Productivity Commission Study into the Relative Costs of Doing Business in Australia: Retail Trade Industry

Submission by the

Shopping Centre Council of Australia

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1.0 Executive Summary

Thank you for the opportunity to provide a submission on the Productivity Commission's Issues Paper on its *Study into the Relative Costs of Doing Business in Australia: Retail Trade Industry*, with its focus on the relative cost of doing business in Australia and the cost structures of the retail trade industry.

The Shopping Centre Council of Australia (SCCA) represents Australia's major owners, managers and developers of shopping centres. Our members facilitate retailing by providing high quality and innovative environments for retailers (and other tenants) and for consumers. Shopping centres have proved a great incubator for retailing in Australia and more than 50,000 speciality retail shops and more than 2,400 'major' retailers are now located inside shopping centres. Nevertheless these numbers must be kept in perspective. They represent only around one-third of the total number of retail stores in Australia and amount to around 40% of retail sales. Contrary to the impression sometimes given in public policy debate, the bulk of retailing takes place outside shopping centres in a range of other formats, including stand-alone stores in CBDs, retail strips and high streets, as well as bulky goods centres, homemaker centres and brand outlet centres.

We have structured this submission around the Commission's identification of the major elements of retailers' cost of doing business listed on page 6 of the Issues Paper. We have also addressed the major aspects of the regulatory environment which directly affect retailers' costs or the competitive environment identified on page 7. Because of the limited time available we have not addressed the following elements: 'wage and labour on costs', which we assume will be covered by retailers and retailer associations in their submissions; nor have we addressed 'distribution restrictions imposed by producers', 'transport' and 'inventory and storage' which are matters to be addressed by retailers.

We have referred in this submission to other submissions (totalling more than 400 pages) that we have made to the Productivity Commission in previous inquiries, namely the *Market for Retail Tenancy Leases in Australia* in 2008 ("the 2008 Retail Tenancy Inquiry"), the *Planning, Zoning and Development Assessments* in 2011, which included focus on "Competition and Retail Markets" ("the 2011 Planning Inquiry") and the *Economic Structure and Performance of the Australian Retail Industry* in 2011 ("the 2011 Retail Industry Inquiry").

Where possible we have sought to provide insights into "*possible ways to reduce retailers' costs in Australia, with consequential benefits for the competitiveness of the industry, and for consumers generally through lower retail prices*". We note that "*the Commission will focus on costs that have a public policy dimension, as opposed to costs that are primarily the purview of the retail businesses themselves".*

The Commission has been asked, where relevant, to "*identify areas of cost advantage and disadvantage for retail trade businesses compared to international competitors".* There is a scarcity of comparative data in this area. Where such comparative data exists, such as for occupancy costs and sales productivity, we have referred to this data in the submission.

Because of the limited time available for preparation of a submission, which is the result of the very tight deadlines given to the Productivity Commission for this study, we are happy to assist the Commission in providing additional information it may seek.

2.0 Occupancy Costs and Rents

2.1 Rent

We have addressed the issue of rental determination in shopping centres in detail in our submissions to the 2008 Retail Leases Inquiry and the 2011 Retail Industry Inquiry. We refer, in particular, to pages 25-33 of our submission to the 2011 Retail Industry Inquiry.

We do not believe this should be a matter of public policy. In the 2008 Retail Leases Inquiry the Productivity Commission recommended (in the context of developing a national code of conduct for shopping centre leases) that "*intrusions on normal commercial decision making in matters such as minimum lease terms, rent levels, and the availability of a new lease" should be avoided*". Retail tenancy legislation currently regulates aspects of rent setting, such as the form and frequency of rent reviews.

Rents are essentially a product of market forces, involving the demand for, and the supply of, retail space for lease. We have addressed below (section 5.1) the extent to which public policy (planning and zoning regulation) may impact on the supply of retail space.

Over the last few years, in some markets, a reduction in the demand for retail space and/or an oversupply of retail space which has led to a reduction in rents in those market areas. Several major institutional landlords over the last year have revealed negative re-leasing spreads (i.e. the average rents under new leases and renewed leases are less than the average rent on expired leases). Similarly some major retailers have revealed publicly they have been able to negotiate more favourable lease deals in their portfolios. In February 2014, the CEO of the Australian Retailers Association, Mr Russell Zimmerman, was quoted in *The Australian:* "*What I am definitely hearing, and most clearly hearing in what I would call the second tier shopping centres, is that as leases come up, landlords are sitting down and doing deals."*

The Productivity Commission examined, in the 2011 Retail Industry Inquiry, how rents in Australia compared to other countries. The Issues Paper for that Inquiry noted that "*evidence to date suggests that, compared to their overseas counterparts, many retailers in Australia pay higher rental and occupancy costs as a percentage of their turnover.*" The paper noted that "*the reasons for this may be quite complex, including the relative cost of land, labour and construction in Australia and the location of retail centres."*

As we noted in our submission to that Inquiry, it is difficult to place Australia in an international context because very few countries collect detailed and comprehensive data on sales and occupancy costs, such as is reported in Australia in the annual *Urbis Retail Averages*. One of the countries with which comparison is possible is the USA and it is usually comparisons with the US which crop up in commentary. In 2009, in order to provide an objective assessment of Australian and US occupancy cost ratios and sales productivity, the SCCA commissioned Michael Baker, an independent retail consultant and former Head of Research for the International Council of Shopping Centers (ICSC), to analyse this issue[1].

This report found that, for regional shopping centres, average occupancy cost ratios (i.e. rent and other occupancy costs as a percentage of sales) for speciality stores were around 3.5 percentage points higher in Australia than in the US. For neighbourhood shopping centres, the average occupancy cost ratios are about 3 percentage points higher than in the US. (It should be noted, however, that this is not a perfect like-for-like comparison since specialty stores in Australia generally average only around 100 square metres while in the US such stores are usually around 400 square metres or more and include what in Australia are categorised as 'mini-major' stores.)

[1] '*US and Australian Shopping Centres Performance Comparison'*, Michael Baker Independent Retail Consulting, May 2009

The major explanation for this discrepancy between the two countries is the much higher amount retail space per capita in the US compared to Australia. The report noted: "*The imbalance between supply and demand (historically tilting towards oversupply) causes shopping centres [in the USA] to operate at lower average occupancy rates than in Australia. This creates an environment where owners need to trade off more in rent to keep centres at acceptable occupancy levels."*

Westfield Group, in its submission to the 2011 Retail Industry Inquiry, compared rents in its Australian, US and UK portfolios. It found "*rents per square metre in Australia are higher than in the United States but lower than the United Kingdom, when compared using long term average exchange rates.*" The average occupancy cost ratio in its US shopping centres was 16.2% compared to 17.6% in Australia, calculated on a comparable basis.

The Productivity Commission also examined the issue of occupancy costs in Australia and the US in its 2008 Retail Leases Inquiry. The Commission found[2]: "*Despite the arguments on either side, if occupancy costs are found to be different or the same in Australia and the United States, it does not provide any direct evidence of market failings. For example, the demand for and supply of retail space is likely to differ significantly and a number of external factors influence what returns landlords would expect (such as construction costs, geography, market risks, and the return earned on alternative investments) and as such what level of rent is paid. Also if rents were found to be different, or the same, it would not provide evidence of a problem in the retail tenancy market in either Australia or the United States."*

Unfortunately little attention has been given, even by the Productivity Commission, to the other side of the equation: that Australian shopping centres achieve very high sales productivity (i.e. sales per square metre of retail space) by world standards. Michael Baker's report[3] also shows that specialty shops in Australian regional shopping centres are 90% more productive than specialty shops in US regional shopping centres. The report also found that specialty shops in Australian neighbourhood shopping centres achieved double the sales productivity of their US counterparts. In *Inside Retail* of 5 August 2011, Michael Baker reported that Australia's sales productivity in 2010 was also higher than that of the United Kingdom, Canada and Germany. Michael Baker concluded his article in *Inside Retail*: "*With [sales] productivities so high in Australia by international standards, it can be argued that higher occupancy cost ratios are justified and are in fact just the market doing its work. Retailers can generate more profit dollars from the same profit margin than their counterparts overseas."*

We noted earlier that one of the main reasons for this superior sales productivity performance is that Australia has only around half the amount of competing retail space per capita as the US. As Baker notes in this *Inside Retail* article, "*there is a broad relationship between higher sales densities and the supply of retail space.*" But this is cannot be the only explanation. Germany, for example, has less retail space per capita (around 1.5 square metres), than does Australia (around 2.0 square metres) but sales productivity in Germany is around 25% less than it is in Australia. The United Kingdom also has less retail space than Australia per head of population but its sales productivity is also considerably lower.

Australian regional centres have a well-balanced mix of non-discretionary and discretionary retailers. The presence of supermarkets and specialty fresh food stores in Australian centres, in particular, boosts foot traffic and sales performance. US regional centres are significantly more dependent on discretionary retail, particularly fashion specialties and department stores. This makes the performance of US centres inherently more volatile. We have seen many examples of this in recent years in the US with many regional malls actually closing their doors and massive reinvestment is now required to revive these as shopping centres or, in some cases, for alternative uses.

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[2] *The Market for Retail Tenancy Leases in Australia*, op. cit. p. 130

[3] Op cit.

2.2 Other Occupancy Costs

As well as rents there are other operating expenses ("outgoings") which contribute to occupancy costs. Shopping centre owners do not merely pass these on to tenants, as is sometimes claimed. Given that retail tenancy regulates how much of such costs can be recovered from tenants, a substantial proportion of such expenditure falls on the landlord. This ensures that landlords have a major incentive to minimise these costs.

At the company and asset level, our members also have strong commercial incentives to minimise outgoings and limit the growth in outgoings. A critical issue is that growth in outgoings can limit the scope for rental increases, which generally need to be reported to institutional investors as a critical financial measure. If rental growth is limited, this will have a negative impact on operating income and on the centre's market valuation. This has obvious flow on effects in relation to cost and availability of financing, asset management and redevelopment opportunities. Accordingly it is very much in a landlord's interest to minimise outgoings where possible.

Occupancy costs that impact on the operation of a safe and productive shopping centre can vary significantly across jurisdictions and shopping centre types. Not all shopping centres, for example, will have security guards so not all will incur this cost (or service). Some shopping centres, particularly smaller centres, operate 'open air' car parks which generally have lower costs compared to underground or multi-decked car parking, which require lighting, lifts and elevators, ventilation and CO2 controls and cleaning.

The Property Council's latest *Benchmarks of Shopping Centre Operating Costs (2013)* provide details of these operating costs, broken down into 'lower range', 'benchmark', and 'upper range'. For 'mid-tier' shopping centres in NSW, such as sub-regional centres, 'benchmark' operating costs included common area cleaning ($23.89/m2 – which increased by 19% from 2009-2013); security ($7.52 – which increased by 2%); electricity and air-conditioning ($14.77/m2 – which increased by 36% and 21% respectively); repairs and maintenance ($5.22/m2 – which decreased by 13%); and insurance premiums ($5.12/m2 – which increased by 34%). Some of these charges are 'quasi-statutory charges' in the sense that the pricing of these services is partly influenced by public policy such as cleaning (where cleaners wages are set by the *Cleaning Services Award* and decided by the Fair Work Commission); electricity (where network and other pricing frameworks are determined by agencies such as the NSW Independent Pricing and Regulatory Tribunal); and insurance premiums (which attract various levels of stamp duty in different jurisdictions).

Cleaning costs (which, for NSW sub-regional centres, increased by 19% from 2009-2013 largely as a result of the introduction of the modern award and national wage increases) are just one example of where shopping centre landlords have sought to minimise costs on tenants and on themselves. Since May 2010 shopping centre owners have also been in an ongoing dispute since May 2010 with the union representing shopping centre cleaners, United Voice, which has been seeking above award payments through a new collective agreement known as 'Clean Start'. This is despite the fact that our members do not employ cleaners; these are employed by cleaning contractors. This claim would have increased labour costs for one of our mid-level members by an additional $2.4 million a year across its shopping centre portfolio. Our sector has resisted this campaign and this resistance has come at a considerable cost, including protected industrial action, picketing of corporate headquarters and individual centres and other reputational damage. In the view of our members any claim for additional payments for cleaners should apply across the cleaning industry and should be determined by the independent umpire, the Fair Work Commission. Our members would not have resisted this claim if outgoings were simply a matter of 'passing on' the increased cost to shopping centre tenants.

We have addressed those outgoings which are government-imposed taxes and charges in section 4.0 below.

3.0 Advertising and fit outs

One of the advantages of shopping centres is that the combined centre marketing fund delivers an advertising and marketing clout that far exceeds that which could be achieved by an individual retailer or that which can be achieved by retailers located outside shopping centres. Generally retailers pay a marketing levy which represents, on average, an additional 3.9% to occupancy costs in regional shopping centres and around 3.3% to occupancy costs in neighbourhood shopping centres. The landlord also contributes to the marketing fund. This 'pooling' of advertising expenditure delivers significant economies of scale. In addition it permits the employment of dedicated and professional marketing managers.

Operation of the marketing fund is heavily regulated by retail tenancy legislation in Australia. For example, the NSW *Retail Leases Act* contains six separate sections, over four pages, regulating advertising and promotion expenditures in shopping centres. We are unaware of any other country which regulates such expenditures. In other countries these are matters to be agreed by the parties in lease negotiations. It should be emphasised, however, that a note to section 52 of the NSW Act states: *"It is good leasing practice for a lessor to require all lessees in the shopping centre to contribute towards advertising and promotion costs for the centre".*

All retailers understand that if they take a lease in a shopping centre then they will generally be required to fit out the premises and in a style which will complement the general amenity of the shopping centre. Fit out standards obviously vary significantly depending upon the type and location of premises. In strip centres and some small shopping centres, fit-out standards are often non-existent or minimal. In high-end shopping centres, however, they are a factor contributing to the centre being classified as 'high-end' and retailers know, if they seek premises in such centres, they must expect to pay higher fit-out costs and that a new fit out will almost certainly be a requirement of a new lease.

Good retailers know that making their shop as attractive as possible to prospective customers, and keeping it constantly fresh, relevant and appealing to customers, is part and parcel of a successful retail business. These retailers also understand that a fit-out is a significant investment required of the tenant in order to take complete advantage of the retail custom the shopping centre will generate for the tenant. They also know that a fit out is a necessary investment irrespective of whether they own premises or rent premises.

Lessors do not impose excessive requirements for fit outs and therefore do not impose excessive costs on tenants. Lessors know that excessive fit out costs will retard rental growth so it makes no sense to do so if that is going to jeopardise their ability to pay rent. Indeed in a climate where retail leasing is tough, or where landlords are seeking to persuade retailers to locate in a new or redeveloped shopping centre, landlords often make significant contributions to the cost of the tenants shop fit out.

A fit out can only occur if it is part of the lease agreement. In other words, the lessee has to agree to undertake a fit out of the premises as a condition of entering into the lease, or entering into the new lease, for the fit out to occur. A requirement to undertake a fit out therefore cannot come as a surprise to a lessee. This is also an area of retail leasing which is heavily regulated. Section 12 of the NSW *Retail Leases Act,* for example, provides that "*a provision of a retail shop lease that requires the lessee to pay or contribute towards the cost of any finishes, fixtures, fittings, equipment or services is void unless the liability to make the payment or contribution was disclosed in a disclosure statement given to the lessee.*" Once again we are unaware of any other country where Parliament regulates fit out requirements of shopping centres.

We are unaware of any data which permits a comparison of advertising costs and fit out costs in Australia with other countries. Anecdotal evidence suggests that overseas retailers, particularly those in the USA, place a much higher emphasis than Australian retailers on having high quality fit outs because they know that is important in attracting customers. This attitude is likely to change with the recent influx of prominent overseas retailers to Australia.

4.0 Government Taxes

A large cost burden for retail property owners, and therefore retailers, is as a direct result of Government imposed taxes. They represent the costs that have a 'public policy' context for the Commission's study.

At an industry level, we allocate significant resources in seeking to minimise a range of 'outgoings' such as land valuation issued by the Valuer-General, land tax, council rates, water charges and electricity regulation. A relevant current issue is the NSW Emergency and Fire Services Levy which is proposed to be transitioned from an insurance-based to a property-based levy.

We won't focus on Federal taxes for the purposes of this submission, such as the GST or company tax, or transaction taxes (e.g. stamp duty), but state and local government 'property-based' taxes that affect operations. These are known as 'statutory charges' for shopping centre operations. Broadly, these taxes include:

- Land tax – generally taxed on 'unimproved' land value.
- Council rates – a mix between 'unimproved' and 'capital' value.
- Fire and emergency services levies – a mix between 'unimproved' and 'capital' value.
- Car parking levies – taxed on number of car spaces (with exemptions).

Statutory charges vs non statutory charges

The nature of statutory charges varies significantly across Australia. The Property Council of Australia produces annual Shopping Centre Operating Benchmarks which outlines a lower range, benchmark and higher range of various statutory and non-statutory costs across a range of shopping centre types. A summary of the 'benchmark' costs (for the year ending 30 June 2013) for NSW sub-regional shopping centres is outlined below:

Sub-regional shopping centres

	Statutory charges ($/m2)	**% of total**	**Non-statutory expenses ($/m2)**	**% of total**	**Total**
NSW	$ 24.30	17%	$ 122.42	83%	**$ 146.72**
QLD	$ 33.28	23%	$ 112.13	77%	**$ 145.41**
VIC	$ 29.35	21%	$ 112.95	79%	**$ 142.30**
WA	$ 45.20	29%	$ 110.78	71%	**$ 155.98**
	Average	**22%**	**Average**	**78%**	

It can be seen from the above table that the average statutory costs is now 22% of total shopping centre operating expenses.

Inefficiency, double and triple dipping

Many property taxes are inherently inefficient and go against good tax design. As one example, land tax is often cited as an efficient tax – in that land is immobile (versus labour and capital) – however this assumes that all land is taxed; and is taxed fairly and evenly. All state governments, however, provide exemptions under their land tax regimes, such as the principal place of residence, as well as income producing properties, such as primary production land.

It's should also be noted that some 'land' is taxed numerous times by different taxation arrangements. As an example, land tax is imposed on a property and council rates, fire service levies and parking space levies are then imposed on the same property. In some jurisdictions (e.g. Victoria and South Australia), council rates are taxed on the 'capital value' of a property which includes land and the built improvements. Even more absurdly, SA Water bases its water pricing on the capital value of land rather than actual water usage (although this is presently being reviewed).

Valuations

As most property taxes are based on valuations issued by the relevant Valuer-General in each state, there have been major pressures on shopping centre valuations over the years which can have a consequent impact on shopping centre operating costs in the form of increased taxes.

As an example, the NSW Parliamentary Committee on the Valuer-General conducted an inquiry into the land valuation system in 2013 and made a number of recommendations which are now being considered and investigated. During the Committee's investigations, however, there was a push to consider a shift from unimproved land value to improved land value. Such a move would disproportionately impact commercial properties – including shopping centres – given the higher proportion of 'improvements' of such properties compared with residential properties.

In 2010 the then Queensland Government sought to overturn a decision by the Queensland Court of Appeal (known as the *Pacific Fair* case). In doing so the Government ignored decades of valuation practice and sought to move methodology to an 'improved' valuation basis, which would lead to massively increased land taxes and council rates. This was eventually overturned, after a major public campaign, but it highlights how the threat of damaging change is constantly present.

Council rates

Council rates have become a major area of concern in recent years mainly due to the invention by Australia's local councils of dubious reasons to impose higher rates on shopping centres even though many of the services usually provided by councils (such as waste collection) are provided and paid for by the shopping centre itself. Although state governments have broad powers in relation to local government they often don't intervene on specific issues and we are therefore left in the hands of an irrational council which will gladly increase commercial property rates in order to maintain lower residential rates.

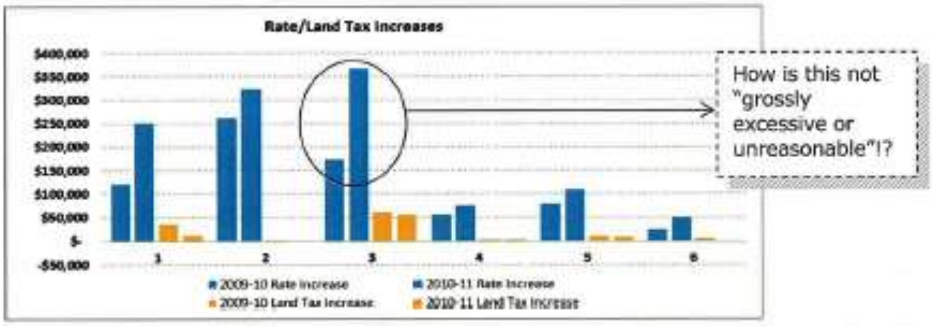
NSW is undergoing the most recent local government reform program. We have made numerous submissions to this process to seek to convince the Government to provide a rating framework which includes 'safeguards' for commercial properties. An excerpt of our last submission (dated 4 April 2014) outlines our concerns with the proposals the Government is currently considering:

>WHAT ARE OUR CONCERNS?

Our concerns relate to the fact that the system enables gouging to occur through:

1. The ability to apply a subcategory inconsistently and to only one property or a handful of properties.
2. The ability to apply differential rates to such a subcategory based on dubious reasons and with no substantial basis.
3. The ability to rate on the 'capacity to pay' approach which has no clear or consistent test (nor is one proposed, despite it being mentioned twice in the report), and can come down to opinion or a blunt measure such as land value.

The following table, provided in a previous submission to the Panel, illustrates the impact and volatility of rate gouging for six properties. This evidence contrasts the Panel's broader view (at page 42) that it can find no evidence..."that councils would subject their ratepayers to grossly excessive or unreasonable imposts if rate pegging were relaxed". The table clearly highlights that grossly excessive and unreasonable imposts already occur. It's worth noting the corresponding land tax changes; in some cases reducing in line with valuation shifts.



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In addition to the significant volatility of council rates outlined above, it should be noted that the actual cost impost is larger than land tax in each of the examples.

Further, in the same submission we provided evidence that NSW council rates for sub-regional shopping centres have increased by 58% from 2009-2013. An excerpt is provided as follows:

While the Panel also observes that total council revenues in "other mainland states" only went up by 8% per annum for the period 2001/02 to 2010/11, it's worth noting that other evidence can paint a different picture.

A snapshot of the rate increases in sub-regional shopping centres outlined below reveals a 58% increase and an average annual increase of around 12% from 2009-2013. This highlights that there can be subtle differences between the overall revenue (or rating) increases versus the impost placed on certain property categories and/or individual properties.

	$/sqm BENCHMARK
2013	
Sub Regional	$15.33
2012	
Sub Regional	$15.19
2011	
Sub Regional	$14.09
2010	
Sub Regional	$11.81
2009	
Sub Regional	$9.68

**Property Council of Australia, Shopping Centre Operating Benchmarks*

Victorian Fire Services Property Levy

Since the 2011 Retail Industry Inquiry report one new property tax has been introduced - the Victorian Fire Services Levy. This was transitioned from an insurance-based tax to a property-based tax.

This has resulted in massive increased in the amounts our members paid under the previous insurance-based levy. This is principally because the Government exempted motor vehicles from the tax base (which means 'immobile property' has to pick up the shortfall which we estimate to be around $90 million per annum); selected Capital Improved Value (CIV) as the tax basis; and also imposed higher rates on commercial properties. This was done to enable the Government to charge lower rates to against residential and rural land. Despite SCCA providing detailed modelling, submissions and practical recommendations to the Victorian Government, and making a number of representations, we were unsuccessful in gaining a reduction in this major impost. In order to give some appreciation of the size of these increases, which ranged up to $1.3 million per annum, across our members' 80 Victorian shopping centres, we have provided below an excerpt from one of our letters to the Victorian Treasurer:

When introducing the new FSL the Government stated it "had ensured that business sectors (commercial, industrial and farm) pay broadly the same share of the overall burden as is the case under the current system". Modelling undertaken for the Shopping Centre Council of Australia by Urbis (which I **attach**) shows this has not been the case. Instead high value shopping centres, for example, have seen FSL increases ranging up to $1.3 million a year, an increase of 273%.

For the commercial land use category generally, the actual variable levy rate in MFB areas is 8.8 times higher than the residential levy rate, while in CFA areas it is 9.5 times higher than the residential levy rate. This disparity is manifestly unfair and contrasts with the *Local Government Act* which requires that the variance between the lowest and highest differential municipal rate is no greater than 4 times. As a result of this disparity, the residential land use category comprises 76% of the total CIV rating base but pays only 52% of the total FSL tax; the commercial land use category comprises 10% of the total CIV rating base but pays 21% of the total FSL tax.

In addition, commercial property in a CFA area pays an 80% premium over those in MFB areas. A sub-regional shopping centre in an MFB area, for example, faced an increase of $66,671 (or 60%) in the FSL while a similar centre in a CFA area faced an increase of $176,094 increase (or 158%) in the FSL.

There is also an inequity where the FSL applies to supplementary valuations as a result of redevelopment, which means that new investment into Victoria is being further taxed under the FSL regime. This approach is different to the treatment of supplementary valuations under the Land Tax Act. We provide an example of a recently completed shopping centre expansion, which was a major employment generator, where the FSL charge increases from $940,005 to $1,323,749. We believe such increases contribute to a potential over-collect of the FSL.

5.0 Regulatory Environment

5.1 Planning and Zoning

Australia's planning systems are no 'walk in the park' for our members.

No retail property company or format is unique in experiencing challenges, inconsistencies, cost imposts or having their preferred outcomes thwarted as a result of Australia's planning systems; or wanting to have the lowest possible costs when acquiring land, accessing new markets or undertaking development.

In the case of our members, this includes issues in relation to regional planning schemes, zoning, definitions, development approvals, design requirements, land owner consents, prescriptive controls, state agency conditions, community consultation requirements and infrastructure charges and contributions. In all cases there is a need to work proactively with governments, retailers and surrounding communities.

It is worth noting that such challenges are in the context of our members continue to innovate with their development programs so that proposals are not merely limited to 'retail' uses or using 'tried and tested' models. New entrants to the Australian retail market are often described as 'new retail formats' but it is our members who are constantly assembling 'new retail formats'.

This includes the incorporation of leisure and lifestyle uses as well as integration with government owned and licensed public transport facilities and interchanges. This also includes the incorporation of residential uses, which is an increasingly desired outcome of State and local governments as enshrined in planning schemes (e.g. Plan Melbourne), infrastructure programs (e.g. WestConnex in Sydney) and more detailed structure planning exercises (e.g. Perth's Activity Centres Policy). This is seeing the traditional model of mixed-use development turned on its head, whereby previously it was often the case of residential developers incorporating street level retail. It is now the case where retail developers are incorporating residential uses into their proposals.

This can, however, present planning challenges. To cite one example, Brisbane City Council's draft new City Plan, which was exhibited last year and which encourages mixed-use development in major activity centres, sought to restrict shopping centre delivery times within certain areas to the hours 6am-7pm in order to avoid "*detrimental impacts on the amenity of adjoining residents*". We raised concerns with this provision (which formed part of 1 of 69 "performance outcomes" for such areas) as it would put certain shopping centres at a disadvantage to other locations; inhibit a retailer's ability to efficiently manage supply logistic;, and be in conflict with another one of Council's desired outcomes for an '18 hour economy' as part of encouraging a vibrant city.

This proposed restriction has been amended in the final draft (with a solution for broader, but still restricted, hours or delivery activities which do not generate disturbing noise) but it highlights the potential for restrictive retail provisions as part of planning schemes amidst broader desired community outcomes.

Well-functioning cities – Australia's productivity and wellbeing

In responding to the Commission's 2011 Retail Industry Inquiry recommendations the then Government sensibly recognised that "*effective planning and zoning regulation is important to encourage well-functioning cities, infrastructure and housing markets which in turn contributes to improving Australia's productivity and wellbeing*". We say "sensibly recognised" because, to suggest otherwise, would fly in the face of the objectives and long-standing practical realities of strategic planning. The Commission should refer to the most recent planning strategies, such as Plan Melbourne, Brisbane City Plan or the Sydney Metropolitan Strategy, as relevant examples. We highlight this to stress the fact that planning systems are not single issue frameworks.

To take this one step further, all governments utilise the concept of urban concentration and consolidation to both maximise and pursue economically efficient outcomes such as transport efficiency, mixed-uses, vibrancy, labour agglomeration and competition.

Planning officials also try to balance the realities of suburban anti-development politics to alleviate concerns about development being spread across suburban areas. They can also want retail investment to be leveraged for other investment opportunities, such as residential and office markets.

To cite Brisbane City Council's proposed new City Plan once again, which has been submitted to the Queensland Government for final approval, this promotes the fact that only 7% of the urban area will be affected by growth. This is promoted as having the benefit of 'protecting' the suburbs. The Victorian Government's draft Plan Melbourne, which is soon to be finalised, also pursues a similar approach.

Previous Commission findings and recommendations

The Productivity Commission has made various recommendations in relation to planning and zoning.

The 2007 Retail Leases Inquiry broadly recommended that "*while recognising the merits of planning and zoning in preserving public amenity, states and territories should examine the potential to relax those controls that limit competition and restrict retail space and its utilisation".*

The 2011 Retail Industry Inquiry went into further detail and made five recommendations (one of which cross-referenced the Commission's 2011 Planning Inquiry report which identified five "best practice approaches to support competition in land use markets").

These recommendations broadly encompass the following:

1. A broadening of business zoning and reduction of prescriptive requirements to allow the location of all retail formats in existing business zones.
2. More 'as-of-right' development to reduce business uncertainty and remove the scope for gaming by competitors.
3. Impacts on existing businesses should not be a consideration during development assessments. Impacts on new retail locations on the viability of activity centres should be considered during the strategic planning process.
4. Ensure third party appeals processes have clear grounds for appeal and allow the awarding of costs against parties found to be appealing for purposes other than planning outcomes.

The most comprehensive pursuit of these recommendations was the Victorian Government's zoning reforms which commenced in 2013 (although some matters are still being addressed). Broadly these reforms:

- consolidated five previous zonings (B1, B2, B3, B4, B5) into two (C1, C2) (in line with Recommendation 1 noted above),
- enabled new uses in zones that were previously restricted (e.g. bulky goods outlets were restricted in the previous B5 zone, but it's compression into the new C1 zone now enables such development)
- enabled more (but not all) development to proceed 'as-of-right' (in line with R2 noted above)
- enabled small supermarkets to be permitted within the IN3 (light industrial) zone, and
- removed retail floor space caps within certain zones (and activity centres) to enable further growth.

Picking winners or competitive neutrality?

It is critical the Commission is aware that even in the case of Victoria's reforms, in coming to a 'balanced' planning outcome, it could be interpreted that it inadvertently picked winners and hasn't fully enabled competitive neutrality.

The notion of competitive neutrality should be a critical aspect of retail planning reform and is often overlooked. To take one example, while retail floor space caps were removed from zones (a positive move), such floor space caps exist in other mechanisms such as overlays and structure plans. We pointed this out in our own submission when the draft reforms were exhibited. The Government has recognised this and, in its response to the Ministerial Advisory Committee which undertook the review, committed to removing such floor space caps by 31 December 2013. At this time these caps have still not been removed.

A similar point can be made about 'as-of-right' development for small supermarkets in the IN3 zone. This is not available to retail premises or restricted retail premises where such developments still require a planning permit.

We have highlighted a few other planning examples where there is a lack of competitive neutrality:

Floor space caps

As mentioned above, under the Victorian reforms, retail floor space caps were immediately removed where they appeared in zones, however retail floor space caps in other mechanisms (e.g. overlays, structure plans) remain, despite government commitment to have them removed by 31 December 2013.

We recently wrote a submission on the draft Logan Planning Scheme (Qld) which proposes imposing retail floor space caps in certain areas.

In addition, since the Commission's recommendations, the ACT Government's Draft Variation 304 to the Territory Plan sought to impose a supermarket floor space cap in local centres.

Development contributions

There are also competitive neutrality issues concerning development contributions.

In Queensland, for example, there is a 'standard' maximum infrastructure charge for shoppoing centre development of $180/m2 of Gross Floor Area. However a 'warehouse' – such as a bulky goods outlet – has a lower charge of $140/m2. A 10,000m2 shopping centre development would pay $400,000 more than an equivalent bulky goods outlet. Further, due to the required location of shopping centres in activity centres, which are often adjacent to state (i.e. major) roads, there are often additional and more costly road-related conditions imposed, such as intersection upgrades.

Structure planning

Under some planning schemes, such as Perth's Activity Centres Policy, retail developments in certain locations are required to undertake structure plans which outline long-term urban outcomes. This can facilitate a better outcome, but it can also add time, cost and uncertainty to the development process. Developments in out-of-centre locations, however, do not have to comply with this requirement.

Design requirements

Some retail developments must comply with relatively more stringent design requirements. As an example, the NSW Government has previously proposed Centres Design Guidelines which would only apply to retail developments within activity centres; would interfere with retail fundamentals (such as seeking to prescribe tenancy uses, mix and sizes); and also seek to impose a one-sided perspective on 'good design'.

Development conditions

Under the draft Brisbane City Plan noted previously, there was a proposed policy that where a development was co-located or adjacent to a public transport facility, the developer would be required to build commuter parking. It should not be the responsibility of a private developer to provide parking facilities for either commuters or non-users of their shopping centre. Our modelling showed this would be a major additional cost impost on development (approximately $5 million per facility in construction cost alone). This policy has now been removed.

Planning permit fees

It was announced in the Victorian State Budget on 6 May 2014 that from 1 July 2015, planning permits with a development cost of $1 million or more will be required to pay a new levy to help fund the Metropolitan Planning Authority. We are currently seeking further clarification but, at face value, this would appear to mean that developers who can develop 'as-of-right' will not have to pay this levy, thereby discriminating against those who are caught and impacted by such a change.

5.2 Retail Tenancy Regulation

This issue has already been thoroughly examined by the Productivity Commission in its 2008 Retail Leases Inquiry and 2011 Retail Industry Inquiry. We refer to our submissions to these Inquiries.

The market for retail tenancy leases in Australia is now heavily regulated. In all States and Territories there is very detailed and prescriptive legislation regulating all aspects of the retail tenancy relationship, beginning even before a tenant signs a lease.

We are unaware of any other country in the world with such a highly regulated retail tenancy market and the Productivity Commission found[4] that *"Australia is unique in its specific regulation of retail tenancies."* This is in contrast to other countries with which Australia generally likes to compare itself. New Zealand, for example, does not have retail tenancy legislation. The only regulation of leases is contained in the *Property Law Act* which applies to all property classes, not just to retail property. There is no retail tenancy legislation in the USA. Even in the United Kingdom (UK), where the *Landlord and Tenant Act 1954* applies to all commercial property, there is no specific retail tenancy legislation to protect retail tenants.

Retail tenancy legislation adds substantially to regulatory, administrative and compliance costs and, where market conditions permit, these costs are passed on to retailers and to consumers. Not only does this legislation regulate the leases of 'small retailers' but also covers retail chains with hundreds of stores, including in some States, retail chains that are listed on the stock exchange.

We listed in our submission to the 2011 Retail Industry Inquiry some of the costs imposed on the retail tenancy market by retail tenancy regulation (pp.39-40). These rules and restrictions impose costs particularly on the shopping centre distribution channel that are not imposed on other retail distribution channels (including the internet) or on similar retail shopping centres in other countries. We noted in our submission two particular case studies of unnecessary regulation (on pages 41 and 42); the first of which was a cost to landlords and the second was a cost to tenants. We are pleased to say the Victorian Government in 2012 repealed the first provision. The second provision was not even raised as an "issue" in the Issues Paper released by the NSW Government for the Review of the NSW *Retail Leases Act* (referred to below).

The Productivity Commission in 2008 recommended a voluntary code of conduct, enforceable by the ACCC, to replace retail tenancy legislation for shopping centre leases. As part of this move to a code of conduct, *"key restrictions on commercial decision making in retail tenancy legislation, including those relating to minimum lease terms, preferential rights of renewal, lease assignment and outgoings"* would be relaxed.

This recommendation has been ignored by all governments. A review of the NSW *Retail Leases Act* is currently underway but the Issues Paper for this review gives scant consideration to the Productivity Commission's main recommendation in 2008 and makes no effort to reduce the amount of regulation. Indeed the Issues Paper, if it was adopted, would lead to an increase in regulation. A review of the Queensland *Retail Shop Leases Act* did focus on removing some unnecessary regulation although this was largely driven by the Queensland Government's welcome seriousness about 'red tape reduction'.

Unfortunately it has been our experience that the costs imposed by retail tenancy regulation receive little consideration by state or territory governments before regulation is imposed. Although most governments require the preparation of some form of regulatory impact statement (RIS) to assess the costs and the benefits of proposed new regulations, it has been our experience in the regular reviews of retail tenancy legislation that these cost assessments, if they occur at all, are perfunctory at best.

[4] "*The Market for Retail Tenancy Leases in Australia*" Productivity Commission Inquiry Report No 43 31 March 2008 p.88

Little real attempt is made to properly consider what new costs are being imposed on the retail tenancy market (both property owners and tenants and ultimately consumers as well) when retail tenancy regulation is expanded. Nor is any consideration given to whether the goals could be achieved by less intrusive means.

Unfortunately the existence of retail tenancy legislation in Australia has led to the existence of a 'protectionist' mentality on the part of Australian retailers and the general response to the inevitable risks and realities of retailing has been to demand more and more regulation. Many of the retailers demanding additional regulation operate in countries such as Singapore, New Zealand and the USA, where no such regulation exists.

Regrettably we may soon see the addition of yet another layer of regulation of retail leases with the Federal Government's pledge to extend the unfair contract terms legislation in the Australian Consumer Law to business-to-business contracts. The Government has given no commitment that retail tenancy leases will be exempted from this new law even though these leases (contracts) are already regulated by governments.

5.3 Trading Hours

The Productivity Commission, in its 2011 Retail Industry Inquiry, investigated the regulation of shop trading hours in considerable detail and recommended that "retail trading hours should be fully deregulated in all states (including on all public holidays)", just as they are in the territories.

Trading hours are effectively deregulated in Victoria and Tasmania: all shops can open at any time, on any day, except on Christmas Day, Good Friday and the morning of Anzac Day. Since these are voluntary closed days in the territories, full deregulation is therefore unlikely to result in any different trading patterns than currently exist in these states.

Trading hours in NSW are not as liberal since (other than in some limited geographic areas) shops also cannot trade on Boxing Day and Easter Sunday. The NSW Government has attempted to remove trading restrictions on Boxing Day but the relevant legislation failed to pass the Legislative Council.

Trading hours in Queensland are heavily regulated with around 20 different trading hours zones existing in the State. The Queensland Government is still to make a decision on the final report of the Queensland Competition Authority on *Measuring and Reducing the Burden of Regulation* which identified 'trading hours restrictions' as one of ten 'fast track priority reforms'. The QCA noted "the potential benefits of reform include an increase in retail productivity, more shopping convenience for the broader community and lower prices."

Western Australia has taken action since the 2011 inquiry. In August 2012, Sunday trading and trading on most public holidays was permitted for the Perth area (but with limited trading hours of 11am to 5pm). Last month the WA Economic Regulation Authority, which has been conducting an inquiry into microeconomic reform in the State, recommended the effective deregulation of trading hours (i.e. the same trading arrangements as Victoria and Tasmania).

Unfortunately trading hours in South Australia are still highly regulated. Sunday trading hours remain fixed at 11am to 5pm more than a decade after Sunday trading was introduced for Adelaide. The vast majority of shops in Adelaide are not permitted to open on any public holiday. This meant, for example, over the most recent Easter period, shops were closed on three of the four days between Good Friday and Easter Monday. This is obviously absurd and extremely harmful to the retail industry. Regrettably in 2012 the Government gave legislative effect to a secret deal in 2011 between the Shop Assistants Union (SDA) and Business SA, subsequently endorsed by the Government, to permit shop trading (but only in the Adelaide CBD) between the hours of 11am to 5pm on most public holidays in return for declaring Christmas Eve and New Year's Eve (after 7pm) as public holidays for all industries, not just the retail industry. We brought this anti-competitive arrangement, which offends the objective of 'competitive neutrality', to the attention of the Australian Competition and Consumer Commission but it declined to get involved.

Restrictions on the hours during which physical shops can open are discriminatory. Internet retailing can be conducted at any time and on any day. The retention of trading hours regulation handicaps physical retailers from competing with online retailing. In addition, while trading hours are still heavily regulated in many European countries, no such restrictions apply in Asian countries or in the United States (except in a few areas where the so-called 'blue laws' still operate) and only very limited regulation applies in New Zealand.

We recognise that, as a public policy issue, this is a matter for state governments. Nevertheless the Federal Government can significantly influence the decisions of these governments, through COAG and in other more direct ways. The threat of suspension of national competition policy payments, for example, was a significant factor in forcing Tasmania to deregulate trading hours in 2002 and forcing South Australia to introduce Sunday trading for Adelaide in the same year.

5.4 Workplace Practices

Our members report an increasing number of retailers in shopping centre are reluctant to open their shops on Sundays and public holidays, despite these days being good trading days, because the penalty rates which are required to be paid to staff means such trading is only marginally profitable or is unprofitable. Retail tenancy legislation and/or trading hours legislation means retailers cannot be forced to trade on these days so shopping centre owners and managers run the risk of an increasing number of shops being closed on these days. This becomes a vicious circle for the shopping centre since closed shops are a turn off to shoppers who may then be reluctant to visit the centre again on these days.

We understand that retailers and retailer associations will be supplying the Productivity Commission with data demonstrating the damaging effect that penalty rates are having on trading on these days. The re-regulation of the labour market in Australia over the past five years or so means this is a fairly peculiar problem to Australia and detracts from the competitiveness of Australian retailing.

Shopping centre owners confront this more directly in the cost of construction of shopping centres which obviously has an impact on the viability of developments and redevelopments. The higher the cost of development the higher must be the rents to ensure that investors gain a reasonable return from putting their capital at risk.

According to the *International Construction Cost Survey 2013*, conducted by Turner and Townsend, the building cost (per square metre of internal area) of a large shopping centre in Australia is 15% more expensive than in the USA, when adjusted to purchasing power parity. This is obviously a significant factor when comparing shopping centre rents in both countries.

5.5 Current Indirect Tax Arrangements

It is not clear what aspect the Productivity Commission is referring to under this heading. We understand this is not a reference to the debate over the low value threshold for the application of GST and customs duty on imported goods, which was an issue in the 2011 Retail Industry Inquiry.

From time to time there is debate about the appropriateness of retail tenants paying their share of land tax (and some other government charges) applied to the shopping centre. For example some states have legislated to prevent land tax being a 'recoverable outgoing' from retail tenants. Oddly this only applies to tenants of retail property, not to tenants of offices or other commercial buildings. This is an unjustifiable discrimination against the owners of retail property and places them at a significant disadvantage compared to the owners of other commercial property who are free to recover land tax from their tenants. A business tax should not distort investment decision-making by penalising certain classes of economic investments while favouring other classes of investment.

As well as being discriminatory, such a prohibition on recovery effectively converts land tax from being a transparent tax (whereby a large range of businesses are aware of the tax and, in particular, are aware of increases in the tax) to being a non-transparent tax. This is because, where market conditions permit, landlords will seek to recover the additional land tax burden in rents. This is why a number of independent inquiries have opposed legislation which prohibits recovery of such indirect taxes. For example, in 2002, the Government-commissioned *Review of State Business Taxes in Western Australia* concluded: "*Moreover, by prohibiting land owners from including land tax in the expenses to be directly met by tenants (i.e. outgoings) under commercial lease arrangements would most likely be ineffective. Such a prohibition would result in land owners incorporating land tax in the base commercial lease rates, rather than as part of the outgoings to be directly paid by lessors. The net result would still be a passing on of all or part of the burden of land tax from land owners to tenants, but in a less transparent manner."* Similarly the *Review of State Business Taxes in Victoria* in 2001 concluded: "*Part of good tax design is to ensure that the tax system is transparent. This means that the underlying purpose and principles behind the design of a tax are clearly identified. It should be clear what is being taxed, who is liable and how their liability is calculated*." It is difficult not to draw the conclusion that State Governments are attracted to such regulation because they believe this will make it much easier for governments to increase land tax rates in the future because a range of businesses will be under the mistaken belief that the tax increase will not affect them.

5.6 Other Regulatory Burdens

The shopping centre industry is impacted by the same regulatory burdens which are imposed on other property classes and on all other industries. These range from compulsory sustainability requirements through to work, health and safety requirements.

In addition retail property is almost unique among the property classes in having a regulated lease. We addressed this in section 5.2 above. (Residential property also has a regulated lease but residential tenancy legislation is not as extensive, or as political, or as frequently reviewed as retail tenancy legislation).

In the 2011 Retail Industry Inquiry we also raised the issue of real estate licensing requirements and regulation. By an accident of history, shopping centre owners and managers are also subject to real estate agent regulation which varies from state to state and imposes significant extra costs on the industry. This legislation was originally introduced in order to protect the ordinary 'consumer' (i.e. property owner) in their dealings with real estate agents. This legislation pre-dated the rise of the sophisticated property owning companies and institutions but such companies are now 'caught' by the legislation. This means if those companies employ a manager to buy, sell, manage or lease the property then that agency relationship is now regulated by the real estate agents legislation. This is despite the fact that the 'consumers' being protected by this regulation are generally large sophisticated companies which do not need, or want, this legislative protection. Even more absurdly the regulation applies to the agency relationship even when the manager is a related-party entity to the property owner. Thus, for example, Westfield Shopping Centre Management must comply with the provisions of the Act even when it is managing centres owned by Westfield Group and AMP Capital Shopping Centres must comply with the Act when managing centres owned by AMP Capital Investors. This is even more nonsensical. We have estimated that this is costing the shopping centre industry around $6 million per annum around Australia.

At the time we were seeking to achieve exemptions from this legislation through the proposed national licence for real estate agents under the National Occupational Licensing System. With the demise of NOLS we are now seeking state-by-state exemptions. The Queensland Government has recently legislated to grant these exemptions and the Victorian Government has announced it will also do the same, as a result of recommendations by the Red Tape Commissioner. We are still battling to convince other State and Territory Governments to follow the lead of Queensland and Victoria to remove this unnecessary regulation.

The Productivity Commission, in the previous inquiry, said there was a prima facie case for examining "*whether this regulation is too broad in its application and could be better targeted, but these questions are best left to separate review processes*" (p. 413). This has now been done, most notably in the Regulation Impact Statements for the proposed national real estate license which recommended these exemptions. Given the demise of the National Occupational Licensing System this should now be implemented by other state and territory governments.

6.0 Shopping Centre Council of Australia

The Shopping Centre Council of Australia represents Australia's major shopping centre owners and managers. Our owners own and manage more than 11 million square metres of retail space. Our members are AMP Capital Investors, Brookfield Office Properties, Charter Hall Retail REIT, CFS Retail Property Trust Group, DEXUS Property Group, Eureka Funds Management, Federation Centres, GPT Group, Ipoh Management Services, ISPT, Jen Retail Properties, JLL, Lend Lease Retail, McConaghy Group, McConaghy Properties, Mirvac, Perron Group, Precision Group, QIC, Savills, Stockland, Westfield Group and Westfield Retail Trust.

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