

EPRA response to the European Commission's public consultation on Retail market monitoring report

About us

The European Public Real Estate Association is the voice of the publicly traded European real estate sector. With more than 200 active members, EPRA represents over €250 billion of real estate assets and 90% of the market capitalization of the FTSE EPRA/NAREIT Europe Index. EPRA members total about €1.1 trillion worth of real estate exposure. EPRA's mission is to promote, develop and represent the European public real estate sector.

EPRA works to foster trust and encourage greater investment in listed real estate companies in Europe through:

- Providing better information to investors and stakeholders
- Actively contributing to the public and political debate
- Improving the general operating environment
- Encouraging best practices and cohesion

As a member of REESA - The Real Estate Equity Securitization Alliance, EPRA regularly works in close cooperation with its counterparts from other regions and national markets such as the National Association of Real Estate Investment Trusts (NAREIT) in the United States, the Asian Public Real Estate Association (APREA), and the Real Property Association of Canada (REALPAC) to name a few.

Our contribution

Commercial retail property is an important part of the real estate that our members develop, manage and maintain. Our members recognise and support the Commission's ambition to remove obstacles to the optimum performance of the retail sector in the internal market. They also adhere to the general objectives of more efficient and fairer retail services for consumers and operators and recognise they have an important role to play in this respect. We therefore welcome the opportunity to comment on the *Retail market monitoring report* and its accompanying working document. We also invite the Commission to involve us in and draw on our expertise for any further discussion on issues of relevance to our members.

The present contribution naturally focuses on the areas in which our members have real field experience and market expertise, which essentially relate to the interaction between the commercial property market and retail services (Chapter 2.2 of the Commission staff working document). We have set out some general remarks below, and then provide specific comments to certain of the issues raised in the consultation documents. In our response, we refer specifically to property

companies whose shares are traded on the public markets, but in most instances, our comments are also applicable to the commercial property sector as a whole, whether listed or unlisted.

Our general remarks aim at giving the Commission a better insight on the interaction between the commercial property sector and retailers. We would notably make the following observations:

- An efficient commercial property market enables efficient retail services
- Commercial property companies focus on serving retailers needs and customers demand
- Listed commercial property companies are key “best practice” influencers in the commercial property market
- Listed property companies lead in improving the sustainability profile of the built environment

Looking at the specific issues most relevant to us in the consultation documents, we would raise the following points:

- Consumer access to retail services is influenced by more important factors than those relating to commercial property development
- The commercial property sector is a key facilitator for retailers access to customers and business success

General Remarks

An efficient commercial property market enables efficient retail services

Consultation documents point: Retail services providers are highly dependent on the efficiency of the commercial property market for the success of their business, notably due to the cost of retail property, whether owned or rented, representing a significant share of their total operating costs. Any malfunctioning in the commercial property market will have direct consequences on retail service providers.

Excessively strict planning regulations can sometimes lead to scarcity of land available for retail development thus further increasing commercial rent levels (impacting on land prices) and inflating consumer products prices.

EPRA response: Any malfunctioning or undue constraint affecting the commercial property market will indeed have repercussions on the retail services market and should therefore be considered.

For instance, urban and rural planning is probably the most important retail efficiency factor. As rightly pointed out in the consultation document, excessively strict or ill-conceived land use planning regulations may hamper an efficient demand-offer-driven property development dynamic. Of course land use planning and zoning is useful to ensure a balanced built environment. But ideally, it should involve commercial property developers at an early stage, not only to prevent the scarcity of land available for retail development (and its inflationary effect on commercial rent levels and consumer products prices), but also and in fact essentially, to make sure that land use planning does respond adequately to citizens needs, consumer demands and retailers imperatives.

The commercial property sector is in a position to inform land use planning decisions because it is constantly scrutinizing societal change, demographics, lifestyle trends and consumer habits to adapt its offering and remain attractive to its retail customer base. Furthermore, most commercial property actors focus on local/national markets. Even the largest players in the sector do not generally venture into more than a few core markets as the in-depth knowledge of local conditions is critical to success. This field expertise should be put to good use when developing land use plans.

With both commercial property development and land use planning being essentially anchored at national if not local level, it seems difficult to address inefficiencies at a non-local level.

Commercial property companies – Serving retailers needs and consumers demands

The commercial property market is a large and diverse market not only when considered at European or global scale, but also at national or even local level. Commercial property owners vary from the individual local shop owner to the large property development groups owning and managing hundreds of different properties. All types of small and medium-size businesses between these two extremes coexist and compete for commercial development and/or management projects. At the larger end of the spectrum a distinction needs to be made between privately owned real estate companies and publicly listed ones. The listed companies – our members – may not be the more

numerous, but they certainly are among the most influential. Because of the public scrutiny that results from their listing on stock markets, listed property companies tend to be best-in-class in the sector.

Most commercial property companies take a long-term value creation approach. They create value for tenants, customers and shareholders by actively developing, managing, maintaining and regularly refurbishing their properties portfolio. The rental incomes they receive constitute their most important source of revenue. In other words, property owners are dependent on the success and quality of the retail services they provide. They are naturally inclined to making sure retailers and their customers are satisfied with the commercial space they provide.

Listed property companies have the additional imperative of generating investors' interest by continuously reinforcing the attractiveness of their assets. Property companies do so by upgrading the layout of their buildings, renewing the tenant mix and enhancing consumers' shopping experience on an ongoing basis.

Listed commercial property companies - key “best practice” influencers in the commercial property market

Commercial property companies that are listed on the public markets are key stakeholders in the retail property market and therefore have an important and influential role to play in the delivery of an efficiently operated European retail sector. A number of factors explain this, which we detail below.

For obvious reasons, listed property companies tend to be larger. They have wide shareholder bases and access to many different sources of capital which provide a stable and reliable long term supplier/partner for the retail sector.

The majority of listed property companies are internally managed, which means that management have long-term strategies in place to respond to evolving needs of tenants and the customers they serve. Listed property companies with internal management are perpetual businesses by nature. This fosters a need to evolve strategies that deliver an efficient, competitive product over the long term – anticipating changes in demographics, consumer trends, regulation, infrastructure and community needs etc – that property companies with external management and fixed period investors are less inclined to prioritize.

Listed property companies tend to be the more professionally managed and the most transparent as they are required to comply with strict financial reporting obligations but more importantly as their operations are under the constant scrutiny of the investor community in the public markets.

Listed property companies - leaders in improving the sustainability profile of the built environment

Buildings and their associated construction and operational activities (the ‘built’ environment) account for at least one third of global greenhouse gas emissions. Analyses of mitigation policies show that the built environment offers the largest potential for greenhouse gas abatement. The real

estate sector has a major responsibility in reducing global energy use and greenhouse gas emissions. Listed property companies are at the forefront of the real estate sector's efforts to reduce its environmental footprint.

Amounting to 30% of a typical office building's operating expense, energy use represents the single largest and most manageable item in the provision of commercial space. Rising energy costs magnify the importance of this issue for final users and property investors alike. Increasingly aware of their financial implications, investors start looking more closely at property companies' environmental policies. Much progress is needed both in environmental performance and in its reporting by property companies, but there are encouraging signs that investors scrutiny increasingly constitutes strong incentive for listed commercial property companies to improve their sustainability performance.

The European Centre for Corporate Engagement at Maastricht University School of Business and Economics) recently conducted a survey of 688 property companies and funds (listed and unlisted) in more than 20 countries. The survey illustrates both the scale of the challenge for the property sector in improving its environmental practice and how it reports environmental performance. It also clearly shows that, while there is still a long way to go in terms of improvement, the listed sector in Europe performs significantly better than the private market, as evidenced by this extract:

"Listed property companies show a much better environmental performance than do their private counterparts. The low scores may be partly due to the limited disclosure, as a result of which there is inadequate public scrutiny of property funds that operate in the private market. Moreover, the finite life of some private funds may lead to a more short-term focus and may hinder investments in energy efficiency. We conclude that private funds should consider their listed counterparts as benchmarks for 'best practices' in environmental performance."

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Specific issues

Consumer access to retail services

Consultation documents point: *The emergence of shopping centres has challenged the traditional location choice for new entrants retailers between prime-site (city centres) and non-prime site. The resulting trend of abandon of non-prime sites raises the issue of diminishing accessibility to retail services in suburban and rural areas.*

EPRA response: The Commission rightly points out that retailers looking for the best possible positioning of outlets and high levels of foot-flow naturally turn to city centers and shopping centers at the expense of non-prime sites in suburban or rural areas. Although this observation does have some merit, other issues should be considered.

As pointed out in our general remarks, there is little uniformity in the sector and it would be a mistake to disregard the variety of business practices and location strategies. There are many retailers with perhaps less of a high profile than the more established brands, who actively seek out secondary locations and do get the right floor space developed for them in these secondary locations. A distinction also needs to be made between small and big format retailers. Small format retailers generally prefer to open shops first in the city centre, then in the best shopping centres. Big format retailers are often forced to go to shopping centres and retail parks because it is very difficult if at all possible to find big outlets in most city centres.

It is also perhaps worth noting an obvious point that just as most economic sectors, the commercial property market evolution is essentially driven by a response to customer and consumer demands. The diminished importance of non-prime sites is essentially attributable to general demographic trends and changes in the consumption behaviour which retailers are responding to. The commercial property sector is essentially responding to a changed demand rather than driving it.

Shopping centers group most if not all services that consumers require in one location. The convenience provided by a one-stop-shop destination follows a similar logic than this of supermarkets and hypermarkets a few decades earlier. With limited time in their hands, shopping efficiency is important to many consumers and explains the success of the shopping centre model. The development of new shopping centers and other retail accommodation has increased choice for consumers and has enabled retailers to serve large concentrations of population in the most efficient way. This has in turn helped to drive down prices for consumers.

The establishment or decline of proximity stores depends on several factors, different from one country to the other, such as cultural characteristics and planning regulations. The discussion on this point is only relevant to the food sector where competition between small shops, supermarkets and hypermarkets is, once again, mostly driven by consumer demand. The largest stores are not always those that attract most of consumers purchasing. In many countries proximity stores such as small supermarkets have more market shares than hypermarkets. In the non-food sector, the discussion is irrelevant. Non-food retailers usually want to open in the best retail streets of each city and/or in shopping centres, hence they do not contemplate to have proximity stores.

In any event, the imbalance between urban, suburban and rural areas is a much broader issue that rather takes its roots in the evolution of society as a whole and changes to the structure of the economy. The concern that such evolution might raise accessibility issues is indeed relevant but can only be effectively addressed by an all-encompassing approach that includes urban planning, infrastructures, social services, housing and many other aspects at local, national and European level. The commercial property sector certainly has a role to play, but attributing it a significant share of responsibility in consumer access to retail issues would be disproportionate and unjustified in our view. EPRA members are nevertheless committed to actively contribute to any debate on the future organisation of the urban and rural environments.

Consultation documents point: *The emergence of shopping centres may also have negative environmental consequences as it implies the use of vehicles to undertake day to day shopping needs.*

EPRA response: Shopping centers, large supermarkets, hypermarkets or specialised stores in peri-urban locations do offer greater surfaces than city centre locations and are typically developed with easy access by car in mind, served by large car parks and located close to major roads. These developments raise interesting questions in terms of transport and environmental impact implications. It is true that shopping centers and other dedicated shopping areas are often easier to access by car, but it is not always and not exclusively the case. Shopping centres are not always peri-urban developments and they are also accessible by public transport most of the time. The consultation documents seem to focus mainly on suburban shopping centers, but these are not the dominant model in all Member States. In Germany, for instance, 43.4 % of the shopping centres are located in city centres (with rising tendency) and 39.3 % in other districts and only 17.3 % on the greenfield (source: EHI Retail Institute, Shopping-Center 2009).

In numerous instances, the development of new shopping centers actually triggers this of new transport infrastructures. New bus/train/metro drop-off points and lines are created to facilitate the access to the shopping area, which in turn benefits populations living in the immediate surroundings of the new development. Urban planning and transport infrastructures issues are fully integrated in the development strategies of commercial property companies. Moreover we see the emergence of shopping center development projects that beyond just shops, do integrate not only culture and entertainment facilities but even housing.

The negative environmental consequences linked to the use of road vehicles to undertake day to day shopping needs are not specific to shopping centers. In fact shopping centers may imply a net reduction of car uses compared to more traditional shopping locations. It is widely acknowledged most people take their car even for the short distance travels implied by proximity shopping. The multiplication of these is avoided by a concentration of services in one location. Damaging consequences of the systematic use of personal cars, such as congestions, energy consumption and GHG emissions can therefore be reduced.

Shopping centers also provide access to consumers to a variety of retail services that is not necessarily available to them elsewhere. Entertainment and culture offering are more and more common in modern shopping centers. It is worth noting that this offering is not necessarily to the detriment of the offering of other locations.

Retailers access to commercial space

Commercial property owners provide an essential service to retailers in the form of commercial space where their offer of goods and services can meet consumer demand. Taking the example of shopping centers, beyond the provision of space, shopping center managers also provide retailers with a number of ancillary services (security, cleaning, parking, animation, etc...) which contribute to facilitating the operation of their business and attracting foot flow.

Shopping centers have high rotation rates of tenants. Actively promoting diversity by allocating any vacant area of the shopping center by preference to stores from activities not yet represented is a common strategy for shopping center managers. It satisfies the existing tenants as it generates additional foot flow and provides consumers with access to a more varied range of retail services.

This also ensures that prime commercial space is not locked to new market entrants and independents from the established retail brands.

Consultation documents point: It is estimated that costs of retail property whether owned or rented currently represent between 16-48% of total operating costs, which is undoubtedly a significant figure on the balance sheet of a business with relatively low net margins.

EPRA response: We believe that shopping centers in particular play an important role in reducing tenants rent. For example, in the shopping centres of ECE (market leader of inner-city shopping-centres in the EU) the rent compared to the turnover averages 7-12%.

Consultation documents point: The rental costs do not appear to be closely correlated to GDP per head of the local population either. Thus for example, one would expect the rents in The Hague, Brussels or Marseille to be higher than those in Prague. Instead those of Prague are 10- 20% higher.

EPRA response: This example is an interesting one, but does not demonstrate any market failure. In fact the stated assumption that a higher rents level in Prague is somehow counter-intuitive has little merit. Compared to The Hague, Brussels or Marseille, Prague is an important touristic destination in Europe¹. The purchasing power of the local population has only limited influence on the rents level in the prime shopping locations.

A more relevant comparison would be to compare Prague with other large touristic cities such as London or Paris. A very different picture arises then. A study by Cushman & Wakefield² shows that the rents per square metre in Prague are with 1.980 euro/sqm clearly below those of Munich (3.600 euro/sqm), Zurich (5.246 euro/sqm), London (5.885 euro/sqm) or Paris (7.732 euro/sqm).

Consultation documents point: Given that retailers are relatively locked-in to such sites and that rental costs for secondary or tertiary locations, although lower, are indexed to those of prime sites, this could well have resulted in escalating rental costs in the EU12 compared to the EU15.

EPRA response: Making a general assumption that retailers are locked-in is inaccurate. For instance, in city centres retailers are often relocating in order to improve their exposure to potential customers or find a more suitable shop size. Without such changes the development of new shopping centres would hardly be possible. The development of new shopping centres in city centres contributes to the creation of new areas and thus increases competition among commercial property owners to attract retailers as tenants. This increased competition has virtuous effects such as the modernisation of buildings or in fact decreased rent levels.

Consultation documents point: Shopping centres engage in practices designed to attract and strengthen the position of prestigious retail brands (including discounted leases and restrictions such as covenants) that are believed to generate high footfall and will justify offering remaining space to

¹ Prague 2004 Top 6 in the number of overnight stays in Europe. For comparison: Prague 10.7m, Brussels 4.7m, The Hague clearly less than 2m, source: Städtetourismus in europäischen Grossstädten. Eine Hierarchie der Standorte und aktuelle Entwicklungen der Übernachtungszahlen.[City tourism in European cities. A hierarchy of locations and current developments of the overnight stays of visitors.] Dr. Tim Freytag, disP 169 · 2/2007.

² Global downturn hits the world's most expensive shopping streets, Sep 22, 2009

other retailers at higher rates. Such practice possibly accentuates accessibility issues in suburban and rural areas.

EPRA response: Offering better conditions to prestigious retail brands or big format retailers is indeed a practice in shopping centers, but it cannot be generalised and should not be seen as detrimental to small retailers. Shopping centre developers are often keen on supporting small retailers, start-up businesses and new entrants to improve the overall mix of business and increase a location's attractiveness as previously explained, but also to avoid being fully dependant on large chain operators. Furthermore the described practice is in no way a distortion of competition or an unjustified discrimination against independents, less prestigious brands or small format retailers. The practice is considered a fair compensation in recognition of the proven effect "anchors" retailers have of mechanically increasing the revenue of all other stores in the shopping center as they attract more customers on site. The effect is not marginal, especially for adjacent stores, and is rightly reflected in the leasing contracts of both the prestigious brand stores and their adjacent tenants.

Consultation documents point: *Pan-European or often global commercial property groups and their financial backers rent or sell properties to wholesalers and retailers at the local level. It should also be noted that some vertically integrated retailers are themselves major players in this market.*

EPRA response: The above statement gives the wrong impression that real estate companies are established globally while retailers are essentially local. On the contrary, there have been massive globalisation and concentration movements in the retail sector for quite some time now. The same dynamic is not generally observed with commercial real estate companies. As explained earlier, very few players have a truly pan-European reach, not to mention a global one. The local or national model remains predominant.

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