



Small
Business
Commissioner

Retail Leases Regulation 2022

Regulatory Impact Statement
NSW Small Business Commission



Contents

Abbreviations and acronyms	3
Introduction	4
Purpose of this Regulatory Impact Statement	3
Better regulation principles	4
Background	6
Retail leasing industry	6
The <i>Retail Leases Act 1994</i> (NSW)	6
Scope of the Act	7
The <i>Retail and Other Commercial Lease (COVID-19) Regulation 2020</i>	8
Small Bars	9
Health and Fitness Businesses	9
Changes to the Retail Industry	10
Consultation	12
Annexure A – Changes to the list of ‘retail shops’	14
Annexure B – Cost Benefit Analysis, Centre for International Economics	15
Summary	B1
1. Background and introduction	B3
2. The need for Government intervention	B4
3. Objectives and options	B8
4. Impacts	B9
A. General assumptions	B26

Title of Regulatory Proposal:	<i>Draft Retail Leases (Schedule 1) Regulation 2022</i>
Proponent:	The Registrar of Retail Tenancy Disputes, the NSW Small Business Commission
Responsible Minister:	The Hon. Victor Dominello, Minister for Customer Service and Digital Government, Small Business, and Fair Trading
Relevant Act:	<i>Retail Leases Act 1994 (NSW)</i>

Abbreviations and acronyms

<i>RL Act</i>	<i>Retail Leases Act 1994</i>
<i>SL Act</i>	<i>Subordinate Legislation Act 1989</i>
<i>Draft 2022 Regulation</i>	<i>Retail Leases Regulation 2022</i>
<i>COVID-19 Leasing Regulation</i>	<i>Retail and Other Commercial Leases (COVID-19) Regulation 2020 (and successors)</i>
The Commission	NSW Small Business Commission

Introduction

Purpose of this Regulatory Impact Statement

The purpose of this Regulatory Impact Statement is to provide interested parties and stakeholders with a detailed analysis of the options being considered to amend the *Retail Leases Act 1994* (“the *RL Act*”) list of businesses contained in Schedule 1 to include additional businesses, specifically: small bars and business tenancies in the health and fitness industry (including gymnasiums, yoga, barre and dance studios) that provide services directly to consumers. The inclusion of these businesses within Schedule 1 would clarify the inclusion of these businesses in the coverage of the *RL Act* irrespective of whether the premises are located in a shopping centre, retail shopping strip or stand-alone premises.

This Regulatory Impact Statement supports the proposal to make a new principal regulation in 2022. Under section 5 of the *Subordinate Legislation Act 1989* (“the *SL Act*”) the NSW Small Business Commission, on behalf of the Minister for Customer Service and Digital Government, Small Business, and Fair Trading, is required to prepare and publish a Regulatory Impact Statement when a principal regulation is made. A Regulatory Impact Statement must be prepared in accordance with Schedule 2 of the *SL Act* and:

- State the need for, and objectives of, government action
- Identify and consider alternative options to meet the objectives
- Assess the economic and social costs and benefits of each alternative option
- Recommend the option that produces the greatest net benefit to the community
- Explain the consultation process

Better regulation principles

All regulatory proposals must adhere to the NSW Government's commitment to making better regulation. All government agencies are required to explain why a proposed regulation is required, and whether it is reasonable and responsive to the economic, social and environmental needs of business and the community. The NSW Government has developed better regulation principles to improve the quality of regulation and the minimise red tape, which must be applied to all regulatory proposals. The seven principles are:

- Principle 1:** The need for government action should be established. Government action should only occur where it is in the public interest, that is, where the benefits outweigh the costs.
- Principle 2:** The objective of government action should be clear.
- Principle 3:** The impact of government action should be properly understood by considering the costs and benefits (using all available data) of a range of options, including non-regulatory options.
- Principle 4:** Government action should be effective and proportional
- Principle 5:** Consultation with business and the community should inform regulatory development.
- Principle 6:** The simplification, repeal, reform, modernisation or consolidation of existing regulation should be considered.
- Principle 7:** Regulation should be periodically reviewed, and if necessary reformed, to ensure its continued efficiency and effectiveness.¹

The NSW Government requires all government agencies to prepare a Better Regulation Statement for significant new and amending regulatory proposals. The Better Regulation Statement explains how the better regulation principles have been applied when developing the regulatory proposal. A Regulatory Impact Statement can be used in place of a Better Regulation Statement to provide a more comprehensive impact analysis. The Better Regulation Statement for the *Draft Retail Leases Regulation 2022* ("*Draft 2022 Regulation*") is incorporated with the Regulatory Impact Statement.

Public notice of the *Draft Retail Leases Regulation 2022* and this Regulatory Impact Statement will appear on the *NSW Government Gazette* managed by the NSW Parliamentary Council's Office at [Home - NSW legislation](#).

¹ NSW Treasury, Policy and Guidelines Paper: *NSW Government Guide to Better Regulation* (TPP 19-01) at 5

Background

Retail Leasing Industry

The retail landscape has changed over the past 20 years, and many new business models have emerged, while others have undergone a complete transformation. The list of businesses covered by the RL Act should be reviewed to ensure that emerging and evolving business models, whether located in shopping centres, on shopping strips, or in stand-alone premises have access to the minimal requirements for leasing practice imposed by the regulatory framework.

The retail leasing industry is characterised by parties of varying size, type, and disparity of power in negotiating lease agreements. The lease is the commercial contract that defines the relationship and covers a range of legal and financial requirements.

The retail leasing industry is regulated in all states and territories by retail leasing legislation however each state differs in terms of the classifications of businesses that fall within the scope of the legislation. NSW is the only state legislation that defines which retail premises will come under the jurisdiction of the Act by a list of businesses² and provisions providing for specific exclusions.³

The Retail Leases Act 1994 (NSW)

The *RL Act* provides a regulatory framework for lessees and lessors of a retail lease to optimise the leasing relationship and balance the risk.

For leases within its jurisdiction, the Act provides for:

- pre-lease disclosure of all costs and liabilities under the lease
- prohibition on key money and lease preparation expenses being sought
- leases of three years or more to be registered
- an executed copy of the lease to be provided to a tenant
- cash security deposits to be deposited, and held, and paid out by the Secretary
- timeframes for the return of bank guarantees at the end of the lease
- provisions seeking capital costs or depreciation costs from the lessee to be void
- limits on sinking fund contributions and recovery of land tax
- limits and notice requirements for lessors seeking to make alterations or refurbishment
- a process for assignment of lease and severance of liability after assignment
- a procedure for obtaining the landlord's consent to an assignment of a lease
- a procedure for obtaining a specialist retail valuation of the market rent of premises prior to the exercise of an option

² *Retail Leases Act 1994*, Schedule 1 contains a list of businesses that are prescribed for the purpose of the definition of "retail shop" in s 3

³ *Ibid*, ss 5, 6 and Part 9A

- a requirement to participate in mediation and for the Registrar to certify the outcome prior to filing the determination of a claim in a tribunal or civil court.

Other legislation that regulates retail and commercial leasing includes the *Conveyancing Act 1919* and the *Real Property Act 1900*.

Pursuant to Part 8, Division 2 of the *RL Act*, the Mediation Services team within the NSW Small Business Commission aids lessors and lessees of shops to resolve disputes through mediation which includes preliminary assistance and procedural advice.⁴ The office of the Commissioner is a statutory office hosted by the NSW Department of Customer Service.

The Registrar of Retail Tenancy Disputes for the purpose of the *RL Act* is appointed by the Minister⁵ under s 64 of the *RL Act* with the functions conferred by s 65 that include reporting to the Minister on the operation of the *RL Act*.⁶

The Minister is responsible for review the *RL Act* to ensure that the policy objectives remain valid and whether the terms of the *RL Act* remain appropriate for securing those objectives.⁷

Scope of the Act

Whether or not a particular business retailing goods or services to consumers is captured by the *RL Act* depends on whether they satisfy the *RL Act*'s definition of "retail shop".

Currently health and fitness businesses that are situated in retail shopping centres are retail shops for the purpose of the *RL Act* pursuant to paragraph (b) of the definition of "retail shop" in s 3(1) of the *RL Act*. The definition of "retail shop" in s 3(1) of the *RL Act* provides:

"retail shop" means premises that –

are used, or proposed to be used, wholly or predominantly for the carrying on of one or more of the businesses prescribed for the purposes of this paragraph (whether or not in a retail shopping centre), or

are used, or proposed to be used, for the carrying on of any business (whether or not a business prescribed for the purpose of paragraph (a) in a retail shopping centre"

The businesses specified in Schedule 1 are taken to be prescribed for the purposes of paragraph (a) of the definition. The definition is subject to exclusions in sections 5 and 6.

Currently small bars and businesses in the health and fitness industry, are not listed in Schedule 1 and therefore do not have the benefit of the dispute resolution mechanism provided by the *RL Act*.

The omission of these categories of business became apparent during the COVID-19 pandemic when they were subject to the dispute resolution regime of the *Retail and Other Commercial Leases (COVID-*

⁴ *Retail Leases Act 1994*, s 67

⁵ The Hon. Victor Dominello, Minister for Customer Service and Digital Government, Small Business, and Fair Trading

⁶ *Retail Leases Act 1994*, s 65(b)

⁷ *Retail Leases Act 1994*, s 86(1)

19) *Regulation 2020* (“the *COVID-19 Leasing Regulation*”) and its successors.⁸ The *COVID-19 Leasing Regulation* and an amendment to the *Conveyancing Act 1919* captured leases for businesses not ordinarily captured by the *RL Act* to apply a compulsory dispute resolution regime to prevent a lessor from taking action against an impacted lessee on the grounds of a prescribed breach unless the parties had attempted mediation under the *RL Act*, Part 8, Division 2 to negotiate rent relief.

During that time, the Registrar of Retail Tenancy Disputes⁹ observed similarities in the tenancy relationships between health and fitness businesses that are not situated in shopping centres, to those businesses listed in Schedule 1 of the *RL Act*. The inclusion of the various types of health and fitness businesses in Schedule 1 of the *RL Act* would potentially remove a distinction between those businesses situated in retail shopping centres and those outside them (for example in standalone premises and premises on retail shopping strips).

Retail and Other Commercial Leases (COVID-19) Regulation 2020¹⁰

On 7 April 2020, the Prime Minister announced the National Cabinet’s Code of Conduct for commercial tenancies: *National Cabinet Mandatory Code of Conduct – SME Commercial Leasing Principles During COVID-19*. To implement the Code of Conduct (“the Code”), the NSW Government enacted the *Retail and Other Commercial Leases (COVID-19) Regulation 2020* (“the *COVID-19 Leasing Regulations*”) on 24 April 2020. The *COVID-19 Leasing Regulations* (and its successors) put in place temporary measures to:

- share the economic impacts of COVID-19 between commercial lessors and lessees
- maximise the number of businesses that can resume operation when public health orders were lifted

The *COVID-19 Leasing Regulations* extended the dispute resolution regime in Part 8 of the Act to commercial leases that would not ordinarily be captured by the jurisdiction of the *RL Act* applied a compulsory dispute resolution regime to prevent a lessor from taking action against an impacted lessee on the grounds of a prescribed breach unless the parties had attempted mediation under the *RL Act*, Part 8, Division 2 to negotiate rent relief.

The Commission facilitated the mandatory mediation requirement for rent relief negotiations under the *COVID-19 Leasing Regulations* for eligible businesses impacted by the COVID-19 pandemic. A case study is available at page 19 of “*The Commissioner’s Year in Review 2021*” which is available at:

[The Commissioner’s Year in Review 2021 | Small Business Commissioner \(nsw.gov.au\)](https://www.sbsc.nsw.gov.au/the-commissioners-year-in-review-2021)

⁸ Up to *Retail and Other Commercial Leases (COVID-19) Regulation 2022*

⁹ Appointed under s 64 of the *Retail Leases Act 1994*, the Registrar has the functions conferred by s 65

¹⁰ The “*Covid-19 Leasing Regulations*” includes the *Retail and Other Commercial Leases (COVID-19) Regulation 2020* and its successors

The Registrar of Retail Tenancy Disputes noted a 4-fold increase in applications for mediation following the introduction of the *COVID-19 Leasing Regulation* and a 34 percent increase in the proportion of applications for mediation for commercial (non-retail) leasing disputes.

With the lapse of the *COVID-19 Leasing Regulation* on 30 June 2022 small businesses that are not listed in Schedule 1 of the *RL Act* will no longer have access to the mandatory mediation mechanism in the *RL Act* for general leasing disputes other than for legacy rights accrued during the COVID-19 pandemic under the *COVID-19 Leasing Regulation*.

The mediation mechanism in Part 8, Division 2 of the *RL Act* effectively prevents a sizeable proportion of disputes progressing to a Tribunal or court for determination. Over 85 percent of mediation applications (for retail tenancy disputes and disputes under the *COVID-19 Leasing Regulation*) filed with the Registrar of Retail Tenancy resolve through preliminary dispute resolution assistance or mediation.

The experience with managing disputes under the *COVID-19 Leasing Regulation* demonstrated the need for an extension of the scope of a mandatory mediation mechanism for small businesses involved in commercial leasing disputes. When a legislative obligation is applied, mediation is an effective dispute resolution mechanism for issues that arise during the term of a lease assisting in the preservation of the leasing relationship and preventing matters escalating to a civil court or tribunal for a determination. It is a similarly effective mechanism when used at any stage of the leasing relationship, for example, finalising obligations under the lease at the conclusion of the lease term, negotiating lease terms or a sale of business and assignment of the lease.

Small Bars

Since small bars are not currently listed in Schedule 1 of the Act, they do not have the benefit of the dispute resolution mechanism provided by the *RL Act*. By contrast restaurants that have liquor licences have the benefit of that mechanism because restaurants are listed in Schedule 1. Small bars are hybrid business model that did not exist in 1994, operating as both a bar and restaurant. Currently, where a small bar is unable to satisfy the ‘predominant purpose’ test applied by the courts (s 3 definition of ‘retail shop’) by operating predominantly as a Schedule 1 business (restaurant) it will not be captured by the *RL Act*. For example, *Uncle Mings Pty Ltd v Scarf Holdings [2019] NSWCAT*.

Health & Fitness Businesses

Currently health and fitness businesses that are situated in retail shopping centres are retail shops for the purposes of the *RL Act* by virtue of the Act’s definition of ‘retail shop’ that captures any business located in a shopping centre.¹¹ The inclusion of the various types of health and fitness business in

¹¹ *Retail Leases Act 1994*, section 3(b) definition of ‘retail shop’

Schedule 1 of the Act would potentially remove a distinction between those business situated in retail shopping centres and those outside them (for example in standalone premises or located on shopping strips) to ensure that the latter group benefits from the mediation regime in Part 8, Division 2 of the *RL Act*.

Many businesses in the health and fitness industry operate on a franchise business model of one of four major players that collectively account for 56.5 percent of industry revenue (\$2.2 bn in 2022) in Australia. Most operators lease rather than own premises and rent is the largest operating cost.¹² Health and fitness businesses are consistent with other service businesses listed in Schedule 1 that involve the retail provision of services directly to consumers. The proposed amendments to include businesses outside shopping centres will not capture the larger operators who would be excluded from the jurisdiction of the Act where the premises are over 1000m² and lease terms less than six months or longer than 25 years.

Similarly, growing consumer trends towards healthy lifestyles and leisure activities has supported the development of a subset of the health and fitness industry, the pilates and yoga studios industry, together with their adoption as alternative medicine which has led to industry growth over the past 5 years. Industry revenue in Australia in 2022 was \$608m.¹³

Changes to the retail leasing industry

The NSW Small Business Commission has identified the potential to make a new principal regulation to deliver an effective and efficient regulatory framework that is equitable to small businesses located in both shopping centres and on shopping strips.

The Schedule 1 list should reflect the trends and business models that are newly developed or have undergone a transformation since the *RL Act*'s introduction in 1994. The exercise of the *RL Act*'s regulation making power to make a new principal regulation to add businesses will ensure that the *RL Act* remains flexible and adaptable to the changing retail industry.

The draft *Retail Leases Regulation 2022* includes the following new businesses added to Schedule 1:

- Business tenancies in the health and fitness industry (including gymnasiums, yoga, barre and dance studios) that provide services directly to consumers, and
- Small bars (with a modification to remove current exclusion for 'beer wine and spirits shops')

Failure to include these businesses may impair an equitable and optimal operating environment.

¹² IBIS World Industry Report R911: *Gyms and Fitness Centres in Australia Industry Report* (March 2022)

¹³ IBIS World Industry Report OD4198: *Pilates and Yoga Studios in Australia* (March 2022).

Government action should ensure that the retail leasing industry, as legislated, functions effectively by having a clear framework of rules governing the lease and leasing relationship with a mandatory dispute resolution mechanism to resolve issues and disputes quickly and cost effectively to minimise business disruption and litigation costs.

The outcomes and objectives of the regulatory framework established by the *RL Act* should remain current and applicable to the small businesses and business models operating in NSW, reflecting the evolution of the health and fitness industry in the last 25 years and emergence of new business models that are 'hybrid' businesses for the purpose of the *RL Act*.

By making a new principal regulation, the *Draft 2022 Regulation*, the NSW Government aims to:

- a. To address imbalances and remove a distinction that currently exist in the market for classes of business property uses that do not currently come under the jurisdiction of the *RL Act* due to their location outside a shopping centre (for example in standalone premises or located on shopping strips).
- b. Prevent confusion and disputes for tenancies and remove the *RL Act's* threshold jurisdictional requirement to demonstrate a predominant business use listed in Schedule 1 of the *RL Act* for small bars operating hybrid business models that include the retail of food and alcohol
- c. To increase access to the mandatory dispute resolution regime in Part 8, Division 2 of the *RL Act* requiring parties to a dispute to attempt to resolve the issue prior to civil proceedings, through mediation
- d. Foster improved leasing practices to reduce information asymmetry and improve decision-making, to ensure all parties to a lease benefit from increased transparency and greater security in standalone and retail shopping strips
- e. Increase access to justice by providing access to the NSW Civil and Administrative Tribunal following mediation to additional businesses
- f. Support small business retail tenancies in NSW in the post pandemic recovery period, and
- g. Ensure that the list of businesses reflects changes in the retail industry since the introduction of the *RL Act* in 1994.

Consultation

A key requirement of the regulatory development process, as outlined in the seven better regulation principles, is consultation with relevant stakeholders, including professional groups, industry associations representing property owners and small businesses and their legal and financial representatives.

The Regulatory Impact Statement is an essential element of the consultative process for the *Draft 2022 Regulation* and invites written submissions from all external stakeholders.

Public notice of the *Draft Retail Leases Regulation 2022* and this Regulatory Impact Statement will appear in the *Sydney Morning Herald* and *Daily Telegraph* newspapers and on the NSW Small Business Commission website at smallbusiness.nsw.gov.au and the *NSW Government Gazette* managed by the NSW Parliamentary Counsel's Office at legislation.nsw.gov.au in accordance with section 5 of the *Subordinate Legislation Act 1989*.

The following organisations have also been invited to provide written submissions:

- AUSactive
- Business NSW
- Communities and Justice NSW
- Franchise Council of Australia
- Independent Bars Association of NSW
- Independent Gyms Australia
- Law Society of NSW
- Liquor & Gaming NSW
- NSW Fair Trading
- Property Council of Australia
- Real Estate Institute of NSW (REINSW)
- Shopping Centre Council of Australia



Disclaimer

This publication may contain information about the regulation of retail leases in NSW. It may include some of your obligations under some of the legislation. To ensure you comply with your legal obligations you must refer to the appropriate legislation.

Information on the latest laws can be checked by visiting the NSW legislation website www.legislation.com.au

This publication does not represent a comprehensive statement of the law as it applies to problems or to individuals or as a substitute for legal advice. You should seek independent legal advice if you need assistance on the application of the law to your situation.

This material may be displayed, printed and reproduced with amendment for personal, in-house or non-commercial use.

NSW Small Business Commission
4 Parramatta Square, 12 Darcy Street,
Parramatta NSW 2150

Customer Service 1300 795 534

Website www.smallbusiness.nsw.gov.au

Copyright NSW Small Business Commission

Annexure A – Changes to the list of ‘retail shops’

The table below outlines the changes to the definition of ‘retail shop’ contained in the draft 2022 Regulation, *Retail Leases Regulation 2022*.

Amendment Type	Proposed amendments to Schedule 1
Legislative	Schedule 1 – Retail shop businesses in the <i>Retail Leases Act 1994</i> is repealed ^[1] . The businesses specified in Schedule 1 – Retail shop businesses of the draft <i>Retail Leases Regulation 2022</i> comprises a new list of prescribed businesses for purposes of the definition of “retail shop” in section 3 of the <i>Retail Leases Act 1994</i> .
Additions – new listings	Gyms and fitness centres, including gymnasiums, yoga, barre, pilates and dance studios.
	Small bars with a legal capacity of no more than 120 patrons at any one time.
Transitional arrangement	Part 8, Division 2 Dispute Resolution applies to lease entered into before the commencement of the Regulation, and lease entered into under an option or agreement made before the commencement of the Regulation.
Deletions / amendments	The exclusion, “except where goods are for consumption on the premises” has been removed from “beer, wine and spirit shops”.
	The following line has been removed: “Any other business as from time to time may be prescribed by the regulations”.
Grammatical / formatting amendments	Several items in the list have been reformatted into vertical lists of goods and/or services.
	Several items in the list have had brackets removed.

^[1] Refers to the current version of the *Retail Leases Act 1994* in force as at 13 October 2022.

Annexure B – Cost Benefit Analysis



FINAL REPORT

Proposed changes to the Retail Leases Act 1994

Cost-benefit analysis

*Prepared for
NSW Small Business Commissioner
October 2022*

The Centre for International Economics is a private economic research agency that provides professional, independent and timely analysis of international and domestic events and policies.

The CIE's professional staff arrange, undertake and publish commissioned economic research and analysis for industry, corporations, governments, international agencies and individuals.

© Centre for International Economics 2022

This work is copyright. Individuals, agencies and corporations wishing to reproduce this material should contact the Centre for International Economics at one of the following addresses.

CANBERRA

Centre for International Economics
Ground Floor, 11 Lancaster Place
Canberra Airport ACT 2609

Telephone +61 2 6245 7800
Facsimile +61 2 6245 7888
Email cic@TheCIE.com.au
Website www.TheCIE.com.au

SYDNEY

Centre for International Economics
Level 7, 8 Spring Street
Sydney NSW 2000

Telephone +61 2 9250 0800
Email ciesyd@TheCIE.com.au
Website www.TheCIE.com.au

DISCLAIMER

While the CIE endeavours to provide reliable analysis and believes the material it presents is accurate, it will not be liable for any party acting on such information.

Contents

Summary	1
Proposed changes to the Retail Leases Act 1994	1
Objectives	1
Options	1
Impacts	2
1 Background and introduction	3
Background	3
This report	3
2 The need for government intervention	4
The need for specific retail lease legislation	4
The case for reform	7
3 Objectives and options	8
Objectives	8
Options	8
4 Impacts	9
Summary of impacts	9
Estimating the impacts	9
Sensitivity analysis	24
A General assumptions	26
 BOXES, CHARTS AND TABLES	
1 Indicative impacts of proposed options	2
2.1 Interaction of participants in the retail leases market	5
4.1 Indicative impacts of proposed options	9
4.2 Summary of the number of shopping centres in NSW	11
4.3 Number of small bars and health/fitness centres, within Shopping Centres	12
4.4 Estimated number of health and fitness centres in NSW, within Shopping Centres	14
4.5 Cost of preparing new and renewal disclosure statements	16
4.6 Classification by in / out RLA	18
4.7 Estimated cost of mediation process	19
4.8 Estimated number of additional mediations	20
4.9 Additional mediation costs	20

4.10	Indicative costs — matters greater than \$20 000	21
4.11	Indicative avoided litigation costs	22
4.12	Estimated annual benefits for a given change in the cost of capital	23
4.13	Sensitivity analysis — alternative assumptions/parameters	24
4.14	Net present value under alternative assumptions	25
A.1	Other assumptions for calculation of costs of disclosure statements	26

Summary

Proposed changes to the Retail Leases Act 1994

The *Retail Leases Act 1994* (RLA) aims to foster good leasing practices in the retail industry.¹ The RLA also provides some protection for both landlords and tenants from the abuse of market power.

The NSW Small Business Commissioner is proposing to extend the provisions of the RLA to cover leases for small bars and/or health and fitness businesses located outside shopping centres.

Objectives

The stated policy objectives of the proposed amendments are as follows:

- to address imbalances that currently exist in the market for property uses that do not currently come under the jurisdiction of the RLA by virtue of their location outside a shopping centre
- to increase access to the mandatory dispute resolution regime in the RLA to additional classes of tenancies
- to provide greater certainty and transparency in decision making in relation to the leasing costs during lease negotiations through the application of the pre-lease disclosure provisions in the RLA
- support retail tenancies in NSW and in the post-pandemic recovery period
- support greater equity in the retail leasing market for retailers located outside the controlled operating environment of a shopping centre
- prevent confusion and disputes for tenancies involving small bars that sell both food and alcohol.

Options

The NSW Small Business Commissioner is investigating potential regulatory change(s) that would add the following business types to schedule 1 of the RLA:

- Small bars; and/or
- Health and fitness businesses providing services to consumers.

¹ Legislative Assembly Hansard — 20 April 1994, <https://www.parliament.nsw.gov.au/Hansard/Pages/HansardResult.aspx#/docid/HANSA RD-1323879322-94871>, accessed 5 October 2022.

The options being considered are as follows.

- Maintaining the status quo — this option will be used as the **base case** against which the other options are assessed.
- **Option 1:** including small bars in Schedule 1 only
- **Option 2:** including health and fitness businesses in Schedule 1 only
- **Option 3:** including both small bars and health and fitness businesses in Schedule 1.

Impacts

Based on the information available, indicative costs and benefits of the proposed changes are shown in table 1. Costs and benefits are presented in net present value terms over 5 years, using NSW Treasury's preferred discount rate of 7 per cent.

The CBA suggests that the additional costs associated with expanding the coverage of the RLA are likely to be relatively modest and broadly offset by avoided litigation costs. Access to low-cost dispute resolution is also likely to mean there are fewer disputes and where there are disputes, fewer of them remain unresolved. If coverage under the RLA reduces risk for relevant businesses (and therefore the cost of capital) by even a small amount, these benefits are likely to significantly outweigh the costs.

As the benefits are estimated to outweigh the costs for both small bars and health and fitness businesses, the **CBA suggests that Option 3 is the preferred option.**

1 Indicative impacts of proposed options

	Option 1: Small bars	Option 2: Health and fitness businesses	Option 3: Small bars and health and fitness facilities
	'000	'000	'000
Additional disclosure costs	- 13.5	- 599.1	- 612.6
Additional mediation costs	- 52.9	- 521.4	- 574.4
Avoided litigation costs ^a	125.7	1 112.4	1 238.1
Reduced risk ^b	219.4	2 017.0	2 236.4
Total	278.7	2 008.9	2 287.6

^a Based on 10 per cent of matters that go to mediation being resolved through litigation. ^b Assumes coverage under the Retail Leases Act reduces the cost of capital for the relevant business by 0.1 percentage points.

Note: Costs and benefits presented in net present value terms over 5 years, using a discount rate of 7 per cent.

Source: CIE estimates.

Although there is uncertainty around these estimates, these findings are considered robust, particularly given that these reforms are utilising the existing frameworks and any additional disclosure/mediation costs are small.

1 *Background and introduction*

Background

In NSW, most (but not all) retail leases are regulated under the RLA. The RLA governs the relationship between the lessor and the lessee of retail premises in NSW. The Act promotes better leasing practices and maximises the value of the deal for both parties through improved transparency. Retail tenancy disputes must be filed with the Registrar of Retail Tenancy Disputes at first instance to promote early resolution by way of mediation.

Key elements of the RLA include:

- a requirement that disputes must be submitted to mediation before proceedings can be taken
- a requirement at the transaction stage to provide disclosure statements, a copy of the lease and retail tenancy guide
- prohibitions on key money, ratchet clauses and lease preparation expenses
- statutory rights for compensation for disturbance, misrepresentations and unconscionable conduct provisions
- recovery of capital costs, limits on sinking funds and land tax recovery, and requirements for accountability on outgoings
- rights in relation to assignment of lease (usually as part of a sale of business)
- the opportunity to have matters determined in the NSW Civil and Administrative Tribunal, in addition to Local or District Courts.

The NSW Small Business Commissioner is proposing to amend the RLA to covers leases for small bars and/or health and fitness facilities outside of shopping centres.

This report

The NSW Small Business Commissioner has engaged the Centre for International Economics (CIE) to prepare a cost-benefit analysis (CBA) of proposed changes to the *Retail Leases Act 1994* (RLA). This will feed into a Better Regulation Statement (BRS) for the proposed changes, as required under the NSW Government's *Guide to Better Regulation*. The remainder is structured as follows.

- Chapter 2 sets out the need for government intervention and the case for reform
- Chapter 3 sets out the objectives of the proposed changes and the options under consideration
- Chapter 4 estimates the impacts of the proposed options based on the information available.

2 *The need for government intervention*

The first step in a CBA is to establish the need for government action. This involves identifying the problem that a regulatory proposal is seeking to solve, including quantifying the size of the problem (where possible).

The need for specific retail lease legislation

According to the Productivity Commission, specific retail tenancy legislation evolved in Australia from the mid to late 1980s in response to concerns about bargaining power and information imbalances between shopping centre landlords and small retail tenants. These concerns escalated with the growth in suburban shopping centre complexes during the 1970s and 1980s.²

That said, the second reading indicates that the intent of the RLA was to foster good leasing practices in the retail industry generally (which presumably benefits both landlords and tenants), rather than the protection of tenants specifically.³

Types of relationships between landlords and tenants

Table 2 outlines the key types of participants in the retail leases market and the relationships between them. It is the perceived imbalance between a large landlord and a small tenant (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’ is 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. 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.

² Productivity Commission, 2008, *The Market for Retail Tenancy Leases in Australia*, Inquiry Report No. 43, Canberra, p. XVI.

³ Legislative Assembly Hansard — 20 April 1994, <https://www.parliament.nsw.gov.au/Hansard/Pages/HansardResult.aspx#/docid/HANSA RD-1323879322-94871>, accessed 5 October 2022.

2.1 Interaction of participants in the retail leases market

	Small low-resourced tenants	Large well-resourced tenants
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), The Market for Retail Tenancy Leases in Australia, Inquiry Report, March. Small landlord small tenant relationship

Relationship A in the table above is the most common in the retail market. Due to both parties being less likely to understand adequately their rights and obligations imposed by the lease and Act, there is potential for non-compliance with the legislation and dispute. Neither the landlord or tenant in this relationship is likely to have superior information and bargaining power.

The Act aims to protect smaller tenants and 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.

Relationship B represents the relationship that the Act was introduced to regulate. There is understood to be a substantial power imbalance between large landlords and small tenants. This power imbalance is typically characterised by superior information and a stronger negotiating position which benefits the landlord during lease negotiations.

Relationship C is less common as the requirements of a large tenant are generally highly specified and smaller investors are less likely to own these particular footprints. Relationship D is viewed as less problematic as large tenants and landlords have sufficient resources to negotiate with each other.

Small bars would typically be in relationship A or B. They occupy small tenancies which have substitutability to alternative uses, such as a café or restaurant. Health and fitness centres are not so clearly defined, as the tenancies are relatively larger than most small retailers and in some cases the health and fitness centres can be a well resourced tenant.

Rationale for disclosure statements

It is established that disclosure statements provide a relatively inexpensive means by which a tenant can access basic relevant information about the lease before commitment.

Each state in Australia requires that certain specified information be made available to prospective tenants prior to entering into a retail lease. In most cases this disclosure occurs through a prescribed disclosure statement, the terms and requirements of which are enshrined in primary or subordinate legislation.

The NSW *Retail Leases Act 1994* outlines that landlords (lessors) and tenants (lessees) must sign a disclosure statement when entering into or renewing a lease (Schedule 2 of the Act). These disclosure statements provide an opportunity to note any statements or representations made by either party to influence their decision to enter into a lease. The statement must be in writing and the lessor must give it to the lessee at least seven days before the lease is entered into. The statement should contain all the information required under Schedule 2.

The lessor's disclosure statement includes important details such as:

- the term of the lease and option to renew
- the rent and rent review method
- works, fit-out and refurbishment
- outgoings and other costs
- trading hours.

Within seven days of receiving the lessor's disclosure statement, the lessee must give the lessor a lessee's (tenant's) disclosure statement, or ask for an extension of time to provide this document.

The benefits of disclosure agreements come in the form of more informed tenants and ultimately a more efficient allocation of scarce resources across the retail sector. These benefits flow to landlords through less churn in retail leases and a reduction in associated costs of vacant premises or attracting and negotiating with new tenants. In addition there is a reduction in disputes and associated costs such as fees for legal advice.

Disclosure statements improve the market for retail leases through the following mechanisms:

- Reducing information asymmetries:
 - Increasing the efficiency and equity of the market for retail leases through better informed decision making.
 - Highlighting key information contained in the proposed lease and presents it in a format that is easier for a tenant, particularly a small tenant, to read and understand.
 - Sets a requirement for the landlord to provide information that will often be readily accessible to them but difficult or impossible for the tenant to acquire.
- Reduce transaction costs:
 - In the short term reduces initial transaction costs incurred by a tenant by decreasing the cost to conduct due diligence before entering into a lease
 - In the long term reduce transaction costs by providing clarity at the outset as to the respective legal obligations of the parties to the lease. 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.

- 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.
- 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 costs of disclosure statements 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.

The case for reform

The *Retail Leases Act 1994* applies to leases of retail shops. A retail shop is defined as:

- premises used for the purposes listed in Schedule 1 of the RLA; or
- premises within a retail shopping centre with five or more stores.

Leases that are not covered by the RLA are instead covered by the less prescriptive Conveyancing Act.

The following purposes are currently not listed under Schedule 1 of the RLA:

- Small bars
- Health and fitness businesses providing services to consumers.

Leased premises outside of shopping centres used for these purposes are, therefore, not currently covered by the RLA.

3 *Objectives and options*

Objectives

Stated policy objectives of the proposed amendments are as follows:

- to address imbalances that currently exist in the market for property uses that do not currently come under the jurisdiction of the RLA by virtue of their location outside a shopping centre
- to increase access to the mandatory dispute resolution regime in the Retail Leases Act 1994 to additional classes of tenancies
- to provide greater certainty and transparency in decision making in relation to the leasing costs during lease negotiations through the application of the pre-lease disclosure provisions in the RLA
- support retail tenancies in NSW and in the post-pandemic recovery period
- support greater equity in the retail leasing market for retailers located outside the controlled operating environment of a shopping centre
- prevent confusion and disputes for tenancies involving small bars that sell both food and alcohol.

Options

The NSW Small Business Commissioner is investigating potential regulatory change(s) that would add the following business types to schedule 1 of the RLA:

- Small bars; and/or
- Health and fitness businesses providing services to consumers.

The options being considered are as follows.

- Maintaining the status quo — this option will be used as the **base case** against which the other options are assessed.
- **Option 1:** including small bars in Schedule 1 only
- **Option 2:** including health and fitness businesses in Schedule 1 only
- **Option 3:** including both small bars and health and fitness businesses in Schedule 1.

4 Impacts

Summary of impacts

Based on the information available, estimated costs and benefits of the proposed changes are shown in table 4.1. Costs and benefits are presented in net present value terms over 5 years, using NSW Treasury's preferred discount rate of 7 per cent.

The CBA suggests that the additional costs associated with expanding the coverage of the RLA are relatively modest. If coverage under the RLA reduces risk for relevant businesses (and, therefore, the cost of capital) by even a small amount, the benefits are likely to outweigh the costs.

4.1 Indicative impacts of proposed options

	Option 1: Small bars	Option 2: Health and fitness facilities	Option 3: Small bars and health and fitness facilities
	'000	'000	'000
Additional disclosure costs	- 13.5	- 599.1	- 612.6
Additional mediation costs	- 52.9	- 521.4	- 574.4
Avoided litigation costs ^a	125.7	1 112.4	1 238.1
Reduced risk ^b	219.4	2 017.0	2 236.4
Total	278.7	2 008.9	2 287.6

^a Based on 10 per cent of matters that go to mediation being resolved through litigation. ^b Assumes coverage under the Retail Leases Act reduces the cost of capital for the relevant business by 0.1 percentage points.

Note: Costs and benefits presented in net present value terms over 5 years, using a discount rate of 7 per cent.

Source: CIE estimates.

Estimating the impacts

Adding small bars and/or health and fitness businesses to Schedule 1 of the RLA would extend the provisions of the RLA to relevant leased premises outside of shopping centres.

The main impacts of the RLA relate to the dispute resolution function and a general increase in transparency (for both landlords and tenants) in lease negotiations. For example, a Productivity Commission Inquiry into *The Market for Retail Tenancy Leases in Australia* (2008) noted that the following elements of retail tenancy laws had been useful:⁴

- simple, low cost and accessible dispute resolution;

⁴ Productivity Commission, 2008, *The Market for Retail Tenancy Leases in Australia*, Inquiry Report No. 43, Canberra, p. XVI.

- disclosure statements;
- lease information.

More specifically, the key impacts are as follows.

- The main costs of the proposed options are:
 - additional costs related the provision of disclosure statements, including:
 - ... the upfront cost of preparing the disclosure statement
 - ... the cost of updating any relevant information in the disclosure statement for each lease.
 - costs associated with the dispute resolution mechanism (a low-cost option to resolve disputes is likely to encourage additional use of dispute resolution).
- To some extent, addressing power imbalances through greater transparency and limitations on conduct that may be considered unfair is a transfer from one party to another (i.e. the cost to one party would be offset by a benefit to the other party). For example, where the RLA prevents a landlord from unfairly charging a tenant more than had been agreed (or through hidden charges), this would be transfer from the landlord to the tenant.
- The main “(net) benefits” (as viewed from a Cost Benefit Analysis perspective) are as follows.
 - the avoided costs associated with higher-cost dispute resolution processes (such as through local or district courts)
 - reduced risk for tenants (and possibly landlords) reflected in a lower risk premium for relevant activities.

Number of businesses affected

In order to understand the impacts of the proposed changes to the RLA, it is important to understand the number of small bars and gyms/fitness studios in NSW and whether they are located within or outside a shopping centre.

Location of shopping centres in NSW

There are a number of sources of information on the location of shopping centres within NSW:

- **Definition 1.** The first source was the NSW Land Valuer general which presents data on all properties in NSW. A separate ‘property name’ variable was included in the database. Common word searches were applied to identify whether the property was a shopping centre.⁵
- **Definition 2.** The second source was from the website <https://www.australia-shoppings.com/malls-centres/new-south-wales> which indicates that there were 322 shopping centres within NSW

⁵ This included the following search terms: shopping, arcade, plaza, mall, Westfield and Stockland.

Both sources provided the latitude/longitudes of the shopping centres so that the location of properties could be identified on a map. Table 4.2 summarises the number of shopping centres located in different SA4 regions in NSW. The total number of shopping centres within NSW is broadly similar, although there are some differences on a region specific level. This, in part, may reflect differences in the definition of a shopping centre.

4.2 Summary of the number of shopping centres in NSW

SA4 Region	Shopping Centre Defn 1	Shopping Centre Defn 2
.	no.	no.
Capital Region	14	8
Central Coast	13	15
Central West	4	10
Coffs Harbour - Grafton	19	6
Far West and Orana	2	6
Hunter Valley exc Newcastle	7	15
Illawarra	12	10
Mid North Coast	7	10
Murray	0	4
New England and North West	16	8
Newcastle and Lake Macquarie	4	18
Richmond - Tweed	8	10
Riverina	2	5
Southern Highlands and Shoalhaven	4	5
Sydney - Baulkham Hills and Hawkesbury	17	11
Sydney - Blacktown	13	16
Sydney - City and Inner South	34	35
Sydney - Eastern Suburbs	7	10
Sydney - Inner South West	7	13
Sydney - Inner West	3	8
Sydney - North Sydney and Hornsby	21	19
Sydney - Northern Beaches	5	9
Sydney - Outer South West	19	9
Sydney - Outer West and Blue Mountains	21	14
Sydney - Parramatta	13	16
Sydney - Ryde	4	7
Sydney - South West	17	16
Sydney - Sutherland	7	9
Total	300	322

Source: NSW Land Valuer General, <https://www.australia-shoppings.com/malls-centres/new-south-wales>

Small bars

Liquor licence data is collected by Liquor and Gaming NSW, the most recent premises list licence data is September 2022.⁶ This includes information on the type of licence (e.g. “small bar licence”), as well as, the latitude/longitude of the premises. We have aligned each premises and shopping centres to the ABS MeshBlock region. Table 4.3 presents the information on the number of small bar licences in the SA4 regions in NSW and the number deemed to be ‘within’ a shopping centre, under the two alternative definitions. There are between 4 and 14 small bars located within shopping centres, depending on the definition adopted.

Rather than utilising the ABS MeshBlocks, we have also tested an alternative approach of creating a 100m buffer around each shopping centre (latitude/longitude) and calculating the number of licences within this buffer.⁷ Under this approach, 9 small bars are located in shopping centres. This approach, however, relies on the precision of the latitude/longitude data on shopping centres and small bar location. Therefore, adopting a low and high range is appropriate.

4.3 Number of small bars and health/fitness centres, within Shopping Centres

SA4 Region	Liquor - small bar licence	Shopping Centre Defn 1	Shopping Centre Defn 2
.	no.	no.	no.
Capital Region	12	1	1
Central Coast	5	0	0
Central West	3	0	0
Coffs Harbour – Grafton	4	1	0
Far West and Orana	2	0	0
Hunter Valley exc Newcastle	2	0	0
Illawarra	12	0	0
Mid North Coast	2	0	0
Murray	5	0	0
New England and North West	3	0	0
Newcastle and Lake Macquarie	11	0	0
Richmond – Tweed	4	0	0
Riverina	3	0	0
Southern Highlands and Shoalhaven	5	0	0
Sydney			
Baulkham Hills and Hawkesbury	1	0	0
Blacktown	0	0	0
City and Inner South	105	1	12
Eastern Suburbs	1	0	0
Inner South West	4	0	0

⁶ <https://www.liquorandgaming.nsw.gov.au/resources/liquor-licence-data>

⁷

SA4 Region	Liquor - small bar licence	Shopping Centre Defn 1	Shopping Centre Defn 2
.	no.	no.	no.
Inner West	7	0	0
North Sydney and Hornsby	6	0	0
Northern Beaches	3	0	0
Outer South West	0	0	0
Outer West and Blue Mountains	4	0	1
Parramatta	2	0	0
Ryde	0	0	0
South West	2	0	0
Sutherland	6	1	0
Total	214	4	14

Source: NSW Liquor and Gaming, ABS Destination Zones

Health and fitness centres

For this sector there is no licensing data available, therefore, a different approach was adopted to estimate the number of these businesses in NSW (located within and outside shopping centres).

There are **5853** Gyms and Fitness Centres businesses in Australia as of 2022.⁸ Assuming that the number of gyms in NSW is proportional to the population, this would imply that around 31% (or 1,839) of these businesses are located in NSW.⁹ ABS Census 2016 data identifies the Place of Work (Destination Zones) of the respondent. The ANZSIC industry descriptor “*Health and Fitness Centres and Gymnasia Operation*” was adopted.¹⁰ The **1839** businesses were allocated to SA4 regions based on the share of *Health and Fitness Centres and Gymnasia Operation* workers in each region. GIS files of Destination Zones and the location of shopping centres was used to estimate the number of health/fitness centres located within a shopping centre (based on the alternative definitions noted above).

Other ANZIC industry definitions were also considered including:

- “Sports and Physical Recreation Clubs and Sports Professionals (9112)”
- “Sports and Physical Recreation Venues, Grounds and Facilities Operation (9113)”.

However, these did not align to our requirements and included, for example, persons working in basketball courts, tennis clubs, swimming pools and golf courses.

⁸ <https://www.ibisworld.com/au/number-of-businesses/gyms-fitness-centres/658/>

⁹ Australian population as at 31 December 2022,
<https://www.abs.gov.au/statistics/people/population/national-state-and-territory-population/latest-release>

¹⁰ This class consists of units mainly engaged in operating health clubs, fitness centres and gymnasia. Units in this class provide a range of fitness and exercise services.
<https://www.abs.gov.au/ausstats/abs@.nsf/Latestproducts/E824FEFEA0753614CA257B9500133E2C?opendocument>

Table 4.4 summarises the results.

4.4 Estimated number of health and fitness centres in NSW, within Shopping Centres

SA4 Region	Employees	Share of employees in SA4	Number of health/fitness centres	Shopping Centre Defn 1	Shopping Centre Defn 2
.	no.	% in SA4	no.	no.	no.
Regional NSW					
Capital Region	135	2	37	1	1
Central Coast	230	3	64	3	3
Central West	117	2	32	-	2
Coffs Harbour - Grafton	89	1	25	-	-
Far West and Orana	63	1	17	-	-
Hunter Valley exc Newcastle	171	3	47	-	6
Illawarra	223	3	62	1	1
Mid North Coast	143	2	40	2	2
Murray	40	1	11	-	-
New England and North West	77	1	21	-	-
Newcastle and Lake Macquarie	315	5	87	-	5
Richmond - Tweed	123	2	34	1	2
Riverina	58	1	16	-	-
Southern Highlands and Shoalhaven	97	1	27	1	-
Sydney					
Baulkham Hills and Hawkesbury	251	4	70	-	1
Blacktown	132	2	37	1	1
City and Inner South	823	12	228	6	14
Eastern Suburbs	490	7	136	2	4
Inner South West	390	6	108	1	2
Inner West	232	4	64	-	1
North Sydney and Hornsby	599	9	166	4	8
Northern Beaches	331	5	92	-	1
Outer South West	204	3	57	2	1
Outer West and Blue Mountains	297	4	82	1	1
Parramatta	275	4	76	1	-
Ryde	223	3	62	-	2
South West	207	3	57	-	1
Sutherland	291	4	81	4	4
Total	6626		1,839	31	63

Source: IbisWorld, ABS Census Place of Work 2016,

Disclosure statement costs

Under the base 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.

In option one, small bars are included in Schedule 1 of the Act and there is a requirement to prepare a disclosure statement. In option 2, health and fitness centres are included in Schedule 1 of the Act with the same requirements. Option 3 is a combination of the previous two options where small bars and health and fitness centres are included in Schedule 1 of the Act.

Our estimates for the costs of preparing a disclosure statement are based on the Retail Leases Regulations – Regulatory Impact Statement prepared by the Victorian Department of Business and Innovation in February 2013¹¹.

Non-shopping centre landlords staff time

The time burden imposed on non-shopping centre landlords for preparing a disclosure statement is estimated at 0.9 hours. This is based on stakeholder feedback to the Victorian RIS which suggested that large landlords generally have the internal capacity to prepare disclosure statements themselves, whereas small landlords require external assistance.

We assume landlords that seek external assistance would spend less time themselves on preparing the disclosure statement. We adjust the estimate of staff time for shopping centre tenants (1.8 hours) to derive the estimate for non-shopping centre tenants (0.9 hours) to account for the reduced burden from using external parties.

We estimate the cost of purchasing external advice is \$713¹². This is based on five stakeholder submissions provided in the Victorian RIS. The submissions ranged between \$220 and \$1000.

Tenant staff time is estimated to be 1.8 hours for a new disclosure statement. This is based on five stakeholder submissions in the Victorian RIS. Four of these estimated two hours, and the remaining estimated one hour.

¹¹ Victorian Department of Business and Innovation (2013), Retail Leases Regulations – Regulatory Impact Statement, <https://www.vic.gov.au/regulatory-impact-statements-2013>

¹² We inflate the 2013 estimate to 2022 dollars using the ABS 6401.0 Consumer Price Index

Number of leases affected

Retail leases in NSW are generally offered in 3, 5 and 7 year terms.¹³ We assume turnover of 20 per cent of the total number of leases annually, either through a new lease being created or an existing leases being renewed.

We do not have sufficient data to identify the share of new leases that are renewed. We understand that there is substantially less time required prepare a disclosure statement for a renewal of an existing lease as opposed to creating a new lease. For the central case, we estimate 30 per cent of leases are renewed. We assume that the costs to prepare a disclosure statement for a renewed lease are 50 per cent lower than that of a new lease.

The alternative usage of sites that are small bars are different to that of health and fitness centres. The requirement to have a disclosure statement for the alternative use would dictate whether this legislative amendment would create additional burden on landlords and tenants. We assume that the alternative usage of a site that could accommodate a small bar would most likely be a restaurant or café, which is already covered under the retail leases act and would therefore already require a disclosure statement. We assume that 10 per cent of small bar leases would require a disclosure statement for our central case.

The alternative use for a health and fitness centres is not as straightforward, as there is a wider range of alternative uses exist for this retail footprint. Alternative uses could include commercial tenants where a disclosure statement isn't required. Considering the uncertainty, we assume that 50 per cent of new leases will be for tenancies that did not require a disclosure statement.

Total cost of changes to disclosure statement requirements

The total cost for new disclosure statement requirements is \$3067 annually for option 1, \$140 303 for option 2 and \$143 371 for option 3, see table 4.5.

4.5 Cost of preparing new and renewal disclosure statements

Total cost of option	Annual	Present value 5 years
	\$	\$
Option 1 - Small bars	3 067	14 621
Option 2 - Health and fitness centres	140 303	668 761
Option 3 - Both small bars and health and fitness centres	143 371	683 382

Note: Discount rate of 7 per cent used for present value calculation.

Source: CIE

¹³ Small Business Commission, How do lease options work? Accessed 21 September 2022, <https://www.smallbusiness.nsw.gov.au/get-help/retail-leases/lease-options>

Dispute resolution costs

Number of additional disputes to go through mediation

To understand the additional number of disputes going through mediation it was important to:

- baseline the number of businesses that go through mediation as a proportion of businesses registered under the RLA
- assess the difference in OSBC result for business' in / out of the RLA

The number of businesses registered under the NSW Retail Lease Act is uncertain, however, an estimate from 2015 determined there were 28 567 businesses. This estimate utilised data from Lease Information Services, where there were 15 712 registered leases, and an assumption that 45 per cent of leases are unrecorded.¹⁴

Data provided by NSW Small Business Commission showed the number of matters which went through the OSBC process between 2000 and 2016. Using the most recent data, 2013-2016, the average number of businesses going through the OSBC process which came under the jurisdiction of the NSW Retail Leases Act was 3 334. 1 740 of those businesses go through either a formal or informal court process:¹⁵

- Formal (FOR): Formal mediation has been booked in, some matters may still be settled prior to mediation.¹⁶
- Informal (INF): Matters are solved prior to mediation

Combining the two data sets reveals that 6 per cent of businesses go through the OSBC process under the NSW Retail Leases Act each year in NSW. Based on this we assume that the same proportion of small bars and health and fitness centres, which are not currently under the NSW Retail Leases Act, will utilise these services under the NSW Retail Lease Act.

Due to data limitations we are unable to estimate the proportion of small bars and health and fitness centres that currently go through a dispute process. To overcome this we have assumed that 6 per cent currently go through a dispute process. This may be an overestimate. Due to the small size of disputes and limited ability for businesses to go through mediation, the proportion may be lower than 6 per cent.

In order to estimate the impact of including small bars, and health and fitness centres within the RLA, we estimate the potential increase in businesses that will go through a formal process with OSBC. Table 4.6 shows that 50 per cent of businesses go through a mediation process under the RLA, compared with 22 per cent of businesses that do not fall under the jurisdiction of the RLA and are not in Schedule 1. As such we assume a

¹⁴ PwC, 2015, OSBC Retail Leases Recommendations – Cost Benefit Analysis Report

¹⁵ Data where the jurisdiction was 'blank' has been included through a proportional distribution with other jurisdictions. Unknown data has been excluded as all unknown jurisdictions were 'enquires'

¹⁶ There are no filing costs but half the applicants may engage a lawyer/agent.

transition to include small bars, and health and fitness centres into the RLA could increase the proportion of these businesses that go through mediation to 50 per cent.

The data was not able to differentiate between small bars, health and fitness centres or other businesses that currently go to mediation in another jurisdiction. As a result our estimates have included all businesses not in Schedule 1 that go through the OSBC process. It must be noted that the proportion of small bars, and health and fitness centres that go through mediation could be different to the value estimated.

4.6 Classification by in / out RLA

	NSW Retail Leases Act	Other jurisdiction (not Schedule 1)
	%	%
Formal	50	22
Informal	50	78

Note: Other includes ADV and BND

Source: OSBC Matters Stats provided by NSW Small Business Commissioner.

Cost per mediation

Where retail lease disputes are required to progress to mediation to try to resolve the issue, there is an additional cost of doing so. Mediation helps parties to a dispute find settlement options that they can both accept, without having to go to court. There are two components to the mediations process.

- A first step to speak to a Mediation Officer for strategic or procedural advice. There is no application or filing fee and no charge to speak a Mediation Officer. Many matters will resolve before any formal process begins, which minimises costs.
- A second step to progress to formal mediation with a solicitor (or specialist mediator).
 - The cost of the mediator is around \$1216 (including GST) for up to 4 hours for, with the cost of any additional time charged at \$304 per hour (including GST). This equates to \$1105 (excluding GST) for each mediation (GST is generally excluded from CBA estimates as that component is a transfer from consumers to the government).
 - From 1 August 2022, each party is asked to pay \$330 (including GST), with the remaining costs (\$556 including GST) borne by the NSW Government.
- There may also be additional costs if, for example, parties need an interpreter.

For the purposes of the analysis, we assume:

- an average cost of \$275 (ex-GST) for the discussion with the mediation officer based on a 1 hour *informal* discussion.
- an average cost of \$1105 (ex GST) for *formal* mediation.

In addition, some parties may have legal representatives involved in the formal mediation process. OSBC's database notes some cases where either party is represented by a solicitor or an agent. However, for most mediations this is unknown.

- Nevertheless, OSBC estimates that at most, parties have legal representation in half of matters. For the purposes of the CBA, we therefore assume that each party has legal representation in 50 per cent of cases.
- OSBC estimates that an indicative cost of legal representation could be around \$2000 for end-to-end management of the matter, including around \$1500 for representation during the formal mediation.

In summary, the average cost of each formal and formal mediation is summarised in table 4.7.

4.7 Estimated cost of mediation process

	Informal	Formal
	\$	\$
Informal discussion ^a	275	275
Formal mediation	0	1 105 ^b
Legal representation	0	2 000 ^c
Total	275	3 380

^a Based on 1 hour discussion. All matters that go through the formal mediation process will have initially gone through the informal process. ^b Based on cost of 4 hour mediation. ^c Assumes each of the 2 parties has legal representation in 50 per cent of matters. The average cost of legal representation is assumed to be around \$2000 for the end-to-end process.

Note: Estimates do not include the time costs for the parties to participate in the mediation process.

Source: CIE estimates based on information provided by the OSBC.

Number of additional mediations

Based on our estimates presented earlier, there are around 200 small bars and 1,770 gyms/fitness centres that are not located within shopping centres. Under the proposed changes, these 1,970 additional businesses would now be covered by the RLA and be able to access the mediation services.

Based on the data available around 5 per cent of retail leases under the RLA access the mediation process each year. Of these, the OSBC database suggests that:

- around 70 per cent are resolved through the informal process
- around 30 per cent go onto the formal mediation process.

Based on these estimates, the number of additional formal and formal mediations is shown in table 4.8.

4.8 Estimated number of additional mediations

	Number of additional leases	Share of leases that require mediation		Number of additional mediations		
		Informal ^a	Formal ^b	Informal	Formal	Total
	No.	Per cent	Per cent	No.	No.	No.
Small bars	200	3.5	1.5	7	3	10
Health & fitness facilities	1 770	3.5	1.5	62	27	89
Total	1 970			69	30	99

^a Based on 5 per cent of leases being the subject of mediation and 70 per cent of those disputes being resolved through the informal process. ^b Based on 5 per cent of leases being the subject of mediation and 70 per cent of those disputes going onto the formal process.

Source: CIE estimates based on data provided by the OSBC.

Additional cost of mediation

Based on the information presented above, table 4.9 summarises the additional cost of mediation if the provisions of the RLA are extended to small bars and/or health/fitness centres outside of shopping centres.

4.9 Additional mediation costs

	Number of matters ^a	Average cost per matter ^b	Total cost
	No.	\$ per matter	\$
Small bars			
Informal	7	275	1 925
Formal	3	3 380	10 141
Total - small bars	10		12 066
Health and fitness facilities			
Informal	62	275	17 036
Formal	27	3 380	89 751
Total - health and fitness facilities	89		106 787
Total	99		118 854

^a See table 4.8 above for further details. ^b See table 4.7 for further details.

Source: CIE based on information provided by the OSBC.

Avoided cost of litigation

Disputes involving the Office of the Small Business Commissioner generally relate to misunderstood obligations, or changes in external circumstances, such as: COVID, some other local crisis, change in customer behaviour, bad business decisions impacting ability to cover the lease liability, bad communication over a small issue escalates it to seem like a bigger issue.

The benefit of mediation is that all of these things can be dealt with earlier and more cost effectively than letting parties just carry on with no resolution, or them having a court filing as their only option.

The cost of resolving matters through the court system would vary depending on a range of factors, including: whether each party engages a solicitor or runs the matter themselves (this is likely to depend on the size of the claim); and whether the matter goes to a hearing or is resolved beforehand.

As indicative estimates:

- The cost of resolving a smaller matter (less than around \$20 000) through the court system that the parties run themselves could be around \$2000.
- For larger matters (greater than around \$20 000), the costs could range between around \$14 300 on average (see table 4.10). This estimate assumes:
 - \$12 000 per party where the matter is resolved prior to the hearing) and around \$32 000 (where the matter goes to a hearing)
 - \$32 000 per party where the matter goes to a hearing
 - 88 per cent of matters are resolved prior to a hearing.

4.10 Indicative costs – matters greater than \$20 000

	Resolved before hearing	Matters go to hearing	Weighted average ^a
	\$	\$	\$
Filing/serving	2 000	2 000	2 000
Manage up to hearing	10 000	10 000	10 000
Hearing	0	20 000	2 326
Total	12 000	32 000	14 326

^a Weighted average based on 88 per cent of civil matters are resolved before a hearing, with the remaining matters resolved before a hearing.

Source: Indicative estimates provided by the OSBC.

These costs are likely to be a significant deterrent, meaning that many issues would remain unresolved, particularly smaller issues, particularly smaller issues.

- For the purposes of the CBA, we assume that around **10 per cent** of matters would go straight to litigation where no mediation is available.
- Around 10 per cent of the matters in the OSBC database for which a value is available are greater than \$45 000.

Under these assumptions, the total avoided litigation costs are estimated at around \$282 000 per year (table 4.11).

4.11 Indicative avoided litigation costs

	Total matters	Avoided matters resolved through courts	Average cost per matter ^a	Total avoided costs
	No.	No.	\$	\$
Small bars	10	1	28 651	28 651
Health & fitness facilities	89	9	28 651	253 563
Total	99	10		282 214

^a Assumes each party incurs a cost of \$14 326 (see table 4.10 above).

Source: Indicative estimates provided by the OSBC.

Reduced risk for businesses

In the absence of the mediation services available under the RLA, the only alternative is to resolve disputes may be through litigation. However, this could be prohibitively expensive for many businesses, particularly for small businesses.

The availability of a low-cost dispute resolution process could therefore have important impacts for relevant businesses over and above the impact on dispute resolution costs.

- Reducing the number of unresolved disputes — where the cost of resolving a dispute is high, many disputes are likely to remain unresolved. The cost of disputes remaining unresolved are unclear.
- Reducing the number of disputes — the availability of a low-cost dispute resolution process could reduce the number of disputes between lessors and lessees by discouraging the party with a stronger bargaining position (which may include having some market power) from abusing it.
 - Without a low-cost dispute resolution process, the party with market power may have an incentive to exercise it if they consider that there is little chance that the other party would be able to afford litigation.
 - By contrast, where there is a low-cost dispute resolution process available, the party with market power has less incentive to exercise it (as the other party could force them into mediation).

Although relatively few disputes involving the Office of the Small Business Commissioner relate to the abuse of market power, this could reflect the protections offered by the RLA (i.e. the provisions of the RLA prevent parties from seeking to exercise their market power). To the extent that the RLA protects both lessors and lessees from the abuse of market power, this would partly be a transfer from the party with market power to the other party (a transfer is where a benefit for one party is exactly offset by a cost to the other party). A transfer from one party to the other implies no **net** impact, although protecting businesses from the abuse of market power would generally be considered a good outcome.

Protecting both lessees and lessors from the abuse of market power (or avoiding the costs associated with a protracted dispute) could also reduce risk for these businesses. For both small bars and health and fitness facilities, the location and premises are likely to be a

significant factor determining the success of businesses and the cost of moving premises is likely to be relatively high. Risks relating to the lease could therefore be significant.

Reducing risk could potentially reduce the cost of capital (although it is unclear whether lenders actually take into account coverage of the RLA when determining the lending rate for relevant businesses). Businesses may therefore be more willing to invest in this type of business.

The change in the cost of capital attributable to the RLA is not known. Table 4.12 shows the indicative benefits for a given change in the cost of capital. These estimates assume the average upfront cost of setting up a small bar or a health and fitness facility is around **\$250 000** (this is broadly consistent with available estimates of the upfront cost of setting up a small bar¹⁷ or a gym¹⁸ in Australia).

Any reduction in the cost of capital is likely to be relatively modest. For the purposes of the CBA, we assume a reduction in the cost of capital of around **0.1 percentage points**. This reduction in risk would apply to all of the relevant businesses (not just new businesses), but would only affect investment decisions for new businesses.

4.12 Estimated annual benefits for a given change in the cost of capital

Change in the cost of capital	Annual benefit per business ^a	Aggregate benefits - small bars ^b	Aggregate benefits - health and fitness facilities ^c
	\$	\$	\$
0.05%	125	25 000	229 875
0.10%	250	50 000	459 750
0.15%	375	75 000	689 625
0.20%	500	100 000	919 500
0.25%	625	125 000	1 149 375
0.30%	750	150 000	1 379 250
0.35%	875	175 000	1 609 125
0.40%	1 000	200 000	1 839 000
0.45%	1 125	225 000	2 068 875
0.50%	1 250	250 000	2 298 750
0.55%	1 375	275 000	2 528 625
0.60%	1 500	300 000	2 758 500
0.65%	1 625	325 000	2 988 375
0.70%	1 750	350 000	3 218 250
0.75%	1 875	375 000	3 448 125
0.80%	2 000	400 000	3 678 000
0.85%	2 125	425 000	3 907 875

¹⁷ See for example: <https://www.lightspeedhq.com.au/blog/cost-of-opening-a-bar/>, accessed 23 September 2022.

¹⁸ See for example: <https://www.finder.com.au/gym-franchise-finance>, accessed 23 September 2022.

Change in the cost of capital	Annual benefit per business ^a	Aggregate benefits - small bars ^b	Aggregate benefits - health and fitness facilities ^c
	\$	\$	\$
0.90%	2 250	450 000	4 137 750
0.95%	2 375	475 000	4 367 625
1.00%	2 500	500 000	4 597 500

^a Assumes upfront capital costs of \$250 000. ^b Based on 200 small bars. ^c Based on 1839 health and fitness facilities.

Source: CIE.

Note that these estimates mainly relate to tenants. To the extent that landlords are also protected from the abuse of market power (or protracted disputes), there would be a similar benefit for landlords.

Sensitivity analysis

Consistent with the NSW Government Guide to Cost-Benefit Analysis, it is good practice to test the sensitivity of CBA results to alternative assumptions and CBA parameters.

- Key areas of uncertainty include:
 - The cost of preparing disclosure statements
 - The cost of mediation (in particular, our estimates have not taken into account the time cost for parties)
 - The cost of litigation
 - The proportion of businesses that are expected to access mediation
 - The proportion of businesses that go directly to the courts (in the absence of low-cost mediation process)
 - The impact of access to low-cost mediation on the cost of capital.
- As required by the Guide to Cost-Benefit Analysis, we also test the sensitivity of the results to alternative discount rates (3 per cent and 10 per cent).

Table 4.13 summarises the alternative assumptions/parameters used for sensitivity testing.

4.13 Sensitivity analysis – alternative assumptions/parameters

Assumption/parameter	Central case	Low alternative	High alternative
Cost of disclosure statements	<ul style="list-style-type: none"> ■ \$921 for initial disclosure statement ■ \$461 for renewals 	Central case - 50%	Central case +50%
Cost of mediation	<ul style="list-style-type: none"> ■ \$275 for informal process ■ \$3380 for formal process 	Central case - 50%	Central case +50%
Avoided cost of litigation	\$14 326 for each party (\$28 651 in total)	Central case - 50%	Central case +50%

Assumption/parameter	Central case	Low alternative	High alternative
Proportion of businesses accessing mediation	5%	1%	10%
Proportion of disputes that would go directly to the courts	10%	1%	20%
Risk premium	0.1%	0%	1%
Discount rate	7%	3%	10%

Source: CIE.

The net present value (NPV) of each option under each of the alternative assumptions is shown in table 4.14. In general, the NPV estimates are relatively sensitive to several of the alternative assumptions.

- However, under most scenarios tested, Option 3 remains the preferred option.
- The one exception is where there is no change in the risk premium. Under this scenario, the costs of extending the RLA to health and fitness businesses would outweigh the benefits, meaning that Option 1 (extending the RLA to Small bars only) is the preferred option.
- The sensitivity testing suggests that the findings are relatively robust, despite significant uncertainty around some of the key assumptions.

4.14 Net present value under alternative assumptions

	Option 1: Small bars	Option 2: Health & fitness businesses	Option 3: Small bars and health & fitness businesses
	\$'000	\$'000	\$'000
Central case	278.7	2 008.6	2 287.3
Disclosure statement - low	285.4	2 308.3	2 593.7
Disclosure statement - high	271.9	1 709.0	1 980.9
Cost of mediation - low	305.1	2 269.4	2 574.5
Cost of mediation - high	252.2	1 747.9	2 000.1
Avoided litigation costs - low	215.8	1 452.4	1 668.2
Avoided litigation costs - high	341.5	2 564.9	2 906.4
Businesses accessing mediation - low	220.4	1 535.9	1 756.3
Businesses accessing mediation - high	351.4	2 599.6	2 951.1
Share of businesses going directly to courts - low	165.5	1 007.5	1 173.0
Share of businesses going directly to courts - high	404.4	3 121.1	3 525.4
Risk premium - low	59.3	- 8.4	50.9
Risk premium - high	2 252.9	20 161.8	22 414.7
Discount rate - low	299.6	2 159.7	2 459.3
Discount rate - high	264.9	1 909.1	2 174.0

Note: Net present values calculated of 5 years, using a discount rate of 7 per cent (unless otherwise stated).

Source: CIE estimates.

A General assumptions

Table A.1 shows the other assumptions used to estimate the cost of preparing a disclosure statement.

A.1 Other assumptions for calculation of costs of disclosure statements

Assumption	Value	Source
Average weekly earnings	1852	ABS Average Weekly Earnings
Week worked per year	45	NSW Government, Measuring the costs of regulation
Hours per week	41	NSW Government, Measuring the costs of regulation
Oncost multiplier	1.18	NSW Government, Measuring the costs of regulation
Overhead multiplier	1.25	NSW Government, Measuring the costs of regulation

Source: Australian Bureau of Statistics Average Weekly Earnings 6302.0, NSW Government Department of Premier and Cabinet Better Regulation Office (2008), Measuring the costs of regulation,

The

CIE

THE CENTRE FOR INTERNATIONAL ECONOMICS

www.TheCIE.com.au