Property Council of Australia
ABN 13 00847 4422

Level 5, 19 Grenfell Street
Adelaide SA 5000

T. + 61 8 8236 0900
E. sa@propertycouncil.com.au

propertycouncil.com.au
@propertycouncil

Australia's property industry
Creating for Generations

18 July 2022

Valuer-General
GPO Box 1354
Adelaide SA 5001

By Email: agd.ovgrentthresholdreview@sa.gov.au

Retail and Commercial Leases Act 1995 (SA) – Rental Threshold

Thank you for the opportunity to provide a submission in relation to the Retail and Commercial Leases Act 1995 (SA) – Rental Threshold Review ("the Review").

The Property Council of Australia takes this opportunity to strongly discourage the threshold from being raised and provides the following data, analysis, commentary, and information to support this position for the purposes of assisting the Valuer-General in conducting the Review.

A snapshot of rental conditions over the Review period

The Valuer-General has requested industry data from FY21 and FY22 that illustrates commercial and retail leasing conditions over the period relevant to the Review to help determine an appropriate rental threshold.

In response, the Property Council has consulted a cross-section of our membership whose holdings represent a diverse range of commercial, industrial and retail asset classes (retail, food and beverage, shopping centres, hotels, warehousing, industrial and bulky goods) in both inner and outer metropolitan Adelaide as well as regional South Australia.

As you would appreciate, for commercial reasons we have deidentified this data across multiple portfolios and summarised into an index format.

Rental Index – drivers from previous 2.5 years

	31/12/2019	30/06/2020	30/06/2021	30/06/2022
Face Rent	100	100	104	105
COVID and/or other general waivers /abatements	2	31	17	11
COVID deferrals	0	24	11	6
Arrears write-offs %	4	7	17	8
Incentives on new leases	17%	47.5%	44%	40%
Average lease term for new lease	5.2	3.1	3.4	4.4
Portfolio vacancy percentage	7%	16%	19%	13%
Average vacancy period	63 Days	127 Days	134 Days	94 Days

The period relevant to the Review has been significantly impacted by the global pandemic – a black-swan event – the impacts of which are still being acutely felt by our members.

For this reason, we have also submitted data into the index model prior to the period in scope for the Review to illustrate the magnitude of the year-on-year change. This context yields a deeper historical understanding of the leasing environment in determining an appropriate threshold.

The above index yields a higher-fidelity image of the true landscape landlords have managed over the relevant period. Analysis of the above reveals that whilst on an index level face rents have remained somewhat stable, other factors such as incentives on new leases, lease terms, portfolio vacancy percentages and average vacancy periods have been negatively impacted and substantially reduced the effective rent collected over the period and yields across portfolios.

Indeed, it is worth highlighting examples from one landlord that demonstrates even greater extremities than the above index. Within their significant portfolio of retail tenancies, arrears write-offs were submitted as high as 81 per cent at their peak (falling back to 57.3 per cent) and their portfolio vacancy is currently at 18 per cent. In terms of COVID, waivers and abatements were consistently in the mid-20s range, once again exceeding the collated index model data listed above.

Rental threshold changes and land tax considerations for landlords

The Property Council has already made the State Government and Valuer-General aware that following the recent Statewide Revaluation Initiative, land tax liabilities among its CBD membership have jumped significantly within the relevant period of the Review.

We resubmit a copy of a recently published research paper, *Statewide Revaluation Initiative – Reviewing CBD land tax impacts and increasing South Australia's investment competitiveness*. This body of work examines deidentified case studies supplied by Property Council members in terms of the land tax implications on commercial holdings in the CBD and inner-ring suburbs from the now completed Revaluation Initiative.

The compound impact on landlords from rental losses absorbed throughout the pandemic - as illustrated in the index above - combined with cash flow issues due to delayed FY21 land tax bills (and overlayed with the aforementioned land tax increases in FY22 and additional costs associated with adapting to the pandemic) cannot be understated.

Under the Act, a retail shop lease cannot require the lessee to pay land tax or to reimburse the lessor for the payment of land tax; however, land tax liabilities can be taken into account when assessing rent. If the threshold is increased above $400,000 there will theoretically be more leases under which landlords cannot recover their land tax liabilities. Increasing the threshold will add to the burden already being experienced because of major and sudden increases in land tax.

Importantly, it should be noted that the industry provided $15 billion worth of nationwide support to tenants in 2020 alone and had gone above and beyond code requirements, negotiating in good faith with tenants to save jobs and keep businesses afloat. Once again, the index above illustrates the significant degree to which landlords have offered incentives, abatements and waivers as part of leasing agreements, together with the uptick in arrears write-offs.

In determining a recommendation for the Minister as to whether the threshold should be raised or remain the same, consideration should be given to the above factors throughout the period in scope for the Review.

Maintaining investment attractiveness in South Australia

The Property Council appreciates and understands why the *Retail and Commercial Leases Act 1995* was initially introduced, reasons that are not being debated or questioned as part of the Review.

A tenant paying above the threshold of $400,000 would in most instances take advice on a lease or understand the terms. In real terms, a $400,000-plus per annum lease would represent an office tenant leasing 1,000sqm, an LFR (large format retail) tenant leasing 2,000 sqm or an industrial tenant leasing 4,000sqm. Most, if not all, of these tenants are sophisticated and understand the lease terms.

In fact, Property Council members report that many tenants that pay $250,000 per annum (the previous threshold) would not conventionally be considered small businesses and would have the required capacity to receive advice on leasing and make informed negotiations on terms. If the objective of the Act was to protect small business, it would appear that the current threshold is already well beyond what typically may be considered a small business lease.

A move to increase the threshold would do nothing but make the commercial property market significantly less attractive to investors. At a time of great uncertainty and a softening market, policy settings – such as the rental threshold – should be geared towards incentivising investment, not threatening it

It should be noted that in other states such as New South Wales and Western Australia, landlords can still recover land tax under respective Retail Leases Acts.

Inflationary pressures

Given the pandemic-driven economic uncertainty over recent years, as well as more recent inflationary pressures, landlords are under pressure to recover costs.

If the rental threshold is increased, thereby lowering the capacity of landlords to recover land tax, landlords are more likely to attempt to recover costs via increased rents or other categories of outgoing costs - such as management fees - that may be passed onto tenants which in turn may encourage businesses to pass costs onto consumers and further inflate prices.

Administrative uncertainty

The matter of raising the threshold creates confusion for landlords, agents and tenants alike, and is therefore worthy of consideration.

For example, in a scenario where a tenant is paying rent marginally over the threshold, say $402,000, and where the threshold was raised to $420,000, the tenant would then fall within the Act and the landlord would be required to provide disclosure statements and not be able to recover land tax.

Additionally, in a scenario under where a listed company assigns their lease to a non-listed company, it is unclear whether the new lease will be subject to the Act or not. Under the current terms, it is assumed that the non-listed tenant now falls within the Act, implying landlords cannot charge land tax. Where commercial terms have previously been agreed that the tenant paid land tax, the landlord in this scenario will suddenly not be able to charge it. In real terms the landlord cannot refuse this assignment and yet this may be financially burdensome.

Please do not hesitate to contact me should you require any clarification or further information.

Yours sincerely

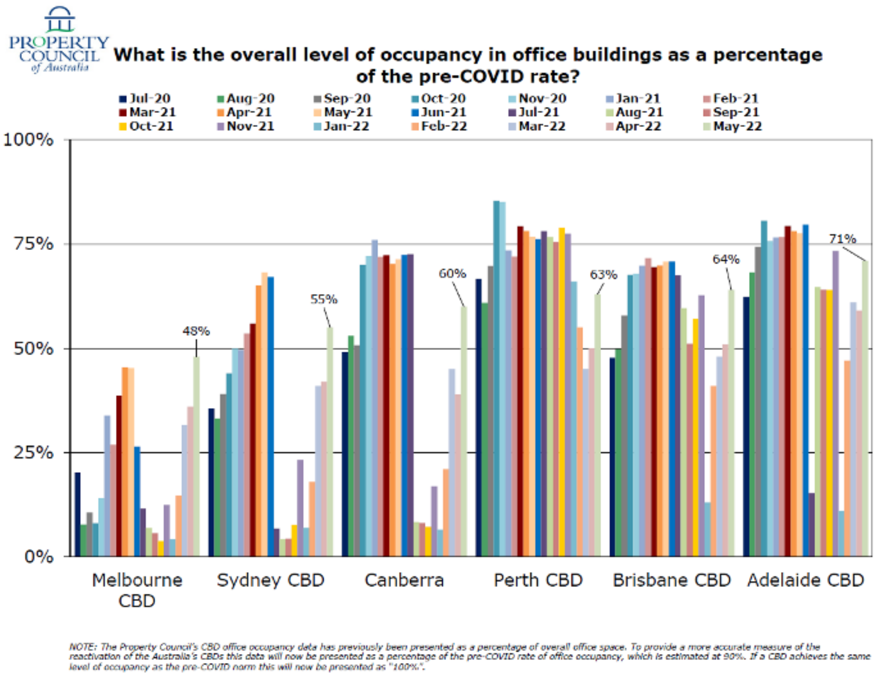
Daniel Gannon | SA Executive Director

Further Information

Commercial Office occupancy in the Adelaide CBD

The Property Council's most recent Office Occupancy data (May 22) finds that the occupancy in Adelaide office buildings as a percentage of the pre-COVID rate sits at 71 per cent. Whilst certainly a nation leading result, recovering pre-pandemic levels is still some way off (see Fig 1).

Figure 1 – CBD occupancy in office buildings as a percentage of the pre-COVID rate



Commercial Office vacancy in the Adelaide CBD

The Property Council of Australia tracks the national office market through its twice-yearly *Office Market Report*, which provides data on vacancies.

A snapshot of the Adelaide CBD across all property grades from the January 2022 report indicates market movement in the relevant period of the review.

2022 OFFICE MARKET REPORT MARKET PROFILES

Select Market **Adelaide CBD** *Select Grade* **Total Market**

Select Sublocale **Total Market**

Period	Stock (sqm)	Direct Vacancy (sqm)	Sub-lease Vacancy (sqm)	Total Vacancy (sqm)	Direct Vacancy Factor (%)	Sub-lease Vacancy Factor (%)	Total Vacancy Factor (%)	Supply Additions (sqm)	Withdrawals (sqm)	Change in Occupied Stock 6 Mths to... (%)	Change in Occupied Stock 12 Mths to... (%)	Audited Net Absorption 6 Mths to... (sqm)	Audited Net Absorption 12 Mths to... (sqm)
Jul-19	1,417,959	176,759	9,233	185,992	12.5	0.7	13.1	1,330	7,074	1.3	1.8	15,824	22,218
Jan-20	1,437,731	180,913	23,122	204,035	12.6	1.6	14.2	29,718	9,946	0.1	1.4	1,729	17,553
Jul-20	1,447,479	185,997	21,689	207,686	12.8	1.5	14.3	11,530	1,782	0.5	0.6	6,097	7,826
Jan-21	1,464,286	210,485	23,279	233,764	14.4	1.6	16.0	16,807	0	-0.7	-0.3	-9,271	-3,174
Jul-21	1,463,166	208,377	21,241	229,618	14.2	1.5	15.7	0	1,120	0.2	-0.5	3,026	-6,245
Jan-22	**1,460,046**	**194,781**	**17,111**	**211,892**	**13.3**	**1.2**	**14.5**	**270**	**3,390**	**1.2**	**1.4**	**14,606**	**17,632**

A snapshot of the Adelaide Fringe across all property grades from the January 2022 report indicates is also available illustrating movements in the relevant period of the review.

2022 OFFICE MARKET REPORT

MARKET PROFILES

Select Market: Adelaide Fringe

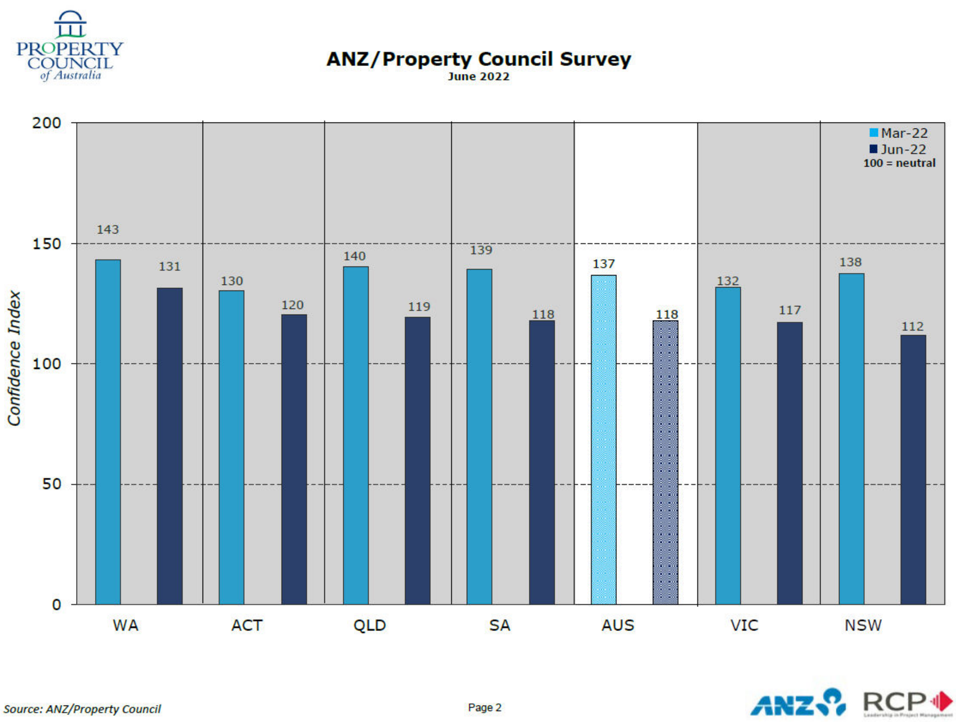
Select Grade: Total Market

Select Sublocale

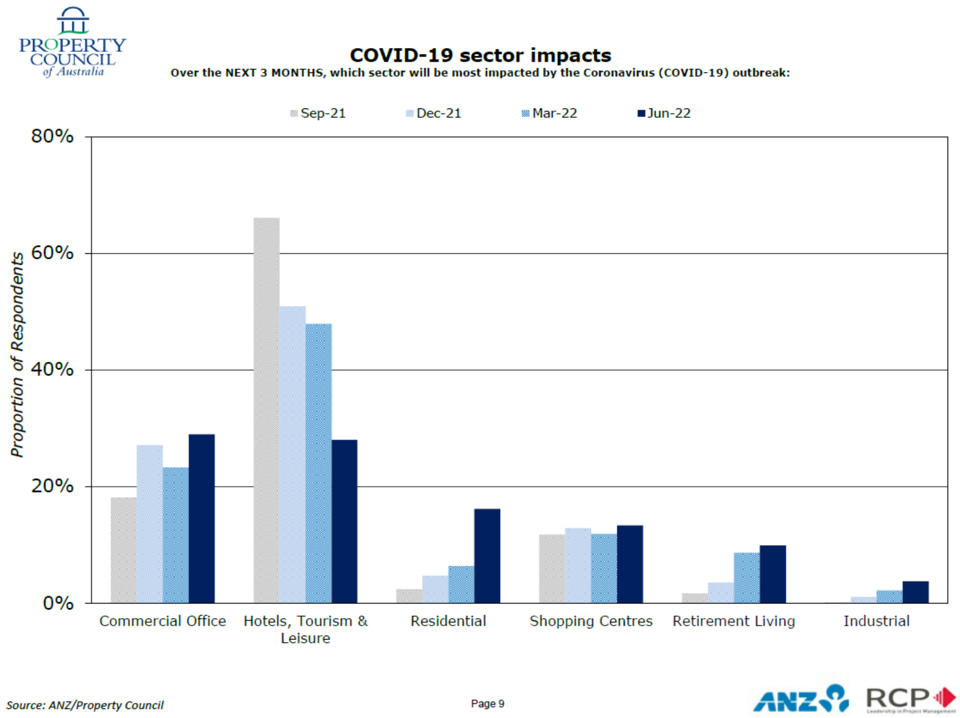
Period	Stock (sqm)	Direct Vacancy (sqm)	Sub-lease Vacancy (sqm)	Total Vacancy (sqm)	Direct Vacancy Factor (%)	Sub-lease Vacancy Factor (%)	Total Vacancy Factor (%)	Supply Additions (sqm)	Withdrawals (sqm)	Change in Occupied Stock 6 Mths to... (%)	Change in Occupied Stock 12 Mths to... (%)	Audited Net Absorption 6 Mths to... (sqm)	Audited Net Absorption 12 Mths to... (sqm)
Jul-19	218,652	23,875	4,840	28,715	10.9	2.2	13.1	0	0	-0.7	-1.7	-1,273	-3,341
Jan-20	220,013	28,825	2,376	31,201	13.1	1.1	14.2	2,161	800	-0.6	-1.3	-1,125	-2,398
Jul-20	220,013	29,463	1,686	31,149	13.4	0.8	14.2	0	0	0.0	-0.6	52	-1,073
Jan-21	216,943	22,635	1,636	24,271	10.4	0.8	11.2	0	3,070	2.0	2.0	3,808	3,860
Jul-21	213,504	22,430	926	23,356	10.5	0.4	10.9	3,750	7,189	-1.3	0.7	-2,524	1,284
Jan-22	**212,365**	**21,174**	**211**	**21,385**	**10.0**	**0.1**	**10.1**	**0**	**1,139**	**0.4**	**-0.9**	**832**	**-1,692**

ANZ/Property Council Confidence

The March to June 2022 ANZ/Property Council Survey Confidence Index finds that while confidence is still in positive territory (above 100 points) across the sector, in South Australia, confidence has dropped from 139 to 118 points over the last quarter.



While 118 points is in line with the national historical average, almost 30 per cent of respondents believe that the Commerical Office Sector will be the most impacted over the three months.



It is also worth noting that in the survey South Australian retail capital growth expectations were expected to decline over the next 12 months.