

NON-CONFIDENTIAL VERSION

ECONOMIC STRUCTURE AND PERFORMANCE OF THE AUSTRALIAN RETAIL INDUSTRY: PUBLIC INQUIRY (INQUIRY) SUBMISSION TO THE PRODUCTIVITY COMMISSION (COMMISSION) BY STOCKLAND CORPORATION LIMITED (STOCKLAND)

1. INTRODUCTION

Stockland provides the following submission in response to the Inquiry by the Commission into the economic structure and performance of the Australian retail industry.

The approach taken by Stockland in this submission is as follows:

- as a member of the Shopping Centre Council of Australia (**SCCA**), Stockland supports and adopts the submission of the SCCA of 20 May 2011¹; and
- Stockland, in this submission sets out the context in which, in its view, the Commission ought to have regard when considering the issues about which it has been asked to report by the Treasurer and makes submissions on particular issues that are of relevance to, or are specific to, Stockland (over and above the submission made by the SCCA). In particular, Stockland addresses terms of reference 1, 2, 3 and 5.

Stockland would be pleased to participate in any oral hearings concerning this Inquiry. Stockland invites the Commission to contact Mr Stephen Bull on 02 9305 3099 should it wish to do so.

2. STOCKLAND: PARTICIPATION IN THE AUSTRALIAN RETAIL INDUSTRY

Stockland is one of Australia's leading diversified property groups, active in retail, office and industrial property as well as residential communities, apartments and retirement living.

As at December 2010, Stockland's Commercial Property Portfolio included:

- 39 retail properties, covering approximately 811,969 square metres of gross lettable area, valued at \$4.2 billion;
- 28 commercial office properties, covering 638,596 square metres of net lettable area, valued at \$2.5 billion; and
- 15 industrial properties, covering 1.2 million square metres of gross lettable area, valued at \$1.0 billion.

Stockland's retail portfolio of 39 shopping centres accommodates over 2,600 tenants, generating retail sales in excess of \$5.0 billion per annum.

3. EXECUTIVE SUMMARY

In addition to supporting and adopting the submission of the SCCA, Stockland states as follows:

- Shopping centres have been, and continue to be, a key driver of retail sector growth and development.
- The retail industry in Australia has been constantly evolving and will continue to do so into the future to meet consumer needs/demands including the more recent trend of on-line shopping.

¹ Stockland is aware that the SCCA intends to submit a second submission to the Commission addressing the appropriateness of current indirect tax arrangements. The submission has not been publicly released.

- It is important that regulation is:
 - efficient, in particular removing overly burdensome unnecessary regulation;
 - consistent within and between jurisdictions across Australia; and
 - certain, as opposed to being subject to ongoing inquiries, recommendations and proposed changes,

in order that correct and certain signals can be made for investment and investment decisions can be made with confidence about future regulatory conditions.

Stockland concurs with section 3 of the SCCA submission and, in particular, that:

- activity centre policies, when properly and efficiently implemented, provide for certainty of use and investment decisions; and
 - it is the inconsistent application of state and local statutory planning mechanisms relating to activity centres and other planning policies that result in uncertainty and apparent high barriers to entry.
- Stockland concurs with the Commission's view that proposed developments be considered having regard to the broader implications on the viability of relevant activity centres at a generic level during the planning processes, rather than in the context of specific businesses during development assessment processes.
 - Retail performance at shopping centres in Australia is subject to both cyclical and structural forces. Retail spending by consumers has remained subdued since the global financial crisis. At the same time, Stockland's vacancy levels are low.
 - There are fundamental differences between Australian shopping centres and those in the US, which account for the structural differences in occupancy costs and sales productivity. Stockland concurs with section 3.3 of the SCCA submission regarding occupancy cost ratios and retailer profitability in Australia.
 - Stockland considers that on-line retailing and attendance at shopping centres are complementary and not alternative offerings. Stockland acknowledges that centres will need to continue to adapt to cater for the changing shopping habits of consumers.
 - In relation to planning and zoning regulation and retail tenancy regulation, Stockland considers the major issues to be as follows:
 - a very large amount of regulation impacts on the industry, the regulatory burdens of which add to costs and create inefficiencies;
 - it is critical that all participants play in a level regulatory environment. To the extent that there are barriers for new entrants into a development area such barriers are also felt by incumbents seeking to undertake developmental changes;
 - the retention of clearly enunciated and implemented activity centres policies create both developmental certainty, investment certainty and from a social policy perspective, urban centres/environments that are attractive and fulfil the shopping and entertainment needs of consumers;
 - there have been multiple reviews and inquiries into the retail industry, retail leasing and zoning and planning at both Federal and State Government levels. These inquiries have all led to recommendations, some of which

are inconsistent, but sufficient time has not passed for such recommendations to be implemented. In Stockland's view:

- ◆ there should be consistency in all States in respect to retail tenancy regulation;
- ◆ information flows between landlord and tenant are important. Stockland supports mandatory registration of leases and also asserts the importance of obtaining retail sales data from tenants to optimise the viability of its centres and suitability for market demands;
- ◆ apart from the issue of consistency and the need for information flows, there is no demonstrated need for additional regulatory oversight of retail tenancy or protections for retail tenants – in particular:
 - market forces should determine length of term of tenancy and rents; and
 - hold over periods provide flexibility at the conclusion of a lease term and there should be no mandated reduction in rents during such hold over periods
- ◆ there should be consistency of retail trading hours and a removal of retail trading restrictions;
- ◆ in the event that State or local government environment planning policies specify issues such as commercial viability of existing developments and competition implications of proposed developments as being part of, or not being part of, consideration by the relevant consent authorities, that there be consistency in approach of such plans; and
- ◆ it is for the ACCC to address any real or perceived restrictions that may substantially lessen competition.

4. TERMS OF REFERENCE 1 AND 2: TRENDS IN RETAIL TRADE AND DRIVERS OF STRUCTURAL CHANGE

Stockland concurs with the views of the SCCA as set out in section 2 of its submission.

The Australian retail industry (shopping centres and other retail formats) has been constantly evolving over the last decades and will continue to do so into the future to meet the needs and demands of consumers.

Shopping centres offer a range of benefits to consumers, retailers² and the broader community.³

The continued success of Australian shopping centres is dependent on the ability / flexibility of landlords to be alive to market dynamics and innovate the centre format to meet the needs of its stakeholders – namely, consumers, retailers, community and shareholders.

² For example: provision of consumer traffic volumes; consideration of tenancy mix and identity of tenant to help ensure success of retailer and the centre as a whole; access to promotions and advertising funds; and removal of property risk from the retailers business plan.

³ Centres have an economic role in the community through, for example, the provision of employment; generation of council rates, etc.

As an example of Stockland's (and other landlord's) ability to respond to market dynamics, the Commission would note that centres regularly provide a leisure and entertainment experience. Centres include:

- supermarkets, specialty fresh food outlets, department stores/discount department stores, specialty retail, a variety of services outlets such as banking, Australia Post and health insurance, entertainment and leisure precincts, centre courts for community activities and restaurants; and
- public facilities – including first class family rooms, bus and transport interchanges, libraries and other community facilities.

Centres therefore are designed with a well-balanced mix of discretionary and non-discretionary retailers (including supermarkets, fresh food, financial services, etc). Such design has an impact on sales productivity.

This is in stark contrast to the design of, for example, centres in the US which are significantly more dependent on discretionary retail (particularly fashion specialties and department stores).

Notwithstanding the balance in Australian shopping centres, Stockland notes that Australian shopping centres achieve relatively high sales productivity (sales per square metre of retail space). Stockland also notes asserted claims that occupancy costs ratios for specialty retailers in the US are lower than in Australia. Stockland submits that in order to be meaningful, such claims/'statistics', and indeed any comparison between Australia and the US, must take account of the fundamental differences in each of the Australian and US markets. In particular:

- Australia has a significantly smaller population than that of the US;
- Australian retail is affected by macro economic changes such as exchange rate fluctuation;
- as between Australia and the US, there is a significant difference in the amount of retail space per capita;
- sales productivity is higher in Australia than in the US;
- Australian and US centres have different tenancy mix; and
- the economics of Australian shopping centres are such that anchor tenants are of paramount importance. In Australia, there exist only two to three anchor tenants in each retailing category. This gives the anchor tenants significant bargaining power. Such bargaining power is accentuated by the fact that they are also significant developers in their own right.

Retail performance at shopping centres is subject to cyclical and structural forces. Anecdotal evidence is that retail spending by consumers has remained subdued since the global financial crisis. At the same time, Stockland's experience is that its centres have had very little vacancy. Occupancy rates have remained above 99% throughout the period of the global financial crisis (on the basis of figures from late 2007 to December 2010).

It is important that the policies and regulatory settings in relation to the retail industry do not dampen a shopping centre's ability to be flexible and innovate to meet market demands.

Transparency to maximise retail offering in centres

It is important to have information flows between a tenant and landlord. Tenants require information to make decisions as to where it will locate and to assist with negotiations about the terms and conditions of the lease. Stockland refers further below (in responding

to Term of Reference 5) to the need for national mandatory registration of leases for tenants.

Equally, it is important for landlords to have information from tenants that assists it in better decision making about its centres. By way of example, Stockland requires its retail tenants across all centres to provide sales data on a monthly basis. Such sales data is critical to Stockland in a number of respects, namely:

- to determine the financial viability of its centres and the strength and weaknesses of its retail offering according to retail categories. This is a key factor in any decision to expand or redevelop a centre. The utility of a landlord obtaining turnover information for this purpose has been acknowledged by the ACCC.⁴
- to observe individual retail performance to ensure its centres have a successful tenancy mix. Stockland must ensure its tenancy mix enables it to adapt to changes in the market place for each individual centre;
- **[COMMERCIAL IN CONFIDENCE]**;
- to comply with the legislative requirements to inform prospective retail tenants in disclosure statements of a particular Stockland centre's performance; and
- as centres approach obsolescence, sales data assists Stockland to identify any associated impact on the centre's performance in order to ensure the ongoing success of the centre.

5. TERM OF REFERENCE 3: ONLINE TRADING: OPPORTUNITIES AND CHALLENGES

In Stockland's view, to date, the take-up of on-line shopping in Australia has been less than countries such as the US or UK, partly for the reasons that:

- the US and UK have a longer history of remote purchasing (eg. catalogue sales); and
- the infrastructure, both IT and delivery of goods, in Australia is either underdeveloped or is expensive with such costs necessarily being passed on to consumers. Given the infrastructure costs, the economics of on-line retailing may not be justified (at this stage) for retailers with high volume, low margin business models.

Nevertheless, Stockland anticipates that online retailing will be a growing area, in particular for categories such as books, music, movies, games and toys.

On-line shopping and attendance at shopping centres are likely, in the foreseeable future, to be complementary and not alternative offerings as:

- consumers continue to seek to physically "sight, touch and feel" the goods they wish to purchase or to "order on line" and pick up the products (in the case of groceries); and
- shopping centres offer an "experience" far beyond a place to purchase a good or service. **[COMMERCIAL IN CONFIDENCE]**

The impact of this trend on landlords is not a new one – the challenge is to continue to adapt and innovate to cater for the shopping habits of consumers. In response to this trend (i.e. the growth of online retailing):

⁴ Graeme Samuel, "Competition and fair trading: a fair go for small business", address to the National Small Business Summit, Sydney, 3 July 2007.

- landlords will need to consider whether different fit outs/layouts/centre configurations are required;
- retailers and centres will likely be required to provide greater service to consumers; and
- landlords will need to continue to work closely with retailers to understand their requirements – for example, retailers may require less space for stock and more space for "displaying" products (allowing customers to "see, touch, feel" goods before placing orders on line). Grocery retailers may desire "car park" space for consumers to "pick up" orders placed online.

Accordingly, it is vital for landlords to retain their flexibility to enable innovation to take account of the inevitable changes to the retail industry.

6. TERM OF REFERENCE 5: OTHER ISSUES IMPACTING ON THE PERFORMANCE AND EFFICIENCY OF THE INDUSTRY

Planning and zoning regulation

The Commission's Issues Paper notes the number of recent inquiries on this issue – of particular relevance:

2008	Commission Inquiry into the market for retail tenancy leases in Australia Australian Competition and Consumer Commission (ACCC) Grocery Inquiry and subsequent Report
2009	COAG recommendation for performance benchmark exercise
2011	Commission Report: <i>Benchmarking Study into Planning, Zoning and Development Assessment</i> (Benchmarking Study)

There have also been various inquiries at the State level.

Stockland concurs with the position of the SCCA and supports the findings of the Commission's Benchmarking Study to improve retail competition under land-use planning. Stockland considers that the key findings of the Benchmarking Study provide a comprehensive response to the 2008 inquiry recommendations.

Stockland concurs with the SCCA's position that the findings of the Benchmarking Study should provide the basis for the planning and zoning issues discussed in this current Inquiry and importantly that appropriate time should be allocated for the consideration and implementation of the key findings through the COAG reform process.

Stockland concurs with the Commission's view that proposed developments be considered having regard to the broader implications on the viability of relevant activity centres at a generic level during the planning processes, rather than in the context of specific businesses during development assessment processes.

The risks associated with a more deregulated scheme whereby centres policy or the impact on activity centres is not given due regard will result in less efficient development and community outcomes and may entrench the position of the existing anchor tenants who are themselves developers in their own right.

Stockland notes the findings of the Benchmark Study endorse and highlight the multiple benefits from the long-standing activity centres policy approach to land-use planning, including greater retail competition, provided local level zoning is flexible to enable a broad range of retail types. Stockland supports the SCCA's submission that this approach is consistent with the Commonwealth's *National Urban Policy*, May 2011.

Stockland is concerned that further inquiries and recommendations for reform may be published before the comprehensive response to the 2008 inquiry recommendations (as provided in the Benchmarking Study) is given time to be considered and implemented through the COAG reform process. As the Commission is aware, steps have already been taken in some States to address the 2008 inquiry recommendations. Examples have been provided by the SCCA.

Retail trading restrictions

Stockland concurs with the SCCA's submission that there should be consistency of retail trading hours and removal of retail trading restrictions. Stockland considers that there should be as little regulation of trading hours as possible in order that shopping centres owners and retailers are in a position to respond to changing customer preferences and lifestyles and to innovate and present different shopping experiences to customers.

Retail tenancy leases

Stockland has made a number of submissions about retail tenancy issues in the past both to the Commission (most recently in 2007) and to other reviews at a State level (such as the NSW Government Inquiry into *Issues Affecting The Retail Industry in New South Wales* in 2008). Stockland has also had regard to other submissions made to the Commission in this Inquiry. Stockland's submission focuses on a few key areas relating to retail tenancy leases.

Implementation of retail tenancy reforms

In its submission to the Commission regarding the market for retail tenancy leases in Australia (July 2007), Stockland strongly supported a single system of national regulation of retail tenancies in place of the current State/Territory regulation.

Stockland, like many other landlords, is required to have a number of different systems in place to comply with individual State/Territory requirements. These inconsistencies create unnecessary cost and inefficiencies for landlords.

Stockland considers that the retail tenancy reforms will result in greater harmonisation of legislation and result in cost efficiencies through the removal of administrative and compliance costs. However, Stockland does not consider that the retail tenancy reforms are being implemented in a timely manner. By way of example, a single disclosure statement does not yet operate in all jurisdictions.

National regulation of retail tenancies should be accompanied by supporting mandatory registration of leases in all States and Territories in Australia. Such measures again ensure consistency across jurisdictions as well as providing for an easy mechanism for retail tenants to obtain information about comparable leases as part of tenants' due diligence processes when entering into leases.

Perception of power of landlords

Stockland concurs with section 3.3 of the SCCA submission regarding occupancy cost ratios and retailer profitability in Australia. Stockland does not consider any assertion that shopping centre owners have market power to be credible. In particular, Stockland notes the following structural issues:

- as between Australia and the US, there is a significant difference in the amount of retail space per capita than in Australia;⁵

⁵ See reference in the SCCA submission to the report by Michael Baker. "US and Australian Shopping Centres: An exposition and explanation of their relative performance with respect to sales per square meter and occupancy costs" April 2011.

- Australia has a very small number of major anchor tenants. These tenants have significant bargaining power, affect shopping centre owner profitability and are developers in their own right; and
- Stockland enters into leases with a myriad of different tenants, however, [COMMERCIAL IN CONFIDENCE].

Market forces determine rents

The SCCA canvasses in detail, all of the factors taken into account in setting rent. Stockland concurs with the SCCA submission on this issue.

Stockland sets rents according to market forces – that is, rents are determined at any particular time by assessing supply of retail space and demand for such space. Rents are one of a number of terms negotiated between shopping centre owners and retail tenants upon entry into, and renewal of, leases – other significant issues for negotiation and which impact on both the rent and the decision making processes of tenants to locate at shopping centres include the length of tenure, fitout and fitout costs, the services generally available at shopping centres, the usage and more generally the greater level of planning and precincting undertaken by shopping centre owners that assists the viability of, particularly smaller specialty tenants. More generally, market forces might manifest in these ways:

- if there is an increase in supply – for example if a new centre is developed the catchment area of which overlaps with an existing centre, downward pressure is likely to be placed on rents for a period of time;
- negotiations during economic downturns in the retail industry are likely to place downward pressure on rents outside of the lease period for those negotiating with landlords during the period of the downturn; and
- where there is a significant redevelopment of a centre, the possible impact on rents vary. The increase in demand from retail tenants for the centre may increase the value of the site and thus increase rents. However, any significant increase in the supply/gross lettable area has a dampening effect on rents being negotiated in anticipation of the expansion and later renewals of leases.

Anchor tenants are the major drivers of foot traffic in centres and accordingly enjoy significantly lower rents per square metre upon entry into, and renewal of, leases than specialty stores. Importantly, anchor tenants occupy a significantly greater amount of lettable area in a centre than special stores. Anchor tenants are of paramount importance to the development and sustainability of shopping centres. In essence, a shopping centre is built around anchor tenants. Customers are generally attracted to a shopping centre by its anchor tenants and, once there, will visit other stores in the centre, namely the smaller speciality retail tenants. Similarly, smaller specialty stores are drawn to the centres by the existence of anchor tenants. Without anchor tenants, the flow of customers into a centre diminishes, making the leasing of retail space at the centre a less attractive proposition for specialty stores.

In brief, the economics of shopping centres are such that landlords receive substantially lower rents from anchor tenants per square metre than from specialty retail tenants (but occupy significantly more space). The position of anchor tenants in Australia is accentuated by the commercial reality that there are a very small number of anchor tenants in Australia in each retail category. The lower rents per square metre provide an incentive for anchor tenants to:

- locate in a shopping centre, as opposed to a competing shopping centre or operate from a free-standing outlet; and then
- invest in larger, higher quality stores than they otherwise would, so as to attract a greater number of customers to the benefit of the shopping centre as a whole.

Overall, Stockland's position in respect of rents, and the position of Stockland as a landlord and tenants in terms of rents is as follows:

- rents are a function of economics, supply and demand, and should be left to negotiation between landlord and retail tenant;
- information about the prevailing "market rate" of rents is available to tenants due to retail tenancy legislation as well as the advisory industry that has developed to assist small tenant at the time they are seeking to enter into a lease, during the life of the lease and at the end of the lease/time for consideration of renewal. Mandatory registration of leases would further assist with transparency of information; and
- there exists legislation that enshrines rights and protections for retail tenants including dispute resolution clauses in circumstances where they are not satisfied with rent negotiations.

Stockland also notes that the issue of "turnover rent" is raised on occasion as a example of the perception of power of landlords. In the case of Stockland, [**COMMERCIAL IN CONFIDENCE**].

Accordingly, there is no need for steps to be taken to further interfere with market forces and the negotiation process between landlords and retail tenants in the setting of rents.

Reform of tenure and holding over provisions

As with the issue of rents, Stockland is of the view that market forces and negotiation should determine the length of tenure of a tenancy and rents at renewal/rents at the end of a lease.

Australian retail tenancy laws do not impose a continued right of occupancy at the expiration of a lease. Such laws do make provision for "end of lease notification" by landlords to retail tenants. In New South Wales, for example, a landlord must give the tenant notice between six and twelve months before a lease ends, that it:

- intends to offer the tenant a renewal or extension of the lease on terms specified in the notification (including terms as to rent); or
- does not propose to offer the tenant a renewal or extension of the lease.

Moreover, if the landlord fails to notify the tenant, the retail shop lease is extended until six months after the landlord gives required notification (where the tenant requests the extension in writing).

Landlords are also required to disclose the term of the lease prior to its execution and provide retail tenants with a copy of a retail tenancy guide at the commencement of lease negotiations.

Stockland's view is that there should be no mandated security of tenure. Stockland is, however, happy to negotiate long term leases with its retail tenants and has a history of doing so.

Stockland does not consider further regulation in this regard necessary but rather considers this a matter for negotiation with retail tenants on a case by case basis.

Longer term leases raise the following additional considerations for Stockland:

- the impact on the existing portfolio lease expiry profile;
- the need for additional capital expense by the tenant to be invested in the business during the term of the lease;

- the impact on design fit-out/refurbishment during the term of the lease;
- rental growth rates from assets (because growth is not uniformly spread between assets); and
- the impact on franchise business models (in particular, financing considerations) by having longer term leases.

There are a number of disadvantages in offering longer term leases. In particular, longer term leases affect Stockland's ability to innovate/respond to market changes, adjust the tenancy mix of a particular centre and ensure entry of new retail tenants, an issue which will be of greater importance with the rapidity of change to the retail environment expected in the next decade.

Security of tenure is likely to increase the barriers to entry for newer specialty retailers and newer concepts of retailing seeking to enter into centres.

Stockland also notes that arguments are made about the "lack of security of tenure" during "lease hold over" periods and that as a consequence, rents should be adjusted during such periods. The commercial and legal realities are that tenants that are holding over are entitled to a monthly tenancy (by virtue of the fact that they are holding over). This provides a flexible form of tenancy in circumstances where landlord and tenant are negotiating/are continuing to negotiate beyond the term of a lease. This position has benefits for both the tenant and the landlord.

Mandating rent reductions for hold over periods has the potential to distort decision making and may end what may otherwise be ongoing negotiations that may result in a renewal of a lease with a tenant (i.e. resulting in less security of tenure for tenants).

In so far as Stockland and its relationships with retail tenants are concerned:

- [COMMERCIAL IN CONFIDENCE];
- [COMMERCIAL IN CONFIDENCE];
- [COMMERCIAL IN CONFIDENCE]; and
- [COMMERCIAL IN CONFIDENCE].

Accordingly, Stockland reiterates that such negotiations should be left to market forces.

Other competition issues: market structure and conduct

As the Commission notes (on pages 33- 34 of the Issues Paper), there has been a number of recent developments in this area (including the pending litigation between Metcash and the ACCC in respect of Metcash's proposed acquisition of the Franklins business). Stockland agrees with the Commission's view that as sufficient time has not passed to enable a considered assessment of the effectiveness of the recent developments and accordingly such matters will not be examined in this Inquiry.

Stockland submits that it is for the ACCC to consider any concerns regarding competition issues and / or enforcement of the *Competition and Consumer Act 2010* (Cth).

8 JUNE 2011