SBV) |
| Discount rate  | 4 per cent | *DTF Guidance on discount rates* |
| Number of retail leases agreed each year that would require the preparation of a disclosure statement  | 16,055 | Inflated using percentage increase of retail businesses from 2012 to 2022 based on ABS 8165.0 Counts of Australian Businesses (excluding non-employing businesses) - Increase of 16.34% in Retail Division |
| Proportion of retail leases that involve shopping centre tenants  | 20 per cent | The Productivity Commission estimated in its 2008 inquiry into *The Market for Retail Tenancy Leases in Australia* that shopping centre tenants comprised 20 per cent of the total market for retail tenancy leases.  |
| Proportion of retail leases that are new leases  | 10 per cent | ABS business count data (cat. no. 8165.0) indicates that 10 per cent of retail businesses in Victoria in the 2022 financial year were new businesses. |
| Proportion of retail leases that are renewed leases  | 84.7 per cent | Based on discussions with SBV |
| Proportion of retail leases that are assigned leases  | 5.3 per cent | Based on discussions with SBV |
| Cost of preparing a disclosure statement  |  |  |
| Shopping centre landlords | Staff time – 0.9 hours | Based on the estimated staff time saved from 2013 RIS  |
| Non-shopping centre landlords | Staff time - 0.72 hours (for new lease)Staff time - 0.603 hours (for renewed lease)Staff time - 0.72 hours (for assigned lease) | Based on the estimated staff time saved from 2013 RIS.  |
| Fees to external parties - $684 | Initial amount from 2013 RIS is inflated by using 2012-2021 CPI - total change in fees is 18.2% over 9 years at annual inflation rate of 1.9% |
| Tenants  | Staff time - 1.206 hours | Based on the estimated staff time saved from 2013 RIS.  |
| Cost estimates - staff time  |  |  |
| Average weekly earnings (full time, Victoria) | $1,807.00 | ABS (2023), Average Weekly Earnings, Australia, May 2022, cat. no. 6302.0 |
| Earnings per week worked per annum after taking away leave | $2,135.55 | DJSIR |
| Hours worked per week | 40 | DJSIR |
| Oncost and overhead multiplier  | 1.75 | *Victorian Guide to Regulation*  |
| Average hourly wage (including oncosts and overheads) | $93.43 | Derived from assumptions above.  |

1. Department of Treasury and Finance (2016), *Victorian Guide to Regulation*. [↑](#footnote-ref-2)
2. Tasmania is yet to have retail lease legislations but had a 2022 Bill in its Parliament to enact retail lease legislation. [↑](#footnote-ref-3)
3. PwC (2009), *Retail Tenancy Disclosure Statements: Proposals for harmonisation – Final report*, January. [↑](#footnote-ref-4)
4. [Entering into a retail lease | Victorian Small Business Commission (vsbc.vic.gov.au)](https://www.vsbc.vic.gov.au/your-rights-and-responsibilities/entering-into-a-retail-lease/). [↑](#footnote-ref-5)
5. [Business Victoria | Business Victoria](https://business.vic.gov.au/). [↑](#footnote-ref-6)
6. Second Reading Speech, Retail Leases Bill (2003), Victoria, Legislative Assembly, 27 February, John Brumby. [↑](#footnote-ref-7)
7. Second Reading Speech, Retail Leases Bill (2003), Victoria, Legislative Assembly, 27 February, John Brumby. [↑](#footnote-ref-8)
8. Victorian Government (2001), *Retail Tenancies Legislation: Discussion paper,* October. [↑](#footnote-ref-9)
9. *Retail Leases Act 2003*, section 1. [↑](#footnote-ref-10)
10. Victorian Government (2001), *Review of the Victorian Retail Tenancies Legislation: Issues paper*, January. [↑](#footnote-ref-11)
11. Victorian Small Business Commission (2016), ‘What are “retail premises”?’, November, available at:  [Retail Premises Guidelines - Amended 14 June 2016.docx (vsbc.vic.gov.au)](https://www.vsbc.vic.gov.au/wp-content/uploads/2016/06/vsbc-Retail-Premises-Guidelines-June-2016.pdf). [↑](#footnote-ref-12)
12. E.g. Barrister’s Chambers – Determination 2; ‘Market Land’ as defined by the Melbourne Market Act Authority – Determination 4. Other excluded premises can be found at:

[Premises not covered by the Act | Victorian Small Business Commission (vsbc.vic.gov.au)](https://www.vsbc.vic.gov.au/your-rights-and-responsibilities/entering-into-a-retail-lease/premises-not-covered-by-the-act/). [↑](#footnote-ref-13)
13. Victorian Government (2001), *Retail Tenancies Legislation: Discussion paper,* October. [↑](#footnote-ref-14)
14. Victorian Civil and Administrative Tribunal (2015), *In the Matter of s11A of the Small Business Commissioner Act 2003; In the Matter of the referral of matters to VCAT for an advisory Opinion pursuant to section 125 of the Victorian Civil and Administrative Tribunal Act 1998 (Vic),* per Garde J, VCAT Reference R115/2014. Available online at https://www.vsbc.vic.gov.au/wp-content/uploads/2019/06/VCAT-Essential-Safety-Measures-1-May-2015.pdf. [↑](#footnote-ref-15)
15. Australian Taxation Office (2022), *Taxation statistics 2021-2022 Companies: Selected items and financial ratios for micro1 businesses by taxable status, profit status, broad industry and state/territory.* [↑](#footnote-ref-16)
16. Second Reading Speech, Retail Leases Bill (2003), Victoria, Legislative Assembly, 27 February, John Brumby. [↑](#footnote-ref-17)
17. Victorian Government (2001), *Review of the Victorian Retail Tenancies Legislation: Issues paper*, January. [↑](#footnote-ref-18)
18. Victorian Government (2001), *Retail Tenancies Legislation: Discussion paper,* October. [↑](#footnote-ref-19)
19. Victorian Government (2001), *Review of the Victorian Retail Tenancies Legislation: Issues paper*, January. [↑](#footnote-ref-20)
20. Productivity Commission (2011), *Economic Structure and Performance of the Australian Retail Industry*, Inquiry report, November. [↑](#footnote-ref-21)
21. Victorian Government (2001), *Review of the Victorian Retail Tenancies Legislation: Issues paper*, January. [↑](#footnote-ref-22)
22. Estimate based on PwC report and updated with current data. Other current stakeholder feedback has suggested that this estimate may be low and have suggested the cost could be closer to $800. [↑](#footnote-ref-23)
23. PwC (2009), *Retail Tenancy Disclosure Statements: Proposals for harmonisation – Final report*, January. [↑](#footnote-ref-24)
24. ibid. [↑](#footnote-ref-25)
25. ibid. [↑](#footnote-ref-26)
26. Victorian Government (2001), *Retail Tenancies Legislation: Discussion paper,* October 2001. [↑](#footnote-ref-27)
27. ibid. [↑](#footnote-ref-28)
28. PwC (2009), *Retail Tenancy Disclosure Statements: Proposals for harmonisation – Final report*, January. [↑](#footnote-ref-29)
29. ibid. [↑](#footnote-ref-30)
30. This definition of retailing is based on various decisions made by Victorian Administrative Appeals Tribunal and by the Victorian courts. For examples of this, see *Wellington v Norwich Union Life Insurance Society Limited* [1991] VR 333, per Nathan J, and *Fitzroy Dental Pty Ltd v Metropolitan Management Pty Ltd* [2013] VSC 344. [↑](#footnote-ref-31)
31. Productivity Commission (2008), *The Market for Retail Tenancy Leases in Australia*, Inquiry Report, March. [↑](#footnote-ref-32)
32. *Australian Bureau of Statistics* (2022), Data cube 2: Businesses by main state by industry class by employment size ranges, June 2022. [↑](#footnote-ref-33)
33. Productivity Commission (2008), *The Market for Retail Tenancy Leases in Australia*, Inquiry Report, March. [↑](#footnote-ref-34)
34. Productivity Commission (2008), *The Market for Retail Tenancy Leases in Australia,* Inquiry Report, March.

*\*While the reference above is more than a decade old the nature of participants in the retail lease market has not changed. The productivity commission report remains the most relevant source on this issue.*  [↑](#footnote-ref-35)
35. These instruments were enacted under the COVID-19 Omnibus (Emergency Measures) *Act 2020* and the *COVID-19* Omnibus*(*Emergency Measures*)(Commercial Leases and Licences)*Regulations 2020, and then further extended with the Covid-19 Omnibus*(*Emergency Measures*) Transitional*Regulations 2021. [↑](#footnote-ref-36)
36. Estimate of 70,000 retail leases in Victoria by the average 900 disputes per year. [↑](#footnote-ref-37)
37. Victorian Small Business Commission (2022), *Victorian Small Business Commission:* *Annual Report 2021-2022* December 2022. [↑](#footnote-ref-38)
38. Ibid. [↑](#footnote-ref-39)
39. Ibid. [↑](#footnote-ref-40)
40. Productivity Commission (2008), *The Market for Retail Tenancy Leases in Australia*, Inquiry Report, March.

*\*While the reference above is more than a decade old the nature of participants in the retail lease market has not changed. The productivity commission report remains the most relevant source on this issue.* [↑](#footnote-ref-41)
41. Productivity Commission (2008), *The Market for Retail Tenancy Leases in Australia*, Inquiry Report, March. [↑](#footnote-ref-42)
42. ibid. [↑](#footnote-ref-43)
43. ibid p 233. [↑](#footnote-ref-44)
44. There are notification periods for several different scenarios including: alterations or refurbishments carried out by landlord (60 day notification period); information provided prior to the option to renew a lease expiring (3 months); and the landlord providing a disclosure statement to the tenant at least 14 days prior to entering into the lease. [↑](#footnote-ref-45)
45. Eastern Bridge Lawyers stated that $684 would be regarded as a low estimate and costs would usually exceed $800. [↑](#footnote-ref-46)
46. DJSIR, Insights team, analysis based on PwC analysis and stakeholder feedback in 2013. [↑](#footnote-ref-47)
47. Second Reading Speech, Retail Leases Bill (2003), Victoria, Legislative Assembly, 27 February, John Brumby. [↑](#footnote-ref-48)
48. Victorian Government (2001), *Retail Tenancies Legislation: Discussion paper,* October. [↑](#footnote-ref-49)
49. Victorian Government (2003), *Proposed Retail Leases Regulations 2003: Regulation impact statement*, March. [↑](#footnote-ref-50)
50. Victorian Government (2001), *Review of the Victorian Retail Tenancies Legislation: Issues paper*, January. [↑](#footnote-ref-51)
51. Victorian Government (2003), *Proposed Retail Leases Regulations 2003: Regulation impact statement*, March. [↑](#footnote-ref-52)
52. *Savills reports 2003 and 2012* [↑](#footnote-ref-53)
53. *Ibid* [↑](#footnote-ref-54)
54. *Australian Bureau of Statistics* (2022), Data cube 2: Businesses by main state by industry class by employment size ranges, June 2022 [↑](#footnote-ref-55)
55. Rent expenses are assumed to represent occupancy cost data. ATO representatives have stated that “rent expenses” should include outgoing costs + rent. [↑](#footnote-ref-56)
56. See Australian Taxation Office (2020), *Taxation statistics 2019–20 Companies: Selected items and financial ratios for micro1 businesses by taxable status, profit status, broad industry and state/territory*, available online at < <https://data.gov.au/data/dataset/taxation-statistics-2019-20/resource/a7262038-745f-4ba8-904e-9f80cbbbab14?inner_span=True>> [↑](#footnote-ref-57)
57. ibid. [↑](#footnote-ref-58)
58. Colliers (2022), *Australian Retail Snapshot Q3 2022*, Colliers International Group Inc. [↑](#footnote-ref-59)
59. *Savills reports 2003 and 2012* [↑](#footnote-ref-60)
60. Victorian Government (2001), *Retail Tenancies Legislation: Discussion paper,* October. [↑](#footnote-ref-61)
61. Victorian Government (2003), *Proposed Retail Leases Regulations 2003: Regulation impact statement*, March. [↑](#footnote-ref-62)
62. E.g. Fire services levy & Owner’s corporation fees. [↑](#footnote-ref-63)
63. Victorian Government (2003), *Proposed Retail Leases Regulations 2003: Regulation impact statement*, March. [↑](#footnote-ref-64)
64. Victorian Government (2003), *Proposed Retail Leases Regulations 2003: Regulation impact statement*, March. [↑](#footnote-ref-65)
65. In this example 50 per cent of tenants benefit from customer service information rather than 100 per cent for the other outgoing types, which changes the relevant fraction as a result. [↑](#footnote-ref-66)
66. Victorian Government (2003), *Proposed Retail Leases Regulations 2003: Regulation impact statement*, March. [↑](#footnote-ref-67)
67. Victorian Government (2001), *Review of the Victorian Retail Tenancies Legislation: Issues paper*, January. [↑](#footnote-ref-68)
68. Second Reading Speech, *Retail Leases Bill* (2003), Victoria, Legislative Assembly, 27 February, John Brumby. [↑](#footnote-ref-69)
69. ibid. [↑](#footnote-ref-70)
70. PwC (2009), *Retail Tenancy Disclosure Statements: Proposals for harmonisation – Final report*, January. [↑](#footnote-ref-71)
71. ibid. [↑](#footnote-ref-72)
72. PwC (2009), *Retail Tenancy Disclosure Statements: Proposals for harmonisation – Final report*, January. [↑](#footnote-ref-73)
73. Victorian Government (2001), *Review of the Victorian Retail Tenancies Legislation: Issues paper*, January. [↑](#footnote-ref-74)
74. PwC (2009), *Retail Tenancy Disclosure Statements: Proposals for harmonisation – Final report*, January. [↑](#footnote-ref-75)
75. ibid. [↑](#footnote-ref-76)
76. ibid. [↑](#footnote-ref-77)
77. ibid. [↑](#footnote-ref-78)
78. 2013 RIS (PwC report) [↑](#footnote-ref-79)
79. Department of Treasury and Finance (2016), *Victorian Guide to Regulation*. [↑](#footnote-ref-80)
80. Ibid. [↑](#footnote-ref-81)
81. Department of Treasury and Finance (2016), *Victorian Guide to Regulation*, August. [↑](#footnote-ref-82)
82. There are notification periods for several different scenarios including: alterations or refurbishments carried out by landlord (60 day notification period); information provided prior to the option to renew a lease expiring (3 months); and the landlord providing a disclosure statement to the tenant at least 14 days prior to entering into the lease. [↑](#footnote-ref-83)
83. Colliers (2022), *Australian Retail Snapshot Q3 2022*, Colliers International Group Inc. [↑](#footnote-ref-84)
84. Australian Taxation Office (2022), *Taxation statistics 2021-2022 Companies: Selected items and financial ratios for micro businesses by taxable status, profit status, broad industry and state/territory –* Codes that most align with small and medium sized businesses as defined by ABS employee data. [↑](#footnote-ref-85)
85. See Table 9. [↑](#footnote-ref-86)
86. As at 16 December 2022, there are 39,960 out of 41,505 retail businesses in Victoria that have 0-19 staff, representing 96 per cent of all businesses. [↑](#footnote-ref-87)
87. See Australian Bureau of Statistics (2022), *Data cube 2: Businesses by main state by industry class by employment size ranges*, June 2022. [↑](#footnote-ref-88)
88. See section 5.4.5 and Table 14 for further information related to the cost of disclosure statements. [↑](#footnote-ref-89)
89. See Appendix B. [↑](#footnote-ref-90)
90. See section 5.4.5 and Table 14 for further information related to the cost of disclosure statements. [↑](#footnote-ref-91)
91. Australian Property Institute (2013), *Submission*. [↑](#footnote-ref-92)
92. Pharmacy Guild of Victoria (2013), *Submission*. [↑](#footnote-ref-93)
93. Estimate based on PwC report and updated with current data. Other current stakeholder feedback has suggested that this estimate may be low and have suggested the cost could be closer to $800. [↑](#footnote-ref-94)
94. Productivity Commission (2008), *The Market for Retail Tenancy Leases in Australia*, Inquiry Report, March. SBV has no reason to believe that the retail leasing market has shifted in the proportions of shopping centre to non-shopping centre tenants. [↑](#footnote-ref-95)
95. Rent reviews are on a timeframe agreed upon in the lease. See section 35 of the Act. [↑](#footnote-ref-96)
96. See section 35 of the Act. [↑](#footnote-ref-97)
97. Australian Property Institute (2013). [↑](#footnote-ref-98)
98. Pharmacy Guild of Victoria (2013). [↑](#footnote-ref-99)
99. Estimate based on PwC report and updated with current data. Other current stakeholder feedback has suggested that this estimate may be low and have suggested the cost could be closer to $800. [↑](#footnote-ref-100)
100. 2013 Stakeholder forum. [↑](#footnote-ref-101)
101. 2013 Stakeholder forum. [↑](#footnote-ref-102)
102. 2013 Stakeholder forum. [↑](#footnote-ref-103)
103. Shopping Centre Council submission (2013). [↑](#footnote-ref-104)
104. Stakeholder forum minutes (2013); REIV submission; Australian Property Institute submission. [↑](#footnote-ref-105)
105. REIV submission. [↑](#footnote-ref-106)
106. Stakeholder forum 2013. [↑](#footnote-ref-107)
107. Estimate comes from the total number of retail leases registered with the VSBC. Registration requirements ended in November 2012. [↑](#footnote-ref-108)
108. As noted by the Shopping Centre Council in its 2013 submission, “In our experience, large landlords generally have the internal capability and personnel required to prepare and issue disclosure statements to tenants. The volume of leasing transactions undertaken by such landlords usually makes outsourcing disclosure statements to third parties … uneconomic. Smaller landlords generally require assistance to prepare such a lengthy and legalistic document.” [↑](#footnote-ref-109)
109. The substantial increase in the total number of businesses, particularly in the total non-employing businesses, as recorded in the Retail Division of the 8165.0 dataset, is likely due to the significant number of Australian Business Numbers changing their industry classes to qualify for Covid-19 related government assistance. [↑](#footnote-ref-110)
110. The exclusion of non-employing businesses results in an approximately 5 percent lowering of the proportion for new leases (from about 15 to 10 percent in the updated analysis). To account for this change, the 5 percent reduction is proportionally allocated among the renewed and assigned leases, based on the ratios of these categories in the original analysis. This reassignment helps to ensure the accuracy and fairness of the results of the analysis. [↑](#footnote-ref-111)
111. Department of Treasury and Finance (2016), *Victorian Guide to Regulation* [↑](#footnote-ref-112)
112. Department of Treasury and Finance (2016), *Victorian Guide to Regulation.* [↑](#footnote-ref-113)
113. Competition Principles Agreement (1995) – As amended to 13 April 2007. [↑](#footnote-ref-114)
114. Ibid. [↑](#footnote-ref-115)