24th July 2007

Retail Tenancies Inquiry
Productivity Commission
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To the Inquiry Members

Overview shopping centre industry: for the Productivity Commission's consideration and for it to make logical decisions for a fully informed, open transparent market to operate, which is preferably self-regulating

This overview of the shopping centre industry has been carried out by me from:

1. An economic point of view;
2. A property economic point of view; and
3. A business economic point of view.

I have used the best benchmarking sources, research and reference material in the industry, from within Australia and overseas.

Instruction

I have been instructed by my clients to prepare an overview of the Shopping Centre Industry, which will illustrate:

1.0 It is not a fully informed, transparent market operating and why it is not an open, transparent market;

2.0 The consequences if this situation is allowed to continue; and

3.0 What must be done to address this situation.

This exercise I have carried out uses 4 Graphs <u>to pictorially and graphically assist the Productivity Commission</u> to understand what is happening in the Shopping Centre Industry from 1993/94 to today.

- **Graph 1 shows: the "average" business in the "average" shopping centre from 1998/99 to 2007 and the consequences of progressively increasing rental changes, which now make setting up or buying a business or franchise operation on "average" something that no-one might consider.**
- **Graph 2 shows: "average" rents across all Regional Shopping Centres when all "average" occupancy costs (gross rent as a % of turnover) were equivalent to 13.8% of turnover in 1993/94. This is depicted by data from the North Rocks shopping centre, when in 1998 the average rents were coincidently 13.8% of sales. This is compared and contrasted to accountancy based CCH**

Business Benchmarks (now MAUS); the "gap" between the two trend lines, being what was affordable and what on "average" was being paid across all categories.

- **Graph 3 depicts: "average" occupancy costs in all Regional Shopping Centres across the country in 2007, represented by Doncaster shopping centre, when in 1998 it's average specialty store gross occupancy costs were 18.1%. <u>Despite all reviews to the legislation, the introduction of S 51 AC of the Trade Practices Act the position has deteriorated for all stakeholders.</u> They are "locked" into their positions because it is not a self-regulating industry. The "gap" is much wider, despite the fact I have drawn in a line to allow for paying a "premium" of say 1½ - 3% more for a specific permitted use and higher traffic in a Regional Shopping Centre.**
- **Graph 4 shows: the consequences for investors, the industry, legislators and regulators, if critical decisions are not made and there is a sudden correction vs introducing common sense laws for the industry to "play by" and letting it "self-regulate".**

It should be noted that 96% of retail business is regarded as small business, and small business according to Price Waterhouse Coopers is worth A$4.3 Trillion[i].

This is one of three submissions I have been instructed to assist with, as a panel member, or to prepare on my own. My Web page, which has a CV attached, best describes my background, knowledge and experience.

This submission is primarily a Public Interest document. It does not seek to represent the interests of any particular "group" but, rather, to consider what is happening in the market; the consequences and possible outcomes for the stakeholders including: shareholders, family superfunds, landlords, tenants, franchisers, legislators, regulators, valuers and so on.

This exercise is an extremely difficult undertaking. It is difficult to communicate the problems succinctly and clearly to those who have had little to do with an industry that has many facets to it.

This submission does not address the questions raised directly with regard to the inquiry or the terms of reference but, instead, answers the questions that have been raised overall.

Confidential information removed

I have had insufficient time to get the balance and structure of this overview as I would like it, however, it accurately conveys the total overall position between landlords and tenants in Australia on the facts and data at my disposal.

I will be relying on many other submissions, which will lend weight to my own submission.

Background

A well-informed colleague advised me that, excluding retail property, the correction that took place in 1989/90 in a much smaller market at a smaller market capitalisation, saw $30 billion written off and the virtual demise of one of our major banks, namely Westpac.

Recently, three mezzanine finance companies have cost small, retired investors over $1 Billion, partially because the property industry per se is not a fully informed market operating.

These points are raised to remind the Productivity Commission of the consequences of what happens when a market does not operate freely and transparently.

In major shopping centres, vacancy rates seem low but we have had 17 years of economic expansion that excludes a downward or full economic cycle, which normally ranges for around 4 – 6 years. We are well into the growth part of this very long business cycle.

Retail property in Australia has never gone through a downturn as occurred in the United Kingdom (see attachment 1[ii], being a graph showing UK Rental Value Growth 1985 – 2000). Despite lease rental moderating factors like perpetual leases and market rent reviews, which we do not have in Australia, the UK saw all sector rentals decline by 20 to 40% from 1987 to 1992 until, by 2000, rentals were, on average, 10 – 20% below their 1987 peaks. One might argue, however, that the local property industry has grown well beyond the ASX for a considerable period and is propped up due to the structural rigidities operating due to failure to legislate and the behaviour of stakeholders.

While the Commonwealth and some states have no debt, the private sector is carrying significant levels of debt, which has been tabled below:

Item	1995	2001	2007	Source
Credit card debt	$5.9 billion	$16 billion	$40 billion	http://www.rba.gov.au/Statistics/Bulletin/C01hist.xls
Household debt	$205.7 billion	$427.4 billion	$1 trillion	http://www.rba.gov.au/Statistics/Bulletin/D02hist.xls Includes credit card debt.
National debt (balance of trade)			+ $600 billion	Recent press reports
Owed to ATO by small business			$7 billion	http://www.abc.net.au/worldtoday/content/2007/s1951679.htm

Over and above this, corporations including the Listed Property Trust, 'LTP' sector have used leverage (debt) to increase returns to shareholders which, in 1995, was 10% of less distorted valuations, but by 2005, had increased to 35%[iii] on average, but up to 60% on international property.

These factors, including debt financing, can and do bolster economic growth and shareholder returns and bring about lower unemployment levels but there is a time-line. The reverse will occur when positive leverage operates in reverse and economic conditions change.

Also, as at December 2005, LPTs including retail, commercial and industrial, represented 9% of the total market capitalisation and 7% of institutionalised asset allocation[iv]. These factors have seen the 'LPT' sector assisted by "average" occupancy costs having risen from 13.8% for all major regional centres in 1993/94 to 18% + (proj) in 2007.

For the "average" retail shop, trading at an "average" 40% gross profit before deducting operating expenses, wages, rent, depreciation (franchise fees) and risk reward, rent alone rose from a high 34.5% of a shop's gross profit to an estimated 46.25% on "average", including the retail chains who can relocate and sole traders who must accept what they are forced to pay.

One must conclude, therefore, that many small traders in the shopping centre industry are in trouble, with many barely earning "wages", let alone a return on their invested capital.

1.0 Is the property market operating as a fully informed, transparent market?

1.1 Shops, shopping centres and occupancy costs

Against the backdrop of higher and ever increasing debt levels, consumers and small business owners who are buying and opening businesses and franchised businesses carry out limited market research. "Warning signs" do not deter people, en masse, seeking to get into business. As in a bad marriage, however, one's capital gets married to the shopping centre and it destroys them, both financially and, often, personally, often with a wider impact on friends and family.

Graph 1, attached, shows four bar graphs. They illustrate the percentage "on average" allocated to a businesses expenses of the "average" retail shop, including wages, advertising, depreciation, rent and "other expenses" and risk reward.

The original analysis was prepared for a professional journal entitled "Issues Affecting Shopping Centre Market Rental Values" by Malcolm Macrae – The Valuer & Land Economist, Vol 34 Nov 4 1996.

The first bar graph on Graph 1 shows an ideal scenario from Mr Macrae's research, leaving the proprietor with sufficient incentive (risk reward) for a return at "business risk" on invested capital. Whilst the research was carried out in 1996, the percentages have hardly changed as businesses adjust to conditions within their reasonable control.

The second, third and fourth bar graphs illustrate what has happened to the "average" retail shop, as rent has increased to around 18.5% of turnover.

Rent has simply replaced proprietor's return, leaving no or negative return. There is no incentive to own a retail shop in a regional shopping centre. There is no provision for franchise fees in Mr Macrae's model, but in a high performing franchise system, if they pass on savings in bulk purchasing, achieve higher sales (than the average) store if franchise fees are reasonable they might be covered.

The market is not working.

From 1998/99 to 2002/03, productivity levels of the "average" retail shop increased by $19,000, of which some 84% or $16,123 went directly to the landlord; none had been apportioned to cover all other operating expenses[v]. Proper accounting convention would see proper apportionment of revenue allocated to pay the rent (and all other expenses), to ensure the business is operated to average standards as set out in the first bar graph in Graph 1.

Of that productivity increase, after the Fair Trading Inquiry, given the average shop has a 40% gross margin, another 44% viz. 40 + 44% = 84% must have been coming from somewhere, let alone pay staff, accountants, banks, insurance, repairs and maintenance and so on. Proprietor equity possibly viz. savings, drawing down on equity in the home?

By 2007, deferred payment of tax revenue owed to the Australian Tax Office, 'ATO' (or to the Australian public) by small businesses[vi] was $7,000,000,000 and one might ask whether there is a co-incidence here?

Given that the "average" occupancy cost was 13.8% of all specialty shops in all regional shopping centres in 1993/94[vii] and the projected "average" occupancy cost today is 18.1%, I have two reports from two shopping centres, produced on 26/10/1998 for North Rocks and Doncaster, whose "average" occupancy costs coincide with the total industry.

Graphs 2 & 3, produced from attachments 2 & 3, are representative samples that best illustrate what has been occurring, what is occurring, and what will continue to occur in each centre until the legislation is fixed. The significant "range" within the "average" for each specialty shop category illustrates this, whereas if the sample were bigger viz. the Jebb Holland Dimasi for all 12,500 stores in all regional centres, the large peaks and troughs would be more even.

A smaller sample records the disparity between what individual businesses and categories should be paying and what they are paying better.

It must be noted that, trading in a regional shopping centre, one might achieve higher sales and so, in some cases, there are economies of scale and businesses can afford to pay rent that is a few percentage points higher on average. But every case is different and so size, location, permitted use and competition in centres is all-important criteria.

Each category is benchmarked against the best-regarded accountancy reference base, namely CCH Business Benchmarking (now MAUS Business Benchmarking)[viii].

The "gap" between the upper trend line and the lower trend line is what "on average" the business is arguably being deprived in terms of reasonable return by way of "overcharged" rent, with a proviso that in big generating traffic centres there is a premium of, say, 1½ to 3% for some categories by way of higher rent which would be reasonable.

Graph 2 is a representative sample of what specialty shops in regional shopping centres were paying in 1993/94. The average occupancy costs were 13.8% for all categories at that point in time. This is represented by data for the North Rocks shopping centre as at 1998.

The arrows drawn on the top trend line show the direction in which all category rents moved and that by 1998/99 they had increased, on average, to 14.8% of turnover, by 2002/03 to 16.6% and that they are estimated to be over 18% + of turnover as at 2007. Clearly, this is indicative of a market that is not fully informed and transparent operating.

Graph 3 is indicative of what all specialty shops are paying on "average" on the top trend line in 2007, represented by Doncaster Shopping Centre where, in 1998, all specialty shops were paying 18.1%. These figures are also compared to the CCH Business Benchmark average.

An imputed trend line (in the middle) has been inserted, showing the “premium” rent one might pay for a higher performing business in a premier performing regional centre, provided the tenancy mix is not saturated and the centre is being properly managed.

In Doncaster for example, there were 20 fashion shops competing for available trade and on “average” they were paying a 20% occupancy cost; arguably 11 – 13% is long-term and sustainable if tenancy mixes are properly managed. In this instance, it is arguable whether an overrepresented woman’s fashion category could trade profitably; a factor under the landlord’s control.

Graph 3 clearly shows the “gap” between reasonably affordable rents and the extent by which each category’s rent is distorted by way of additional rent being charged which represents, say, “deprival value” to the weaker party’s return.

Given that shopping centre managers measure occupancy costs monthly, they can immediately:

- measure and monitor centre occupancy costs against the best benchmarking sources available;
- monitor the consequences of too much introduced competition;
- measure and monitor performance levels and benchmark closures in other centres in a group; and
- measure and monitor business rents from the time an lease offer is made and the terms of that offer.

It is surprising the industry has adopted a “culture” not to rectify these imbalances, with its knowledge base.

What Graphs 2 & 3 illustrate are the disproportionate rent being paid, on “average”, by each business, even in 1993/94, as is illustrated by the North Rocks model.

Before the new business proprietor has started trading, statistically the business has failed due to structural adjustments that are necessary viz. rent agreed to via informed negotiation.

This is abject failure of a fully informed market to operate. Had the Fair Trading Recommendations in the Reid Report been robustly implemented, including the recommendations of uniform tenancy legislation, this and 13 other reviews and inquiries might not have been necessary.

1.2 Valuers to value shopping centres at “passing rent levels”

The industry, I am informed, instructs asset valuers to arrive at capital value and they must use “passing rents”. Asset valuers become beholden to major shopping centre groups for professional fee generation, including their terms of appointment.

This breaches the International Valuation Standards ‘IVS’, by not reverting “passing” rents back to current market rent which, in turn, inflates asset value and could be fraudulent.

Graph 4 clearly shows the consequences of this, which is enhanced by the industry, having used “financial engineering” and leverage to bolster returns in a lower interest rate environment.

Graphs 2 & 3 are representative samples of the whole market in 1993/94 and 2007, showing already high occupancy costs of 13.8% increasing to over 18%.

Market failure is inevitable unless valuers follow ‘IVS’ and legislation is introduced, taking away the unfair leverage landlords have at lease renewal time. As long as there is an “incentive” to cheat, it appears the industry will habitually continue to do so. And so there comes a time for government intervention.

In addition, it is well known that the shopping centre owners, who have access to a significant amount of data and information, deliberately withhold that information from valuers, making their jobs as hard as possible.

One does not need to elaborate on what the consequences of this behaviour might be, but it does illustrate the level of fanaticism and the lengths the industry is willing to go to keep the uninformed market operating.

The “value” is created by market rent being capitalised to produce “market value”; not “market value” being “engineered” via creative valuations due to instructions which might lead to fraudulent outcomes. Then rentals are being charged to creatively support or “prop up” this engineered value.

In my opinion, there are many reasons for this status quo which explain why it is not a fully informed market operating.

1. Culturally, we do not like to face up to “bad news” stories. We do not like to face up to facts.

2. One hardly ever talks about “rent”.

3. “Rent” appears to have an apparent mythical quality; it only ever goes up, unlike the price of wheat, barley, coal, gold, oil, carrots, livestock and the Australian Stock Exchange which can all rise and fall according to market forces.

4. Armed with all the knowledge, power and data, aspirant business owners pay the “rent”, which start at levels which shopping centre owners know led to the business failure of the previous business. Graphs 1 – 3 clearly show that, statistically, at the “average” rent being charged in regional shopping centres, the sole operator (with all one’s eggs in one basket) cannot realistically expect to survive. After the lease is signed, one has no recourse. One is locked into a 5-year negative cash flow; there is no market review opportunity to adjust the rent, say, for the introduction of similar businesses until one’s equity runs out. It is a fatal marriage.

5. At the end of the 5-year term, the business has not yet fully amortised its fixtures and fittings. The Australian Taxation Office, ‘ATO’, allows eight years. The “business” owes the proprietor, as the assets have not been fully depreciated. Shopping Centre owners may demand another fitout (even sometimes 2 years before the end of a lease by the landlord), further locking the family’s capital (equity in the family home) into the fatal marriage with the shopping centre; at renewal the business proprietor is now completely vulnerable, the shopping centre owner may demand a certain rent (no disclosure document will save him or her); there is no prescriptive requirement to allow this person to write off the balance of the fitout; There is no lease dispute resolution mechanism to offer a new lease at “market rent”, or to go to mediation, or failing that to have an expert determine the “current market rent”.

6. As Graphs 1 – 3 irrefutably indicate, the shopping centres, as they have grown in Australia (US regional centres are on average 45,635 M2, Australian centres are around 75,250 M2 and, as recently reported, some are seeking to grow to 200,000 M2), give owners the opportunity to monopolise significant trade areas and destroy existing shops and smaller strip and neighbourhood shopping centres. Then, using the threat of non-renewal, skilled leasing professionals "gazump" the business owner whose assets are tied to the centre into accepting impossible lease terms[ix]. Unless there is an "option" which rarely, if ever, is given or a prescriptive lease rent dispute resolution mechanism, one has no recourse.

This demonstrates what is occurring in a nutshell. Other than inviting any member of the Productivity Commission to invest their superannuation nest egg in a business in a shopping centre and to join the "queue", further explanation is not necessary.

2.0 The consequences if this is allowed to continue

On the 19th June the Shopping Centre Council 'SCC', representing the interests of the major shopping centre groups, sent out a media release which stated that in the last 10 years there have been 13 reviews of state and territory legislation that the last decade, following the Fair Trading Inquiry, has seen the introduction of section 51 AC of the Trade Practices Act. It also stated that the industry is overregulated, the regulations are too complex and there are too many jurisdictions adding to the cost of doing business.

Despite this, and from Graphs 1 – 3, it is irrefutable that rents are higher and the life cycle of the average retail business shorter.

Now, had the recommendations of the Fair Trading Inquiry been implemented, it would have gone part of the way to dampen the disparity of landlord and tenant expectations occurring today.

The Reserve Bank of Australia (and other central banks) must reign in debt. There is no cushion to absorb a high percentage of extreme occupancy costs and any change in the direction of the economy which could be pandemic following falling liquidity, change in consumer confidence or terrorist attack.

The effect of "financial engineering" on shareholder equity, using borrowed funds to bolster returns, operates in reverse during periods of downturn. It must either be controlled by letting the market operate as a market should, with a downturn over a period of time, or there will be a sudden correction.

This is a direct consequence of no lease/rent flexibility and "engineered rents" being negotiated.

3.0 What must be done to fix it?

The following table represents areas the Productivity Commission might consider to bring about a fully informed market to operate, and to avoid the necessity of further inquiries:

Area to review	Explanation
Market be allowed to operate	Known "pressure points" should be taken out of the equation and or neutralised, which gives the one party undue leverage over the other party.
Too much unnecessary legislation	Like the 'SCC' submitted in their press release, there is too much unnecessary legislation. The legal fraternity love it; commerce becomes embroiled in legal point scoring, which sees long and

	convoluted cases out of "point scoring" and the true recipients in commercial disputes get no reward from the funds they put up when seeking legal recourse.
"Rules" are needed in key areas	This will force open, impartial, transparent "negotiating" and "higgling" in the market[x].
Valuers must follow the IVS[xi]	Valuers must be compelled to follow the standards set by the International Valuation Standards Committee.
Media's role	The media must take up the stories that come out of the shopping centre industry, and the financial journalists and media commentators must tell it as it is.
Disclosure statements are not a panacea	Disclosure statements alone will not fix these issues. It is an easy "soft option" for key decision makers to make and to pass on the blame to others. Disclosure Statements is only one of many things that should be addressed.
Flexible leases, lease negotiation and prescriptive lease rent dispute resolution	It is illogical for lease tenure, or the total tenure (with options) to be shorter than the reasonable time to amortise set-up costs. It is also illogical (other than opportunistic leverage) for shopping centre owners to significantly change their centres in less than say 15 to 20 years. Why then given shopping centre owners and managers who screen their tenants, do not offer tenure to cover a logical period other than for unfair bargaining purposes? There must be lease flexibility for changes in tenancy mixes and or market conditions. Why no mid-term and end of lease market review opportunities; even if they are not used? It will take this unfair leverage away form the stronger party. **Even these prescriptive provisions were in the legislation, as a deterrent for fairer bargaining, it would force willing informed fully prudent and not overly anxious parties to negotiate fairer terms and conditions.**
Landlord's right to properly manage tenancy mixes	This is a given, all that is necessary and that is to take responsibility and manage.
Outgoings	This is a contentious issue and must be fixed.
Shopping centre owners must take responsibility	Shopping centre owners and managers screen their tenants, they can choose whether to offer a tenant a lease (or not). One of the key points raised during the Fair Trading Inquiry, was that "retailers needed training". The rent was not too high, sales were too low. If the retailer is not competent, do not offer them a lease. **Shopping centre owners must take responsibility for the decisions they make. The difference between a "good" tenant and a "bad" tenant, is not because they pay their rent or not, but the reasons why they cannot pay their rent? The consequences of a market not operating.**
One party has too much information	Using BASS, all sales data excluding GST can be collected via an independent third party and disseminated in a proper form.

Conclusion and recommendations

The failure by the Federal and State Governments to implement the Fair Trading Inquiry recommendations has seen the already distorted 1998 market (see graph 2) explode, as represented in Graph 3, which represents what an "average" regional shopping centre's category occupancy costs in today's market viz. paying 18.5% of turnover.

The gap between the high and low is the distortion between what is being paid across all regional shopping centres in Australia and what is fair and reasonable.

The imputed line in Graph 3 represents a 1.5 – 3% premium which a high performing store in a typically higher performing regional centre might pay, provided there is not "saturation" of the tenancy mix.

Shopping centre owners and managers receive monthly trading figures from most shops. They issue leases, manage tenancy mixes and know exactly what each retail shop is paying as a percentage of turnover. This can be benchmarked, measured and monitored. They can probably predict when business failure can and will occur because they will also have a statement of the trader's assets and liabilities. This is equivalent of one party "subsidising" the other's business.

Owners and managers must also take responsibility for their own actions; they cannot blame everyone else.

Shopping centres in Australia have continued to increase in size to 75,000 M2 on average, so as to have their monopolistic influences over a trade area. What is the justification to extend and expand the centres? The distorted "market rent". This destroys strip shops and smaller shopping centre businesses and investment properties.

Management fees are also a percentage of all revenue collected (rent, outgoings, promotion fees, utilities). It is a "cost plus" culture; not market based.

Retailers will seek to avoid bankruptcy and will, logically, raise their prices. The consumer is paying and has not had the benefit of cheaper imports (which is another failure of the operating market).

Systematically, the "system" is failing because it is not an open, informed market operating. There are allegations (and academics confirm) that the major groups have "arranged" sales between them to "inflate" asset values, drive down yields, then call for portfolio revaluations. I do not need to elaborate what the implications of such an allegation means but Trevor Sykes, a highly regarded journalist in the AFR, covered the failure by Governments to prosecute corporate officers for systematically breaching the Corporations Law in his article "An Investor Impersonation" 24- 25th June 2006.

Valuers who accept instructions to value and capitalise rental income streams in Australia are breaching the International Valuation Standards, which further "props up" the system[xii].

A correction in this market will occur: it is not a matter of "if" but "when". If the total value of the LPT industry is worth 9% of the country's stock market capitalisation and, say, the retail sector is worth 50% of that and other sections of the retail property sector are worth a total of 6% of our national wealth, a 1% correction over 4 – 6 years would not register as a blip on the nation's Gross Domestic Product indicators.

On the "flip side", will be a pick-up of growing wealth of small business and innovation, noting that 96% of retail businesses are defined as "small business", less the hidden costs associated with the dysfunctional industry (medical, unemployment benefits, accelerated write-off and depreciation of failed businesses, the cost to the community of funding failed business owners on government pensions, divorce and so on).

In short, a failure by legislators to legislate and regulators to regulate is the primary cause of this debacle. If this country is going to play in the world arena of economics and commerce, it must get its house in order as far as openness and transparency are concerned.

Under AASB 138, accountants must record the positive and negative values of "intangible assets" under a businesses' balance sheet. Leases with limited tenure left, too little tenure offered, per se, to write off set-up costs and rent disproportionate with business opportunity must be regarded as negative value to a business. Of course, the opposite is true if the site goodwill (the landlord's asset) is separated from that of the business, which is determined by fully informed bargaining and negotiation of lease and rent terms.

Unless Australia is seeking to subvert and ignore International Accounting Standards, 'IAS', it must subscribe to and follow these standards.

With proper legislation in place, Australia could easily:

- **have the best "self regulating" system in the world;**
- **whilst it might be exporting some of its intellectual property of the shopping centre industry world-wide, it is not doing so based on the whole truth;**
- **write simple, effective legislation giving reasonable tenure and lease rent dispute resolution mechanisms that would see the culture change; and**
- **introduce simple, effective regulation and even-handed enforcement with disputes settled in "equity" that would also see the culture change.**

In short, simple effective legislation would change the culture of the industry overnight. Even shopping centre managers might enjoy going to work!

Having known these facts following the Fair Trading Inquiry, and having to revisit these areas, is a clear indication of substantial failure of the market to operate.

None of this submission is confidential. It is based on fact.

I am available to appear before the members of the inquiry in person to answer any queries or questions.

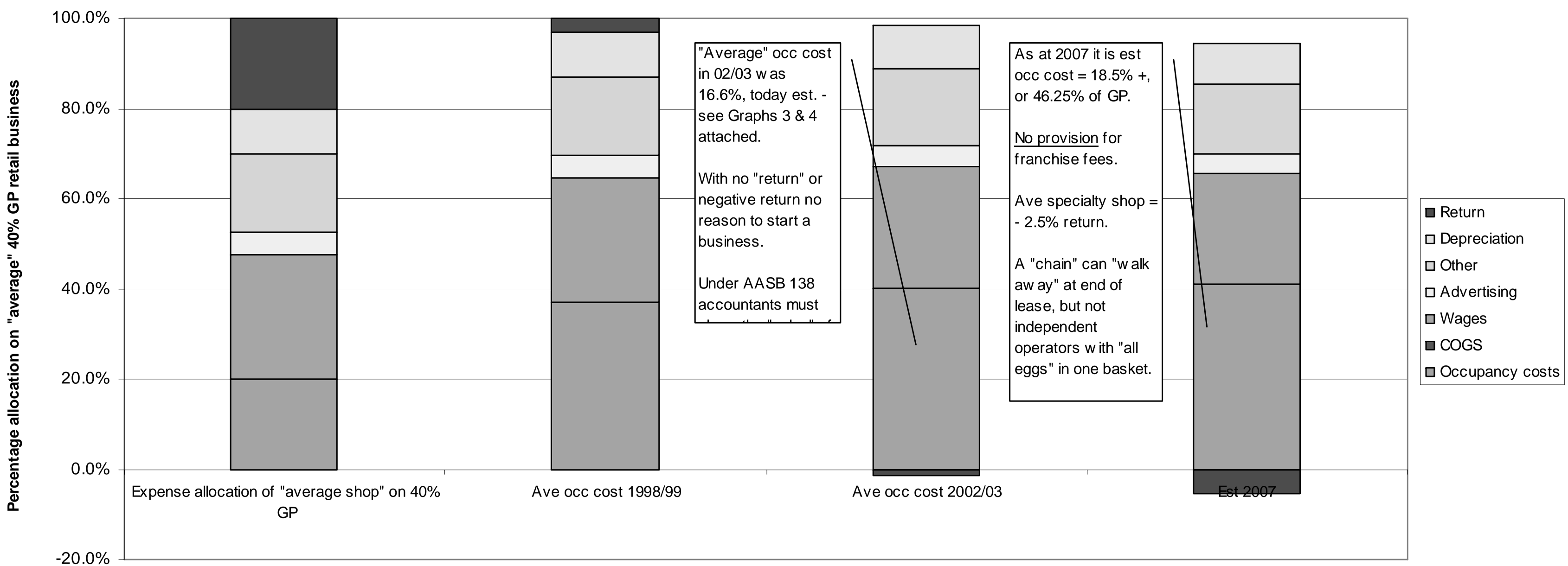
Sincerely

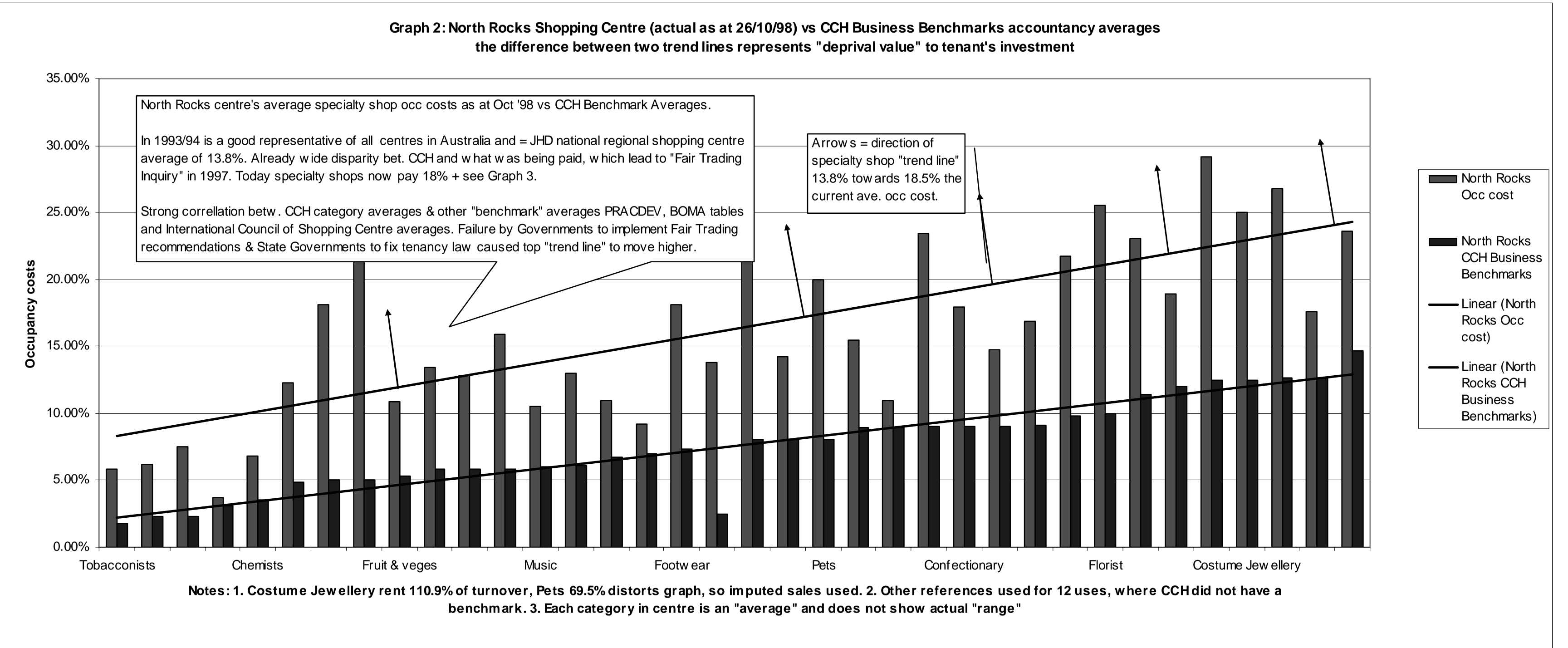
Don E Gilbert
Specialist Retail Valuer and Accredited Arbitrator
Val Reg No 2652

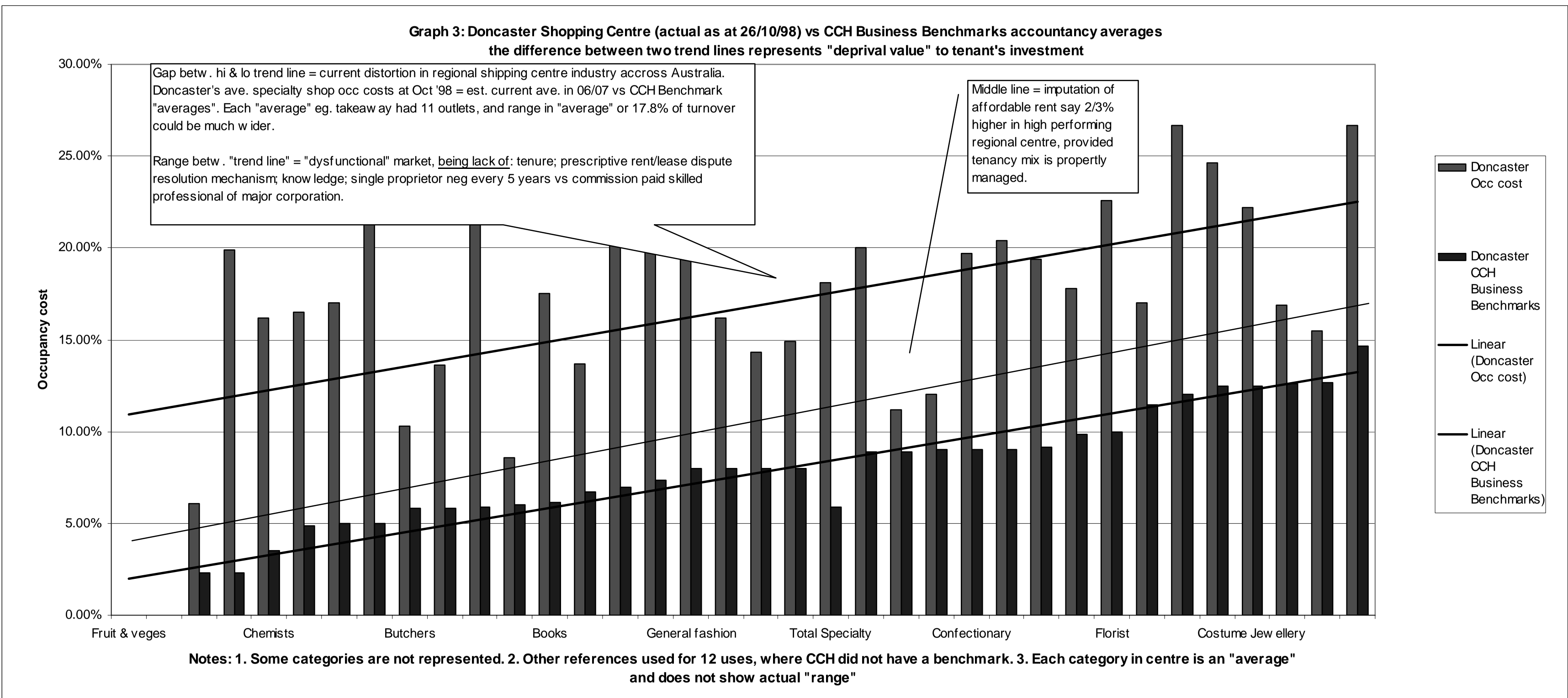
Encl

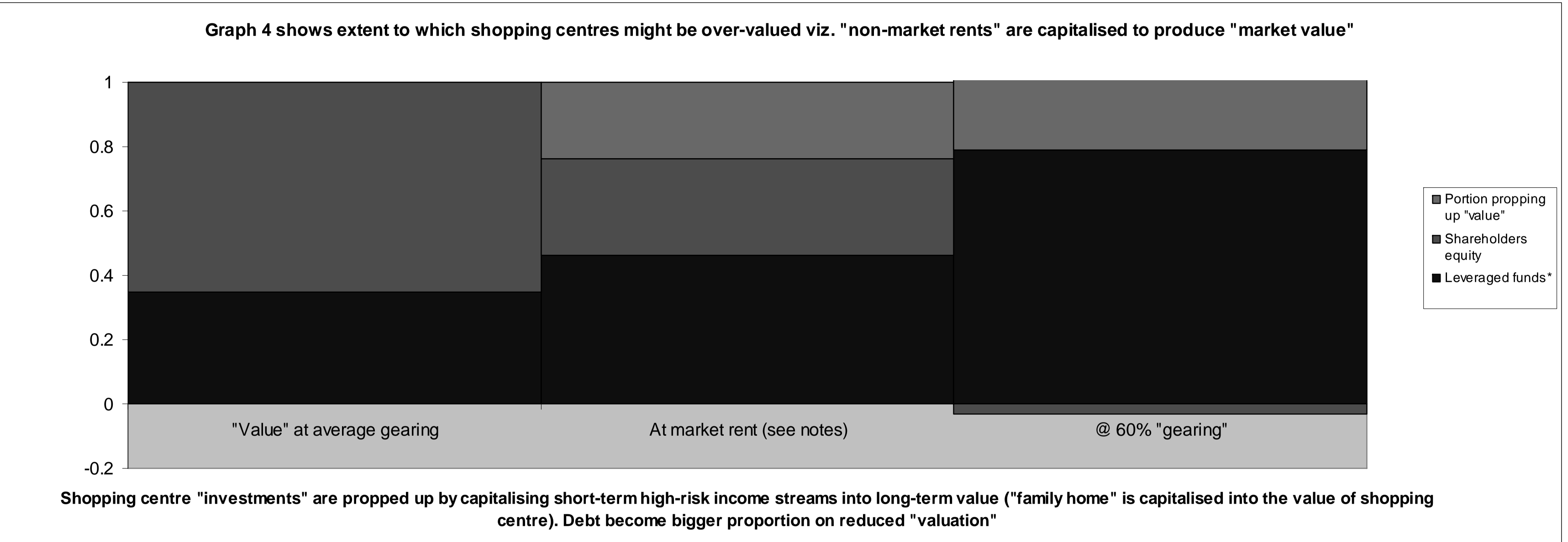
Graphs 1 - 4

Four attachments


Graph 1: Percent of gross profit margin allocated to major operating costs of an "average" retail business: average specialty shop in "average" Regional Shopping Centre (including chains) excluding franchise fees makes negative return.
100.0%
80.0%
60.0%
40.0%
20.0%
0.0%
-20.0%
Percentage allocation on "average" 40% GP retail business
Expense allocation of "average shop" on 40% GP
Ave occ cost 1998/99
Ave occ cost 2002/03
Est 2007
"Average" occ cost in 02/03 was 16.6%, today est. - see Graphs 3 & 4 attached.
With no "return" or negative return no reason to start a business.
Under AASB 138 accountants must
As at 2007 it is est occ cost = 18.5% +, or 46.25% of GP.
No provision for franchise fees.
Ave specialty shop = - 2.5% return.
A "chain" can "walk away" at end of lease, but not independent operators with "all eggs" in one basket.
Return
Depreciation
Other
Advertising
Wages
COGS
Occupancy costs
Allocation of gross profit to all operating expenses including return: Ref "Issues Affecting Shopping Centre Market Rental Values" by Malcolm Macrae – The Valuer & Land Economist, Vol 34 Nov 4 1996


Graph 2: North Rocks Shopping Centre (actual as at 26/10/98) vs CCH Business Benchmarks accountancy averages
the difference between two trend lines represents "deprival value" to tenant's investment
North Rocks centre's average specialty shop occ costs as at Oct '98 vs CCH Benchmark Averages.
In 1993/94 is a good representative of all centres in Australia and = JHD national regional shopping centre average of 13.8%. Already wide disparity bet. CCH and what was being paid, which lead to "Fair Trading Inquiry" in 1997. Today specialty shops now pay 18% + see Graph 3.
Strong correllation betw. CCH category averages & other "benchmark" averages PRACDEV, BOMA tables and International Council of Shopping Centre averages. Failure by Governments to implement Fair Trading recommendations & State Governments to fix tenancy law caused top "trend line" to move higher.
Arrows = direction of specialty shop "trend line" 13.8% towards 18.5% the current ave. occ cost.
Occupancy costs
35.00%
30.00%
25.00%
20.00%
15.00%
10.00%
5.00%
0.00%
Tobacconists
Chemists
Fruit & veges
Music
Footwear
Pets
Confectionary
Florist
Costume Jewellery
North Rocks Occ cost
North Rocks CCH Business Benchmarks
Linear (North Rocks Occ cost)
Linear (North Rocks CCH Business Benchmarks)
Notes: 1. Costume Jewellery rent 110.9% of turnover, Pets 69.5% distorts graph, so imputed sales used. 2. Other references used for 12 uses, where CCH did not have a benchmark. 3. Each category in centre is an "average" and does not show actual "range"


Graph 3: Doncaster Shopping Centre (actual as at 26/10/98) vs CCH Business Benchmarks accountancy averages
the difference between two trend lines represents "deprival value" to tenant's investment
Gap betw . hi & lo trend line = current distortion in regional shipping centre industry accross Australia. Doncaster's ave. specialty shop occ costs at Oct '98 = est. current ave. in 06/07 vs CCH Benchmark "averages". Each "average" eg. takeaw ay had 11 outlets, and range in "average" or 17.8% of turnover could be much w ider.
Range betw . "trend line" = "dysf unctional" market, being lack of: tenure; prescriptive rent/lease dispute resolution mechanism; know ledge; single proprietor neg every 5 years vs commission paid skilled professional of major corporation.
Middle line = imputation of affordable rent say 2/3% higher in high performing regional centre, provided tenancy mix is propertly managed.
Occupancy cost
30.00%
25.00%
20.00%
15.00%
10.00%
5.00%
0.00%
Fruit & veges
Chemists
Butchers
Books
General fashion
Total Specialty
Confectionary
Florist
Costume Jew ellery
Doncaster Occ cost
Doncaster CCH Business Benchmarks
Linear (Doncaster Occ cost)
Linear (Doncaster CCH Business Benchmarks)
Notes: 1. Some categories are not represented. 2. Other references used for 12 uses, where CCH did not have a benchmark. 3. Each category in centre is an "average" and does not show actual "range"



Graph 4 shows extent to which shopping centres might be over-valued viz. "non-market rents" are capitalised to produce "market value"
1
0.8
0.6
0.4
0.2
0
-0.2
"Value" at average gearing
At market rent (see notes)
@ 60% "gearing"
Portion propping up "value"
Shareholders equity
Leveraged funds*
Shopping centre "investments" are propped up by capitalising short-term high-risk income streams into long-term value ("family home" is capitalised into the value of shopping centre). Debt become bigger proportion on reduced "valuation"

[i] "*The total value family-owned businesses in Australia in 2006 was A$4.3 trillion - a value four times greater than annual GDP and greater than the combined capitalization of public companies listed on the Australian Stock Exchange plus all funds under management"* – ref http://www.narga.com.au/content/files/documents/2007/nrPWC_NARGA_OVERVIEW_20070702.pdf

[ii] "An Evaluation of the Policy Implications for the UK of the Approach to Small Business Tenant Legislation in Australia" by Prof Neil Crosby, Department of Real Estate Planning, University of Reading Business School, Aug 2006

[iii] "The Changing Risk Profile of Listed Property Trusts" by Prof Graeme Newell, Australian Property Journal Sept 2006, Vol 39/No 3

[iv] "The Changing Risk Profile of Listed Property Trusts" by Prof Graeme Newell

[v] Jebb Holland Dimasi regional shopping centre averages

[vi] *"Close to 70 per cent of that $10-billion is owed by small businesses. And it seems it's no coincidence that they've decided not to remit the GST"* http://www.abc.net.au/worldtoday/content/2007/s1951679.htm

[vii] JHD Regional Shopping Centre Averages 1993/94

[viii] One should note there are other benchmarking references such as Pracdev Hartley, and overall there is a strong correlation between accounting based benchmarks.

[ix] "An Evaluation of the Policy Implications fort the UK of the Approach to Small Business Tenant Legislation in Australia". Professor Neil Crosby pg "The use threats of prospective retailers waiting in the wings and the lack of the right to renew to replace tenants or force them to pay higher rents, which may include part of their goodwill to secure their position. Where the option to renew exists, tenants can, under the RLA, have their rents fixed by specialist valuers, appointed by the SBC, at the market rent as previously defined."

[x] Decision of Scott LJ in Robinson Brothers (Brewers) Ltd v Houghton and Cheser-Le-Street Assessment Committee [1937] 2 KB 445 at 468 – 471

[xi] House of Representatives Standing Committee on Industry Science and Technology pg 794, 24th January 1997, Mr Briggs, GM Westfield *"First of all, a lot of adjustment of property values happens all the time, both up and down. It happens with the Westfield Trust. It is common knowledge. it happens with Lend Lease."*

Mr Richard Evans *"It is not reflected in the rents, though is it?"*

Mr Briggs *"Generally speaking, yes, because the value of the property is driven by the rent."* and *"The value of the business is driven by the income you can earn and by the bottom line profit you can make. Our industry is no different from any other. That is just one of a number of criteria that a valuer would put into place – but it is of primary importance. If there is a suspicion that the rentals will not be maintained,* ***then the valuer is duty bound to base his valuation on that instinct or knowledge of premise.****"* [emphais added]

[xii] IVS International Valuation White Paper, "The Valuation of Real Estate Serving As Collateral for Securitised, Instruments" – "Valuers examine the market to ascertain the Market Rent generated by the real estate, backing a securitised instrument, or the Market Rent to be generated by a prospective property or properties, intended to back a securitised instrument. The Valuer should investigate any information, provided by a portfolio manager about prospective contractual rent, to ensure that the data is indeed accurate. **Estimates of contract rents, which are unrealisable, are engineered rents; valuations based on engineered rents will not result in Market Value"**