

**Productivity Commission Inquiry:  
The Market for Retail Tenant  
Leases in Australia**

**Submission by:**

**Colonial First State Property  
Management Pty Ltd**

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# The Market for Retail Tenancy Leases in Australia

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## 1 Introduction

### 1.1 Inquiry

This submission is in response to the Australian Government's Productivity Commission Inquiry into The Market for Retail Tenancy Leases in Australia issued on 29 June 2007 (**Inquiry**).

### 1.2 CFSPM

Colonial First State Property Management Pty Ltd (**CFSPM**) is one of Australia's leading managers and developers of retail property in Australia. It manages approximately \$9.6 billion in retail assets and has approximately \$2.2 billion in its development pipeline. CFSPM currently manages 35 retail properties across Australia comprising approximately 4,700 tenancies.

The 35 shopping centres managed by CFSPM can be categorised as follows:

	<b>Vic</b>	<b>NSW</b>	<b>Qld</b>	<b>SA</b>	<b>WA</b>	<b>Tas</b>	<b>Total</b>
<b>Super Regional</b>	1	-	-	-	-	-	<b>1</b>
<b>Sub-Regional</b>	4	3	3	3	-	-	<b>13</b>
<b>Regional</b>	5	1	2	1	2	1	<b>12</b>
<b>CBD</b>	-	-	3	1	-	-	<b>4</b>
<b>Neighbourhood</b>	1	1	1	-	-	-	<b>3</b>
<b>Bulky goods</b>	-	2	-	-	-	-	<b>2</b>
<b>Total</b>	<b>11</b>	<b>7</b>	<b>9</b>	<b>5</b>	<b>2</b>	<b>1</b>	<b>35</b>

### 1.3 Shopping Centre Council of Australia

CFSPM is a member of the Shopping Centre Council of Australia (SCCA).

CFSPM has reviewed and strongly endorses the content of the SCCA's submission to the Inquiry. The purpose of this, CFSPM's submission to the Inquiry, is to supplement the SCCA's submission by providing additional information and experiences from CFSPM's perspective that may be relevant to and assist the Inquiry.

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## **2 Investment context**

### **2.1 Centre ownership**

CFSPM manages retail property on behalf of various ownership groups being:

- (i) the CFS Retail Property Trust (**Trust**), which is a sector specific (Australian retail shopping centres only) unit trust listed on the Australian Stock Exchange.

Unit holders in the Trust are either institutional investors (for example, superannuation funds, life insurance funds and managed funds) or private investors. Beneficial ownership of units in the Trust is generally evenly split between institutional and private investors.

As at the date of this submission, there are approximately 18,500 unitholders in the Trust;

- (ii) various wholesale property funds.

Beneficial ownership of the units in the wholesale funds is held by institutional investors; and

- (iii) various private owners/investors that have direct ownership interests in certain retail properties.

Therefore, having regard to the beneficial ownership of the shopping centres that CFSPM manage, the wider community has an interest in and reliance on the performance of these shopping centres either by virtue of direct holdings (through units in the Trust) or through indirect holdings (through investment in superannuation funds or managed funds).

### **2.2 Investment decisions**

The owners of CFSPM managed centres acquire, manage and develop shopping centres over time pursuant to a long term investment strategy.

The success of the investment in a centre is assessed over time through a consideration of:

- (a) the return to investors by way of regular income flows; and
- (b) the increase in capital value of an asset.

Consequently, a long-term perspective is adopted in all key decisions relating to the management and development of a shopping centre, with a view to maximising and sustaining owner returns over an extended time horizon (being at least 5 years). If returns are not competitive over the long-term, investors will turn to other asset classes for investment and this will adversely impact the management and the ability to further develop a centre and ultimately, the retailers located within them.

The key requirement to maximising owner returns over the long-term is the ability to attract and retain strong retailers whose retail offer is highly attractive to consumers. Satisfaction of this requirement will drive customer traffic in centres and will enable other strong retailers within a centre to convert increased customer traffic into increased sales. An increase in customer traffic and higher centre sales makes a centre a more attractive investment proposition for both current, and prospective, retailers. The consequent increase in retailer demand for space in a shopping centre leads to an increase in rents (and stronger returns) flowing to owners. Owners are then willing to reinvest returns into improving and developing centres. So the positive investment cycle continues.

However, the converse is also true – if existing retailers are under-performing, there will be an adverse impact on customer traffic, centre sales and ultimately market rents, returns to owners and further investment in that centre.

Therefore, from an investment perspective, it is in the owners' best interest for retailers to succeed.

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## **3 Management context**

### **3.1 Retailer support**

As detailed above, the owners have a vested interest in ensuring retailers succeed. This is particularly critical when a new retailer enters the centre and commences trading. The retailer needs to be able to establish a presence within the relevant trade area and the owners and manager work closely with retailers through a variety of support initiatives.

These initiatives continue throughout the term of a retailer's lease when appropriate. The success of these initiatives relies heavily on the cooperation and participation of the retailer. If a retailer does not enthusiastically embrace these initiatives (which occurs more often than CFSPM would wish), then it often does so to its own detriment.

The ability to deliver different retail support activity differs from centre to centre as some activities are dependant on the individual characteristics of a centre or the physical availability of support mechanisms on site (such as available signage). However, there is a vast array of initiatives that CFSPM adopts (generally at no cost to the retailer) at its centres with the purpose of helping retailers improve their own businesses. Schedule 1 of this submission lists some of the usual retailer support initiatives adopted by CFSPM at its centres.

However, it is also important to recognise that despite retailer support initiatives, some retailers and their businesses will still fail for reasons such as the tenant's lack of retail experience, business acumen or financial support. It is in this context that it must be acknowledged that a large proportion of small businesses fail in Australia each year and owners of shopping centres cannot guarantee the success of a retailer's business. However, because owners of many shopping centres adopt retailer support initiatives such as those offered by CFSPM, the failure rate of small businesses within shopping centres will be significantly less than outside of shopping centres.

### **3.2 Security of tenure**

Tenants often argue in favour of a right to a new lease upon expiry of the term of an existing lease.

However, as detailed above, it is in the interests of both owners and tenants to ensure flexibility on the part of an owner to:

- (a) retain strong retailers and replace non-performing ones; and
- (b) ensure that a centre has the best possible tenancy mix for its trade catchment and to appropriately respond to a changing retail market.

Maintaining this flexibility is critical to allow shopping centres to evolve over time, in response to consumer demands and needs in the face of ever changing retail concepts and trends. Removing or restricting this flexibility will stifle this evolution and eventually, investment in shopping centres, to the detriment of owners, tenants and ultimately, the consumer.

The reality is that the market forces of demand and supply operate efficiently in the shopping centre market place, as owners wish to minimise vacancies, and retailers wish to lease premises within those shopping centres that perform. These market forces will ultimately determine which retailers agree new leases with owners, and which ones do not. Also, these forces will determine the appropriate price at which retail space should be let at.

The CFSPM experience shows that of the total number of expiries in the past year, approximately 70% resulted in renewals of the sitting tenant. The remaining 30% of tenants were replaced for a range of reasons, including at a tenant's own instigation; as a result of a change in a tenancy mix; or as a result of retailer non-performance.

Consequently, from CFSPM's perspective, any preferential rights or security of tenure given to tenants will benefit the under-performing tenant only, to the detriment of landlords and other tenants, and therefore, must be avoided.

### **3.3 Refits on renewal**

As a general rule, CFSPM requires tenants to conduct a complete refit of their tenancy upon the renewal of a lease in order to maximise a centre's customer appeal and market relevance. Given that leases are generally for a period of 6 years, the fit-out of a tenancy can easily become tired and dated.

CFSPM's experience indicates that tenant sales generally increase by 10-30% following a refit – this again is not only a benefit to the tenant, but to the owner and the other tenants in the centre. A centre that does not adopt such a policy will quickly lose appeal with the customer to the detriment of all tenants and the owner.

CFSPM's policy would generally be consistent with that of other major shopping centre owners and managers, and such a policy compliments the significant expenditure by owners on developing centres, and on repairing, refurbishing and improving non-tenanted parts of centres, such as common areas.

### **3.4 Outgoings**

Subject to applicable retail legislation, there are various ways in which outgoings regimes can be structured in shopping centre leases. Some owners adopt a gross approach, which means that tenants simply pay one fixed amount under their lease; others use what is commonly referred to as a net lease structure, under which the tenant pays a base rent component, plus an additional amount for a contribution to centre outgoings. There are also hybrid structures in between. Despite the different structures, the outcome is usually the same in terms of the tenant's total occupancy cost.

CFSPM generally adopts a net structure with its leases – that is, tenants pay a base rent amount plus a contribution to centre outgoings (as permitted by law).

There is a perception that retail property owners have little incentive to minimise outgoings costs. However, the opposite is in fact correct. When considering a lease proposal, a tenant will want to know what their total occupancy cost will be – that is, the combined amount of rent, outgoings and any other charges payable under a lease, as they would have a total budget and a financial model they must adhere to. Therefore, the larger the outgoings component is in this equation, the smaller the rent component is. From an owners perspective, the returns required to justify their ongoing investment in a centre is dependent upon ensuring that rents, preferably, increase over time. Consequently, it is in the owners' best interests to also ensure that outgoings are minimised (as they are purely a recovery of actual costs), so that as much of a tenant's total occupancy cost is derived from rent, resulting in real returns to owners.

This is certainly consistent with the management approach adopted by CFSPM where annual increases in centre outgoings costs have generally been kept to a minimum, while ensuring that appropriate centre standards are maintained. Of course, there are sometimes factors which impact on CFSPM's ability to achieve these outcomes (a good example of this is when insurance premiums increased following September 11, or more recently, a very sharp increase in statutory costs in Queensland). However, these external impacts are mitigated to the extent reasonably possible by CFSPM through ongoing intensive asset management activities such as the lodgement of statutory objections, national supplier contract negotiations, and risk management processes.

### **3.5 Sales reporting and rents on renewals**

The collection and recording of individual tenant sales information is an essential part of the management process of any retail property. It is an important measure of the performance of a centre – if sales are growing at a rate greater than industry benchmarks, the centre is performing well, and further investment into that centre by the owners may be justified. If sales are growing at a rate lower than industry benchmarks or is in decline, intervention is required by an owner through, for example, retail support initiatives (discussed above), replacement of non-performing retailers, or modification of the tenancy mix within the Centre.

Sales information is also used for both internal and external benchmarking purposes. Internal benchmarking is used to assist in decision making on redevelopments, tenancy mix adjustments, marketing and promotion purposes. Sales information (suitably aggregated) is also provided to retailers and other third parties for research purposes. This external benchmarking gauges the performance of stores and products within centres, on a total centre basis and across the wider industry. Both retailers and owners use this information to assist in various decision making processes.

Tenants often express concern that owners use sales information for setting rents. The reality is that rents for a new lease are set by market forces. As mentioned above, it is in an owner's best interests to ensure that vacancies are minimised. If demand for space is low (because the rent is too high), then the space will remain vacant. Conversely, if the economy is doing well, and the retail industry is generally doing well, then demand for retail space increases, which naturally places upward pressure on rents.

### **3.6 The educated tenant**

Over the past 10 years, tenants have become far more educated in their rights and entitlements under law. It goes without saying that the burgeoning amount of regulation and legislation affecting the industry is generally intended to protect and benefit the tenant.

As retailers grow and develop their businesses, they are represented in a larger proportion of retail properties across Australia, thereby developing strong leasing and business development personnel, and consequently, are able to utilise stronger negotiating positions with owners. In the CFSPM portfolio of centres, approximately 80% of tenancies are leased to tenants that have national chains.

As far as the non-national retailer is concerned, there has been a massive proliferation of tenancy advocates who provide advice and negotiate on behalf of such tenants; there has been a massive increase in the amount of information provided to tenants, not only by landlords (as a requirement of the law or otherwise), but by relevant governmental bodies and private seminars; there are tenant associations that continually support and educate tenants; and tenants regularly talk to each other.

From CFSPM's perspective, tenants have a substantial amount of information available to them (both before they enter into a lease and during the term of the lease) and consequently, are armed with sufficient information to ensure an informed decision making process.

### **3.7 Disputes**

CFSPM is committed to resolving disputes as quickly as possible, to the reasonable satisfaction of all parties concerned if possible. This is reflected in the low number of disputes initiated by CFSPM's tenants in the relevant tenancy dispute authority in each State.

CFSPM's experience indicates that most claims made by tenants are resolved commercially before a tenant initiates any formal dispute or legal process. In CFSPM's portfolio of approximately 4,700 tenancies, only about 30 to 40 disputes per annum (leaving aside usual rent recovery matters) would be referred to a formal dispute resolution process by a tenant. These disputes are almost invariably all resolved through the mediation process and over the past 5 years, with only 2 or 3 disputes with a non-major tenant progressing to a formal hearing in a court or tribunal.

These statistics show that:

- the current dispute resolution processes in each State are working; and
- CFSPM is committed to ensuring that disputes are resolved quickly, commercially and without the need to spend significant time and money.

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## **4 Regulation**

The retail property market in Australia is a highly regulated one. The SCCA submission details the extent of that regulation.

With this large amount of regulation comes some uncertainty, inconsistency, and significant compliance costs affecting both owners and tenants. CFSPM has been involved in several reviews of retail legislation over the past 5 years and has noticed that in some cases at least, regulation was introduced which served no material benefit to either owners or tenants, yet resulted in additional compliance costs. In other cases, regulation was introduced as a result of only a small number (supported by empirical evidence) of isolated incidents in the retail leasing market, although again, it had a material and significant impact on the vast majority of participants in the retail leasing industry.

CFSPM strongly supports the principle of one national regime to cover retail leasing in Australia, reflecting the fact that many landlords and tenants operate nationally – this would reduce the complexity, inconsistency and compliance cost for both landlords and tenants. However, CFSPM recognises the limitations of achieving this aim as detailed in the SCCA submission.



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## 5 Conclusion

In CFSPM's view:

- the interests of owners of retail space in shopping centres and tenants are strongly aligned – that is, the success of a tenant's business leads to better centre performance, which leads to the success of other tenants and ultimately, greater returns for the owner.
- owners of shopping centres adopt a long term investment outlook and must maintain maximum flexibility regarding the tenancy mix of a centre to ensure the ongoing success and return on investment of that centre.
- as the beneficial ownership of shopping centres is very broad, a large portion of the community benefits directly or indirectly from the success of shopping centres.
- the market for retail space in Australia is working efficiently.
- the market process for determining market rents for retail space in Australia is working efficiently.
- there is sufficient information symmetry between owners and tenants.
- when required, dispute resolution processes in all States are working efficiently.
- one piece of legislation governing retail leasing in Australia is preferred as it would more appropriately reflect the reality that the market for retail leases is a national market.

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## Schedule 1 – CFSPM Retailer Support Initiatives

### Training

- ARAV industry training
- Compliance to Food Safety Legislation
- Cultural Awareness
- Customer Service
- Financial Services/Accounting
- General Retail Skills Training (Category by Category)
- Provide list of Consultants (discount rates) to assist retailers
- Security/loss prevention/other
- Speakers for retailers
- Substance Abuse and Crime
- Training programs for CMO staff (retailer understanding)
- Visual Merchandising
- Workplace Training Advisory

### Other

- Advertising Email to database
- Advertising Eyecorp
- Advertising Local Press
- Advertising Media Puzzle
- Advertising Reduced rates with local press
- Advertising Signage "Opening Soon"
- Advertising Show Card stands
- Audit certain retailers each year
- Centre directories with tenants and phone numbers
- Centre magazine
- Centre newsletters (Centre performances)
- Centre website
- Communicate "50 Useful Retail Tips" to retailers
- Cross promoting (cinemas & food court)
- Discount offers to employees at Centre in newsletters
- Food tastings/samplings
- Full tenant induction process
- Include retailers products in catalogues
- Inclusion in coordinated fair/expo - Casual Leasing
- Internal and external signage (eg. pylons)
- Invite retailers to industry lunches/dinners
- Joint Retailer / Centre Promotions
- Library of books & articles - circulate
- Link retailers with special CML activities

- Marketing plan updates to retailers
- Morning walk thru with Centre standards checklist each morning
- Mystery shopper reports
- Optimisation of trading hours
- PA announcements on retailer specials
- Post promotion retailer reviews
- Promote gift vouchers in Centres to Corporates
- Promote over lease line
- Promote tenant Casual Leasing at discounts to normal casual leasing
- Public Relations Centre Support
- Quality catalogues in our stands & info booths
- Regular sales
- Retailer category meetings
- Retailer Networking Opportunities
- Retailer watch list
- Rewards for top windows
- Sales analysis & ladders distributed each month
- Signage on perimeters of centre
- Shuttle bus from CBD to centre
- Special retailer promotion badges for info booth & CMO staff
- Spruikers
- Static displays
- Track to ensure retailer meetings (every 2 months)
- VIP nights