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Ms Lisa Buckingham
Deputy Secretary, Employment and Small Business
Department of Jobs, Skills, Industry and Regions
121 Exhibition St
MELBOURNE VIC 3000

8 February 2023

Dear Ms Buckingham,

REGULATORY IMPACT ASSESSMENT FOR THE RETAIL LEASES REGULATIONS 2023

I would like to thank your staff at the Department of Jobs, Skills, Industry and Regions (the Department) for working with the team at Better Regulation Victoria on the preparation of a Regulatory Impact Assessment (RIS) for the Retail Leases Regulations 2023 (the proposed Regulations).

As you know, the Commissioner for Better Regulation provides independent advice on the adequacy of the analysis provided in all RISs in Victoria. A RIS is deemed to be adequate when it contains analysis that is logical, draws on relevant evidence, is transparent about any assumptions made, and is proportionate to the proposal's expected effects. The RIS also needs to be written clearly so that it can be a suitable basis for public consultation.

I am pleased to advise that the final version of the RIS received by us on 8 February 2023 meets the adequacy requirements set out in the *Subordinate Legislation Act 1994*.

Background and Problems

The proposed Regulations are intended to replace the Retail Leases Regulations 2013 (the current Regulations), which sunset on 16 April 2023.

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, retail leases receive greater legal protection under the Victorian Act. The Department explains in the RIS that 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. The Department notes that other State governments around Australia have retail leases legislation in place.

The Act is enabled by the Regulations. Without the Regulations, no leases would be covered by the Act. The Department explains that if the current Regulations were allowed to expire (the 'base case'), many of the current protections would not be contained in lease terms and conditions. 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 current Regulations have three main objectives:

1. Setting a threshold to exclude larger retail premises from protection under the regulatory framework, as the primary purpose of the framework is to protect small and medium sized tenants. This threshold is currently set at \$1 million in occupancy costs per annum (occupancy costs are equal to rent plus outgoings).
2. Determining how outgoings are apportioned between tenants. Outgoings are shared costs in a multi-occupancy property such as a shopping centre. Outgoings include the costs of air conditioning, marketing, water rates, owners' corporation fees and fire services property levies.
3. Prescribing disclosure statement requirements to help tenants be better informed when signing a lease. These statements require the disclosure of key information such as the lease term, rent and rent reviews, options for renewal, estimated outgoings and declarations by the landlord and tenant.

Options and Impact Analysis

In the RIS, the Department analyses different options for setting occupancy cost thresholds, regulating how outgoings are apportioned and determining disclosure statement requirements.

For the purposes of impact analysis, options related to each of the three objectives are analysed separately.

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).

Each set of options is analysed using multi-criteria analysis (MCA) and compared to a 'reference case' (a point of comparison) rather than the base case. This is because it is not clear what protections would be available in the absence of the Regulations. The criteria and weightings in the MCA are:

- **Protect small and medium-sized retail business tenants (40%),** by reducing information asymmetries and market power imbalances.
- **Protect small and medium sized retail landlords (10%),** by making the rights and responsibilities of landlords clear and reducing the potential for disputes.
- **Costs to tenants (25%),** 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%),** 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.

Analysis of options in the RIS draws heavily on the 2013 RIS (prepared for the current Regulations). The Department explains that:

- 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. The Department explains that recent analysis by Invest Victoria suggests that occupancy costs have not changed significantly in recent years and analysis of 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 the retail leasing market in Victoria.

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 would continue to lease retail premises, but these leases would become subject to commercial leasing regulations.

The Department explains that 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. It explains that 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.

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.

The Department explains that Option 1 (F1) is its 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 to attract large tenants and then recovering the shortfall from smaller tenants. However, the Department explains that, overall, the protections to small and medium tenants and landlords outweigh the greater costs imposed on large landlords and tenants.

The Department explains that 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 base 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.

Implementation and Evaluation

In the RIS, the Department explains that since the proposed Regulations remake the current Regulations, implementation will be straightforward. The Regulations can be remade before they expire in mid-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, in particular whether the data sourced from the 2013 RIS remains relevant. The Department explains that once the Regulations have been remade it will gather updated data and undertake further analysis to evaluate the effectiveness of the Regulations against the objectives. The Department is particularly interested in developing new data sources, including analysis from the Victorian Small Business Commission's newly commissioned case management system, and conducting additional analysis of taxation statistics. BRV is willing to support the Department in developing an approach to gather and analyse additional data. The Department commits to undertaking a mid-term review of the Regulations within five years (by April 2028).

Should you wish to discuss any issues raised in this letter, please do not hesitate to contact my office on (03) 7005 9772.

Yours sincerely



Anna Cronin
Commissioner for Better Regulation