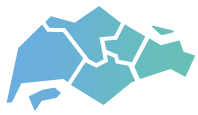
MEASURING MALL PERFORMANCE POST COVID19



How the performance of Singapore's malls is measured is becoming increasingly important given the current Covid19 pandemic. In this paper we examine different ways of thinking about the financial performance of malls and we explain why focussing on tenant sales is so important.

This analysis highlights 6 key strategies that will provide landlords with a far deeper understanding of their mall, which will help them navigate this turbulent period:.

1. **FORGET RENT, FOCUS ON SALES AND OCRS:** Only by focusing on sales and Occupancy Cost Ratios (OCRs) can you understand the strength and the sustainability of your income.
2. **UNDERSTAND WHERE YOUR SALES COME FROM:** A 3 km radius is not a trade area – shoppers don't follow such cartographic definitions. Use mobile phone data or surveys to understand who your shoppers are, where they live, and what their preferences are.
3. **FIND GAPS IN THE MARKET**: Landlords often think about gap analysis in terms of tenants. But we suggest first looking at your market, and finding the markets (locations, cohorts) that you are not penetrating. Then think about tenants that will penetrate these markets.
4. **BENCHMARK, BENCHMARK, BENCHMARK:** The Singapore retail market remains highly opaque compared to many other global markets. This holds the market back. Understanding how your tenants are performing is critical to optimising a malls performance, and this can only be done with effective benchmarking that looks beyond your own portfolio.
5. **A MALL IS A PARTNERSHIP**: A mall is more than the sum of its parts. Tenants and landlords must work together, sharing the risk and reward of their collective effort.
6. **THINK ABOUT THE FUTURE**: Sales, unlike rent, can be directly attributed to shoppers – the population, how much they spend, their preferences. As such, with the right analytical framework, the sales performance of mall can be forecast, scenarios can be tested and the outlook better understood.

Want to know more about how Cistri can help optimise the performance of a mall?
Click here to read our full analysis or speak to us today.

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FIRST, A QUESTION

WHAT IS THE MOST IMPORTANT METRIC FOR RETAIL MALLS?

Footfall? Rent? Invariably these are the metrics quoted by mall owners in Singapore, so surely these are the most important?

Wrong.

Perhaps it's Singapore's retail sales data? Singapore's per capita provision of shopping centre floorspace? Important, yes. The most important to a specific mall? Not even close.

If twenty years of analysing the performance of shopping centres has taught me anything, it is that the **most important metric for understanding the performance of a mall is centre sales**. Dollars through the till.

And this lesson has never been more apparent or important than now, as mall owners and tenants battle the impact of the Covid19 pandemic.

FOOTFALL: THE CRUDEST MEASURE OF ALL

At the best of times footfall is a crude measure of centre performance. Sure, you cannot have shops without footfall. But shopping mall footfall does not tell you anything about how much shoppers spend, and it tells you precious little about which tenants are succeeding, and which are struggling. In Singapore, many malls can generate large volumes of footfall simply because they sit adjacent to a train or bus station. But this does not always translate to success.

The weakness of footfall as a measure has never been so apparent as now. Circuit breaker (CB), both Phases 1 and 2, have totally changed the footfall dynamic. In Phase 1 of CB, malls with 'essential services' like supermarkets could still generate footfall, but with most high renting shops shut the benefit was limited. Now that malls are opening up, shoppers have returned but social distancing measures have impacted how this translates to sales and income for the retailers.

RENT IS IMPORTANT… BUT ONLY PART OF THE STORY

Centre owners often report rent or net income for a mall, and this is how the performance of the mall is often judged. However, measures of rent are only part of the story. Whilst high rents should indicate a successful mall, this is only the case if the rents are sustainable.

What is sustainable? Rent must be affordable to the retailer based on the profit they are able to generate from the sales going through their store. If a mall's rents are unsustainably high, they will invariably adjust downwards over time.

In our experience across many countries, it is not uncommon for centres to be over-rented. There are several reasons explaining why this might occur:

1. An over inflated expectation of the mall's success in attracting customers and sales. This is particularly the case for a new mall or an existing mall which has undergone a major upgrade. The tenants have committed to the centre on the expectation that their store will be able to generate sufficient sales to support the agreed rental. Sometimes, for various reasons, new malls do not perform as expected.
2. The impact of new competition (either bricks'n'mortar or online) has not been adequately understood, again impacting sales performance.
3. Too much duplication and over-lapping in the mall's tenant mix, or a tenant mix that does not reflect the catchment, limiting the sales potential for some retailers.
4. Significant adverse changes to the overall economy (such as SARS, the GFC and now Covid19) which, in turn, impact Singapore's retail sales and the sales of individual malls and retailers.
5. Internal operational issues for a particular retailer.

RENTS MUST BE SUSTAINABLE

A good example of malls becoming over rented occurred after the Global Financial Crisis in 2009. The Singapore retail market went into the GFC with strong momentum, having had a number of years of solid growth in sales and rents.

The GFC resulted in a short, sharp decline in sales and rents followed by a strong rebound. Between 2009 and 2012 rents grew as sales productivity (sales per sq.ft) increased. The market was riding high.

However, in 2012 there was a change. Rents continued to grow – tenant demand remains strong, and only flattened out in 2015. However in 2012 sales productivity started to decline. Few in the market would have noticed this, as total reported retail remained flat. At the same time the supply of retail floorspace continue to increase. The result? As retail floorspace increased, and total sales didn't, sales productivity had to fall.

It wasn't until 2016, after sales productivity had declined by almost 10% from its peak, did rents adjust downward. And adjust they did. According to the URA, Orchard Road rents decline by 8%, and Suburban rents declined by 14%by 2018.

This is a really good example of the relationship between sales and rents, and what happens when malls become over rented.

COMPARING RENT TO SALES PRODUCTIVITY

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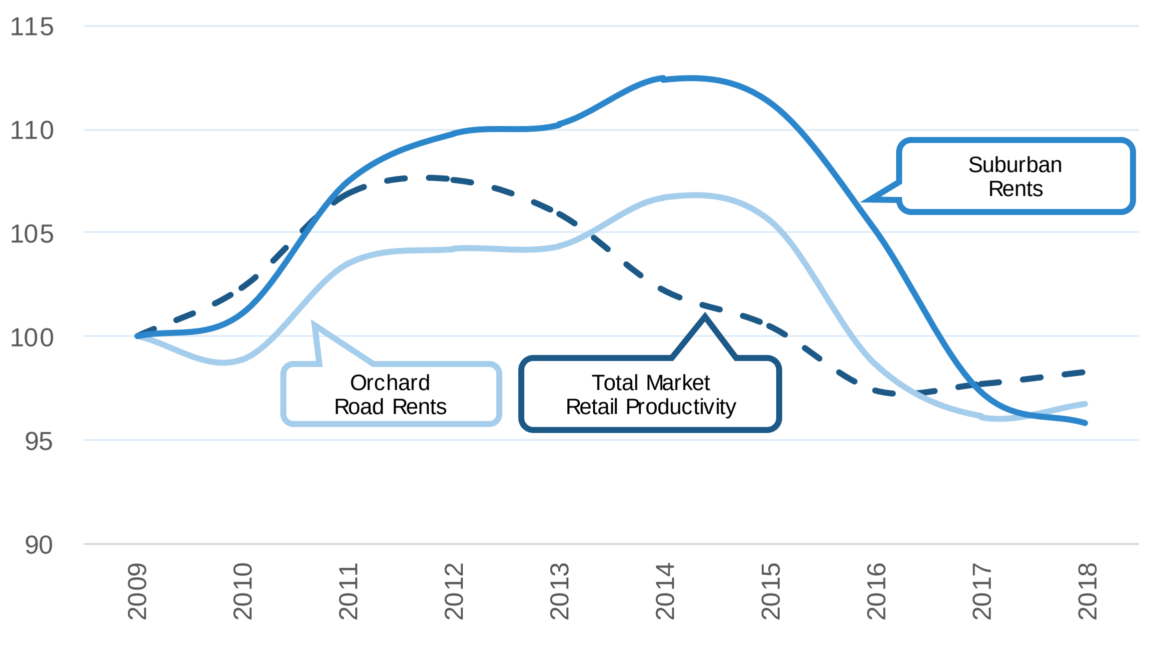

THE IMPORTANCE OF OCRS

This question of rent sustainability is critical. How then do we measure the sustainability of rent?

The best measure is what we call the Occupancy Cost Ratio (or OCR), or the ratio of gross rents to sales. Tenants of different types can generally afford to pay a certain share of their sales in rent, and with most retailers reporting their sales to their landlord under lease obligations, owners should be looking closely at the OCRs of all their tenants to ensure sustainability.

Not all tenant types will support the same OCR. Anchor tenants such as department stores, supermarkets and hypermarkets, will generally be able to support an OCR of under 10% over the long term. Smaller specialty shops would typically sustain OCRs of 16% or more, but again there are differences between and even within tenant categories such as fashion and F&B.

The OCR is clearly the best measure of income sustainability and more owners now report it. However, OCRs also have a weakness. Malls with higher sales productivity can often support a higher OCR than a mall that is trading poorly. A high OCR could mean a strong and successful mall, or a mall that is over rented.

Again, the Covid19 pandemic has thrown all measures of rent and occupancy costs up in the air. What rent should a tenant pay if it is forced to close? What rent can they afford to pay as they open up? How does a landlord maximise income – by maximising rents and risk losing some tenants, or focussing on protecting occupancy?

SALES METRICS ARE THE ANSWER

An expert in the field once told me that retail lease negotiations should not be about agreeing on the rent. The negotiations should focus on achievable sales for a store, and then calculating the supportable rent on this basis. Such an approach defines why sales and sales productivity are so critical to the performance of a mall.

The sales of any given tenant can be influenced by both the performance of the tenant, and the performance of the mall owner. Focussing on sales helps remind the owner that they should think of tenants as a partner, not a tenant. The owner's job is to help maximise the sales for the tenant, and not just collect the rent.

The final benefit of focusing on sales is that it allows a mall's performance to be properly understood in the context of its catchment. Afterall, who ultimately pays the rent? Shoppers do.

A chink in the theory?

In recent years there has been a realisation that the relevance of sales to the performance of a mall was declining as retailers were able to drive some of their sales through online channels. Many in the market were looking at different ways of valuing retail space while still ensuring that both landlord and tenant interests were aligned. For example, accurately measuring footfall throughout the centre had been one suggested way of measuring the value of space – rent levels could be aligned to footfall levels in front of a store, for example.

This is certainly a trend that will continue. We know of one landlord in the USA that has agreements with omni-channel retailers that include a percentage of local online sales as part of the rental agreement. Increasingly landlords will need to think of innovative ways of measuring the value of their floorspace.

However, this trend is slow moving - tenant agreements in Singapore generally remain as they were – base rent plus a small turnover rent component.

TURNOVER RENT… THE NEW NORMAL?

However, in the short to medium term, as tenants struggle through the Covid19 impact and gradual recovery, a steely focus on sales will be critical for landlords. One interim response adopted by some Singaporean mall owners has been to move many tenants temporarily onto turnover only rent- a positive short-term step to help support occupancy.

We believe that percentage rent leases will become increasingly common in Singapore's malls and this represents an equitable and sensible outcome for both parties. Even in the post Covid19 world, we expect turnover rent leases to play an increasingly important role. As such, the principal focus for Singapore's malls owners should be on sales rather than rent.

While some landlords have made the shift towards turnover rent leases, some landlords are taking more of a wait-and-see approach, providing only short-term relief. It is now however, becoming increasingly apparent that the Covid19 impact is likely to last a couple of years, so eventually a decision on longer term rent levels will need to be made. Again, understanding sales potential of tenants will be what matters.

The Singapore retail market stakeholders, including many landlords, still has a way to go before it fully appreciates the value of using sales performance to understand retail performance at a far deeper level than rent or footfall will ever allow. Singapore is not alone in this regard, with many other Asian markets having the same narrow focus. Changing focus towards sales will not be easy, but in the post Covid19 'new normal', it will be critical.