

# RENTAL INSIGHTS

## Focusing on fundamentals

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This is one of three documents prepared by Retail Dynamics that focus on the operational fundamentals of the shopping centre business.

- Improving marketing efficiency
  - Increasing sales
  - Increasing rental income.

If a copy of one or both of the others is required, please contact [info@retaildynamics.net](mailto:info@retaildynamics.net).

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# Introduction

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The mall industry does not have an objective method to determine the value (or rental) of individual premises to retail tenants. This leads to some tenants paying rentals that are too high & others paying rentals that are too low. The former impacts negatively future rental growth & the latter on current rental yields.

*Critically, the lack of an objective process to determine the value of premises means that mall managers are not able to determine which of these circumstances apply to individual tenants or premises under their management & so are unable to address this issue.*

The purpose of this document is to draw attention to some underlying, quantifiable fundamentals that can be used by malls to improve their insights into rental potential & to maximize short term rental income without impacting adversely on the ability of tenants to trade & so generate future rental potential.

# Overview

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The rental a retail tenant can afford to pay is determined by the potential sales it can produce from premises. The higher the potential sales, the higher the rental can be & vice versa.

The two main factors that determine the sales that can be generated from premises are:

- the number of customers passing its shop front – the greater the number, the higher the sales potential; &
- the shape of premises – because it is easier to extract high sales yields from shallow than from deep space.

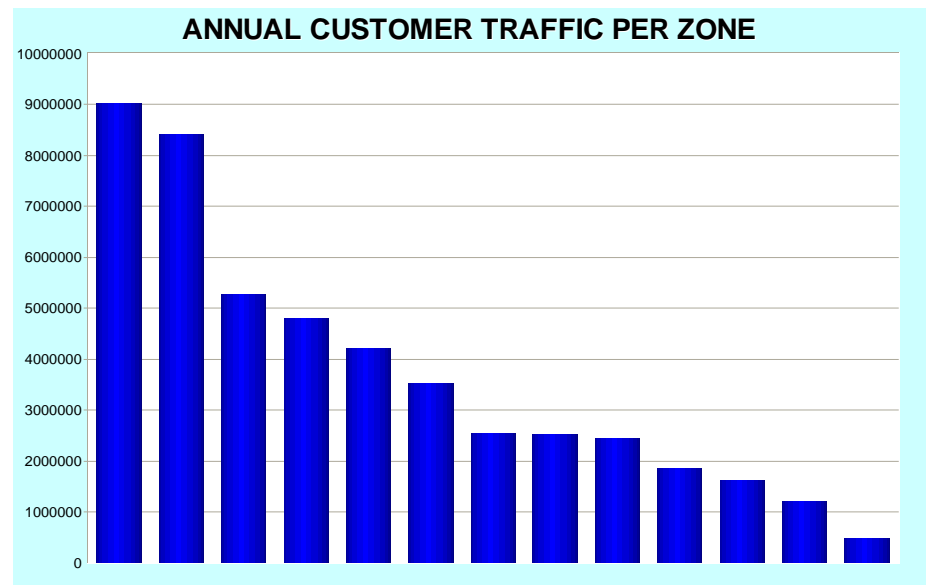
As the sales potential of premises impacts directly on its rental potential, these same factors can be used to more objectively compare the rentals of different premises in the same mall or across different malls. What follows provides insights into how this can be achieved & the benefits that will flow from it.

# Passing customer traffic

The total number of customers visiting a mall is of no relevance to individual tenants because it does not reflect the customer traffic in any one area of a mall. While one million customers might visit a mall per month, some tenants might only have access to a quarter of this number. Therefore, if customer counts are to be used to improve insights into rental levels & potential, customers must not only be counted at entrances to malls but also at internal points. This enables a mall to be divided into zones & the customer traffic in each zone to be quantified. The rental & sales data of individual tenants can then be integrated with the customer count in their specific zone to develop customer based rental & sales ratios per tenant.

This is an example of the extent to which customer traffic within a mall can differ by zone. Clearly these differences must have a material impact on size of premises, potential rental m<sup>2</sup> & trading densities per zone. If customer traffic is not counted internally, these insights are not available to management & decisions relating to size of premises, sales & rentals will not be as objective as they could be.

The cost of internal counting equipment can produce a substantial yield if the data it provides is used as suggested in this document.

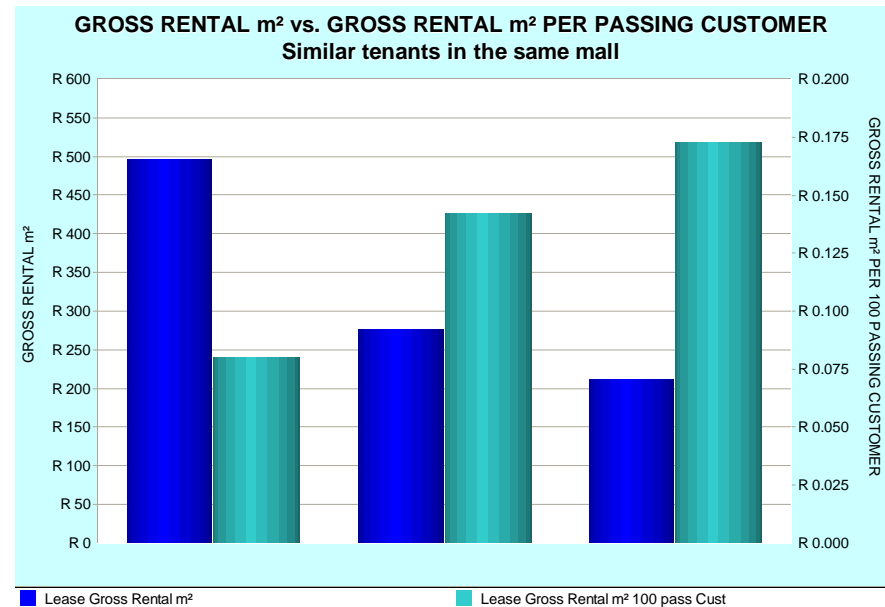


# Customer based rental ratios

To our knowledge, no mall **objectively** brings customer traffic to account when setting rentals. This limits insights into ideal rental levels & rental potential.

By integrating zone customer counts with individual tenant rentals, customer based rental ratios can be developed, the value of which is illustrated in this example. This graph reflects the data of three comparable tenants in the same mall. The tenant on the left paid the highest & the tenant on the right the lowest rental m<sup>2</sup> (dark blue bars). These differences were attributable to differences in customer volumes.

However, because mall management did not bring actual customer numbers per zone to account when setting rentals, the tenant on the left was paying the lowest & the tenant on the right the highest rental m<sup>2</sup> per passing customer (light blue bars). Despite its high rental m<sup>2</sup>, the tenant on the left had the greatest potential to pay more rental. Conversely, despite the tenant on the right paying the lowest rental m<sup>2</sup>, its rental m<sup>2</sup> per customer was more than double that of the left tenant. When customer based rental ratios are not being used, this type of situation exists without management being aware of it or being able to respond to it.



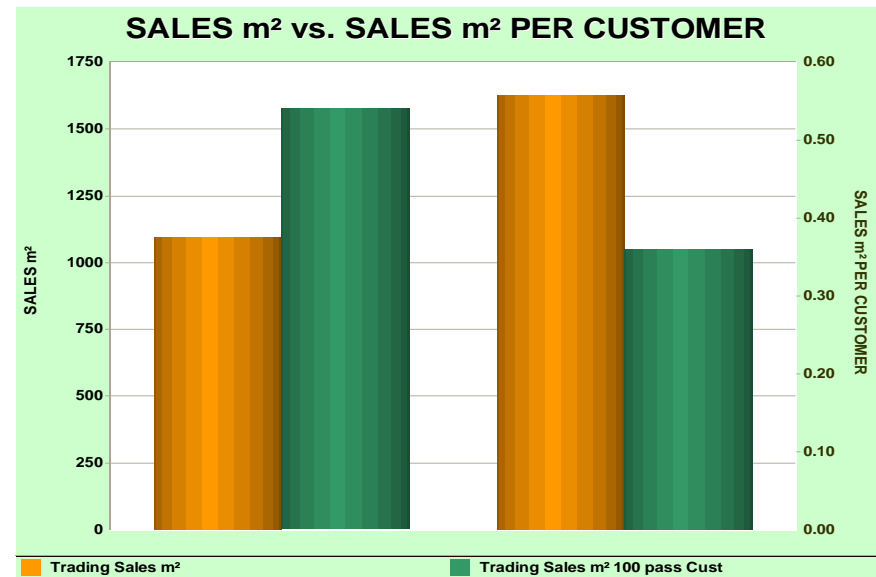
# Customer based sales ratios

In the same way, internal customer counts can also be used to generate sales m<sup>2</sup> per passing customer ratios, which is a measure of selling efficiency. The sales potential of a tenant is determined by the number of customers passing its shop front & the extent to which it exploits this potential is indicated by its sales per passing customer ratio. This example illustrates the difference between sales m<sup>2</sup> & sales m<sup>2</sup> per passing customer.

The tenant on the right generated a higher sales m<sup>2</sup> (orange bars) but a lower sales m<sup>2</sup> per customer ratio (green bars) than the tenant on the left. The tenant on the right generated a high sales m<sup>2</sup> because it was in a high traffic zone of the mall but it was not exploiting its customer traffic to the same extent that the left hand tenant was. Despite its higher sales m<sup>2</sup> ratio, the right hand tenant had significant potential to increase sales.

Conversely the tenant on the left had a low sales m<sup>2</sup> ratio because it was located in a quiet area of the mall & was over spaced relative to its passing customer traffic. Its high sales m<sup>2</sup> per passing customer indicated that there was nothing operationally it could do to increase its sales m<sup>2</sup>. The only way to achieve this was by reducing its m<sup>2</sup> occupied.

This illustrates that without customer based sales ratios, malls cannot differentiate between efficient & inefficient tenants.



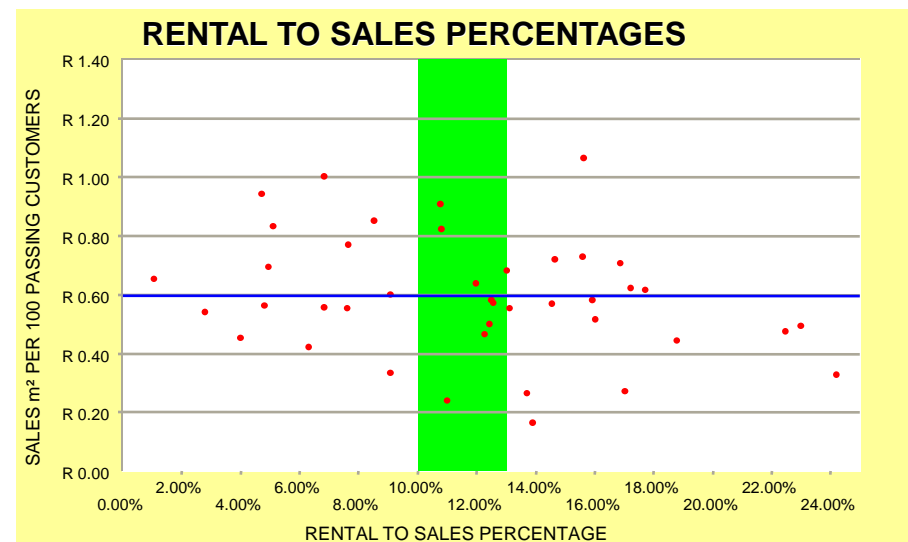
# Rental to sales percentages

Frequently tenants paying low rental m<sup>2</sup> complain that their rentals are too high. More often than not, these tenants also produce low sales m<sup>2</sup>, so mall management believes that it is not the rental that is the problem but the lack of sales – i.e. it is the tenant's & not the mall's problem. However, often this conclusion is totally flawed. As shown on the previous page, very efficient traders can produce low sales m<sup>2</sup>. To more objectively assess the merits of each case of high rental to sales percentages, the sales m<sup>2</sup> per passing customer of each tenant can be plotted against their rental to sales ratios – as illustrated in this example of all tenants in the same category in one mall.

We have included a horizontal blue line in the graph which represents the average sales m<sup>2</sup> per passing customer & a vertical green stripe which reflects a range of desirable rental to sales percentages.

The tenants in the top right segment have average levels of selling efficiency but despite this have high rental to sales percentages. Their rentals are on the high side. The tenants in the bottom left segment are trading at below average levels but despite this have low rental to sales percentages. Their rentals are on the low side.

This type of assessment does not eliminate the problem of high rental to sales percentages but it certainly identifies its real causes, which is the starting point to addressing the problems.



# Shape of premises 1

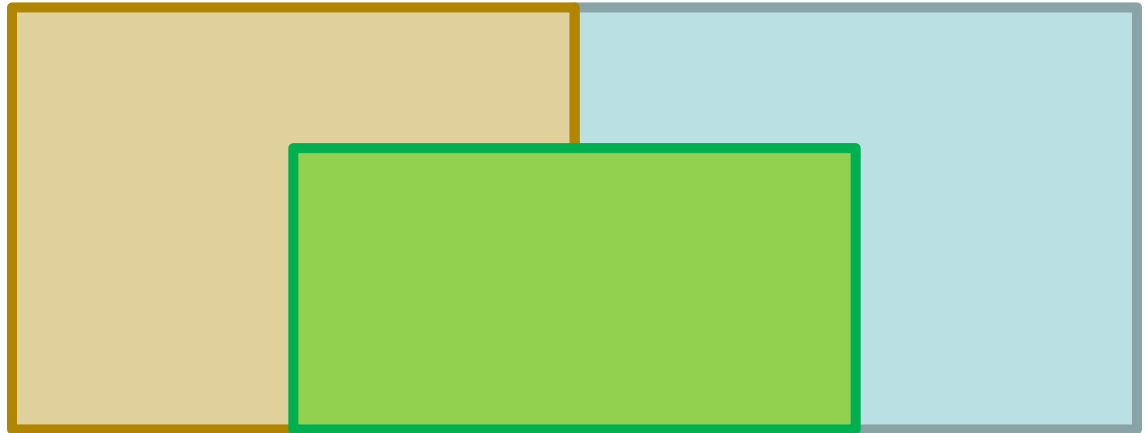
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Shape of premises has a direct impact on trading densities because it is much easier to generate high sales yields from shallow than deep space. The starting point of incorporating shape of premises into rental assessments is to quantify shape of premises so that it is easy to differentiate between different shaped premises.

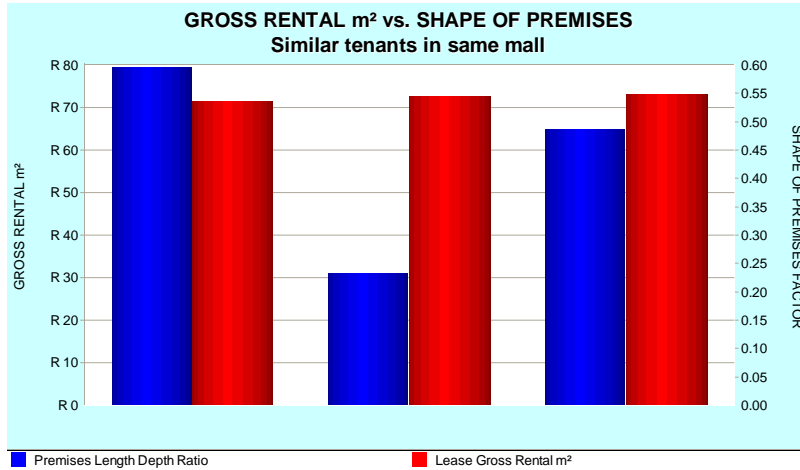
We use a shape of premises ratio for this purpose. This ratio reflects the relationship between the width of the shop front & the average depth (because tenancies are often not rectangular in shape) of the premises.

In this example, we show three theoretical premises, all of which are the same size. Obviously it will be easier to generate a higher sales yield from the middle premises than either of the other two & if shape of premises impacts on potential sales yields, it should also impact on rental levels. However, in our experience, shape of premises is seldom objectively factored into rental considerations as rental m<sup>2</sup> differentials are mostly based on size of premises.

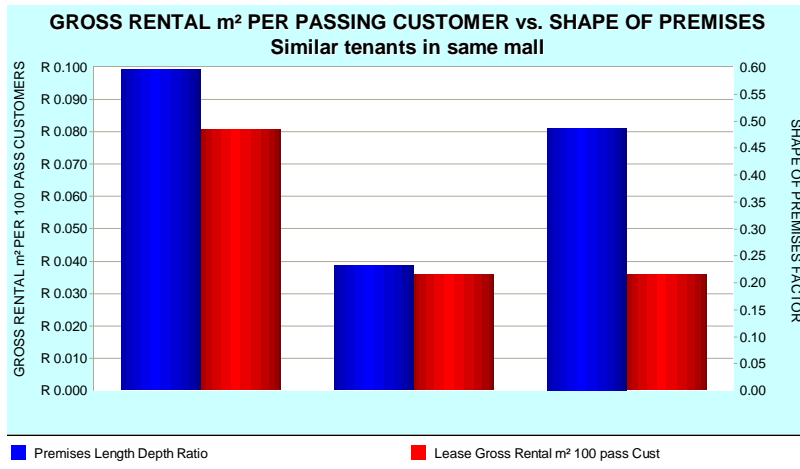
When shape of premises is used as an input into the setting of rentals, larger space users only enjoy lower rentals rates if they occupy deep space & the extent of their rental reduction is determined by the amount of deep space they occupy.



# Shape of premises 2

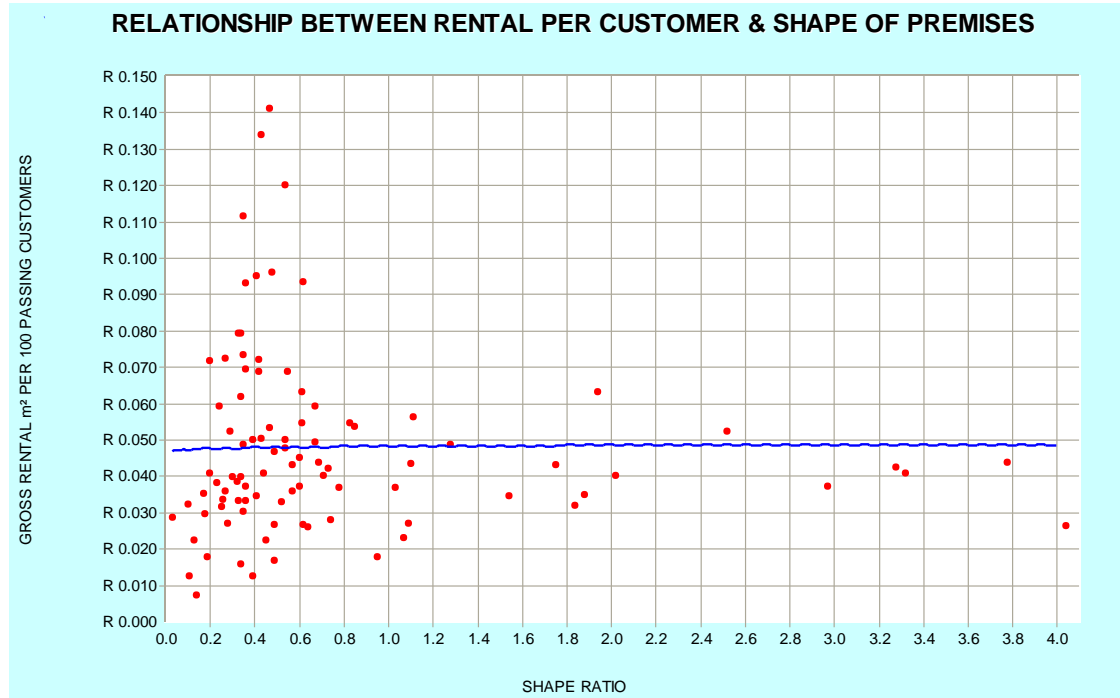


The example on the left compares the rental m<sup>2</sup> & shape ratio of three fashion retailers trading out of similar sized premises in the same mall. All three were paying a similar rental m<sup>2</sup> (red bars) but had very different shape ratios (blue bars). While their different shapes impacted on their ability to generate sales, this was not reflected in their rentals. Either the rentals of the tenants on the left & right were too low or the rental of the middle tenant was too high.



This second graph shows the same tenants but uses rental m<sup>2</sup> per passing customer rather than rental m<sup>2</sup>. This is a more valid comparison in our view because it brings both customer traffic & shape of premises to account. This graph suggests that the rental of the right hand tenant was significantly lower than it could have been. This type of assessment does not indicate what rentals should be but highlight anomalies in rentals & provide insights into where it might be possible to obtain higher rentals & where it might be necessary to ease up on rentals.

# Scope

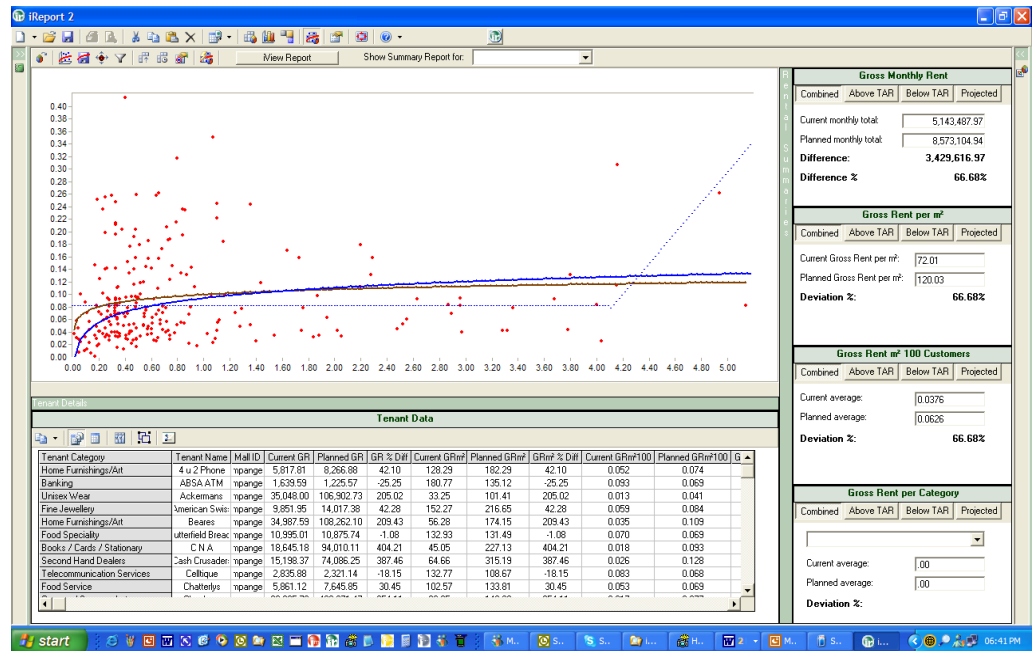


This chart plots all the tenants in one mall against their shape of premises (x axis) & gross rental m<sup>2</sup> per 100 passing customers (y axis). The dark blue line reflects the average relationship between these two variables. The fact that this blue line is virtually horizontal indicates that shape of premises has not been brought to account to any meaningful extent when determining rentals. If it had, the line would slope down markedly on the left (bad shape = low rentals) & upwards on the right. This is a fairly typical scenario & illustrates significant scope for improving the way rentals are set.

# Process

Previous graphs show how customer based rental & sales ratios & shape of premises can be used to improve insights into rental potential, However, if there is a desire to go further than just benefitting from improved insights, we do have a process that can be used to determine asking rentals based on these variables. This is a visual of rental setting software, containing a graph similar to the one on the previous page. In this case the brown average line illustrates the actual relationship between shape of premises & rental per customer & the blue line reflects the desired relationship (set by management). As the position & shape of this (blue) line is changed, the system indicates the impact on rentals.

The system generates a suggested rental for individual tenants by reading the rental m<sup>2</sup> per 100 passing customers off the y axis at the point at which the tenant's shape of premises intersects the desired rental line. This suggested rental m<sup>2</sup> per 100 passing customers is then factored by the customer traffic in the zone in which the tenant is located to derive a suggested rental m<sup>2</sup>. This process can be applied to all tenants simultaneously or only to tenants in the same category or occupying similar sized premises – at management's discretion.



# Systems support

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We have the systems to:

- Count customers at entrances of malls & at internal points;
- Include customer counts per zone of the mall in customer traffic reports (if customers are counted internally).
- Collect the monthly sales of individual tenants via the web, integrate this data with zone customer counts & or m<sup>2</sup> to provide sales m<sup>2</sup> & sales m<sup>2</sup> per passing customer ratios per tenant.
- Integrate rental data with zone customer counts & or m<sup>2</sup> to provide rental m<sup>2</sup> & rental m<sup>2</sup> per passing customer ratios per tenant.
- Provide malls & head office with access to all of this data held in one central database via web reports in 3 different formats – tables, graphs & color coded layout reports (pictured in back ground). The data reflected in the color coded layout reports can be changed at the click of a mouse. Tabular & graphic reports can include benchmarks, if required.
- Provide benchmarks using the data of all malls owned or managed by the same company.

In all cases, data integration & reporting can be managed by us, the mall owner or the managing agent.

# Rentals: Getting started

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The first step in the process is installing customer counting equipment at entrances & internal points within the mall. This is required to generate customer based sales & rental ratios. The purpose of the internal counting points is to break the mall down into different zones & quantify the customer traffic in these zones so the internal counting points must reflect both the layout of the mall & the perceived differences in customer flows within the mall.

Customer counting equipment can be sourced either from us or another vendor but an important consideration in the choice of vendor needs to be the ease of extraction of customer count data from the counting system & its integration with the sales & rental data of tenants.

The next step is the integration of data on an ongoing basis & providing mall management with easy access to these customer based ratios. If implementation of these ratios is being contemplated by a company that owns or manages more than one mall, there are three important facts to consider. These are:

- Centralized processing of data. It is impractical to expect individual malls to deal with the integration of data & generation of customer based ratios. This needs process needs to be centralized.
- Centralized access to data. If data is processed centrally, ideally all malls should access one centralized data base to view & work with their ratios. This ensures that there is only one version of the truth & also creates the opportunity for benchmarking.
- Benchmarks. In our experience there is considerable value to be had from making benchmarks available to mall managers. It allows them to compare the rental paid by a specific tenant in their mall against the rental paid by the same tenant in other malls or to compare rental m<sup>2</sup> per customer ratios across different tenant categories or sizes of premises – all of which improve insight & strengthen negotiating positions.

We have the infrastructure to do this work for malls or our systems can be used by mall owners or managers without our involvement.