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Retail Tenancies Inquiry
Productivity Commission
PO Box 80
Belconnen
ACT 2616
retailtenancies@pc.gov.au

Retail Tenancy Leases in Australia

Introduction

Coles Group Limited appreciates the opportunity to contribute to the Productivity Commission's deliberations on the retail tenancy market – the examination of concerns expressed by some small businesses and their industry groups that they are being exploited in their dealings with shopping centre management, and more general concerns about the disparity between the retail tenancy laws across jurisdictions.

As indicated in the Commission's call for public submissions, this is not a new area of inquiry, nor one where Governments have been unresponsive, with various legislation enacted and further amendments to the *Trade Practices Act* currently being considered by Federal Parliament.

Coles is not covered by any Retail Tenancies Legislation and the impact on the group, as a result of any changes where Coles acts as landlord is minimal. Therefore Coles does not believe it appropriate to comment on behalf of those retailers who may be more affected, other than to highlight that consistency across the states would provide for easier understanding, cheaper administration costs and fewer areas for dispute or debate.

Coles recommends caution when considering further regulatory impost on the commercial negotiations between shopping centre owners and retailers, to avoid any unintended consequences such as increased costs to consumers. However the company does believe that there is room for clarifying landlords' responsibilities, particularly in relation to disclosure statements, and harmonisation between jurisdictions.

Discussion

In the context of the retail tenancy leasing market, Coles is both a landlord and shopping centre developer, and an anchor tenant. Coles also owns and leases standalone, mixed use and strip shopping sites.

Coles has 746 supermarkets and 448 discount department stores, and over 1,000 specialty and convenience stores. The average size of the supermarkets is 2,821 m² with some 231 supermarkets located in sub-regional and regional shopping centres. The remainder are either freestanding or located in local and neighbourhood shopping centres. Leases and options can extend out to 40 years. The annual lease expenditure is in the order of \$1.2 billion pa across the entire portfolio.

Coles' involvement in new shopping centres varies. A developer might approach Coles and invite it to be a tenant or alternatively, Coles might approach a shopping centre developer to encourage a development in an area and negotiate an anchor tenant agreement. Additionally Coles might choose to develop a centre itself.

Each year the company invests over \$400 million in new stores, replacement stores, major refurbishments and shopping centre acquisitions or developments. Shopping centre developers with which Coles has anchor-tenant agreements invest considerably more.

Given that Coles is primarily a retail business rather than shopping centre manager, it frequently sells the shopping centres it develops and leases back space for its various brands. This usually occurs a few years after the centre has opened, when all specialty shop spaces have been let and have proven viable, and the centre has established itself as a shopping destination.

Consequently, the success of Coles' operations is usually intertwined with the success of the specialty retailers and shopping centres more generally.

Coles is aware of concerns expressed by small retailers that they pay considerably more per square metre than the major supermarket chains. This would seem a natural consequence of the economies of scale and the other benefits brought to a shopping centre by a major supermarket. To illustrate, the following outlines factors influencing the leasing arrangements entered into by Coles.

Coles leasing agreements with shopping centre owners are influenced by the large areas leased, the high probability that the lease will be secure and run for decades, the ability of the supermarkets in particular to draw large numbers of customers to the centre each day, the position in the centre and the amount of shared risk in the development. The tenure of the supermarket lease and options is usually well beyond the payback period of the development, while the churn rate of smaller stores is considerably higher.

Consequently, supermarkets are sought as anchor tenants – they occupy large spaces for a long time, invest heavily in marketing, draw large numbers of customers regularly to the facility and have a relatively low call on centre management resources for the floor space occupied.

The ability for Coles' supermarkets to underpin the viability of a shopping centre enhances Coles' ability to negotiate a reasonable lease. Conversely, Coles could not countenance entering a supermarket leasing agreement that imposed the rates similar to those of the smaller specialist retailers given that supermarkets are a high volume-low-margin business.

In establishing new shopping centres, it is important that the total offer be attractive to customers. While supermarkets provide a significant draw card providing the platform for a regional shopping centre, specialty shops offer the variety that when combined with large chains offer the retail choice consumers prefer¹. It is in Coles' commercial interests to be located in a healthy and vibrant shopping environment, where all parties can benefit from the traffic and sales generated.

Rents in terms of dollars are struck on market forces ie high profile, high turnover and high traffic sites attract higher rents, but we consider there should be far more visibility for tenants with respect to the calculation and apportionment of outgoing charges.

Coles recommends caution when considering further regulatory impost on the commercial negotiations between shopping centre owners and retailers, to avoid any unintended consequences such as increased costs to customers as a flow on from increased rents or cost to retailers. However the company does believe that there is room for clarifying landlords' responsibilities, particularly in relation to disclosure statements, and harmonisation between jurisdictions.

Coles considers all landlords should be responsible by law for the following, no matter how large the tenant:

1. Land tax may only be calculated on a single holding basis, and shall not impose additional costs to tenants due to the landlord holding land in a trust structure
2. The landlord should always be obliged to keep the premises structurally sound and waterproof
3. The landlord should always be obliged to make full disclosure as to how outgoings are calculated
4. The tenant should not have to indemnify the landlord for any loss or damage not caused by the tenant.

Coles believes there is a case for greater consistency across jurisdictions.

As the Commission's Issues Paper indicated, there are a number of Acts and Regulations in each State and Territory, apart from the provision of the Trade Practices Act, which seek to facilitate fair dealing and competition in leasing arrangements. Unfortunately the inconsistencies and overlap across jurisdictions creates uncertainty and increases administration, legal and other costs.

¹ Australian national Retailers Association National Survey released 13 July 2007

Specific examples or inconsistencies are:

- Whether the Act applies to that tenant in that State (the thresholds and criteria are different for each State/Territory)
- How outgoings are to be calculated including whether land tax is payable
- The extent of the landlord's responsibility in keeping the premises structurally sound and waterproof
- Whether a release is granted to the assigning tenant upon assignment
- When disclosure statements must be given to prospective tenants, the form in which the disclosure statement must be given and the issues that arise if none is given
- Whether the landlord's legal costs are payable for the drafting of the lease
- Whether the tenant must be granted a guaranteed minimum term (usually of five years)
- Whether there are limits placed on the tenant's liability when in possession of the premises
- How turnover rent is calculated and how sales figures are dealt with in the landlord's hands
- The type and frequency of rent reviews
- Whether contributions to sinking funds are necessary
- Whether payment of key money is illegal
- Whether there is statutory protection when the tenant has not exercised its option to renew the lease correctly
- For how long and on which days the tenant must trade
- How security deposits and bank guarantees are to be held by the landlord
- Whether rights of the tenant (including tenure) are protected upon the premises being damaged, and
- How the tenant is protected in the case of relocation in a shopping centre
- At present, businesses can come within the ambit of retail tenancies legislation in some States and Territories, but not in others.

Uniform legislation covering these issues is needed. For instance, one form of disclosure Statement should be settled with clear penalties stated for a landlord's and assigning tenant's failure to give a disclosure Statement or where a disclosure Statement is inadequate or late.

The variances in retail tenancy legislation across each jurisdiction impose unnecessary costs on business and ultimately customers. These include:

- Sizeable legal costs in engaging external consultants in each jurisdiction as well as internal legal costs to ensure compliance with each State's legislation.
- Occasional payments to landlords to obtain releases upon assignment of the lease when the business in question is not technically defined as a 'retail tenant'.
- Penalties incurred for failure to provide adequate disclosure statements to sub-tenants and assignees and dealings with landlords who have failed to issue disclosure statements.
- Costs in calculating outgoings in accordance with retail tenancies laws as well as clarifying calculations of outgoings with landlords who need not make full disclosure of those calculations
- "Hidden overcharges" as a result of complexity of calculating and administering outgoings
- Audit requirements (which tenants pay for) that differ from state to state and are imprecise in what they are trying to achieve

A more uniform and consistent approach to retail leases across all jurisdictions would significantly reduce the regulatory compliance burden on business, increase certainty and deliver a more efficient retail tenancy market.

Yours sincerely



Pat Wilson

Government Affairs Adviser
Corporate Affairs