

Productivity Commission Inquiry

The market for retail tenancy leases in Australia

Submission No.4

INTERNATIONAL RETAIL RENT COMPARISONS

Are Australian Retailers at an International Competitive Disadvantage ?

Southern Sydney Retailers Association

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INTERNATIONAL RETAIL RENT COMPARISONS –

Are Australian Retailers at an International Competitive Disadvantage ?

The Spending Power of the American Consumer.

The American consumer is one of the richest in the world with GDP per head 31% higher than compared to Australia.¹

On the basics², Americans spend only 6.5% of their income on food compared to 10.5% spent by the average Australian. For alcohol, the average American spends just 1.5% of their income, while the average Australian spends 4.1%

Consumer spending in the USA is also not diverted to gambling and into the club industry like it is in Australia.

While it's often said the American consumer is addicted to shopping, in contrast, the Australian consumer is addicted to gambling. Australia, with only 0.3% of the world's population has 21% of the entire number of poker machines in the world.³

In 1999-2000 Australians lost \$13.3 billion through gambling. This amounted to \$931 for every man, woman and child in the country. The figure for 2007, with Woolworths Ltd controlling more poker (slot) machines than Caesars Palace and the Bellagio Hotel & Casino combined - is likely to be substantially higher.

Given the above statistics, it is clear that the average American has a much higher disposable income to spend on clothing, footwear, furnishings, and household articles - all items typically purchased from the average shopping centre - than the average Australian does, which may help explain the greater demand for retail space in the USA.

Furthermore, with the colder climate across the majority of the USA, and more distinct seasons, Americans spend more on clothing per person than the average Australian. Further, the colder climate in the USA placing less emphasis on outdoors activities like there is in Australia, leading to a greater supply of indoor retail space.

However, despite the greater supply of retail space in the USA, the spending power of the American consumer still comes through, as American department stores that anchor shopping centres, have a superior sales productivity than that of Australian department stores.

A report for the International Council of Shopping Centres⁴, by Michael Baker dated 25th October 2004, states;

According to SCORE United States mall anchors average \$192psf. Australian department store anchors don't do as well, at an anaemic \$168psf.

¹ Organization of Economic Development and Cooperation (OECD) <http://www.oecd.org/dataoecd/55/60/33747039.pdf>

² United States Department of Agriculture, Economic Research Service " Food CPI, Price and Expenditures by Selected Countries, 2000" <http://www.ers.usda.gov/Briefing/CPIFoodAndExpenditures/Data/table97.htm>

³ *Productivity commission exposes poker machine Culture*, 7.30 Report <http://www.abc.net.au/7.30/stories/s37514.htm>

⁴ "Shopping Centre industry benchmarks – an international perspective on the collection analysis and dissemination of operating statistics" Michael Baker 25th Oct 2005 <https://www.icsc.org/srch/rsrch/wp/globalwhitepaper.pdf>
[Southern Sydney Retailers Association – International Retail Rent Comparisons](#)

Discount department stores at Australian Malls do somewhat better than department stores, producing an average \$220psf.... Given the weakness of the Australian department stores, it is perhaps surprising that the discounters don't do better. The inability of Australian discount stores to capitalize fully on the fragile competitiveness of their department store competitors runs very much counter to the US experience.

Therefore given the vastly greater spending power of Americans to purchase goods from Shopping Malls, and given the superior sales performance of American Department stores compared to Australian department stores - one would expect retail rents in American shopping malls to be substantially higher than retail rents in Australian malls, even given the greater quantity of retail space in the USA per capita.

USA v Australia - Shopping Mall Rents.

Over the last few years, there has been anecdotal evidence and rumours of absurdly high retail rents in Australian malls compared to shopping Malls in the USA.

However, the Westfield group have been very helpful to confirm these rumours by publishing this data on page 11 in their 2005 annual report, for the world to see the massive differences in rents between Australia and the USA

| Portfolio Overview | PORTFOLIO LEASED ⁽¹⁾ | LEASE DEALS COMPLETED ⁽²⁾ | | AVERAGE SPECIALTY STORE RENT AMOUNT ⁽¹⁾ | GROWTH ⁽³⁾ | COMPARABLE NOI GROWTH ⁽²⁾ |
|-------------------------|---------------------------------|--------------------------------------|----------------|----------------------------------------------------|-----------------------|--------------------------------------|
| | | NUMBER | AREA | | | |
| UNITED STATES | 95.1% ⁽⁴⁾ | 1,340 | 3,758,412 SQFT | US\$38.83 PSF | 3.3% | 3.6% |
| AUSTRALIA & NEW ZEALAND | > 99.5% | 2,819 | 334,624 SQM | A\$1,167 PSM NZ\$995 PSM | 5.2% | 5.3% |

If we convert the average speciality store rents in the USA of US\$38.83 psf to A\$ and square meters to make an accurate comparison – the average speciality store rent in Westfield malls in the USA is **A\$499** per m2.

So what is going on in Australia where the average speciality store rents are **\$1,167** per m2 – an incredible **134%** higher !

For such a discrepancy to exist- there must be something manifestly wrong with the operation of the market for retail leasing in Australia. Yes, things are different in America – but other than the fact that water goes down the toilet in a clockwise spiral in the USA – how is it possible that retail rents in equivalent shopping malls are 134% higher in Australia.

Attempts by the 'existing retail hierarchy' to gloss over these massive higher rents in Australia, with the explanation of "larger average stores sizes" - verges on the comical. Just divide the shops in two and double the rent ?

There is an argument that smaller stores should attract **less** rent. Comparing a 100m2 store against a 200m2 store – in the small store a retailer needs to set aside a greater percentage of the store for a sales counter, a front entrance, and a small storeroom, and the smaller store will be more expensive per m2 to fitout and to staff. For example, a 100m2 might need 3 staff – but if the store is double the size, it doesn't need double the staff.

Therefore, a retailer operating a small 100m² store, is actually substantial less efficient in operating costs per m², than a retailer operating a larger 200m² store.

The other excuse peddled in an attempt to explain the unexplainable of the absurdly high retail rents in Australia is “more retail space per capita in the USA”, but just like the others, this excuse lacks credibility given the vastly greater expenditure of the USA consumer and the fact that department store anchors in USA malls have a substantially higher sales per m² than Australian department stores.

Further information for shopping mall rents from the USA is available from the Simon Property Group, the world’s largest owner of Shopping Malls with 171 regional shopping malls across the USA.

Figures published in the 2006 annual report for the Simon Property Group⁵ also provides further evidence of the absurd level of retail rents in Australia. The Simon Property Group reports average rents slightly less than the Westfield group at US\$34.49 for 2005 – the equivalent of **A\$443 per m²**.

Further, the ‘rent/sales ratio’ reported by the Simon property group for their American Malls is **7.4%** - compared to rent/sales ratios in Australian shopping malls now estimated to be pushing **18%- 20%**.

If any other business cost, be it office rents, or industrial rents, had a 150% higher cost in Australia – it would be a national scandal requiring the Government to act urgently.

Likewise the fact that shopping mall rents – a major business costs - that feeds through to the prices of most consumers goods - is 150% higher in Australia than the USA, should set off alarm bells throughout the nation, that even the spin doctors behind the existing retail hierarchy can’t silence.

But it gets worse.

The Simon Property Group also report average rents for 36 Premium Outlet shopping centres across the USA – and here average rents in 2005 were US\$23.16 psft –the equivalent of **A\$297 m²** – at a rent/sales ratio of **5.1%** and **occupancy cost at 7.8%**

Such figures are likely to make thousands of Clothing Retailers trapped in Australian Malls paying over \$1,200 per m² with occupancy cost ratios in excess of 20% physically sick, when they realise American clothing retailers can operate in such high quality malls with occupancy costs at just **7.8%**.

⁵ <http://thomson.mobular.net/thomson/7/2245/2469/>

The Following Images are reproduced from Simon Property Groups 2006 Annual report and for these shopping centres in the USA, occupancy costs are 7.8%



Round Rock Premium Outlets in Round Rock, Texas opened on August 3, 2006. Located just 20 minutes north of Austin, Round Rock Premium Outlets comprises 432,000 square feet and features 125 designer and name-brand outlet stores. The center was 99% leased at year-end.



Above and Opposite: Orlando Premium Outlets, our most productive Premium Outlet for the past two years, reported sales in excess of \$1,000 per square foot in 2006. An expansion of Orlando is expected to begin in 2007.

Office Rents – Australia V USA

Another possible excuse, likely to be rolled out by the ‘existing retail hierarchy’ in an attempt to explain the unexplainable of shopping mall rents being 150% higher in Australia – is the story of “higher interest rates” or “higher constructions costs” in Australia.

If these excuses had any legitimacy, these higher rents in Australia would also show up in the difference for office rents or industrial rents, between Australia and the USA.

However, an Australian government publication ‘*Invest in Australia ; International Data Comparisons*’ for July 2006 shows average office rents in Australia’s most expensive city, Sydney were the equivalent of US\$39.60 per sq ft, while in New York they were US\$55.20 per sq ft.⁶

Other comparisons⁷ of Office rents between Australia and USA provided by *Global Prime Office Rents* show the same;

Brisbane US\$29.32 - Miami US\$31.46
Perth US\$27.25 - Boston US\$39.65
Melbourne US\$23.99 - Los Angeles \$38.50
Canberra US\$23.98 - Washington US\$41.84
Adelaide US\$18.50 - Toronto US\$37.71

So comparing rents between Australia and the USA - if office rents are around 30% to 50% **lower** in Australia, how is it possible that retail rents are 149% **higher** ?

Clearly something is manifestly wrong with the market for retail leases in Australia – and claims that the price of retail rents in Australia are the result of “the normal forces of supply and demand” are sheer nonsense. If the normal forces of supply of demand were working in the market for retail leases in Australia - retail rents in Australia for speciality retailers in our shopping malls would be between just \$400-\$500 per m2 – instead of the over \$1200 per m2 that retailers are paying now.

These massive higher retail rents in Australia as compared to the USA, simply place the entire Australian retail sector at enormous international competitive disadvantage – they add to the cost of doing business in Australia – they flow on to retail prices, and at the end of the day, they penalise 21 million Australian consumers.

Europe v Australia - Shopping Mall Rents

While the existing retail hierarchy searches for their latest excuse to explain the farcical situation of shopping mall rents in Australia as compared to the USA, hoping to hoodwink the public into accepting this distortion as “normal” - data is also available to compare retail rents between Australia and Europe.

⁶ Invest in Australia, International Data Comparisons, Australian Government.
<http://www.investaustralia.gov.au/index.cfm?menuid=478636E2-FFC6-AE54-09F20416BDC47C23&setLanguage=AU>

⁷ Global prime office rents <http://www.finfacts.com/cbre.htm> and http://www.realestatejournal.com/columnists_com/blueprint/20050922-blueprint.html

The Simon Property group also reports average specialty rents across 53 European Shopping malls at an average of Euro 25.72 for 2005 which is the equivalent of **A\$435 m2** with a rent/sales ratio of at **6.7%**.

This indicates that rents and occupancy costs are **200%** higher in Australian shopping Malls than European Shopping Malls.

Yet again, the evidence is clear that something is **very** wrong with the price of rents in Australia.

Further evidence from Europe is available for Rodamco, Europe's Largest Shopping Mall owner in their 2006 annual report.⁸

Although Rodamco do not report rents, they do report occupancy cost ratios and state;

Occupancy Cost Ratio : This is this the rent and service costs as a percentage of retail sales. It is **a key number** for our customers.

Therefore, it is interesting to compare this **"key number"** of occupancy costs in Australian shopping malls with the occupancy costs in European Shopping malls.

In Australia, the Westfield Group reported the following occupancy costs at June 2005 for their NSW shopping centres⁹ figures which are likely to be lower than the actual occupancy costs because of an incorrect apportionment of GST;

Fashion **20.8%**
Footwear **20.2%**
Jewellery **18.1%**
Leisure **16.1%**
General Retail **17.2%**

Now compare these occupancy costs in NSW with the leading Shopping Malls throughout Europe's most fashionable cities.

France

La Part Dieu Shopping Centre, Lyon - **7.5%**
Parly 2 Shopping Centre, Paris – **6.9%**
Villeneuve Shopping Centre, Lille **8.5%**
Velizy Shopping Centre, Paris – **8.3%**
St, Seve Shopping Centre, Rouen – **9.9%**

Sweden

Taby Centrum Shopping Centre, Stockholm – **7.7%**
Solna Centrum Shopping Centre, Stockholm – **8.2%**
Forum Nacka Shopping Centre, Stockholm – **10.2%**
Haninge Shopping Centre, Stockholm – **7.3%**

Austria

Donauzentrum Shopping Centre, Vienna **7.6%**

Spain

Parquesur Shopping Centre, Madrid – **8.2%**

⁸ Rodamco 2006 Annual Report <http://www.rodamco.com/Group/English/>

⁹ Westfield Leasing, Hurstville Fact Sheet, as at 30th June 2005.

La Vaguada Shopping Centre, Madrid – **10.6%**
 Les Glories Shopping Centre, Barcelona – **11.8%**
 Bonaire Shopping Centre, Valencia - **11.5%**
 Vallsur Shopping Centre, Valladolid – **9.8%**

Denmark

Fisketorvet Shopping Centre, Copenhagen – **9.9%**

Czech Republic

Chodov Shopping Centre, Prague – **9.1%**

Poland

Galeria Mokotow Shopping Centre, Warsaw **9.8%**

Therefore, while retailers in these high end shopping malls in some of the most fashionable cities in Europe have occupancy costs at less than 10% - meanwhile back in the Western Suburbs of Sydney, fashion retailers are trying to survive with occupancy costs of 20% and above.

Canada v Australia - Shopping Mall Rents

The same massive distortion of retail rents in Australia is also obvious with comparisons from Canada.

Industry Canada, has posted on their website a report titled “How Much Rent Can you Afford to Pay” in which they state;

“How much rent a retailer can afford to pay is best described using the following table. Please note that rent payments should be directly related to expected gross margins. Occupancy costs are expressed as percentage of total sales.”¹⁰

| STORE TYPE | AVERAGE GROSS MARGIN | TARGET OCCUPANCY COST (% OF SALES) | UPPER LIMIT RECOMMENDED |
|--------------------|----------------------|------------------------------------|-------------------------|
| Fashion & Footwear | 40% to 50% | 9% to 10% | 14% |
| Appliance | 30% | 5% to 7% | 7% |
| Hardware | 30% to 40% | 7% to 9% | 11% |
| Fast Food | 50% to 60% | 10% to 12% | 16% |
| Grocery | 20% | 4% | 6% |

¹⁰ [http://strategis.ic.gc.ca/epic/site/retra-comde.nsf/vwapj/chapter9.pdf/\\$FILE/chapter9.pdf](http://strategis.ic.gc.ca/epic/site/retra-comde.nsf/vwapj/chapter9.pdf/$FILE/chapter9.pdf) - page 10
 Southern Sydney Retailers Association – International Retail Rent Comparisons

With the average occupancy costs in Westfield's NSW malls at 20%, they are more than **double** what industry Canada recommends as a target of 9% to 10% and even substantially above the "upper recommended limit" of 14%

A very important factor that the above table from Industry Canada makes clear, is that a direct consequence of the higher occupancy costs is that **retailers must operate on higher marks up.**

There is a direct relationship between occupancy costs and a retailer's mark-up. Higher occupancy costs in Australia, places Australian retailers at an international competitive disadvantage, and they also punish the Australian consumer paying higher prices.

Japan v Australia - Shopping Mall Rents

The Simon Property Group also reports data from Japan, where they own 40% of five Premiums Outlet shopping centres.

An example of these is the *Toki Premium Outlet* shopping centre near Nagoya. In 2005 this was 100% leased to upmarket retailers including, Adidas, Bally, Coach, Diesel, Lacoste, Nautica, Nike, Timberland and Versace.

These high end centres report average sales of 89,238 Yen per sq ft, the equivalent of A\$9,427 per m2.

With the high cost of land in Japan, surely these high end Japanese shopping centres must have higher rents than shopping centres in suburban Australia ?

However, the Simon group reports ¹¹ average rents at these centres at 4,646 Yen per sq ft – the equivalent of **A\$490 per m2** and a rent/sales ratio of **5.2%**

Conclusion – High Occupancy, the Australian consumer ultimately pays.

The evidence from around the world; USA, Canada, Europe, Japan, France, Spain, Denmark, Austria, Sweden and Poland all indicate that average occupancy costs for a retail business are less than 10%, and in many cases substantially less than 10% with speciality retail rents for some of the world's most fashionable shopping malls averaging less than A\$500 per m2.

Further, the evidence is that in 1989/90 occupancy costs for speciality retailers in Shopping Centres in Australia were around this 10% worldwide average - but since 1989/90 something very strange has happened only in Australia and nowhere else in the world. During this period, shopping mall rents in Australia rents have skyrocketed – pushing occupancy costs for Australian speciality retailers to around 20% the highest in the world.

¹¹ Simon Property Group 2006 Annual Report.
Southern Sydney Retailers Association – International Retail Rent Comparisons

Clearly, something is drastically wrong with the operation of the retail leasing market in Australia that has resulted retail rents so much out of alignment with the rest of the developed world – which has placed the entire Australian retail sector at massive international competitive disadvantage.

But at the end of the day – it's the ***Australian Consumers that pays the penalty*** of increasing occupancy costs in Australia, with higher prices, higher inflation, greater pressure on interest, increased trade deficits and mounting foreign debt.

The long term damage to the Australian economy and the threat to the nation's future prosperity from the distortion of the broken market for retail leases cannot be over emphasized.

The Productivity Commission faces one of its greatest challenges in sorting out the mess of the market for retail leases in Australia.

With increased globalisation, the Australian retail sector cannot continue with retail rents being so much of alignment with the rest of the developed world.

The first challenge will be to see through the spin and smoke & mirrors of the existing retail hierarchy, and for all parties to acknowledge the seriousness of the problem that exists in Australia.