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Retail Property *insights*

Plaza Gentor, a neighborhood center in Monterrey, Mexico
Courtesy of MAC | L arquitectos

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INTERNATIONAL COUNCIL OF SHOPPING CENTERS

The illustration on the cover depicts Plaza Gentor, a neighborhood center in Monterrey, Mexico (*Courtesy of MAC | L arquitectos; special thanks to Juan Ignacio Rodriguez Barrera*.)

Mexican Shopping Centers: In Search of Common Definitions

Standardization Furthers Understanding of a Growing Industry

*JUAN IGNACIO RODRIGUEZ BARRERA**

Abstract: *This article proposes a system for classifying shopping centers in Mexico, which has been reviewed, discussed and embraced by ICSC's Mexican Research Group. Criteria are provided for five center types based on tenant mix, anchors and markets.*

The International Council of Shopping Centers' (ICSC) Mexican Research Group (MRG) recognized the need for investors and the Mexican shopping-center industry to have a uniform classification of shopping centers so as to better understand the supply and demand for retail real-estate properties in the nation and to benchmark the investment and operational performance of like-types of properties.

There are several ways of classifying shopping-center types based on size, shape or tenant mix. This article presents a consensus view among the MRG of the definitions of the various schemes of shopping centers in Mexico, but also presents a current picture of the industry size and its segments along with the trends in new development projects for the nation.

What is a Shopping Center?

ICSC defines a shopping center as a purpose-built property, which includes retailers, restaurants and/or other commercial establishments, owned and managed as a single entity. But not every shopping center is the same; these differences require a classification system that best distinguishes unique shopping-center schemes. A national standard needs to be formulated that captures that character and purpose of the range of centers in the country. But there is a second reason for this classification standard: to facilitate cross-border shopping-center comparisons.[1]

The task that will be described herein is to lay out that classification scheme and to give it content. But as always, some parameters have to be set for determining and counting a shopping center. For this purpose, shopping centers have at least one anchor store (a department store, grocery and/or cinema complex), gross leasable area (GLA) greater than 50,000 square feet (sf) and more than 20 stores. One exception is for centers with more than one anchor store included, even if these properties have fewer than 20 stores.

Classification Without Doubt or Subjectivity

According to the dictionary, "classify" means to sort or divide a set of elements into classes based upon a set criteria. But when those criteria are too vague or flexible, the segmentation is meaningless. It is, therefore, imperative to generate a framework for grouping all the different types of shopping centers into specific sets that leave no room for doubt or subjective categorizations.

Among the industry classifications commonly used to describe Mexican shopping centers are grocery-anchored, power center and power town, lifestyle, town center, entertainment center, village town center, festival marketplace or specialty center, community center,

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[1] See *Towards a Pan-European Shopping Centre Standard: A Framework for International Comparison*, International Council of Shopping Centers, Inc., 2005. Globally, there are two broad types of centers—traditional and specialized. ICSC recognizes, however, that it is not always possible to roll-up every center type in every country to common schemes that would be directly comparable globally. In some cases, ICSC's "concordance table" allows country-specific schemes to be mapped to that international standard. In other cases, specific country or regional center types are unique and there is no aggregation possible for global comparison.

Figure 1-1
Trade Areas for Mexican Shopping Center Types

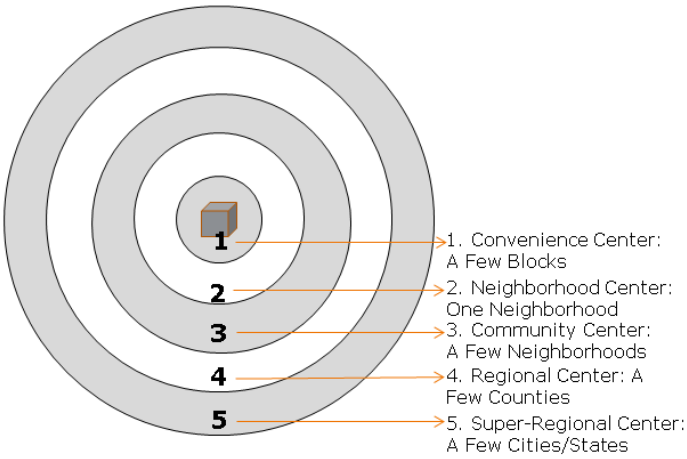


Figure 1-2
Plaza Central, A Regional Center

Source: MAC | L arquitectos

enclosed mall, fashion mall, galleria, mixed-use center, open-air, strip, urban mall, urban infield and value-oriented mall. Unfortunately, it is possible to classify the same shopping center within several of these categories, even those seemingly inconsistent with each other. An example is Plaza Antara in Mexico City. It is known as a fashion hall, a term derived from fashion mall, but it could also be classified as an entertainment center, lifestyle center, open or open-air mall, mixed-use, large, festival marketplace, urban mall or simply mall, among many other types. Finally, a new classification sometimes is created just to describe a project and help the market to understand and identify it.

This MRG-endorsed segmentation framework initially classifies shopping centers based on the trade area they serve, which is directly related to the tenant mix rather than configuration and architecture, which often bear little relation to the center's commercial operation. Figure 1-1 helps to conceptualize how a trade area can help to determine the type of center. **Then this criterion is combined with anchor information and the number of tenants**. This application yields five shopping-center schemes in Mexico:

1) Super-regional malls: These centers attract populations that reside in cities beyond where they are located. Their size (averaging 700,000 sf of GLA) and tenant mix is not possible to repeat in many markets. This type of mall usually focuses on fashion or outlet retail.

In Mexico, only six shopping centers are considered fashion-oriented super-regional malls. These contain at least three department stores and range upward from 800,000 sf of GLA. They always include entertainment, services and, in some cases, a grocery store. One example of a super-regional mall of this type is Plaza Satelite, a project built in Condominio in 1971.

The six outlet-type super-regional malls in Mexico range from 100,000 to 350,000 sf of GLA. Most have a department store and cinema complexes. Some even have grocery stores, making outlet centers in Mexico more like community centers than outlet centers in the United States, for instance.

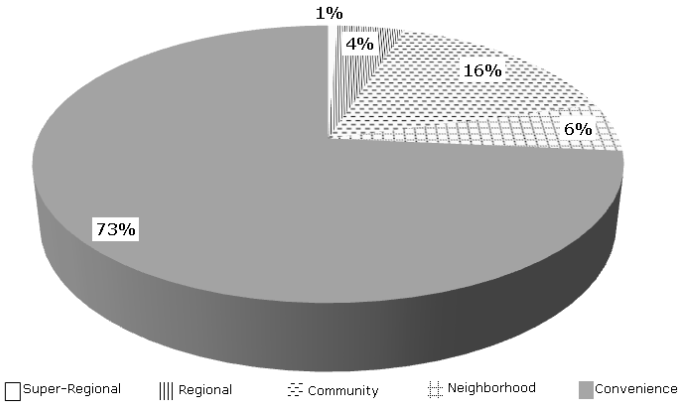
2) *Regional malls*: This center concept or scheme features one or two department-store anchors and has a trade area that is smaller than for super-regional centers. Although in some cases they might attract people from other cities, they generally cater only to those in the city closest to the site.

In Mexico, 101 shopping centers fall into this category, with at least 47 and up to 425 stores. Though that last number might seem too big, it is due to a high-density trade area or one with high purchasing power. Typically, the number of stores in this center type is 135. Sometimes, grocery stores are included in the tenant mix. Plaza Central, a Grupo E project that opened in 2010, typifies this type. (See Figure 1-2.)

In some cases, projects in this category might lack a department store, but they are anchored by a large proportion of entertainment tenants, so they manage to cover a wider trade area.

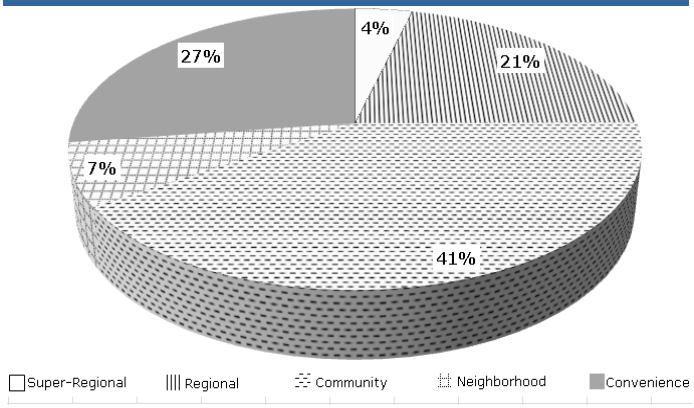
3) *Community centers*: This is the most common type

Chart 1-1
Format Share of Mexican Shopping Centers



Source: ICSC Mexican Research Group

Chart 1-2
Format Share of Mexican Shopping Center Gross Leasable Area



Source: ICSC Mexican Research Group

of shopping center in Mexico; its median size is 200,000 sf. Almost all cities with populations of more than 150,000 people have at least one center of this type; in some cities, it is the only major shopping center. In total, 366 community centers operate in the country.

Typically, such centers are anchored by a grocery store with a hypermarket format. But there are also shopping centers with size and tenant mix significant enough to influence a medium-sized trade area, even though they are anchored instead by cinema complexes and restaurants. Therefore, specialty or entertainment centers can also be assigned to this category.

Also included in the community center type are power centers, i.e., centers with two or more grocery stores, cinemas and/or wholesale stores, usually with no more than 30 small shops due to these centers' need to reach large trade areas. (Figure 1-3 depicts Las Tendas San Esteban, an example of a community center.)

Figure 1-3
Las Tendas San Esteban, A Community Center

Source: MAC | L arquitectos

4) *Neighborhood centers*: As the name implies, this center type has a smaller area of influence, serving the needs of the neighborhood in which it is located. Because of its size and tenant mix, this format can be used extensively. Some trade areas have several of these centers. Currently there are 130 shopping centers that fit this concept in Mexico.

This type of shopping center is always anchored by grocery store with supermarket format. It can appeal either to a middle/high socioeconomic level or to a middle/

Table 1-1
Mexican Center Breakdown by Number and Square Feet

Category	Number	Gross Leasable Area (GLA)*	Average GLA*
Super-Regional	12	8,400,000	700,000
Regional	101	45,750,000	450,000
Community	366	88,800,000	240,000
Neighborhood	130	15,610,000	120,000
Convenience	1,700	59,200,000	30,000
Total	**2,309**	**217,760,000**	**94,310**

Note: * = square feet
Source: ICSC Mexican Research Group

Table 1-2
Mexican Shopping Center Characteristics

TYPE	SUB-TYPES	TRADE AREA RANGE (KILOMETERS)	NUMBER/TYPE OF ANCHORS	TYPICAL ANCHORS	ANCHOR SHARE	TENANT MIX	SURFACE		STORE RANGE	AVERAGE STORE NUMBER
							GROSS LEASABLE AREA	LAND		
Super-Regional	Fashion Mall, Outlet Center	25+ KM	3 department stores (>10,000 square meters)	Senior Department Stores: Liv/Sears; Phierro; Cines	70%	General Merchandise, Fashion, Entertainment, Services	Average: 700,000 square feet (sf) / 65,032 square meters (sq m)	15 hectares	120-385	230
Regional	Fashion Mall, Entertainment Center	8 up to 25 KM	1 department store (>10,000 square meters); hypermarket; cinema	Senior Department Stores: Liv/Sears; Phierro; Dorian's; FF; Cinemas; Grocery Stores	70%	General Merchandise, Fashion, Entertainment, Services	150,000-1,000,000 sf/13,935-92,903 sq m	10 up to 15 hectares	47-425	135
Community	Grocery-anchored, Power Center, Entertainment Center	3 up to 5 KM	Department store (< 10,000 square meters); hypermarket; cinemas	Hypermarket: Wal-Mart / Mega / Soriana / Chedraui; Cinemas; Junior Department Store; Home Improvement Store	75%	General Merchandise, Convenience, Fashion, Entertainment, Services	Median: 200,000 sf / 18,581 sq m	5 to 13 hectares	30-360	90
Neighborhood	Neighborhood center	1.5 up to 3 KM	Supermarket	Supermarket and Warehouse Stores; Superama: Superama/ Bod. Aurerra / Com. Mexicana / BCM / HEB / Hkdo. Soriano / Casa Ley	65%	Convenience	50,000-200,000 sf / 4,645 sq m-18,580 sq m	2 to 7 hectares	30-150	65
Convenience		0.25 up to 1.5 KM	Convenience Store	Convenience, Drugstores: Oxxo / Super 7 / Extra	25%	Convenience, Services	Less than 50,000 sf / less than 4,645 sq m	500-5,000 square meters	6-120	21

Source: ICSC Mexican Research Group

lower, in which case the supermarket is formatted as a warehouse. These shopping centers typically contain 65 stores, although the average store size is only 500 sf.

5) *Convenience centers*: These so-called "strip" or "open-air" centers are the smallest type of shopping center, offering convenience products and services and serving a smaller trade area than the other categories. Therefore, this type is more heavily represented throughout the country. The best estimate is that approximately 1,700 centers fit into this category. Though convenience centers comprise nearly three-quarters (73%) of all centers in the country, they constitute only one-quarter (27.2%) of total center GLA. (See Charts 1-1 and 1-2, respectively, for breakdowns by category.)

Typical characteristics for each type of shopping center in Mexico are presented in Tables 1-1 and 1-2.

The Mexican Shopping Center Industry

Mexico has 609 shopping centers that might be classified in the four larger categories in Table 1-3 and another 1,700 convenience centers of less than 50,000 sf of GLA. Total GLA amounts to 217.8 million sf.

In recent years, the development of shopping centers in Mexico focused on community center, anchored by a supermarket and a cinema complex. This center type is much more widespread throughout the country and can now be found in almost all cities with large populations.

More recently, Mexico has seen increasingly rapid development of smaller, neighborhood centers. These schemes are easier to adapt to urban areas, which allows for higher lease rates and, in some cases, integration into mixed-use projects.

Although several regional malls are currently being developed in Mexico, most shopping centers that will be built in the near future are expected to be small centers.

Conclusion

Throughout the world, different systems of shopping-center property classification exist.[2] The ICSC's Mexican

[2] James R. DeLisle, "Towards the Global Classification of Shopping Centers," *ICSC Working Paper*, February 10, 2009, http://www.icsc.org/srch/rsrch/wp/GlobalRetailClass_Feb2009.pdf, retrieved April 12, 2012.

Table 1-3
Mexican Center Breakdown by Subcategories and Size

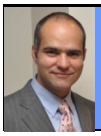
Type	Center Count	SIZE (IN SQUARE METERS) Very Big > 80,000	Big 40,000-79,999	Medium 20,000-39,999	Small 5,000-19,999	Very Small <5,000
Super-Regional	**12**					
Fashion Mall	6	4	2	0	0	0
Outlet Center	6	0	0	5	1	0
Regional	**101**					
Fashion Mall	99	6	43	34	16	0
Entertainment Center	2	0	1	1	0	0
Community	**366**					
Entertainment Center	49	0	1	8	40	0
Grocery-Anchored	268	2	34	108	124	0
Power Center	49	0	1	18	30	0
Neighborhood	**130**					
Grocery-Anchored	130	0	0	0	130	0
Convenience	**1,700**	0	0	0	0	1,700
Total	**2,309**	**12**	**82**	**174**	**341**	**1,700**

Source: ICSC Mexican Research Group

Research Group approached the classification of Mexican shopping centers based on their size and tenant mix. However, to the extent that the trade area is a function of size and the tenant mix, it is suggested here that trade areas are an effective way to classify the five types of shopping centers in Mexico.

Having a clear, simple classification system allows all industry participants—developers, lenders and investors alike—to identify every center in the same way and to understand the supply and demand of retail space better.

Classification may change over time as the industry evolves—this is almost a given. So this framework is only a starting point to better understand the size and character of the Mexican shopping-center industry today.



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Surmounting Cultural Barriers to Entering Mexico

Retail Real-Estate Companies Weigh How Much to "Tropicalize" South of the Border

*ANDREW STRENK**

ABSTRACT: *Technical, legal and logistical barriers can pose major difficulties for retailers and developers who are eyeing locations in Mexico. Often overlooked, however, are cultural barriers to entering this market. This article considers three scenarios in which grave mistakes by United States retailers led to underperforming centers—and a fourth case in which another company achieved its goals and made a breakthrough in the market.*

When considering an expansion into Mexico, retailers, developers and their financial partners from the United States tend to focus on the technical, legal and logistical aspects of market entry. However, cutting across and overlaying these barriers is one of context, not content: culture.

One often hears about the need to "tropicalize," or to adapt to those aspects of local culture without forgetting one's core values or identity. The trick is knowing how much, or little, to accommodate, or acculturate, or both. Companies entering the Mexican market that decide to adopt all behaviors prevalent in the business culture are unlikely to possess much of a competitive advantage, having shed what makes them unique in the first place. On the other hand, if they refuse to change *any* of their own procedures and behaviors, they are likely to be frustrated, if not defeated, by innumerable and often not very visible obstacles.

This cultural barrier does not arise simply from a linguistic difference. As important as knowledge of the Spanish language is, so is appreciating Mexican history in order to know how and why matters turned out the way they have today, and how historical developments have impacted business owners, business culture, consumers and their behavior. In all respects, Mexican culture must be learned, if one wants to remain in business in the nation over the longer term.

In Mexico, many large businesses are still owned and operated by families, with many, if not all, members generally playing roles of one kind or another. This personalized dimension impacts many different aspects of business. Four specific examples, all drawn from real-life cases, illuminate the cultural divide. (Some of the non-cultural barriers are highlighted in Box 2-1.)

Case 1: Business *Is* Personal Too

A major United States retailer was already well-known throughout Mexico, enjoying very positive name recognition. A series of older, experienced real-estate veterans were chosen to lead their expansion into Mexico. Unfortunately, management decided that the real-estate function was to be each individual's last assignment, a kind of reward for long years of loyal service before they went into retirement. So, after a year, more or less, each individual retired and was replaced. As the years went by, the company began to wonder why progress in finding and acquiring new sites had slowed to a crawl.

After all, before departing, the real-estate veterans spent their terms meeting with contacts, building relationships, developing friendships and evaluating properties. Unfortunately, around the time they were gaining traction and about to close deals, they retired. New people stepped in. Rather than picking up where predecessors left off, the new directors of real estate had to meet property owners, lawyers and *notarios publicos* all over again and build new relationships. The cycle of lunches, dinners and meetings began anew. At the point when the new people finally seemed ready to make major progress, they retired, too. Again, they were replaced by someone with no experience in Mexico. With each change, the expansion program slowed a little bit more. Eventually, it ground to a complete halt.

*President, Strategic Planning Concepts International LLC

Box 2-1

Non-Cultural Barriers to Entry

As significant as it can be, culture presents only one barrier to developers and retailers looking at new markets in Mexico. The following factors should also be carefully considered before entering:

***Legal*:** Issues such as the lack of transparency in real-estate ownership, unrecorded deeds of sale, the existence of unpaid back taxes, and the all-powerful role of the *notario publico* in real-estate transactions are all important and must be taken into consideration. The amount of time required to complete a transaction generally exceeds the norm in the United States and cannot always be done easily over the telephone.

***Logistics*:** Many of the best retailers today are, in reality, more logistics companies than retailers. While the logistical situation has improved tremendously in Mexico, it still does not match the United States. The road, rail and air infrastructure has never been better than it is in 2012, but serious gaps remain when trying to link different markets with each other and with the United States. The many regulations stemming from the North American Free Trade Agreement, while intended to promote trade, often become barriers every bit as serious as those that the agreement was designed to eliminate, adding paperwork and delays to the transport of goods.

***Security*:** Complicating matters is the fact that different layers of government contest with various drug cartels for control of geography. Even in areas where government control is good and government-cartel or inter-cartel violence is low, intra-cartel feuds can wreak havoc with shipments and schedules. The change of administration that will ensue as a result of the 2012 federal election may or may not bring about a change of government policy in the conflict with the cartels. But either way, retailers must manage the security risk, which will require extra resources.

***Data*:** In Mexico statistics often can take a subordinate role to other requirements. The various levels and agencies of governments can (and often do) produce multiple sets of data, which can (but often do not) agree with each other, and sometimes do not agree with reality. Understanding the reasons for this and for whom data was intended can be helpful in sorting through conflicting information. Reviewing population figures for the National Institute of Statistics and Geography (Instituto Nacional de Estadista y Geografia, or INEGI), for example (and especially with its predecessor, the Direccion General de Estadistica, or DGE), makes it nearly impossible to establish any meaningful trends due to changes in methodology and the mishandling of the 1970 and 1980 Census results. In addition, the most common measurement in Mexico would indicate that for the last few decades, the nation's unemployment rate was not only less than that of the United States, but often a fraction of the U.S. rate. Whether trying to measure population, income levels, retail sales results, rates of inflation, gross domestic product growth, levels of unemployment, annual profits or many other things, it is best to realize that this is a different culture. Numbers often are produced differently, aimed at different audiences, used differently and manipulated for a variety of differing reasons. When one is requesting even public data in Mexico, one should expect that, instead of immediately providing the information, the official holding it will inquire for what purpose it will be put to use, who will see it and use it and how widely it might be disseminated. With some effort, it is possible to work through this maze, but for some United States companies that are obsessive-compulsive about acquiring accurate data, this can be a big barrier.

So what happened? Business owners in Mexico like to familiarize themselves with partners or colleagues. If they do not like someone, they largely avoid doing business with that person, and will warn family, relatives and friends against doing so, too. The deal not only has to make sense, but more importantly, the individual proposing it must be likeable and personable. It takes time to build a relationship and trust. A replacement cannot necessarily resume where the last person left off. This company would have made much more progress by selecting a different, younger candidate and leaving him in place longer. The company eventually gave up and left Mexico. Their difficulties, while not all due to real-estate issues, did have a strong cultural dimension.

Case 2: Taking the Time to Learn

Understanding the culture is not always a matter of ethnicity. Another major United States retailer initially chose for its head of operations in Mexico a Cuban-American. When this did not work out, it then chose a Mexican-American, under the theory that both candidates were Hispanic and therefore things would proceed more smoothly. Neither choice worked out well, as their linguistic affinities with potential partners were torpedoed by their brashness and arrogance.

Ultimately, the company selected an older, friendly Anglo who was well-educated, cosmopolitan, urbane, quiet, and attentive. Even though initially he spoke no Spanish, knew no Mexican history, and had not visited the nation before, he eventually succeeded in his job. His advantage was, to use a trite phrase, that "he knew what he didn't know." Patient and personable, fascinated rather than frustrated by the nuances of Mexican culture, he proved willing to enjoy long lunches and good food, learning what he could as he went along. He also resisted jumping into the first deals that were offered to him.

Within a year, he made 21 property deals. Soon, property owners undercut each other for the chance to do business with him. In addition, they, in turn, referred relatives and friends to him. Unfortunately, home-office politics led to his removal for "lack of sufficient progress" (as measured against United States standards).

Over the next five years, four successors completed only half the number of deals he had accomplished in three years. Each successor, after failing to meet a pre-assigned quota of transactions, was replaced by an ever-more boastful one who promised quicker results. Instead of accelerating, the company's expansion program slowed to a crawl. The company learned the hard way that entering the Mexican market is a long-term process that needs to be built one relationship at a time.

Case 3: Know Partners Well *Before* the Deal

In a country such as Mexico, information is not necessarily widely available to the public, available data are not necessarily accurate or complete, and the legal system is not always transparent. It is important, then, to know one's partners and contacts well before making a decision with long-term implications.

Massaging the data is a global issue, not unique to Mexico. But favorable impressions generated by a culture that values hospitality and politeness can interfere with accurate assessment of capabilities. A foreign company may need to tropicalize when it moves into Mexico, but not by completely shedding its own basic identity. A frequently heard comment is that many companies when first entering the market tend to "check their brains at the border." A major part of the necessary due diligence consists of getting to know the people with whom one is dealing, not just the corporate financials. For example, in Mexico, the first family or company contacted may not be the best choice for a long-term, successful joint venture.

Deciding that it required a joint-venture partner for its expansion program into Mexico, another major American retailer quickly met, on its first trip, a local company that seemed to mirror itself, at least in terms of the kind of business involved. After some initial meetings and lunches, the two companies agreed to form a joint venture to help the American company expand into the market. The Mexican partner would provide all the market research, select and acquire the sites, acquire the entitlements and permits, massage the political connections and control the relationships with general contractors, among other things. Assuming that its partner would know the trade areas better and naturally would pick the best sites, the United States company did not devote many resources to store-location decisions. After a promising start, many stores underperformed due to their weak locations. Even worse, expansion progress slowed, and then halted, because the Mexican partner had zero interest in expanding beyond its core area of operations. Many years later, the U.S. company still has not fully achieved its strategic plan to expand to the rest of Mexico. The Mexican partner continues to drag its feet, placing politeness and diplomacy ahead of candor. Discussions about further expansion just did not happen. Not wanting to disappoint its partner, or be the bearer of bad news, the Mexican partner in this joint venture has never clearly admitted that it lacked both the interest and the resources to assist in further expansion.

Lost Opportunities

A better understanding of cultural differences in terms of how the world is perceived, how decisions are made and how they are communicated would, in the opinion of this author, have resulted in radically different outcomes for all three preceding cases. The first American company would still be in business in Mexico, with enough units to be a serious competitive presence. The second would have met its announced expansion targets far sooner. The third would be truly national in scope, instead of only regional.

Case 4: Overcoming Cultural Barriers

In contrast to these three unsuccessful companies, a fourth American retailer adeptly mixed creativity, patience, firmness and flexibility to achieve a breakthrough in the market and change the industry. They found the right "tropical" formula. A major stumbling block was removed when an internal market assessment concluded that not only would none of the potential joint-venture partners really be able to help the company, but that they would more than likely become unintentional obstacles on the path to success.

Instead, the company turned to a mix of in-house bilingual and even more importantly, bicultural executives, to help lead the expansion effort. Most of the team subsequently put together in Mexico consisted of Mexican nationals rather than expatriates. The small executive team understood the Mexican culture and various subcultures from long years of experience. They also grasped the goals and objectives of the United States company. In addition, this retailer invested several years of intensive due diligence about demographics, legal issues, logistics, markets and sites before ever opening its first store. This investment in time and effort considerably exceeded the combined efforts of several competitors, who handed these assignments off to partners. While various specialists and consultants were retained to provide expertise for particular purposes, the company largely chose to "go it alone."

The result was that, while the company slightly adjusted its overall strategy in response to some

challenges, it leveraged its brand, experience and format to carve out significant market share within Mexico. Following the first opening, expansion then increased. There was no need to keep partners "happy," so errors were rather quickly corrected without hard feelings. The situation was somewhat deceptive, because seemingly quick decisions tended to based on extensive research and planning.

Conclusion

From the United States, Mexican culture can look monolithic. However, like the terms "Hispanic" or "Latino," many nuances exist. When working in Mexico, it is useful to know that there are many different subcultures, demographically, educationally, ethnically, geographically, linguistically, politically and socially. These distinct subcultures exist within the larger national environment, rendering impossible any attempt to impose a single, unified strategy for the entire country. Even many Mexican retailers have stumbled over regional differences as they move into new regions. There are differences between north and south, coastal resort areas and the interior, frontier borders and more interior areas, and large urban, small town and rural areas. Even between Mexicali and Tijuana, two large border cities in the same state of Baja California, serious differences loom. And that represents only the beginning of all the variations in local culture, food, music, dialect and business behaviors.

Understanding all these subtle but important distinctions can have a huge impact on business negotiations, merchandising selection, pricing, marketing and a whole host of interrelated operational issues. Risk acceptance, the speed involved in decision-making, the ability to try new things varies greatly by region. In general, the *nortenos* (who, because they live closer to the United States, are more susceptible to the "*pocho* effect"—i.e., Mexican-Americans who put on *gringo* airs), tend to be more entrepreneurial, make decisions faster, follow more American business practices, even dress more casually. Other regions emphasize their ability to enjoy life more deeply and to place pleasure before work. When considering merchandise mix, one size does not fit all, but it is amazing how many retailers have stumbled over this point. Yet they know that Miami, Boston, San Diego, and Seattle do not share the same climate or lifestyle.

Often, from a distance, invisible and intangible, these cultural issues can present significant barriers to entering Mexico, as demonstrated by the long list of retailers from the United States whose performance south of the border did not match their expectations. Those who have persisted have generally done well, but many others have left after a few years. Among the failures, a large number simply had the wrong joint-venture partner. Others expected results too quickly. Several did not tropicalize at all. However, a history of frequent failure does not predict a repetition of this pattern, as long as today's retailers learn from the avoidable mistakes of predecessors who stumbled on the road to retail success in Mexico.

Many newcomers still repeat the mistakes of predecessors. The good news is that there are now some retailers in Mexico that have been there for a decade or more (e.g., Sears, Wal-Mart, Costco, Home Depot), and much can be learned by studying their experiences. Various European retailers, including Auchan, Carrefour and Metro, have also experimented in the Mexican marketplace and an assessment of their ventures is helpful as well. The more successful companies have learned from this accumulated databank of experiences.

A mixture of due diligence and research, along with a people-oriented approach to doing business, provides a good basic framework for success in the Mexican culture.

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Economic Impact of the U.S. Shopping-Center Industry

An Investigation at the State and Congressional-District Levels

CHRISTOPHER S. GERLACH

Abstract: *This paper summarizes the findings of a December 2011 study conducted by ICSC Research to quantify the comprehensive economic impact of the shopping-center industry at the state and congressional-district levels. The data are reported as either direct or total impacts in terms of employment or labor income for the most and least impacted states and congressional districts. The final section describes the process by which National Retail Federation and U.S. Census data were transformed to arrive at this unique dataset.*

Overall Impacts

In 2010, there were over 109,000 shopping centers in the United States. These shopping centers directly employed over 12 million individuals and were responsible for supporting over 17.6 million total jobs, or 12.7% of the nation's workforce. Individuals directly employed in shopping centers earned over $451 billion in personal income while the total number of employees supported by the industry earned over $848.5 billion, or 6.9% of the nation's total labor income (see Table 3-1).[1] Map 3-1 illustrates the magnitude of the employment impact at the state level and Table 3-2 shows the five most and five least dependent states.

Table 3-1
Shopping-Center Impact
on the U.S. Economy (2010)*

	Direct Impact	Total Impact	Share of U.S. Economy
Employment	12,080,392	17,635,051	12.7%
Labor Income (Bill. $)	$ 451.0 B	$ 848.5 B	6.9%

* Labor income is defined as annual wages and salaries and benefits as well as proprietors' income.

New Hampshire has by far the highest share of shopping center-related employment impact to all-sector employment. This could be due in part to the fact that it does not have a state sales tax and thus has developed this sector as a result of its relative competitive advantage.

Interestingly, however, two of its bordering states, Maine and Vermont, are also in the top five. This seems to suggest that the economies of New England are similar—either in terms of synergies created by clusters of retail-related employment or in terms of generally small economies in which retail and shopping centers would assume a proportionately larger share.

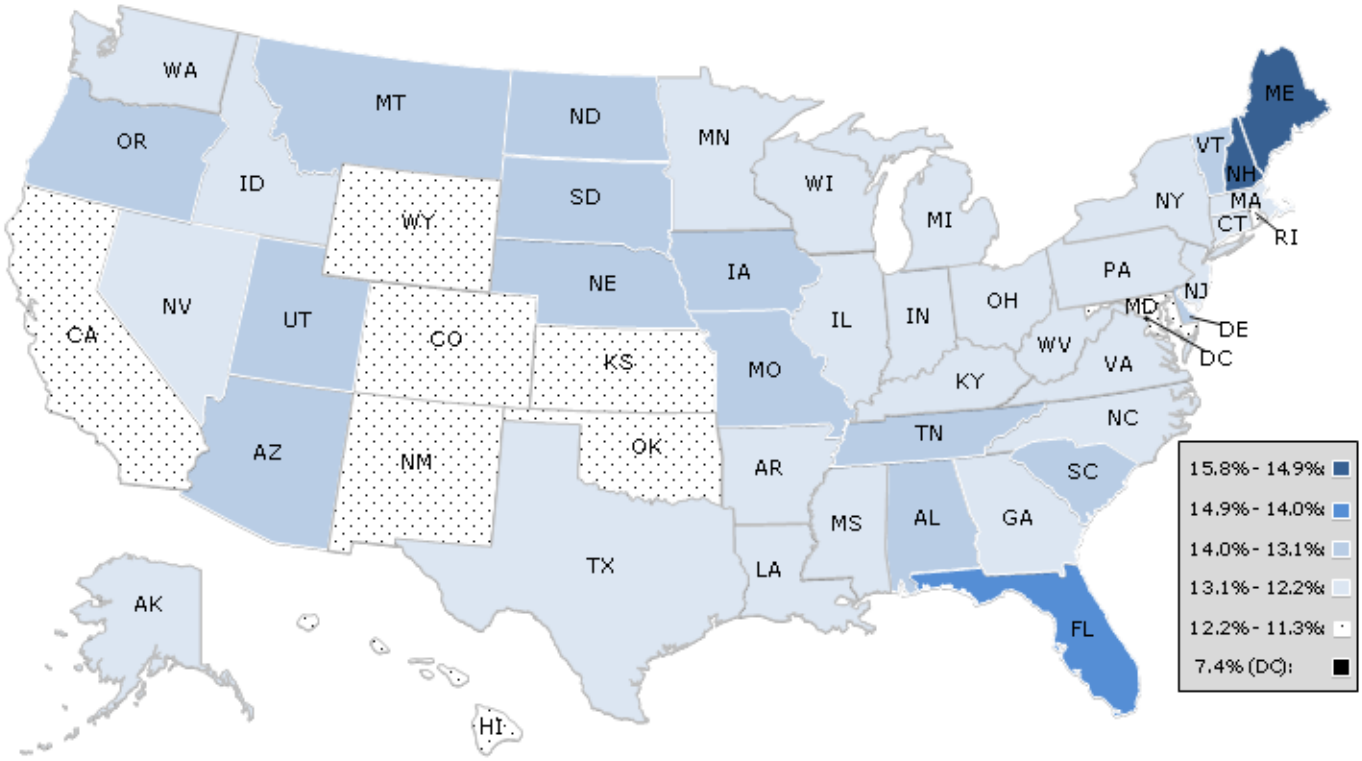
Washington, D.C. has by far the lowest share of shopping center-related employment impact to all-sector employment. This is likely due to the high concentration of federal employees in a relatively small, predominantly urban area with fewer shopping centers as compared to freestanding retail.

Map 3-2 and Table 3-3 illustrate the magnitude of the labor-income impact at the state level.

Not surprisingly, New Hampshire is again in the top five. With such a large percentage of total employment being due to the impact of the shopping-center industry, it follows that a disproportionate share of the state's income would be due to the same industry.

[1] In December 2011, ICSC Research released a report titled, *The Economic Impact of the U.S. Shopping Center Industry*. This report detailed the direct and total impact of the shopping-center industry in terms of employment and labor income at both the state- and congressional-district levels. This study was conducted to complement and expand upon existing estimates of shopping-center direct-employment impacts at the state level. As economic data are scarce at the congressional-district level, the ICSC study derived economic multipliers from *Retail Means Jobs*, an August 2011 National Retail Federation (NRF) report measuring the comprehensive economic impact of the retail industry on the national economy. The NRF study, conducted by PricewaterhouseCoopers (PWC), utilized custom-built input-output models to generate direct, indirect and induced retail employment, labor income and gross domestic product (GDP) impacts at both the state- and congressional-district levels. This study showed the full scale and scope of the shopping-center industry's economic footprint and its connection to the economy at large. Clearly, these data have political implications; at the state level, they inform senators and governors from all 50 states; at the congressional-district level, they inform the 435 elected members of the House of Representatives.

Map 3-1
Total Shopping-Center Employment Impact as a Share of All Employment



This same logic can be applied to the high percentage observed in Utah and the low percentage in Washington, D.C.

Table 3-2
Five Most/Least Impacted States,* Ranked by Total Employment Impact on All-Sector Employment

Rank	State	Ratio of Total Employment Impact to All-Sector Employment	Total Employment Impact	Direct Employment Impact
1	New Hampshire	15.8%	108,133	76,841
2	Maine	14.9%	95,341	67,722
3	Florida	14.7%	1,169,106	771,050
4	Utah	13.9%	170,972	115,638
5	Vermont	13.9%	44,800	31,626
U.S. Average		12.7%	345,785	236,870
47	Maryland	11.4%	329,559	231,122
48	Hawaii	11.4%	72,699	54,704
49	Rhode Island	11.4%	55,782	39,277
50	Colorado	11.3%	276,387	197,032
51	Washington, D.C.	7.4%	22,268	15,239

* Includes 50 states and Washington, D.C.

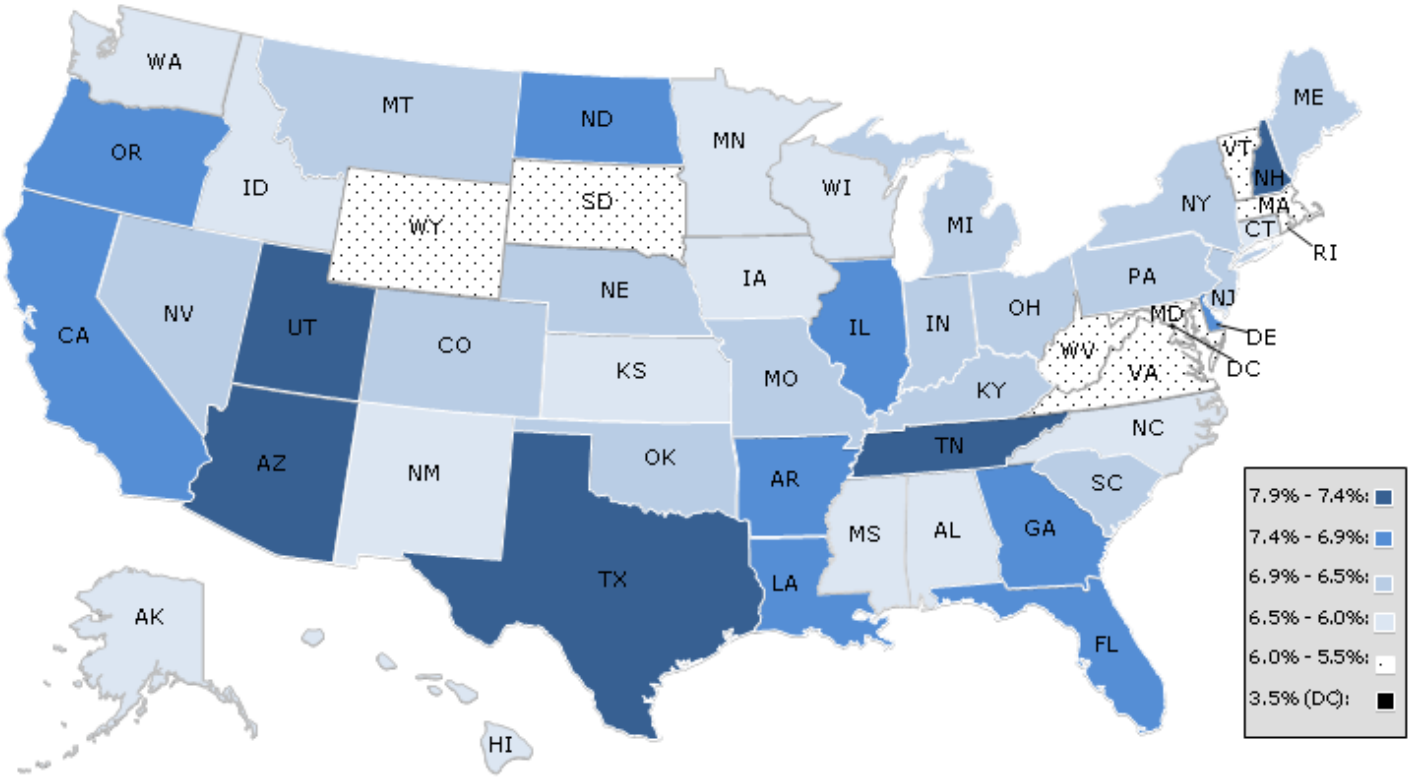
Table 3-4 illustrates the magnitude of the employment impact at the congressional-district level.

At the congressional-district level, the story clearly revolves around the New York metropolitan area. New York's 14th and 8th Congressional Districts encompass the majority of New York County (Manhattan)—a region dominated by businesses rather than residents. It is important to note that the figures here represent the total employment impact share of a region's economy. Thus, with a region dominated by industry of all kinds, the reverberation effects are greater as supply-chain needs are met in-region and a larger share of spending in the economy is retained and re-spent, contributing to an increased overall economic impact.[2]

Conversely, the congressional districts with the lowest shares of total employment impact to all-sector employment are those that are primarily residential in nature. New York's 10th and 11th Districts are mostly in Kings County (Brooklyn)—by far the most populous of the five boroughs (2.5 million). New York's 6th District consists of most of Queens County the second-most populous borough (2.3 million). The 16th District

[2] A more in-depth explanation of the comprehensive accounting of an economic impact analysis is included in the following section.

Map 3-2
Total Shopping-Center Income as a Share of All-Labor Income



encompasses most of Bronx County, with 1.4 million residents. It stands to reason that these residential districts that border on the business-centric urban core would have little need for extensive shopping-center employment and would have none of the industry needed to support that sector.

Table 3-3
Five Most/Least Impacted States,* Ranked by Total Income Impact on All-Sector Income

Rank	State	Ratio of Total Income Impact to All-Sector Income	Total Income Impact (in Millions)	Total Income Per Capita
1	Utah	7.9%	$7,134	$2,569
2	Arizona	7.9%	$17,409	$2,714
3	Tennessee	7.7%	$17,194	$2,705
4	Texas	7.7%	$73,143	$2,896
5	New Hampshire	7.6%	$4,365	$3,315
U.S. Average		6.9%	$16,391	$2,743
47	Maryland	5.7%	$16,319	$2,820
48	Rhode Island	5.7%	$2,516	$2,389
49	South Dakota	5.7%	$1,835	$2,247
50	Virginia	5.5%	$19,439	$2,422
51	Washington, D.C.	3.5%	$1,500	$2,482

* Includes 50 states and Washington, D.C.

Table 3-4
Five Most/Least Impacted Congressional Districts,* Ranked by Total Employment Impact on All-Sector Income

Rank	Congressional District	Ratio of Total Employment Impact to All-Sector Employment	Total Employment Impact	Direct Employment Impact
1	New York - 14	33.4%	123,050	76,129
2	New York - 8	32.1%	110,799	71,230
3	Illinois - 7	26.5%	73,284	41,117
4	Florida - 3	23.4%	57,716	37,591
5	Georgia - 5	22.1%	64,675	40,873
U.S. Average		12.7%	40,447	27,707
432	California - 35	6.6%	17,732	10,882
433	New York - 10	5.4%	15,388	9,614
434	New York - 16	5.2%	12,621	7,962
435	New York - 6	4.6%	13,973	9,417
436	New York - 11	4.1%	12,161	8,069

* Includes 50 states and Washington, D.C.

Table 3-5
Five Most/Least Impacted Congressional Districts,* Ranked by Total Income Impact

Rank	Congressional District	Total Income Impact (in Millions)	Direct Income Impact (in Millions)
1	New York - 14	$11,125	$4,153
2	New York - 8	$9,420	$3,791
3	California - 8	$5,095	$2,314
4	Illinois - 7	$4,798	$1,576
5	Texas - 7	$4,532	$1,905
U.S. Average		$1,917	$1,016
432	Alabama - 4	$953	$576
433	New York - 10	$741	$381
434	New York - 6	$698	$381
435	New York - 16	$619	$319
436	New York - 11	$587	$323

* Includes 50 states and Washington, D.C.

Table 3-5 illustrates the magnitude of the labor-income impact at the congressional-district level.

As all-sector personal income data were not available at the congressional-district level, it was not possible to report a "share" figure as in the three tables above.

However, the same pattern observed at the state level holds at the congressional district. That is, those districts with a higher-than-average total shopping-center related employment impact have a higher-than-average total shopping-center related income impact—and, of course, those districts with a lower-than-average employment share display a lower-than-average total income impact.

Economic Impacts

As noted above, these comprehensive data go beyond historical ICSC-reported statistics on the direct impact of the shopping-center industry at the state level. Not only do they measure the impacts at the congressional-district level, but they capture the "total" economic impacts that result from the operations of the industry. These total impacts include an accounting of the sum of *direct*, *indirect* and *induced* effects.

Direct impacts are somewhat intuitive and can simply be characterized as the employment or personal income for those individuals directly employed at shopping centers. According to ICSC's definition of shopping-center employment, these individuals fall into one of 10 industries included in the North American Industry Classification System (NAICS).[3]

However, a simple count of these direct employees and their corresponding personal incomes is an incomplete picture of the full magnitude of their economic contributions. These industries are inextricably linked to others in the economy. That is, the operations of this industry rely on the operations of other industries that support shopping centers. The summations of these supplementary economic impacts are referred to as the indirect effects.[4]

These indirect effects are calculated using input-output models that rely on public data collected by the Bureau of Economic Analysis (BEA).[5] Input-output tables, or I-O models as they are commonly known, allow users to simulate an economic or fiscal event and witness the reverberations that occur in a regional or national economy as a result.[6] The model calculates several iterations for any event sending each successive "shock" back through the matrix until such time as the marginal impact is negligible. The initial event or shock would therefore be the direct impact, while the sum of the reverberations would constitute the indirect impact.

This, however, is still not the end of the story, as all employees accounted for in the direct and indirect impacts are presumably being compensated for services rendered. Thus, a full measure of any industry's impact must include some measure of the economic productivity of those wages and salaries. Fortunately, the I-O tables mentioned above include income information corresponding to the impacted industries. Using information about a propensity

[3] NAICS categorizes every possible industry in the nation, covering 2-digit broad categories (i.e. Retail Trade) to 6-digit specific categories (i.e. Camera and Photographic Supply Stores). The 10 NAICS codes included in shopping-center employment are: 442, Furniture and home furnishings stores; 443, Electronics and appliances stores; 444, Building material and garden equipment and suppliers dealers; 445,Food and beverage stores; 446, Health and personal care stores; 448, Clothing and clothing accessories stores; 451, Sporting goods, hobby, book and music stores; 452, General merchandise stores; 453, Miscellaneous store retailers; 532, Rental and leasing services.

[4] Take, as an example, NAICS 442: Furniture and home furnishing stores. This industry requires inputs—such as furniture—that may be produced within the nation. Therefore, the extent to which the furniture stores thrive, so too do the domestic furniture manufacturers. This is, however, just the first iteration as the furniture manufacturers themselves rely on other industries—such as forestry, wood processing, transportation, etc. — which in turn rely on still further industries. A complete accounting of all of these complex reverberations is necessary to understand the full magnitude of the indirect impacts.

[5] The BEA compiles detailed Make and Use Tables that quantify the interconnectivity of all industries to all other industries.

[6] This technique was developed by Wassily Leontief , who received the Nobel Prize in Economics in 1973 for his work.

to consume locally (however that locality is defined), the model can quantify the economic impacts to potentially non-related industries resulting from the spending and re-spending of wages and salaries owed to the existence of the shopping-center industry. This final effect is known as the induced impact.[7]

In the above analysis, results are reported as either direct impacts (shopping-center specific) or as total impacts which aggregate the direct, indirect and induced effects.[8]

Those data were then normalized and shared among the constituent congressional districts, according to the percentage ratios of direct retail congressional district employment to direct retail state employment, as reported by NRF. Unique NRF state and congressional-district employment multipliers were then used to scale-up ICSC's normalized direct employment estimates to arrive at total employment impact estimates. Those data were then estimated for the 2010 direct and total shopping-center employment impacts using the 2009 statistical relationships.

Labor Income

The process for estimating the labor income impact was slightly different than it was for employment. In this case, the "adjustment" was done by backing out non-shopping-center-related income from the NRF retail income figures.

As noted above, ICSC includes 10 NAICS sectors as those related to the shopping-center industry. NRF includes 13 NAICS sectors as those related to the retail industry. To reconcile the two, four of the NRF sectors were removed and one was added at the state level.[9] As was done with employment, the direct state-income estimates were shared among the congressional districts according to the proportions reported in the NRF study. The unique NRF state and congressional-district income multipliers were then used to scale-up ICSC's direct income estimates to arrive at the total impact estimates. Those data were then estimated for 2010 using existing statistical relationships from 2009.

Given that these results rely on a static 2009 dataset and that the Census Bureau is currently re-drawing the congressional district boundaries based on the 2010 Census, it is unlikely that ICSC Research will update this study for 2011 and beyond. Should these data be particularly useful and updates are warranted, a new methodology will have to be devised to obtain the requisite input data at the congressional-district level and new I-O tables will have to be constructed to obtain the indirect and induced impacts.

Conclusion

From this analysis, the private sector and policy makers alike can begin to understand the size and scope of an industry as widespread as shopping-centers. That understanding will be vital as they make decisions that ultimately affect the development and operations of these centers going forward. With over 12% of national employment being owed to the shopping-center industry, these decisions must seek to minimize any adverse impacts.

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[7] Again, using the furniture store example; the employees of the furniture store (direct) and employees of the domestic furniture manufacturer and lumber mill, etc. (indirect) are paid wages and salaries. These employees spend a portion of their pay in their local economies on restaurants, movies, and possibly even furniture stores. The full extent to which the food and beverage and movie theater industries thrive as a result of this spending is known as the induced impact.

[8] A statistical relationship estimated at the state level was used to derive the direct shopping center-employment impact at a congressional district. This relationship was estimated as a function of retail employment and retail establishments at the congressional-district level.

[9] NAICS codes removed: 441: Motor vehicle and parts dealers; 447: Gasoline stations; 454: Nonstore retailers; and 722: Food services and drinking places. The NAICS code added was 532: Rental and leasing services.

Repositioning Retail and Warehouse Properties for Tomorrow

Consequences of the New Borderless Marketplace

CURTIS D. SPENCER and STEVEN SCHELLENBERG***

ABSTRACT: *Physical-location needs are changing to meet the challenges from a new virtual world and this will have real-estate consequences. This edited version of a NAIOP Research Foundation and ICSC-commissioned study found: (1) The storefront of tomorrow must seamlessly integrate its physical and virtual channels with emerging electronic, mobile and social-media technologies. (2) Retailers must balance the complexity of the product search, selection, financial transaction and delivery processes with the simplicity desired by the consumer. (3) Retailers must offer a suite of delivery and return options for the consumer. (4) Retailers must actively manage their transportation costs, taking into account the benefits of strategic packaging and locating distribution centers closer to the end user. (5) Retailers must implement new cost-effective ways to deliver merchandise, which may include reconfiguration of retail properties and/or distribution centers or outsourcing the logistics to third-party vendors. (6) Retailers must embrace a borderless strategy to enhance their opportunities and stay ahead of the competition.*

The NAIOP Research Foundation and ICSC commissioned a study[1] to explore the backroom—if you will—of the shop and how it is changing to meet the needs of e-commerce. How does an order get processed and delivered to the end user—the consumer? On the surface, this may not seem like a real-estate issue, but it is. Where is that warehouse or distribution center? How far is the distribution center from the retail store? How far is the distribution center from the transportation point—either for incoming or outgoing goods? Even in this virtual world, the reality of where the merchandise is and where it is going still makes this a very physical retail world.

The New Storefront

The traditional storefront is a physical location where stock is kept on hand to support customers' choices and purchases. But the physical store has been evolving in recent years because of better inventory management and control, more coordinated logistics and advancements in payment systems. Nordstrom, for example, will ship directly to the consumer from any location if that store has the merchandise the consumer wants, but the local store does not. This required an integrated inventory management system.

Another example of this change is at some furniture stores, which have become only showrooms, built without any inventory on hand. In fact, regional warehouses can support over 100 furniture stores, delivering customized products (in some cases assembled and finished) after the storefront order is made and paid for. This "storefront showroom" is supported by assemblers who take "knocked-down" furniture manufactured around the world, finish and upholster the goods for direct delivery to the consumer within days of the order transaction.

Retail stores also are becoming depots where online customers can opt for a store pickup rather than a home delivery. This benefits the store, as pickup orders could include additional purchases made by the consumer while shopping there. In order to enhance the prospect of additional sales, many retailers produce an advertisement targeted to provide a discount to the buyer for use when the storefront is visited to recover the goods. This option,

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[1] Curtis D. Spencer and Steven Schellenberg, *The New Borderless Marketplace: Repositioning Retail and Warehouse Properties for Tomorrow,* White Paper Prepared for NAIOP Research Foundation and the International Council of Shopping Centers, April 2012, http://www.icsc.org/srch/rsrch/wp/The_New_Borderless_Marketplace.pdf, retrieved April 30, 2012.

Box 4-1
The Multi-Dimensional Storefront

- A **building** of concrete, brick, glass and doors which welcomes customers to a location where advertising, product placement and merchandising drive traffic and prompt sales transactions.
- A **catalogue** mailed to prospective customers that provides visibility into retail showrooms, motivating buyers to come to a store and conduct a transaction.
- An **electronic browser catalogue** and a virtual showroom to support Internet commerce, where access to electronic advertising, available price checking and secure payment options offers customers a choice for when, where and how to conduct a transaction and receive purchased goods.
- A **physical-virtual place** where customers in a physical store can simultaneously browse a competitor's products online. Through a new application that is available for mobile devices, customers can scan a product's bar code to receive pricing from competitors, determine product availability and choose which transaction to complete.
- A **virtual space** where social networks will host social interaction, advertising, publishing, movies, finance, payments, entertainment, tickets, gaming, television and retail, all bundled into one mobile device, which is used to inform, entertain and conduct transactions.

however, must also be integrated within the retailer's supply chain and distribution strategy and reflect the retailer's flexibility to fulfill the order and deliver as promised to the customer. It may also be necessary to separate out floor space so that customers who pick up their online purchases at a store are able to access these products easily. By astutely arranging floor space within the store floor-plan, retailers can position the pick-up area in a manner that provides customers with additional in-store shopping and buying opportunities.

Retail competition for the physical store also is evolving. Retail companies that may or may not have a traditional storefront are impacting how in-store business occurs. This competition may be from a company's own virtual store or some other virtual competitor—which now has vastly changed the concept of a "trade area" for a physical retailer. To be sure, there always was some of this competition from mail-order businesses, but today the breadth, depth and even international reach of the virtual store has permanently altered the physical storefront.

As a result, the traditional concept of a store is blurring because of new access points by consumers and "multi-channel distribution" by retailers. Therefore, today's store has given way to *a multi-dimensional storefront* (See Box 4-1).

The Virtual Retail Impact

In 2011, about one-third of Americans owned an Internet-enabled smartphone.[2] But as people trade in their cell phones for smartphones, they will naturally take more advantage of their devices' powerful capabilities for doing a range of mobile activities, including shopping and buying. A Federal Reserve study noted that, "The adoption of smartphones with barcode scanning software and Internet access has the potential to substantially alter consumer behavior in the retail environment. With this technology, consumers can quickly and easily compare prices across retailers while in store or online, or locate an item that is out of stock."[3]

With more smartphone adoption, the use of and comfort with mobile commerce will likely increase transactions over time. These expected changes in commerce will have a profound impact on global supply chains and the delivery of products between manufacturing centers and individual consumers. This "customized-for-the-consumer" delivery system must be managed in parallel with the traditional distribution center replenishment strategy used by the largest retailers today. In many cases, this delivery system also must continue to support a catalogue sales strategy that generates additional sales. Logistics and facility decisions must be made to assess the value of utilizing current retail distribution networks or adding new channels for fulfillment to support Internet commerce.

Electronic commerce (e-commerce), mobile-device commerce (m-commerce) and social-networking-based

[2] A May 2011 survey by the Pew Research Center reports that 35 percent of American adults owned a smartphone. Aaron Smith, "35% of American Adults Own a Smartphone," Pew Internet & American Lift Project, July 11, 2011, http://pewinternet.org/~/media//Files/Reports/2011/PIP_Smartphones.pdf, retrieved April 3, 2012.

[3] *Consumers and Mobile Financial Services*, Federal Reserve Board, Washington, D.C., March 2012, pp. 15-16.

commerce (s-commerce) are all growing and evolving at different speeds. Already the distribution and facility strategy may require new, reconfigured facilities and networks in order to support the demands of multi-channel fulfillment. Furthermore, some retailers will need to add new purpose-built distribution centers which strictly support their multi-distribution platforms; others will utilize a third party, such as Amazon.com, to perform their new commerce fulfillment requirements.

As multi-channel sales increase, changes in the supply chain and distribution systems are required to accommodate the demand for these different sources. The multi-channel offering will impact manufacturing systems, inventory control systems, packaging and shipping requirements. This will likely entail partnerships with new vendors to accomplish single-item delivery from around the world and will require new storefront configurations and locations, order-picking protocols and fulfillment strategies. Having a physical location that allows late departures of shipments to meet next-day delivery demands for products also may play a key role in future site selections and product-storage procedures. Returns, reverse logistics, claims and damage protocols will need an updated process to support repeat shopping, regardless of which channel the consumer chooses. Change also is occurring in how transactions are conducted in the new storefront; payment options may include checks, electronic funds transfer, debit and credit cards, layaway programs, gift cards and new electronic payment applications for mobile devices.

As revolutionary as these changes already are for the traditional storefront retailer, the next challenge will be about creating and sustaining a multi-dimensional storefront in the global marketplace. With Internet users currently accounting for 32.7% of the world's 6.9 billion inhabitants at the end of 2011,[4] the retailer that wants to reach this new marketplace must manage its international payment transactions and the delivery of those products in a total landed cost context through a method that meets the demand of the buyer. As the poster child of the online-only retail segment, Amazon.com Inc. already generated 41% of its operating income in 2011 from outside of North America, and the global marketplace is likely to continue to expand much further, with potential future competition, even for Amazon.com, likely to be from foreign shores.

These rapid changes in non-traditional storefront commerce and transactions call for changes across the retail industry and the supporting cast of logistics service providers and developers. Retailers that successfully fulfill this challenge will help to ensure their survival; those missing the challenge will likely face severe problems. There is no middle ground in the new commerce transaction, distribution and retail industry.

Demand and Supply Chain Transactions

The buyer-supplier transaction has two parts: a "demand chain" and a "supply chain." The catalyst for the demand chain is the buyer, who triggers a customer order and provides delivery information (the location where the item is needed) and financial transaction data (the payment). This demand information both precedes and continues through the supply chain, the global conveyor belt that moves goods from origins to destinations/ consumers in bulk or as a single item. Effectively matching the demand and supply chains is the logistic challenge of moving goods between seller and buyer.

Elements in the demand chain include the mode through which information about the product is made available to the buyer (computer, tablet, smart-phone), the process through which the order is placed (telephone, Internet, smartphone), the means which supports the transaction (check, electronic funds transfer, credit card, debit card, gift card, cash or smartphone-enabled transfer), the process utilized by the seller to confirm that the order is "picked-packed and shipped" (delivered by e-mail, text, or telephone), the method utilized by the seller to ship the product to the buyer (overnight delivery by air, ground, U.S. Postal Service, courier or other delivery conveyance), the tracking information provided by the delivery services company of the transportation and delivery status of the shipment (by email, by text or by accessing the delivery company's item tracking system) and the delivery confirmation communicated to the buyer (left at specific location, signed for by specific individual, delivered to fulfillment kiosk, mail kiosk or other secure delivery site). These informational, financial and delivery details require reliable, service, access to information and a delivery outcome that satisfies buyers sufficiently to bring them back for repeat transactions.

The supply chain links global sourcing, order preparation, order management, site selection, warehouse configuration(s) and replenishment strategies are intertwined more than ever before. The supply chain supports the fulfillment strategies and expected growth in e/m/s commerce so that the demands of store-front sales

[4] See "Internet World Stats: Usage and Population Statistics," "World Internet Usage and Population Statistics" chart, December 31, 2011, http://www.internetworldstats.com/stats.htm, retrieved April 6, 2012.

and e/m/s commerce fulfillment are accommodated. To make this more cost-efficient, more packaging uniformity may be required,[5] as well as reconfiguring warehouse layouts. Already, many warehouses used to support traditional store replenishment by a distributor of retail goods are being reconfigured in order to support multiple volumes, stock items and surges in demand for order processing and picking based on e/m/s-commerce demands. Warehouse configurations today must take into account the: daily-unit volumes, number of units per order, number of lines/product-types per order, size of the product (cubic measure) and the turnover of each warehouse item.

In order to support the emerging e-commerce and m-commerce demands, retailers today must deploy a new approach to supply chains that efficiently moves goods from distribution centers directly to consumer sites. While some retailers will choose to completely outsource their e/m/s-commerce fulfillment to third-party specialists, others will reconfigure parts of their current distribution system networks in order to support a multi-channel or blended fulfillment strategy.

The decision to outsource the entire e/m/s-commerce distribution platform or to retain part or all of both channels of fulfillment is largely a function of the proximity to ground or air hubs for UPS, FedEx or the postal service. Close proximity to a transportation hub allows for longer daily order fulfillment cycles and is likely to reduce shipping costs.

Proximity to sea-hubs or large inland ports also may improve supply chain reliability for imported goods, which allows an importer/retailer quicker and more efficient transfer of goods from ships to trains or trucks to reach distribution centers. Many retailers now utilize sites located in Foreign-Trade Zones in order to manage import fees, duties and taxes. The issue of taxes, including sales tax, is a critical factor in the site-selection process for e/m/s-commerce distribution center locations. Lastly, workforce availability and flexibility are also key issues in the e/m/s-commerce distribution center, as seasonal or "surge" labor forces are often required during peak fulfillment seasons.

Home delivery, the "last mile" of the supply chain, often provides the retailer or the company's logistics-service provider with the largest challenge in meeting or exceeding the customer's expectation. The problems dealing with this last mile vary widely based on the size, weight and configuration of the products and the location of the delivery.

Less Time on the Road

The location of distribution centers throughout the United States can be a critical factor for ground transportation. New truck-driver restrictions by the federal government are likely to make the need for closer distribution centers more important or multi-driver systems necessary. Under the U.S. Department of Transportation's regulations for hours-of-services of drivers, which became effective February 27, 2012 with a compliance date of July 1, 2013, these guidelines require an 11-hour daily limit for driving and cap weekly total hours at 60/70 hours rather than 82 hours previously.[6] This means that in some cases, deliveries made "today" under current guidelines may not be possible under the new rules.

The Need for a Global Strategy

Going global with an Internet or e/m/s-commerce platform is daunting, but the opportunities are staggering too. E/m/s-commerce retailers in the United States must now look globally for their incremental growth, and with this expansion into fast-growing consumer markets—such as in the Asia-Pacific region—comes a wide array of logistical considerations and technological issues.

Also, the greater the number of global sources used as origin manufacturing centers, the more complex the fulfillment network gets. As the number of countries "sold to" increases, so too does the number of custody transfers between the local/global order origin point and local/global fulfillment destination. Increasingly complex international initiatives directly correlate to more transportation and logistics service intermediaries required and more ports, inland ports, airports and final-mile delivery options to be managed. Total landed costs

[5] If the dimensional weight (amount of space occupied) exceeds the actual weight of the package, the shipper is charged for the dimensional weight instead of the actual weight. For domestic shipments, the difference between the two weights is not as significant as for international shipping, where the dimensional weight is often much larger than the actual weight. Shippers can realize major savings by reengineering packaging so that dimensional weights are not as significant a part of the overall shipping/cost equation. See Paul Demery, "How 16 E-retailers Slashed International Shipping Costs," *Internet Retailer*, December 12, 2011, https://www.internetretailer.com/2011/12/12/how-16-e-retailers-slashed-international-shipping-costs, retrieved April 13, 2012.

[6] For the full regulations and provisions, see, the U.S. Department of Transportation's Summary of Hours-of-Service Regulations, http://www.fmcsa.dot.gov/rules-regulations/topics/hos/index.htm, retrieved March 19, 2010.

as a part of the transaction process are critical for the success of a global e/m/s-commerce initiative, but the process of arriving at a real-time, total landed cost will require immediate access to libraries of trade laws, tariffs, taxes, transportation costs and transaction costs across the supply chain, all calculated before the sales transaction is confirmed. Global transportation service providers can provide valuable assistance to the retailer, leveraging their international technology platforms, local in-country knowledge and international shipping capability.

Final Observations

Four American companies, Facebook, Apple, Google and Amazon, have led in defining the 21st century's information technology and entertainment industry. However, over the next decade they will increasingly compete in the market for mobile phones, tablets, applications, social networking, advertising and transaction management. These companies do not recognize any borders and are marching into retailing, advertising, movies, television, commercials and finance. *And this, too, is the future for all companies*.

New post-PC devices, such as smartphones and tablets, encourage and facilitate consumption. The strategy of the successful company will be to convert the wealth of consumer shopping data culled from these technologies into more targeted sales. For the retailer, the ability to retain as many pieces of the retail transaction as possible, rather than allowing a third party to "slice" off portions of the transaction, is the ultimate prize. By maintaining control over the transaction, the retailer can retain the highest percent of the revenue generated from each sale. This perspective provides a view into the competition facing the traditional retailer from the e/m/s-commerce service providers today.

The traditional storefront, the new storefront and the transaction-processing systems provide both a challenge and an opportunity for meeting the customer on their terms, in their timeframe and maybe even in their pajamas. About 10 years ago, Wal-Mart executives said they were not a retailer, but a supply-chain manager. It seems those words were more prophetic than they may have realized for the 21st-century retailer.

But all of these changes will require businesses to re-evaluate their locations, their space needs and their logistics. Clearly, retail-and-warehouse property owners will need to strategize how the multi-dimensional storefront will affect those decisions.

The full text of the report commissioned by the NAIOP Research Foundation and ICSC, *The New Borderless Marketplace: Repositioning Retail and Warehouse Properties for Tomorrow*, can be accessed here.

Financing Indian Shopping Malls

A Case Against Fragmented Ownership

*HARVINDER SINGH**

ABSTRACT: *Some problems that affect India's shopping malls—including lack of differentiation, plummeting occupancy levels and reduced profitability—result primarily from inappropriate financing. Developers raise funds by selling retail space to investors and speculators, fragmenting ownership. Improper tenant mix, zoning distortions and demolition of the concept of the mall are outcomes of this situation. This article calls for such broad changes as real-estate regulation, a steady inflow of global debt and equity capital, and increased transparency to remedy the situation.*

Introduction

India is a late starter in developing malls, building only three until the 1990s: Spencer Plaza in Chennai, Ansal Plaza in Delhi and Crossroads in Mumbai. The number of malls increased rapidly during the last decade. Currently, about 310 centers operate, providing nearly 89 million square feet (sf) of space.[1] Although slowed by the 2007-09 recession, India is still expected to have nearly 750 centers with 350 million sf of space by 2015.[2] The high-density urban areas in which these malls tend to locate foster a vertical design orientation.[3]

Future Potential for Mall Space

The inability of conventional retail formats in India to provide young, affluent shoppers with the ultimate shopping experiences they desire has given rise to an urgent need for investment in building quality retail space.[4] For 2011 alone, industry estimates suggested that retail space demand would outstrip retail supply by 400 to 500 million sf or about one-third of India's annual need.[5]

Issues Faced by Indian Malls

Despite initial euphoria, Indian malls have failed to match the standards set by their global counterparts. Lack of differentiation, mall clustering and inadequate concept planning and zoning have become serious issues. Malls suffering from such deficiencies have seen their vacancy rates rise. Most of these problems are rooted in the financing of malls in India.

Sources of Financing for Indian Malls

The Indian real-estate business is typically either privately held or has moved toward the public-ownership model only very recently. Investments in this sector have primarily been arranged by developers, either as their contributions (seed capital) or from different sources and in different varieties. Sources of finance for this sector are derived from:

1. Private Debt and Equity

Private debt comprises nearly 60% of financing in Indian projects.[6] Bank loans for commercial real estate increased by more than 500% between 2001 and 2006. However, banks remain apprehensive because of the perceived opacity of market pricing, lack of clarity and standardized practices, and the perceived risk of a speculative bubble.[7] Nearly 40% of the requirement is met by private equity. Broad-based private-equity participation in the real-estate sector is constrained primarily due to regulatory impediments. In 2005, the

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1 ICSC Global Shopping Center Directory, http://www.icsc.org/srch/rsrch/globalSCdir.php?section=rsrch, retrieved March 22, 2012.

2 Amitabh Taneja, *Malls in India: Operational Shopping Centres and Malls* (New Delhi: Images Multimedia, 2009), pp. 12-13.

3 Harvinder Singh and Swapan Kumar Bose, "My American Cousin: Comparison Between Indian and the U.S. Shopping Malls," *Journal of Asia-Pacific Business*, 2008 (Volume 9, Number 4), pp. 358–372.

4 Arvind Singhal, "Consumer Demographics and Changing Consumption Demand Innovation in Upcoming Mall Projects," in *Malls in India: Shopping Centre Developers and Developers*, edited by Amitabh Taneja (New Delhi, India: Images Multimedia, 2007), pp, pp. 54 – 60.

5 A. Puri, "Designing India's Mall Potential," in *Malls in India: Shopping Centre Developers and Developers*, pp. 72–75.

6 Bhuvan Yadav and Saurabh Mahajan, *Indian Real Estate* (Report for Karvy Stockbroking Limited), Hyderabad, India: 2007.

7 Srikanth Srinivas, "Capital Ideas: Realty Check," *Business World* (February 2008), pp. 33 – 34.

Securities and Exchange Board of India (SEBI) approved the formation of Real Estate Funds (REFs) to address this problem. However, at present, REFs are only open to high net-worth individuals, institutional investors and global investors.

2. Public-Market Debt and Equity

The public-debt market in India, comprising commercial mortgage-backed securities and corporate bonds, is still in its nascent stage. Public equity comes through initial public offerings (IPOs) in the stock market.[8] Between 2005 and 2007, a number of retail real-estate companies planned IPOs. In 2006, real-estate IPOs were the second-largest mobilizers of funds from the stock markets (INR 39.93 billion), second only to energy companies. But the stock-market crash of 2008 dampened development.

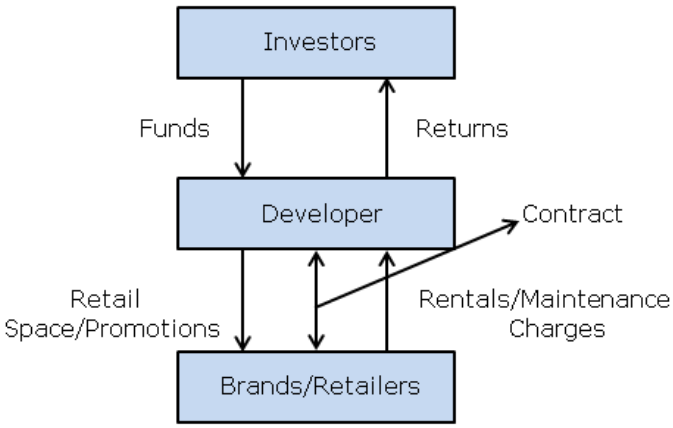
Global Lessons in Mall Financing

The real-estate sector contributes over 5% to India's gross domestic product. The Indian government's permission for foreign direct investment (FDI) comes with riders in the form of a three-year lock-in period, a minimum capitalization and construction-area requirements. International players currently operate through wholly-owned subsidiaries as well through joint ventures with local partners.

Singapore-based real-estate developers, including Ascendas, GIC, Keppel Land and Lee Kim Tah Holdings, have already established a foothold in India. Emaar Properties PJSC of Dubai began operating in India in 2005, and is currently collaborating with MGF Developers Limited of India. Emaar maintains a pan-Indian presence as it builds in all segments of the real-estate industry. Recently Sahara India started a joint venture with the United States-based Turner Construction Company. The new unit, called Sahara Turner Construction, will build integrated townships called Sahara City Homes and other Sahara India projects in India worth US$25 billion over the next 20 years. In December 2011, DLF, India's leading real-estate company, bought out Hilton International's share in their joint venture, making DLF Hotels & Hospitality Limited a fully-owned subsidiary. A major portion of American investments in this sector has come primarily through REFs. Prominent U.S. investors in Indian real estate include Tishman Speyer, Vornado Realty, GE Capital, Warburg Pincus, Citibank, Apollo Real Estate and Morgan Stanley. Of all the international companies with a presence in India, Emaar figures prominently among the leading mall developers.

In developed economies, ownership of malls remains with one entity, the developer, and investment is recovered over a longer period of time (10 to 20 years) through rent. Tenants have a direct contractual relationship with the developer, who collects rents, and investors receive returns in the form of dividends throughout the life of the project. (See Figure 5-1.)

Figure 5-1
Standard Model of Mall Management



Source: H. Singh, S.K. Bose, and V. Sahay, "Management of Indian Shopping Malls: Impact of the Pattern of Financing," *Journal of Retail and Leisure Property*, Volume 9 (1), pp. 55-64.

Indian Model of Mall Financing

The Indian model of financing is characterized by the selling of mall space, rotation of funds and piecemeal ownership of the mall by different stakeholders. The developer invests with meager funds in the project. Finances are raised during construction, or after the mall is built, by selling retail space. In this manner, investments are recovered and returns are invested in the next project. This model evolved because mall projects in India receive loans at high rates of interest due to inherent risk. India has a lower rate of capital formation compared with developed nations, and demand for capital from different sectors of the economy is tremendous, pushing interest rates even higher.[9] Under such circumstances, developers become anxious to recover an

[8] Capital markets in India are regulated by SEBI, a statutory body. The regulator does not permit real estate investment trusts (REITs) and real estate mutual funds (REMFs) to subscribe from the general public. The likely reason for this is a higher perceived risk associated with the real-estate sector. But, though not permissible at present, there is an urgent need to open REITs and REMFs to public equity.

investment quickly. Rotation of capital among different projects becomes critical for overall profitability over a period of time.

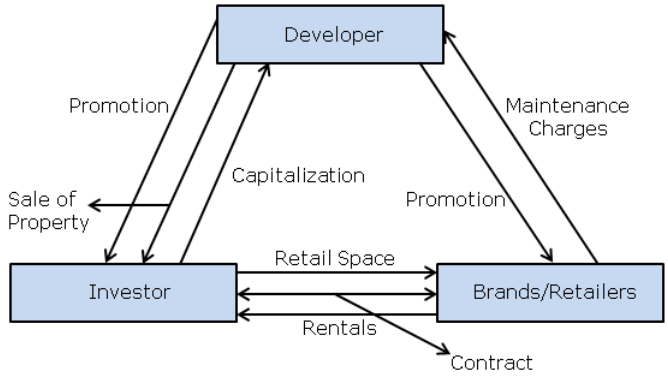
Different types of investors in mall projects in India are:

* *Private creditors*, who extend loans to developers expecting interest.
* *Investors who buy mall space anticipating rents promised or guaranteed* by the developer.
* *Speculators*, who book or purchase space hoping to resell it for profit.

In India, most mall developments are capitalized before groundbreaking. Individual stores are sold to a large number of investors. Capitalization provides required funds to build the project. Tenants are then approached about opening space in the mall. Some may also buy retail space. Although the tenants are contacted and persuaded by the developer's marketing team, the actual lease contract is signed between the tenant and the investor/ speculator, who is the legal owner of that piece of mall space. Whereas the investor recovers an investment over a longer period of time by receiving rents, speculators try to sell the mall space to some other investor or tenant at remunerative prices. Private creditors obtain their interest and capital refund from sale proceeds of the space. After settling the liabilities, the developer is left with a share of the profit that can be reinvested in a future project.

On the management front, routine operations and promotional activities are handled by a mall management team put in place by the developer. This team manages operations on the basis of common area maintenance (CAM) charges paid by the tenants (retailers). Such an ownership and financing structure means that most malls are owned in piecemeal by a number of stakeholders. It results in unplanned and uncontrolled development of malls and eventual loss of rental values, as will be discussed in the next section. Figure 5-2 visually depicts a standard model of Indian mall management.

Figure 5-2
Standard Model of Indian Mall Management



Source: H. Singh, S.K. Bose, and V. Sahay, "Management of Indian Shopping Malls: Impact of the Pattern of Financing," *Journal of Retail and Leisure Property*, Volume 9 (1), pp. 55-64.

Problems Due to Structure

A mall sold in pieces to individuals faces the following problems:

1. *Short-term focus on immediate profitability*: The developer sells the retail space under pressure to recover immediately investments arranged as private debt. In a bid to maximize returns, the developer deliberately overvalues the project and tries to capitalize it at a higher rate. Depending on negotiations, different investors may be charged different prices for similar mall space. The same might happen while signing tenants, where different tenants may be charged different rents for similar space in the mall.[10]

2. *Disturbing the concept of the mall*: In order to ensure occupancy, developers lease out retail space on a first-come-first-served basis. This creates a sub-optimal tenant mix and zoning.[11] During later stages, some tenants do not renew their lease agreement. Developers are tempted to accommodate unsuitable tenants in order to keep that space occupied. Sometimes the project is divided into a large number of small retail units so as to ensure quick and remunerative disposal of space. These spaces are readily accepted by speculators and investors, but are detrimental for a mall.[12]

3. *Improper facilities management and maintenance*: Once a developer recovers an investment, his interest in that mall diminishes. However, the mall needs greater maintenance and support as it ages. Another reason for developers' reduced interest is that the major part of

[9] Shabana Hussain, "Cash-Strapped Developers Look to Buyers to Fund Construction," *The Mint* 27 (May 2008), p. 7, http://www.livemint.com/2008/05/27011523/Cashstrapped-developers-look.html, retrieved March 13, 2012.
[10] Mansi Tiwari, "Big Brands Plan to Pull Out of Malls," *The Economic Times* (September 21, 2008), p. 6.
[11] Debarpita Roy and Nitika Masih, "Mall Management—A Growing Phenomenon in the Indian Retail Industry" (New Delhi: Jones Lang LaSalle Meghraj, June 2007), http://www.slideshare.net/Ghada.hashem/mall-management, retrieved March 13, 2012.
[12] Hussain, p. 7.

revenue, rent, goes to the investor, or store owner of the store, whereas the developer, through the mall management team, can only manage CAM charges. If the developer tries to economize and spend less of collected CAM charges than what is genuinely required for adequate maintenance, facilities management and maintenance operations in the mall become adversely affected.

4. *Developers' declining promotion of the mall*: Once stores are leased, developers lose interest in promoting the center. But paradoxically, it needs more support as time goes on due to increasing competition. Once the novelty of a mall wears off, customers need to be engaged through promotional activities. Many developers do nothing about the branding, marketing and promotional aspects of running a mall.[13]

Prescription for Indian Malls

Most Indian mall developers are real-estate developers. Hence Indian malls have inherent problems, such as high undervaluation, speculation using "black money" (i.e., money unaccounted for and not declared before the taxation authorities) and lack of transparency. The following suggestions are designed to address these and other problems:

1. *Infuse real estate with public money*: Public funds would enable developers to plan on a long-term basis since they would feel no pressure to recover their investment immediately. This money would also make developers answerable to a larger set of stakeholders. For safeguarding public investment, the government and its statutory authorities such as SEBI would also have a role to play.

2. *Establish REITs / REMFs*: Real estate investment trusts (REITs) would allow participants to invest in a professionally-managed portfolio of properties, resulting in broad-based participation by investors in the real-estate market. They would lower the threshold level of investment in real estate and introduce a high degree of liquidity, transparency and fairness in management.[14] Similar advantages would ensue from real estate mutual funds as these would be governed by provisions and guidelines under the SEBI (Mutual Funds) Regulations, 1996.[15]

3. *Attract foreign funds*: India permits 100% foreign direct investment in various categories of real-estate projects, including malls.[16] Global real-estate securities funds have sought investment opportunities in emerging markets, particularly in Asia. This investor interest sparked the establishment of approximately 60 global real-estate securities funds with over US$ 14 billion in assets under management. Asia accounts for 27.5% of these fund assets under management.[17] With an estimated US$79 billion in investment-grade real state, India accounts for 0.5% of the world's investable real estate, and is the sixth largest real-estate market in Asia after Japan (13.5%), China / Hong Kong (1.9%), South Korea (1.6%), Taiwan (0.8%) and Singapore (0.6%).[18]

4. Ensure transparency: To ensure investor confidence, real-estate transactions in India need to be more transparent. Despite considerable opacity at present, the nation's real-estate market is showing signs of improvement in this respect. In the Jones Lang LaSalle Global Real Estate Transparency Index, India placed in the "semi-transparent" category in 2008 along with China and South Korea, up from "low transparency" in 2004.[19] Still, despite consistent improvement on this measure, much remains to be done.

5. *Adopt a standard model of mall management and partnership*: Indian malls need to follow international management practices and ownership patterns. Developers should retain ownership of the complete mall and recover their capital investment over the long term by collecting rents directly from tenants. It is heartening to see that new mall projects are adopting this model, and it

[13] Sunil Jain and Parvathy Ullathil, "It's All About Footfalls and Conversions," *Retail India Abroad*, October 17, 2003, http://www.rediff.com/money/2003/oct/17malls.htm, retrieved November 22, 2011; Malini Bhupta, "Mall Mania," *India Today*, November 21, 2005, pp. 17 – 18, http://archives.digitaltoday.in/indiatoday/20051121/cover.html, retrieved March 13, 2012.

[14] S. Patil, "Draft, Real Estate Investment Trusts Regulations, 2008: A Critique," 2008; Securities and Exchange Board of India, "Draft, Securities and Exchange Board of India (Real Estate Investment Trusts) Regulations," Mumbai, India: 2008 (circulated for public comments by Securities and Exchange Board of India), http://124.153.64.100/mccode/news/lp_news_detail.php?autono=561, retrieved April 20, 2012.

[15] G. Srinivasan, "Real Estate Mutual Fund Keenly Awaited," *The Hindu Businessline*, December 27, 2007, p. 12, http://www.thehindubusinessline.in/2007/12/27/stories/2007122752161000.htm, retrieved March 12, 2012.

[16] Taneja, *Malls in India: Shopping Centre Developers and Developers*, pp. 72-75; Vandna Singh and Komal, "Prospects and Problems of Real Estate in India," *International Research Journal of Finance and Economics,* Issue 24 (2009), pp. 246, http://www.eurojournals.com/irjfe_24_21.pdf, retrieved April 24, 2012.

[17] Graham Newell and Rajeev Kamineni, "The Significance and Performance of Real Estate Markets in India," *Journal of Real Estate Portfolio Management*, April 2007 (Volume 13, Number 2), pp. 161–172.

[18] *Ibid*.

[19] *Real Estate Management and Development in Asia-Pacific: Industry Profile*. London, UK: Datamonitor Group, 2006, report reference code 0200–2132; *Global Real Estate Investment Trust*, London, U.K.: Datamonitor Group, 2008, report reference code 0199–131.

is to be hoped that this trend will spread.[20]

Mall developers should view stores as partners and not merely rent-paying tenants. Creating this partnership would require constant consultation and trust-building. In case the property must be sold, strict conditions should be imposed on permissible uses. Investors would be the legal owners of the retail space, but developers would decide on tenants. Investors, however, would retain the right to sell the property.[21]

6. *Promote a revenue-sharing model*: Malls should adopt a revenue-sharing model, in which the tenant pays a percentage of sales as rent along with a fixed monthly base rent as minimum guarantee. This would encourage the developer to promote the shopping mall, as revenues would depend on the quantity of business done by tenants. It has been demonstrated that this model works successfully in both bullish and bearish market conditions.[22] This method also develops a bond between developer and tenant because of the link between revenues and turnover.

Conclusion

The real-estate sector desperately needs a proactive statutory regulator. To be effective, the regulator needs to act on multiple fronts: *Policy*—ensuring enactment of regulations for this sector; *Performance*—setting standards and benchmarks to be followed by different players in this sector; *Information*—requesting statutory information and the latest developments from different players for sharing with stakeholders; *Supervision*—keeping an eye on violation of norms; and *Adjudication*—receiving and processing customer complaints on a fast-track basis.

Policy initiatives are needed to streamline and stimulate the entry of international developers in the Indian real-estate sector in general, and in developing malls in particular. In addition to FDI infusions for development, international developers can transform the real-estate landscape by imparting attributes such as transparency in operations and global practices in mall development and management.

India is still in the growth stage of the mall lifecycle. If global best practices during this phase are taken as lessons for charting a course of action, the future of malls will be bright. To accomplish this, developers and the government need to cooperate in making the retail real-estate sector more transparent, accountable and customer-oriented. Only then will the growth of India's malls be truly sustainable.

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[20] Charles Grossman, *Inaugural Address, Second Annual ICSC-India Shopping Centre and Retail Conference*, August 29-30, 2005, Mumbai.
[21] Hussain, p. 7.
[22] Roy and Masih.

Tracking Shopping-Center Sales Performance in Europe

An Overview of Existing or Planned National Turnover Indexes

SARAH BANFIELD

Abstract: *This article summarizes the different national shopping-center sales indexes either existing or under development in Europe, including variations in methodology that make comparisons difficult across countries. It also explains why a single pan-European index would provide tenants, landlords and asset managers with consistent performance benchmarks for an era when retail portfolios are no longer confined to borders.*

Sales-Floorspace Ratio as a Performance Metric

The success of a physical store largely depends on maximizing the efficiency of sales floorspace. Retailers have long used sales per square meter (sq m) of gross leasable area (GLA) to track store productivity and to monitor performance within a business across a portfolio of shops. Although this is a good measure of comparative success for different locations within the same retail brand, it is equally beneficial for evaluating performance relative to competitors in the same genre.

The average value of sales per sq m is highly variable, depending on the type of products being sold—for example, jewelers and telecommunications retailers have a much higher average sales per sq m ratio than, say, a food-and-beverage or discount retailer. Thus, an average sales per sq m figure for all retailers is somewhat misleading when attempting to appraise the performance of a business. Differentiating average sales per sq m by retail category is a key component of a turnover index, enabling comparisons to be drawn with industry standards for a particular sector. A lower-than-average ratio would indicate the need to re-evaluate stock selection, store layout, pricing, marketing or management.

The ability to track average turnover by category is not only an extremely valuable tool for retailers, but it also provides shopping-center owners and managers with a means of analyzing the performance of malls and their tenants in order to maximize the asset's value. This enhances the landlord/tenant relationship and helps owners/managers understand which stores in a scheme are outperforming or underperforming in their respective sectors. In the latter case, owners and managers can identify struggling retailers at an early stage and work with them to improve their results. Likewise, it also helps them better understand which retailers are the key anchors and income drivers in their schemes, as it should not be assumed that the largest units or those that have the highest total annual revenue are the most successful. It is, after all, a question of relativity.

In short, turnover indexes by category lead center landlords, investors and asset managers to better appreciate the business models of tenants, which is crucial to the success of a scheme. This has become increasingly important in recent years, as the global economic downturn has led to more "turnover rent" leases.[1]

A national and/or regional index can, therefore, particularly help retailers exploring a new retail market, as it can assist them to project return on investment (ROI). This is important as retail markets across Europe

[1] In Europe, a turnover lease differs from a market-rent lease in that the base rent is at a reduced rate—typically 80% of the market rate—and the retailer pays an additional annual sum based on an agreed percentage of the store's gross turnover. The appropriate percentage, critical to the success of such lease arrangements, varies between operators. Hence, while the future income stream of a retailer is uncertain, a turnover benchmarking tool can indicate the sales that a tenant can potentially generate and can assist developers in justifying rental levels for future negotiations in existing schemes or future developments.

have different characteristics. (For example, a homewares retailer in the United Kingdom wishing to expand to Hungary should not necessarily assume that the sales/sq m ratio will be the same as in its country of origin and would need to adjust its business plan accordingly.)

Impact of Multi-Channel Retailing

A critical weakness of any shopping-center turnover per sq m model is that it only relates to in-store sales and therefore does not reflect the increasingly multi-channel nature of modern retail operations. An increasing number of consumers are researching products in-store before purchasing online and vice versa. As a result, the traditional sales per sq ft or sq m metric no longer reflects the true contribution of stores.[2]

Retailers are increasingly using some of their sales space as showrooms or display areas for a wider range of products available online, allowing customers to research products before completing the transaction at home or via a mobile device. Likewise, many consumers use stores as part of a click-and-collect service or to return goods purchased online—all of which distort the performance of bricks-and-mortar retail.

Overcoming Confidentiality and Trust Issues

Despite the impact of multi-channel retailing, the benefits of utilizing a national shopping-center sales index remain. A key barrier to the development of such a benchmarking tool, however, is the reluctance of retailers and mall owners to release financial information. The unwillingness to provide sales figures stems from a deep-rooted fear that this privileged retailer or shopping-center performance data will be leaked into the public domain.

This is understandable, as disclosing confidential information to competitors would greatly damage a business. However, the purpose of an index is to provide a benchmark without identifying information from individual retailers or shopping centers. When developing the methodology, measures are put in place to ensure that there is a minimum sample size for each location, type/size of shopping center and retailers in each category so that individual results are not discernible. Confidentiality agreements ensure that the only information released to the industry is based on aggregated data.

Despite these rigid "masking" procedures, mistrust often lingers, particularly with regard to the company tasked with consolidating the raw data. It is imperative that a reputable, independent organization collects and processes the information so as to alleviate participants' concerns. In order to further preserve privacy, in many cases property owners need only provide the data collector with a summary of their shopping-center portfolio for a particular country, before it is then amalgamated with other portfolio data to generate a national index.

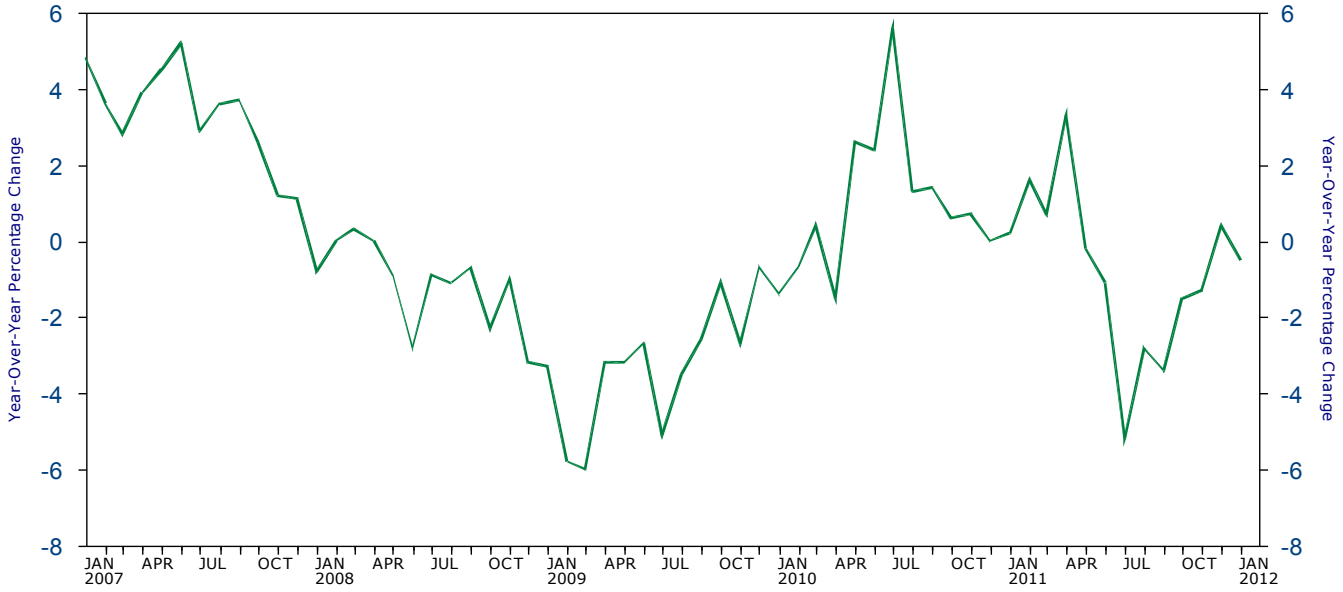
Overview of Existing National Indexes

Compared with the United States and Canada, where the sharing of market information is established and shopping-center sales by retail category has been tracked for years, many European retail markets lack this transparency. In a number of countries, however, the national shopping-center council has compiled a turnover index, with a summary report made available to members, as summarized in Table 6-1.

- *France*: The nation has the continent's most established sales index (which also includes footfall data), in existence for over 10 years. The National Council of Shopping Centers, known as Conseil National des Centres Commerciaux of France (CNCC), collects the data on a monthly basis from nine participating companies, equating to a total sample of approximately 170 centers. Sales data are broken down into eight retail categories, which are further divided into sub-sectors (e.g., the "Household Equipment" retail category is split into "Home furnishings" and "DIY and gardening"). Results are also analyzed by shopping-center type—"regional," "community" and "city center"—and adjusted by the category's weight in the national market. The index provides an overview of sales trends by retail category; however, it does not analyze productivity. (Please see Charts 6-1 and 6-2 for shopping-center sales-value and sales-volume performance in the nation since 2007.)
- *Italy*: The Italian Council of Shopping Centers, also known as CNCC, began collecting quarterly turnover data approximately three years ago, grouped into eight retail categories and five size bands. At present, four management companies provide data for the index, representing 46% of shopping centers larger than 40,000 sq m GLA and 24% of malls larger than 20,000 sq m GLA. Unlike the French model, data are aggregated by an external company before being

[2] Deloitte LLP, "Retailers Review the Role of Stores as Multi-Channel Booms," press release, February 23, 2011, http://www.retailcustomerexperience.com/article/179542/Retailers-review-the-role-of-stores-as-multi-channel-booms, retrieved April 27, 2012.

Chart 6-1
Shopping-Center Sales Value Performance in France, 2007-2012

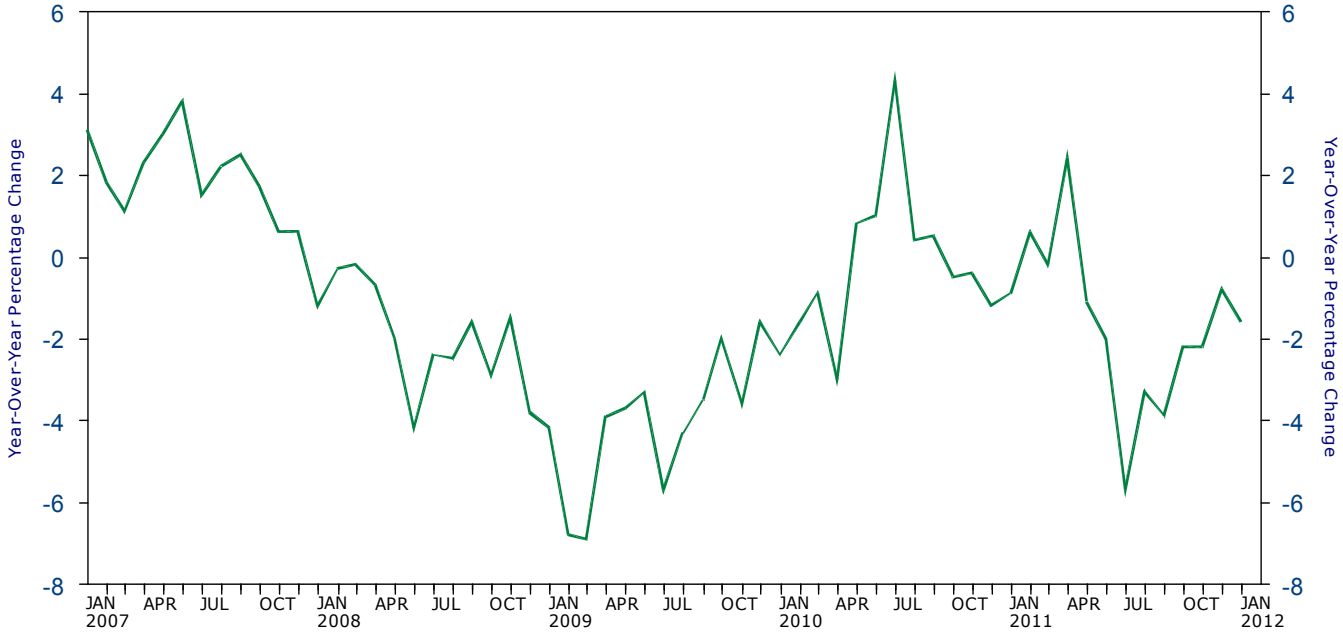


Source: National Council of Shopping Centers of France

analyzed by a CNCC committee. (See Chart 6-3 for quarterly results from this index for the last two years.)

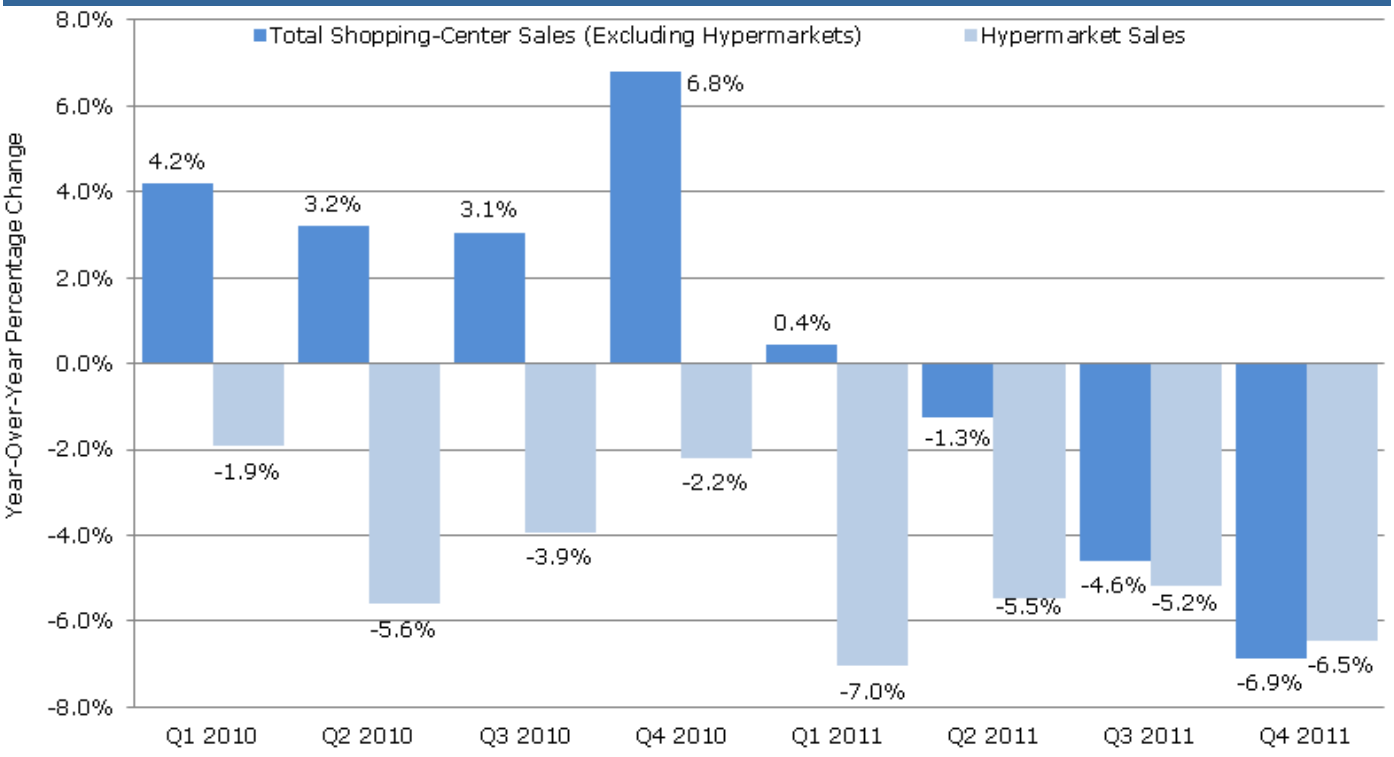
- *Poland*: In 2010, the Polish Council of Shopping Centers (PRCH) published its inaugural shopping-center turnover index. Monthly data are submitted to PricewaterhouseCoopers (PwC) by 10 companies for the schemes they manage, equating to a total sample of approximately 75 shopping centers. The PRCH

Chart 6-2
Shopping-Center Sales Volume Performance in France, 2007-2012



Source: National Council of Shopping Centers of France

Chart 6-3
Quarterly Shopping-Center Sales, Italy, 2010-2011



Source: Italian Council of Shopping Centers

Turnover Index represents a sample of the industry that is about 13% of the total traditional shopping-center supply. Data are analyzed by city/region and grouped into eight retail categories without any center-specific data, as confidentiality is crucial for participating companies. Additionally, the PRCH has been aggregating footfall data from the same companies since January 2011 in order to present the possible correlation between the turnover and footfall figures. The PRCH actively encourages more of its corporate members to participate in this project, as this is a unique point of reference for the market.

- *Scandinavia*: The Nordic Council of Shopping Centers (NCSC) also publishes information on shopping-center turnover broken down by retail category; however, to date, only Sweden is included and data are collected annually. Every center owner in the country (approximately 300 in total) is requested to provide the information with the understanding that the greater the level of participation, the more valuable the statistics to benchmark against—though, in general, only half of the potential respondents provide figures. Where it is supplied, however, sales information for each shopping center is split into five broad retail categories and published in an online database alongside basic facts about each scheme, which is accessible for a charge. Besides turnover data, information is collected on average rental levels and common administrative costs, but on an aggregated geographical level. In the future, this will be developed into a Nordic database with a partner in every country, who will be responsible for collecting the information. HUI Research has been collecting turnover data on a quarterly basis from 20 to 25 real-estate companies for approximately 75 to 90 shopping centers in Sweden since 2005; however, the information is only available to participants. Data are analyzed by "non-durable goods," "durable goods," "cafes/restaurants"' and "other services." The "durable goods" category is further divided into fashion and "home/leisure." Analysis is also carried out by geographical region and type of center (city center, out-of-town shopping center and community center).

Table 6-1
Summary of National Shopping-Center Sales Turnover Indexes

	France	Italy	Poland	Sweden	Spain (under construction)	Portugal (under construction)	Czech Republic (proposed)
Metrics Reported	Sales value,[1] sales volume,[2] footfall	Sales value,[1] sales volume[2]	Sales value,[1] footfall	Sales value[1]	Sales value,[1] footfall	Sales value,[1] footfall	Sales value,[1] footfall
Frequency of Data Collection	Monthly	Quarterly	Monthly	Annual	Monthly	Monthly data collected quarterly	Monthly
Sample Size	Approximately 170 centers	Approximately 100 centers	Approximately 75 centers	Approximately 150 centers	Approximately 120 centers	Not available	15 centers
Number of Participants	9	4	10	150	11	Not available	15
Names of Participants	Altarea SCC Cório Hammerson Unibail-Rodamco Immochan Mercialys Ségécé Eurocommercial-Properties	Sonae Sierra Gallerie Commerciali Italia Larry Smith Cogest	Auchan Apsys DTZ Management Polska ECHO Investment Forum Gliwice GE Real Estate Metro Group CBRE Global Investors Ségécé Unibail-Rodamco	Data provided by individual centers	Auxideico Gestión Cório Chamartín Inmobiliaria Gentalia Immochan Metrovacesa Ségécé Sonae Sierra Testa Inmuebles en Renta Unibail-Rodamco Vastned Management	Not available	Data provided by individual centers
Detailed Report for Participants? Customized?	Yes – not customized	Yes – not customized	Yes – not customized	No	Yes – not customized	Not available	Not available
Data Collector	In-house - National Council of Shopping Centers of France	External – Adhera	External - PwC[3]	In-house – Nordic Council of Shopping Centers	In-house – Spanish Association of Shopping Centers	In-house – Portuguese Council of Shopping Centers	External - PwC[3]
Number of Retail Categories	8	8	8	5	3	0	To Be Decided
Retail Categories	Restaurants Personal Goods Household-Equipment Culture/Gifts/Leisure Health and Beauty Services Entertainment MSU	Restaurants Clothing and Footwear Household Goods Culture/Gifts/Leisure Personal Care/Health Services Electronics Hypermarket / Supermarket / Discount	Fashion and Accessories Health and Beauty Household Appliances and Accessories Services Speciality Goods Food/Groceries/ Supermarkets Restaurants/ Cafes/Catering Entertainment	Convenience Goods Comparison Goods – Fashion Comparison Goods – Home and Leisure Restaurants and Cafes Services	Fashion Household Goods Restaurants	Not available	To Be Decided
Further Analysis	Sub-sectors: e.g., Household Equipment is divided into "Vehicles," "Home improvement" and "DIY and gardening"; Type of center: regional, community and city center	Unit size: Less than 250 square meters (sq m) 251–600 sq m 601–1,500 sq m Less than 1,500 sq m Restaurant	Geographical area: cities, regions	Not available	Not available	Not available	Geographical area: Prague, Bohemia and Moravia In-town and out-of-town

[1] Nominal or current value; [2] Real or inflation-adjusted value; [3] Pwc=PricewaterhouseCoopers
Sources: National Council of Shopping Centers of France, Italian Council of Shopping Centers, Polish Council of Shopping Centers, Nordic Council of Shopping Centers, Spanish Association of Shopping Centers, Portuguese Council of Shopping Centers, Czech Republic National Committee of the International Council of Shopping Centers

Aside from the established national indexes, a number of countries have similar projects in the pipeline:

- *Spain*: The Spanish Association of Shopping Centers is developing a footfall and turnover index by collecting monthly data from 11 companies that either own or manage shopping centers, equating to a total sample size of approximately 120 centers. A general index is calculated, with data broken down by three retail categories: "'fashion," "household goods" and "restaurants." The inaugural index is due to be published in September 2012.
- *Portugal*: The Portuguese Council of Shopping Centers is also creating a national footfall and turnover index. Although still in the development stage, monthly data are being collected on a quarterly basis and aggregated on a national basis—it will not be reported by retail category or geographical area.
- *Czech Republic*: The National Committee of the International Council of Shopping Centers is establishing a footfall index with future plans to incorporate turnover data. Monthly data are submitted by 15 centers (with the aim of increasing this to 25) directly to PwC and the information is aggregated by location: Prague, Moravia, Bohemia and in-town/out-of-town. It is envisaged that turnover data will be added following a six-month trial period, which will then be expanded to include analysis by retail category after a further six months and based on participation request.

Differences in Methodology and Collection

It is evident that the methodologies adopted by different European countries vary considerably in terms of frequency of data collection/reporting, whether the information is submitted by individual shopping-center owners or their management companies, the organization responsible for data processing and the classifications used to analyze the data.

One of the key differences among the national shopping-center sales indexes is whether the data collation is carried out by the national council of shopping centers or a third party such as a major auditing firm. Both are reputable options to ensure neutrality and confidentiality.

While the majority of existing national indexes analyze average sales per sq m by retail sector, as well as location or size/type of shopping center, there is little consistency between the categories employed. The French and Italian models are most similar in terms of retail sector groupings; however, differences in the frequency of data collection make it difficult to draw any meaningful conclusions when comparing the two datasets.

Potential for a Pan-European Index

Inconsistencies in methodologies make existing national turnover indexes problematic to compare, not least due to the use of different currencies and membership requirements of national councils in order to access the information. However, in today's property market, retail-investment portfolios traverse a number of national boundaries, and the ability to compare the performance of shopping-center markets in different countries or regions would be a valuable resource for the global retail industry. To this end, the development of a pan-European shopping-center turnover index would be an invaluable tool, not only for owners, investors and property managers, but also for retailers, whose shop portfolios are also becoming progressively more global.

The primary barrier to the creation of such a benchmarking tool is divergent degrees of transparency across Europe with regard to information exchange. Some retail markets, such as France, are relatively candid about sharing shopping-center performance data; however, other markets (e.g., Turkey) are much more cautious about releasing such information, even in a controlled environment. In order for a European-wide shopping-center sales index to be created, the benefits of sharing such information need to be widely recognized, and the major shopping-center owners need to lead by example to establish a best-practice protocol.

Conclusion

Shopping-center turnover by sq m, particularly when categorized by retail sector, is a valuable performance metric because it:

- Enables retailers to benchmark themselves against competitors in the same retail category;
- Indicates to owners and asset managers whether occupiers in their centers are outperforming or underperforming market trends;
- Provides new entrants to a market with a sales measure and helps them to project a realistic ROI;
- Assists landlords and tenants when negotiating leases, particularly in relation to turnover rents;

- Enables owners to better understand retail operations and enhances the landlord/tenant relationship;
- Allows comparison of shopping-center sales performance overall and by key goods categories with official statistical retail sales data at the national level.

Lack of trust and concerns about confidentiality remain key barriers to information exchange. An industry statement or protocol might help in developing a voluntary code of best practice to encourage the sharing of information across countries.

European markets may look to the example of North America where there is a breadth of information available on the shopping-center industry. In this fast-moving economic environment, anyone transacting, owning or operating in domestic or foreign markets needs to keep a close eye on performance trends and react quickly to change. While the various existing national shopping-center turnover indexes are no doubt of significant merit, inconsistencies in the methodologies and data-access requirements make it difficult to compare markets. Thus, the development of a pan-European shopping-center sales index would be a beneficial resource.

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Using Property Scoring to Find the Right Location

A Methodology for Matching Retailer Needs and Locations

*RICHARD FENKER**

Abstract: *This article provides an overview of the development and application of a property-scoring system, dubbed BrandScore, which blends various characteristics of location analysis with the retailers' customer profile. It is argued that this methodology helps retailers make more informed decisions on appropriate locations.*

Introduction

Finding optimum locations for retail chains is a challenge as old as the modern commercial real-estate industry. From a retailer's perspective, the problem is relatively straightforward: better locations will likely yield higher sales volumes. From the center owner's or property manager's perspective, the problem is more complex: to find the right retail tenants.

Quick, intuitive judgments are often made by the owner or leasing agent based on the retail chain's success in similar centers. In many cases this analog or pattern approach worked well, especially when center development was in its prime. Today, however, more limited center options, the decline of some major chains and the importance of small chains and local retailers vastly increase the challenges involved in finding and recruiting the best retailers.

Does a general solution exist that would provide a scientific base for determining which specific retail chains or brands belong in any shopping center, large or small? Good intuitive and experiential knowledge still prevails many times. But, more often than not, the decisions are too difficult and essential data are unavailable.

With these needs in mind, *TheRetailPlanet.com* developed BrandScore, which statistically maps all retail chains to all centers based on factor scoring. This article describes this general approach to assist *center owners and leasing agents to identify top retail chains based on their relevance to center customers and retailers to assess their potential success in the center*.

Sales Potential as a Key to Growth Strategies

What determines a "good" location versus a "poor" one depends ultimately on performance of store volume, sales per square foot or other similar measures. However, inferences can be made about location factors' influence on retail sales. For example, sales estimates based on information about the trade area, the local shopper demographics, the traffic and site features (such as visibility and access) would help to statistically explain that performance. This approach becomes problematic, however, when attempting to predict all of a store's performance from location factors alone. Using just location factors to predict sales simply does not work well in practice.

What works for sales prediction, however, is to use an expanded set of explanatory variables about the broader area. Begin this process by considering the 20 or so obvious factors that retailers, brokers and owners are likely to agree on as relevant, such as a good supply of customers in nearby homes, employees working in the trade area, nearby synergistic retailers or centers and good visibility or accessibility. Next, evaluate and rank all locations for a retailer based on the quality of these factors. Finally, plot this overall quality rating for each location against a performance measure such as total sales. This *location quality* measure is highly correlated with sales, though it will not be perfect because many other factors contribute to sales performance.

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BrandScore is a logical extension and application of this approach. Some factors, for example, such as visibility or ease of access, are more important to convenience-oriented businesses (e.g., McDonald's) than to Sam's Club; other factors, such as a unique lifestyle profile in nearby households, are more important to Books-A-Million than to Family Dollar or a convenience-store chain. But these differences are about how the factors are weighted, not their relevance to the prediction model. BrandScore is based on the statistical relationship of data from more than 200,000 locations with actual performance of retailers and restaurants in these locations.[1]

Credit Scores versus Property Scores

A scoring system for retail properties is analogous to a credit score. Both use a widely accepted set of indicators to generate a score, in one case for "financial health" and in the other for "location health" based on the expected performance of specific chains. In the credit-scoring example, no one would expect to predict an individual's total wealth based on indicators of credit worthiness, but regardless, those indicators should be consulted before a home is sold to that person. The property score (which also is an indicator of performance) is not intended to predict annual sales revenues for a retail chain, but it can definitely help to quickly filter out most weak locations.

The Core Components of BrandScore

BrandScore measures the potential of a retail location based on five component scores that have a long history in sales-forecasting models. These five components (see Chart 7-1) include:

1. *Economic/Competitive Environment*: Data are combined on the trade area's economic health, retail sales, level of competition relative to customer demand, and overall retail sales. Competition is generally not considered a negative unless the demand for products associated with this type of retail activity (for a specific chain) is weak.[2]
2. *Commercial Environment*: Often described as "daytime activity," this measures the strength of all customer sources other than local residents, including employees and shoppers in the area, diners, local traffic, visitors to nearby offices and to entertainment venues (including theaters, sports parks, and museums) plus other customer sources during the day or evening. Additionally, the number of walk-by customers can be included in this element.[3]
3. *Synergy*: This measures the degree to which nearby retailers will attract similar customers, along with the added draw or agglomeration power that comes from clusters of retailers.[4] Synergy between two specific retailers or among a collection of retailers (as in a

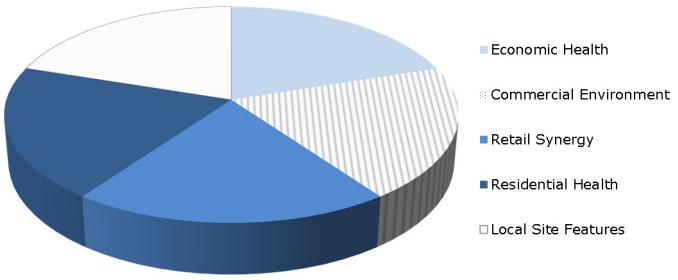
[1] The science behind BrandScore has been detailed in *The Site Book: A Field Guide to Commercial Real Estate Evaluation* (Mesa House Publishing, Fort Worth, Texas, 1996) and *How Retailers Find Their Place, Introducing BrandScore* (TheRetailPlanet.com, Inc., Santa Fe, New Mexico, 2011), both written by the author of this article.

[2] A simple analysis of supply and demand might suggest that high-demand/low-supply trade areas would work best. Many *gap analyses* for retailers are based on similar principles. Yet, reality frequently contradicts what might seem obvious here. The low-hanging fruit or high-demand areas that are undersupplied have been in short supply for many years (unless companies are focused on new or developing areas). *In many sales-prediction models, low-supply areas with few retailers tend to have zoning, physical or behavioral constraints on retail development.* The classic low-supply area, for example, is the affluent suburban neighborhood with limited retail space and a street network that often impedes access to nearby retailers. Even property available in such areas is potentially risky. Residents are more likely to drive a couple of miles to visit the nearest well-established retail district with a full array of stores plus restaurants. On the other hand, high-supply trade areas, even when demand is moderate, are not necessarily bad for most retail chains. These areas tend to be the primary retail districts in a market with major shopping centers, power centers, restaurant rows and other attractors. Many retailers have the impression that direct competition is bad for sales. This is very difficult to demonstrate scientifically except in special circumstances. This seldom occurs with branded/synergistic retailers and, even with commodity-based retailers in many high-supply settings, the sales reduction will be slight to moderate. Excessive competition for major chains in high-supply areas tends to lead to low-average sales performance, not failure.

[3] Virtually all retailers benefit from having a strong base of potential customers coming from sources other than households in the trade area. The best retail districts generally have a healthy mix of many customer sources. As the mix becomes biased in any direction, commercial or residential, the location is at greater risk. As the number of non-residential customers in an area increases so does the competition. Brands, such as fast food, that tend to receive some portion of non-residential customer visits (even though the competition will also receive visits) will perform adequately. Hot, expanding brands will often do very well. Weaker brands and local retailers will tend to have below-average performance. In creating the Commercial Environment Score, the focus of BrandScore was simply to rate a retail environment based on the potential of different customer sources to use a brand. Employees, for example, are often regular customers for nearby restaurants. When restaurants are present in the retail district, this will improve the final commercial score for most brands. Although locations with high scores on this BrandScore component often will not always be the top-performing locations for a chain, good scores here are often a condition for high sales. Low scores tend to be risky.

[4] Shopping centers and city centers, of course, are the classic examples of powerful retail clusters. Lifestyle centers tend to have the highest agglomeration power (for a specific set of consumer groups) because all stores appeal to a limited set of lifestyles.

Chart 7-1
Components of Brandscore



Source: TheRetailPlanet.com

center) simply means they work together in ways that help one another.[5]

4. *Neighborhood Potential*: This component measures the potential of residents in the surrounding trade area to use this retail chain or type of retail product. It is especially important for retailers such as supermarkets, fast-food and local-service businesses that depend on nearby households for the majority of their customer base. When available, this measure depends on preferences for specific brands as measured by MRI or Simmons surveys, lifestyle patterns near current locations, and general lifestyle patterns associated with specific retail categories. Fast-food restaurants, for example, tend to belong to one of five generic neighborhood profiles that TheRetailPlanet.com has evaluated for the entire United States.[6]
5. *Site features*: These add location-specific attributes such as visibility, accessibility, performance of nearby retailers, ease of parking and other factors that depend on a person actually visiting the site.[7]

BrandScore provides an area-based score using these components, calculated for all retail locations in the United States. Local site features generally is quite significant and alone can explain 20% to 40% of variance in sales performance. The overall BrandScore ranges from 40 to 300 with an average reading of 100. Scores of 175 and above (representing the 95% threshold and above) are considered excellent. Appendix 7-1 displays a sample output with retailer scoring for a specific area.

How Can Property Scores Help Center Owners?

The strength of a shopping center begins with selecting retailers that are synergistic with each other and appeal to the potential customers living, working, shopping or visiting in the trade area. The scores of the center's top

[5] This help can come in several forms: (a) *Increased draw potential*: a larger retail presence attracts users from larger distances. (b) *Additional customers*: customers shopping in a nearby store may now want to shop or dine in your store because it's convenient. (c) *Linked errands*: people purchasing groceries may also want gifts, dry-cleaning, sandwiches or flowers. The *grocery-anchored shopping center* is a good example of a center organized around this idea. (d) *Linked lifestyle behaviors*: this is a more general version of linked errands that comes from observing the behavior of people across the day, often based on segmentation or lifestyle profiles, and then connecting the key behaviors in one setting. An analysis of 50,000 large centers from TheRetailPlanet.com database shows there are 15 distinct patterns or associations of retailers that underlie most centers and shopping districts today in the United States. Most likely, there is a Darwinian process in play here. As some retail configurations worked and others did not, the more successful elements for a specific type of center or retail environment persisted. In turn, weaker associations gradually disappeared through inconsistent application or a change in strategy. As a result of that evolutionary process, retailers naturally organized around lifestyles or functions that make sense for consumers. The synergy measures used in BrandScore come from an analysis of approximately 3,000 major retail chains and 95 retail categories in both center and non-center locations across the United States.

[6] Neighborhood-based customers are the most important factor for many retail locations in BrandScore models. To achieve a high score, the location must have a healthy proportion of potential brand users living in the surrounding trade area. Settings with the highest number of potential brand users tend to be neighborhood locations that are weak in other customer sources such as employment or retail activity. This results in store performance lower than other locations with fewer households but better balance across all of the factors that support retail sales. By accurately predicting store performance, the use of brand preferences of trade-area households is a major BrandScore strength. But adjustments need to be made, for instance, in cases where a retail area is thriving despite few nearby households. The Brandscore model resolves this difficulty by using scenario logic first to classify each location on a commercial-residential continuum and then apply scoring rules that fit that situation. These rules include a second important measure of trade area fit called a Deployment Profile. Such profiles measure the extent to which the people in the trade area match the typical profiles for other locations for a chain. Deployment profiles are especially important for retailers who locate in commercial areas that are not necessarily near their customer base. Upscale shopping centers are a classic example of this scenario.

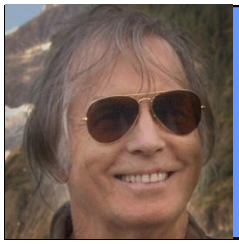
[7] For the most part, site features are collected as a forecasting model is constructed, weighted using a statistical process that connects the features with performance data, and then applied to new locations with the same weights. Traditionally, these kinds of data are not used unless this type of correlational analysis is available; however, there is little evidence to suggest that this degree of caution is warranted. In fact, hundreds of examples suggest the opposite; Site Feature ratings are relevant to performance for every retail/restaurant brand. By adding site-feature data to the BrandScore, even without a statistical weighting process, the score is always improved, in many cases significantly.

retail tenants measure its relevance to its potential customer base as well as its strength compared with competitors.

Because BrandScore is already calculated for all retail brands, it becomes possible to quickly identify the highest potential retail chains for the center. This can be used to decide how to fill available space or plan around center developments or re-developments. Then, simply generating an average score (weighted by the center's GLA) will do a good job of characterizing the strength of the center in this location based on its retail tenant mix.

Conclusion

Property-scoring systems provide strategic information to help the shopping-center industry better evaluate the fit of tenants and landlords. But even more so, this approach has key benefits: (1) more objectivity in risk assessment, (2) consistent evaluations across time, location and brands and (3) a faster way to filter the "good" and the "poor" locations.



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Appendix 7-1
Sample Brandscore Output for a Specific Geographic Area

Top Retail Tenant Report

Powered by BrandScore, the Top Retail Tenant Report measures how well the retail brands listed are likely to perform in this location.

RETAIL CATEGORY All Top Categories

What is BrandScore?
BrandScore is a measure of the location quality for a retail brand for the retail district selected (the 1km X 1km square to the left). BrandScore is derived from thousands of data elements drawn from the surrounding trade area. These data elements are grouped into four components: **Neighborhood** (fit for the type of people living in the trade area), **Retail Synergy** (help provided by neighboring synergistic retailers), **Competitive Environment** (supply demand dynamics in the trade area) and **Commercial Environment** (effect of daytime population). Using the BrandScore application at TheRetailPlanet.com you can add **Site Features**, a fifth component that is specific to your property which takes into account 'on-the-ground property knowledge' such as visibility, access, parking, economic health, etc. Learn more at our BrandScore Technology page.

Filters Applied:
Brands displayed have locations in East South Central region

BrandScore scale: 100 = Average; 175+ = Excellent

Retail Location Address
2405 Crestmoor Rd
Nashville, TN 37215

For this Retail District there are a total of 334 brands that have an excellent BrandScore, 347 that have an above average BrandScore and 90 that have a below average BrandScore.

RETAIL CATEGORY	SUB-CATEGORY	BRANDED RETAILER	BRANDSCORE	BRAND PRESENT IN TRADE AREA
Accessories	Fine Jewelry/Watches	Tiffany & Co	206	Yes
	Leather/Luggage	Louis Vuitton	205	Yes
	Shoes	Fleet Feet	203	-
	There are 20 additional brands in this category with an excellent BrandScore.			
Apparel	Apparel - Women's - Mid-scale	Benetton	205	Yes
	Apparel - Men's - Upscale	Tommy Bahama	205	-
	Apparel - Women's - Upscale	Cache	204	Yes
	There are 45 additional brands in this category with an excellent BrandScore.			
Art Supplies/Novelty	Gifts/Novelties/Souvenirs	Ten Thousand Villages	201	Yes
	Gifts/Novelties/Souvenirs	Yankee Candle	201	-
	Gifts/Novelties/Souvenirs	Home Town Threads	189	-
	There are 3 additional brands in this category with an excellent BrandScore.			
Auto	Auto Supplies/Car Care	Mister Car Wash	203	-
	Auto Supplies/Car Care	SpeeDee Oil Change & Tune Up	203	-
	Auto Supplies/Car Care	Jiffy Lube	201	-
	There are 10 additional brands in this category with an excellent BrandScore.			

For more information on the BrandScore methodology, see www.TheRetailPlanet.com. Also, refer to The BrandScore Book, by Dr. Richard Fenker by requesting a copy through our website. TheRetailPlanet.com, Inc. 369 Montezuma Street #295 Santa Fe, NM 87501 (505) 629 0235

Real-Estate Portfolio Optimization

Steps That Can Be Taken to Think "Out of the Box," Benchmark Operations, and Discover Cost Savings

*WILLIAM JEGHER**

Abstract: *This article explores how to improve a real-estate company's financial performance. Next, real-estate discounted cash-flow analysis is considered, especially if disposing of properties and/or looking for new acquisitions is a feasible option. In addition, this article explains how this analysis can help add value to properties while cutting costs.*

The recent film *Moneyball*, adapted from the Michael Lewis bestseller, chronicles how Billy Beane, general manager of the Oakland A's, made his cash-strapped, cellar-dwelling team competitive with richer franchises, such as the New York Yankees. A fan of analytics, Beane began in the late 1990s to put his faith in sabermetrics, a baseball statistical movement that focuses on valuing players in unconventional ways—studying trends and benchmarks—rather than more traditional methods used by other teams. Instead of ex-ballplayers, he hired for his front office a Harvard-educated economist (in the film, a Yale-educated one) who could help identify market inefficiencies that could be exploited to the A's benefit. Suddenly, without raising its payroll to match the big-market clubs, the perennial also-ran started contending and, in some cases, beating the behemoths of the game. Beane challenged years of conventional thinking with a new, different approach. And it worked.

How does this story apply to real-estate portfolio optimization, acquisitions and dispositions, especially on the retail side? What can companies do to save money, elevate themselves over their peers and ultimately, make the right decisions and conclusions about their portfolio?

Staying on Top of the Game

Sometimes it becomes difficult to pull away from day-to-day responsibilities and critically analyze real-estate portfolios. Corporations generally do not have time or resources for this. Most third-party facility managers do not engage in such exercises.

Essentially, portfolio optimization is about thinking outside the box. What tangible results could that actually achieve? While most people think they are paying attention to what their portfolio requires, it is possible that they are not always in tune with its needs.

Initiative 1: Operating Cost Benchmarking

Benchmarking is the continuous process of measurement, analysis, implementation and remeasurement. While many types of benchmarking exist, almost all methods use some form of comparison.

One type of benchmarking is the search for and implementation of leading practices; another uses industry data to compare results. Organizations can also execute internal benchmarking by comparing similar processes at different locations or within different functions. Several ICSC publications can be used in shopping-center managers' search for meaningful benchmarks, such as the monthly reports *U.S. Mall Performance* and *ICSC Chain Store Sales Trends*.

Not an Exact Science: It is almost impossible to find a significant sample size by which to compare one set of building costs to another. Too many variables exist: different building ages, different building sizes, different operating hours, different electrical systems…the list goes on. Benchmarking, then, is not an exact science.

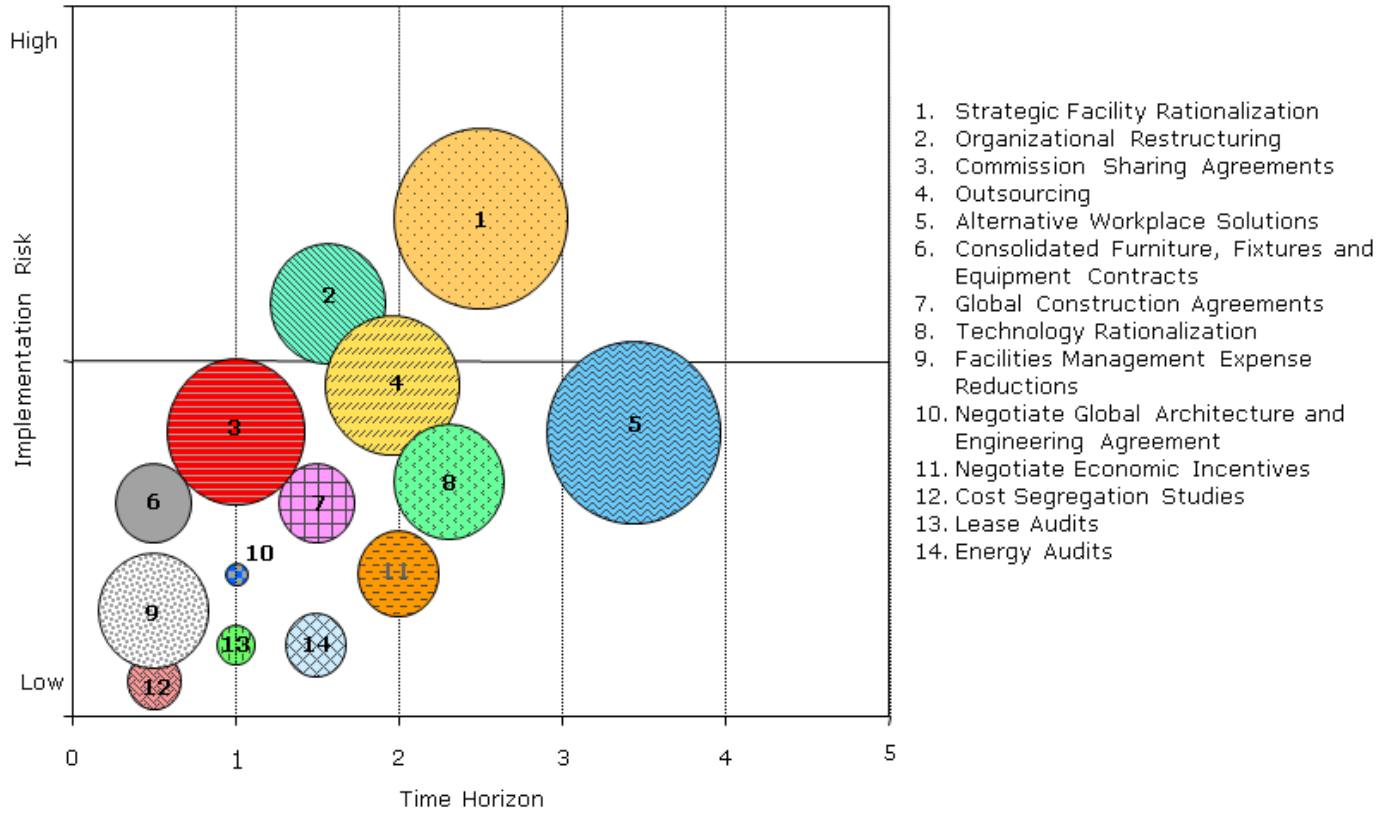
However, if one embarks on a benchmarking exercise just looking for red flags, one gains a much broader understanding of how a property stacks up. Red-flag identification will usually lead to cost savings.

If a meaningful benchmark cannot be found, there is nothing wrong with benchmarking within a portfolio. Simply look at retail outlets of similar age, equipment, operating hours and location, and continue from there.

The Traffic Light System: Once operating-cost data are gathered, it is important to research and find meaningful

*Ernst & Young Real Estate Services, Canada

Figure 8-1
Timeframe for Correcting Problems



Note: Diameter of circle indicates size of opportunity
Source: Ernst & Young LLP

benchmarks. This can be done by using some industry benchmarking data (*Income/Expense Analysis: Shopping Centers*, from the Institute of Real Estate Management, could be one such source), hiring a consultant to do a fully customized benchmarking study, or organizing a benchmarking roundtable. The latter sort of gathering, a particularly easy and low-cost way to obtain data regarding peers, is becoming more and more commonplace in the real-estate industry, sometimes occurring monthly in major North American cities. Essentially, any type of information-sharing among industry peers will usually provide the most meaningful of benchmarks. Typically, third parties can gather data from organizations and blend them into an anonymous report that all participants can then use.

With data and some meaningful benchmarks in hand, it becomes possible to "traffic light" every major line item in a portfolio. That is, each item can be rated from green light (acceptable) to red light (not acceptable). Before traffic lighting, it is important to establish specific criteria related to performance. For example, if utility costs are 5%-10% better than the benchmark, it might receive a green light. Between 0%-5% better, or 0%-5% worse, a yellow light might be in order. Anything above 5% would receive a red light.

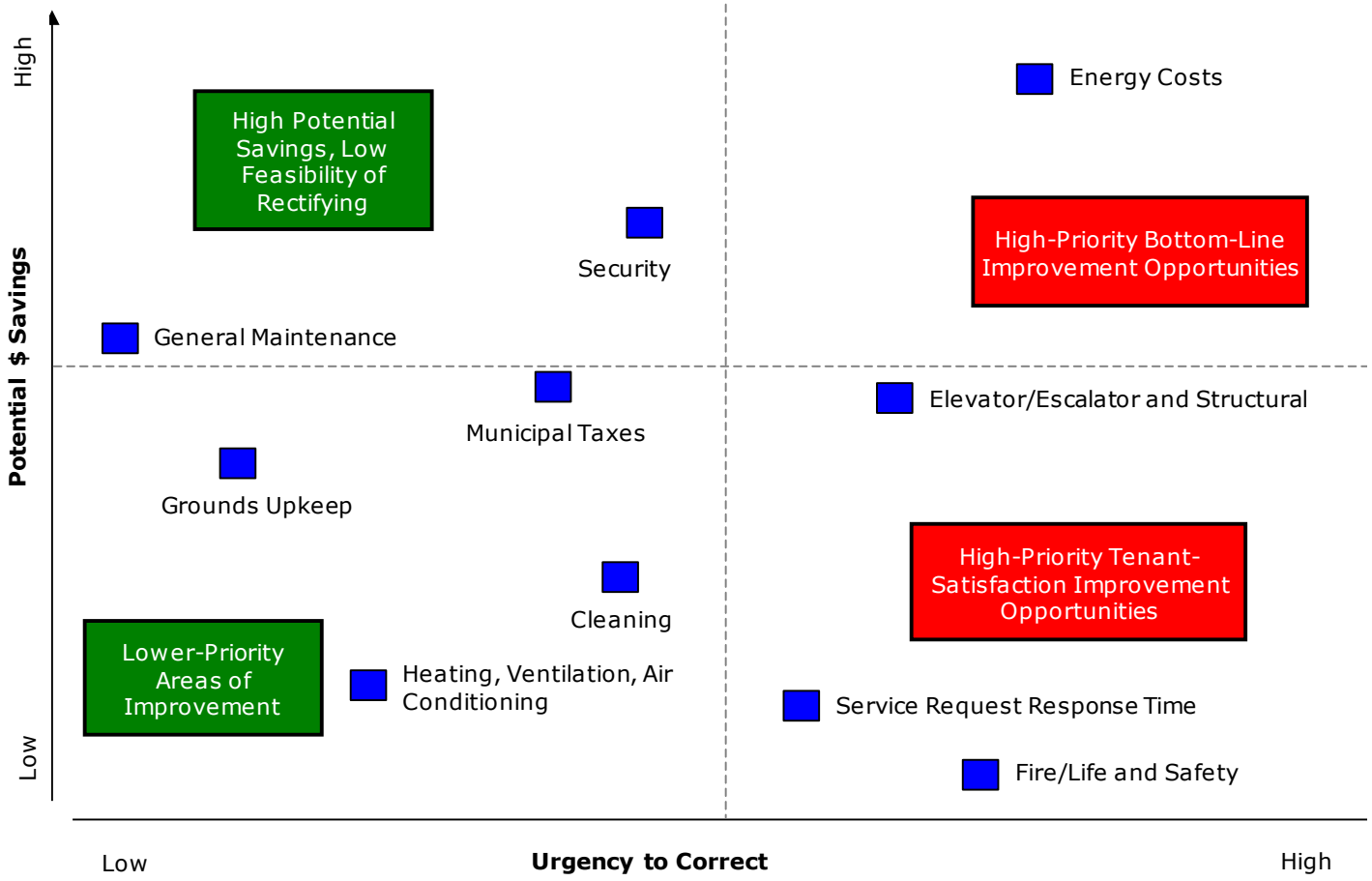
Determine Priorities: Once it is established where a company stands vis-à-vis peers, it is time to prioritize. With the data mined, it becomes critical to judge the sense of urgency required to investigate and correct each issue identified. Figures 8-1 and 8-2 can help accomplish this task. This will likely be portfolio-specific and industry -specific, and will largely depend on several factors.

Initiative 2: Facility Condition Index

While the Facility Condition Index (FCI) applies more to owned facilities, the implications are potentially enormous in the retail sector.

Developed in the 1980s by the United States Navy and published by National Association of College and University Business Officers in 1991, the FCI has gained broad acceptance across numerous industries, public and private corporations, including the U.S. federal government, ministries of the Canadian, Quebec and Ontario governments, and many others.

Figure 8-2
Potential $ Savings Versus Urgency to Correct: Quadrant Analysis



Source: Ernst & Young LLP

This method of measuring the relative condition of a single facility or group of facilities is used in setting targets for annual funding and for the duration of the level of deferred maintenance.

The FCI is the ratio of (1) the level of deferred maintenance and cost of remedying facilities; to (2) the replacement value of the facility(ies).The higher the FCI, the worse the condition of the facility.

$$FCI = \frac{\text{Current Amount of Deferred Maintenance}}{\text{Current Replacement Value of Base Building}}$$

The FCI can be better understood with a practical personal example. If a home's replacement value (not market value) is $100,000 and its deferred maintenance is $3,000 (FCI = 3%), a homeowner would probably be quite satisfied that things are under control. Alternatively, if a neighbor has an identical house with a deferred maintenance level of $25,000 (FCI = 25%), he will likely feel much less comfortable.

The most widely accepted industry-accepted category standard for is:

- 0 to 5%: good;
- 5% to 10%: fair;
- Greater than 10%: poor.

Securing increased capital funding and embarking on a programmed strategy to tackle an institution's high levels of deferred maintenance requires a number of prerequisites, including:

- Identifying the assets in question;
- Determining the funding requirement to replace them;
- Prioritizing locations based on their relative condition;
- Communicating results and the implications of inaction to the decision-makers and stakeholders of the institution.

Table 8-1
Asset Replacement Matrix

	Priority	Useful Service Life	Condition: Good	Condition: Fair	Condition: Poor
Priority and Service Life	1	Over	5	3	1
	1	Under	10	5	1
	2	Over	5	3	1
	2	Under	10	7	1
	3	Over	10	7	5
	3	Under	15	10	5

Year of Replacement

Source: Ernst & Young LLP

The first steps, identifying the assets and their replacement costs, requires an Asset Management Data Base (AMDB) that lists each asset and piece of equipment for each location.

In addition, each asset/equipment needs to be evaluated and rated in terms of condition (e.g., excellent, fair, poor, requires immediate replacement), expected life, year of installation, replacement cost, and finally priority based on predefined criteria, such as:

- Health and safety;
- Laws, codes and regulations;
- Assurance of continuous uninterrupted operation;
- Asset safeguarding; and
- The institution's public image.

With a comprehensive AMDB in place, identifying and establishing the deferred maintenance level and estimating the amount of capital that the institution's infrastructure portfolio will need in future years requires developing investment criteria based on the expected life, age, condition and priority of the assets.

In the example shown in Table 8-1, management must decide when to replace a particular asset relative to its effective or useful service life. This asset replacement matrix will help to quantify the institution's capital requirement, by location, over the next number of years.

The next step is to prioritize capital-investment dollars based on each location's relative condition and effectively communicating the results. This is where the FCI plays an important role.

Having determined the FCI for each building, one can then prioritize investment locations, combined with a risk assessment related to each. Estimates can also be made of the institutions' medium- and longer-term capital-investment requirements.

Results of the study should be shared with senior management as well as with the board of directors, who have the responsibility of addressing risks and ensuring they are appropriately managed. Significant risks result from inadequate capital funding and excessive deferred maintenance levels, and these issues needed to be recognized. These risks include:

- Increased business risk;
- Risk and financial implications of operational disruptions;
- Health and safety of employees;
- Larger future expenditures to correct backlog, such as compliance to costly building codes, which may not apply to minor renovations;
- Potential liability;
- Impact on productivity and employee morale; and
- The institution's public image.

In fact, these risks are so important that in the United States, the U.S. Federal Accounting Standards Advisory Board (also known as FASAB Statement No. 6) mandates that deferred maintenance standards require disclosures related to the condition and estimated cost to remedy deferred maintenance of property, plant and equipment.[1] Similarly, in Canada, the Canadian Institute of Chartered Accountants and the Public Sector Accounting Board are examining the issue of deferred maintenance disclosure.

[1] FASAB Statement No. 6.

The Next Step: Discount Cash-Flow Analysis

After engaging in this analysis (or others not covered in the scope of this piece), one might be in a position to dispose of some properties. Or, perhaps an acquisition mode would be more appropriate. How should such transactions be executed in a conservative, measured and cost-effective manner?

Although real-estate financial analysis relies on cash flows, discounted cash flows (DCF)[2] and net present values (NPV), the absolute and unquestioning reliance on DCF will lead to poor decision-making, and ultimately destroy value as opposed to its oft-stated objective of value creation. Before recommending and/or making any final decisions, the decision-maker and board of directors, where applicable, need to perform their own due diligence. What follows is a brief overview of the bumps and potholes that one needs to be cognizant of, and what decision-makers need to be keenly aware of.

The Discount Rate: Perhaps one of the most glossed-over variables in any DCF analysis is the discount rate. Usually a firm's weighted average cost of capital has been used as a proxy for the discount rate. However, it should not be that simple. In its essence, this rate needs to be a measure of risk, and risk is multi-dimensional. Risk is not static and the discount rate should not be either—it needs to reflect the nature of the risks inherent in a particular project as well as the alternative strategies that will be examined. Here are only a few of the questions that the selection of a discount rate needs to take into consideration:

- How easily, how accurately and to what degree of reliability can the cash flows be projected?
- How far into the future are the cash flows being projected? Should the same discount rate be used for projecting cash flows for the next five years as for years 16 to 20 in the analysis?
- How is the project being financed? Only rarely does the use of debt/leverage create economic value. Yes, financing with debt can improve cash flows, but debt financing also increases risk (default risk, refinancing risk, interest rate risk, etc.). At the end of the day, the discount rate needs to be appropriately adjusted based on how the project is expected to be financed.
- What can go wrong—what is the relative volatility of the cash flows associated with each of the strategies? Watch assumptions and build the model assuming that on occasion the worst may indeed happen.

Choosing the appropriate discount rate is an art not a science, and art is in the eye of the beholder. The best strategy is to perform sensitivity analysis using different discount rates to better understand the risks and how value is created or lost. Then, the sensitivity-testing results can be risk-weighted using probabilities. Will the final analysis be 100% accurate? Definitely not. But asking the right questions will lead to a better understanding of the alternatives.

The Status Quo: Many project analyses compare alternative strategies to a status quo baseline and measure the differential impact in terms of absolute annual cash flows, cumulative cash flows for break-even/paybacks and for NPV. Much focus is usually placed on predicting the cash flows of the alternatives, yet in many cases insufficient effort is placed on fully comprehending the status quo. One of the biggest pitfalls is to assume that the status quo is indeed the status quo. Doing nothing, whether it is investing in infrastructure or in research and development, will certainly have negative impacts on the health of a company or of a building. Consider this simple example: A firm has decided not to invest renewal dollars in its buildings which require maintenance dollars. Avoiding the investment will lead to improved short-term cash flows, but in the longer-term the status quo will really not be the status quo. Continual deterioration will reduce the class rating of the buildings, which will result in lower net rents. Combining lower net rents with a lower capitalization would be disastrous for valuation. In addition, the firm should determine the financial impact of: lower employee productivity associated with poor working conditions; the effect on absenteeism related to health and safety issues; the negative impact on the firm's customer perception and its impact on prices and margins.

Identifying and quantifying all the issues related to a "do nothing" status quo is certainly challenging but the deterioration needs to be recognized and the forecast must nevertheless be done.

Terminal/Residual Values: One of the key drivers of value in a real-estate analysis is the terminal value of the property at the end of the study term, which is then discounted to the present. Given that the terminal value is an estimate that goes far into the future, its reliability needs to be weighted in the overall decision. Further, the terminal value is based on a particular building's net cash flows and the capitalization rate at the time. Both of these determinants in turn require underlying

[2] The DCF methodology was first articulated by John Burr Williams in *The Theory of Investment Value* (Cambridge, Mass.: Harvard University Press, 1938).

assumptions concerning future economic conditions, general inflation rates, energy inflation rates, the future class of the building as it ages, interest rates, etc. Given the risk that these key assumptions can differ materially in the far distant future, the present value of the terminal value needs to be put into perspective relative to the total NPV of the project. If most of the NPV of the project is being derived from the terminal value, this may be a warning that the financial success of the project will ultimately be at risk.

On the subject of DCF, it is always best to be conservative. Being conservative implies addressing all the factors discussed above, and even then, applying a safety margin or a contingency.

Where to From Here?

Here are some of the key takeaways from this article:

- *It is always best to have a measured approach as opposed to acting on instinct*. Understanding the numbers and statistics behind certain metrics is an important element in ensuring streamlined and cost-efficient operations.
- *Always look to add value and increase the bottom line*. If measuring a particular metric, ask, "Why am I doing this? What are we looking to do with this? What steps am I actually prepared to take once I analyze the results?"
- *Once the optimization exercise is completed, be prepared to take action*. This could include disposing of properties, acquiring new ones, performing sale-leasebacks, etc. Always make sure that a well-constructed financial model with the proper assumptions is ready when embarking on these steps.

Analytics and statistical analysis are often overlooked in the real estate industry, as they were overlooked once upon a time in major league baseball. However, more and more corporate real-estate users, owners, developers and landlords are beginning to take notice and are slowly starting to understand that performance is driven by gaining a more intimate understanding of operations.

This article focused on a mere sample of elements that can and should be measured in a real-estate portfolio, depending on applicability. The possibilities are endless. Having an in-depth understanding of the menu of options available will allow one to select those that most apply to a portfolio.

The goal of this exercise should be to save money and gain a seat at the boardroom table for real estate. In retail real estate, as with underachieving baseball teams like Billy Beane's, thinking outside of the box can turn operations around for the better.

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This section attempts to distill academic research relevant to shopping-center practitioners. For a more complete discussion of this study, refer to the original article.

- ICSC Editors

François Des Rosiers, Marius Thériault and Catherine Lavoie, "Retail Concentration and Shopping Center Rents: A Comparison of Two Cities," *Journal of Real Estate Research* (Volume 31, Number 2), 2009, pp. 165-205.

This study[1] explored what influences the base rent of regional and super-regional malls. Obviously, numerous factors affect that performance, including tenant mix, age of the center, regional competition, retail diversification, retailer agglomeration by like-store type and customer behavior. Although the authors evaluate each of those typical factors, their primary test was to assess the impact of "retail concentration" of store types on rent. The term "retail concentration" may be somewhat of a misnomer for the practitioner, but the **essence of their hypothesis really is about showing that more *diversification* generates more base rent.** The authors' statistical tests found that the degree of retail diversification, indeed, was positively correlated to base rent and that lower retail diversification caused lower rents, but the effects on rent were uneven by store type.

Testing the Conventional Views

Des Rosiers, Thériault and Lavoie[2] have shown that rents are directly impacted by store size, lease duration and shopping-center age. Other findings indicate that percentage rent rates complement base rent and that in some markets, retail rents increase over time with inflation. The authors began their investigation with an updated look at those factors and found:

Retail Unit Size Most Important: Rent per square foot is inversely related to retail unit size (i.e., the higher a store's gross leasable area or GLA, the lower the base rent). These findings were statistically significant. The empirical work further suggested that a 10% increase in GLA results in a rent discount of roughly 4%, with all other variables held constant. *The authors also found that store size was the most important determinant of shopping-center rents.*

Percentage Rent Rate: The relationship between percentage rent and base rent is somewhat difficult to test, as there are two opposing theories. Some industry researchers view these two rent determinants as substitutes, while others think percentage rents reflect the surrounding stores and are not related to the base rent. The results of the authors' study found that (1) percentage rent rates complement base rent and (2) these rents are the third most important base rent determinant in the markets being studied.

Lease Duration: Many researchers think current tenants in a shopping center will be willing and able to pay a higher base rent than new tenants because existing tenants benefit from operating successfully in the space for some time. This research suggests that a statistically significant relationship exists between retail rents and lease durations; every additional year negotiated in lease duration will translate into an increased base rent of 1.5%.

Overall Inflation: Institutional investors often view retail as an important investment for hedging against inflation, because, as long-term retail rents are typically set to adjust to inflation, base rents will increase over time. However, in this paper, the results were mixed, suggesting that shopping centers may not always be a good investment to hedge against inflation.

Shopping-Center Age: Some retail experts disagree about how the center's age impacts retail rents. Some argue that rents should rise with a center's age as customers form habits and loyalty to a given center. Other researchers believe that rent levels tend to decrease with a center's age due to neglected structures, inadequate tenant mix and fading images. This study found that age affected rents negatively, highlighting the need to keep the center up to date. This variable was the second most important determinant of the base rental rates negotiated in this dataset.

[1] These statistical tests assessed the impact of several negotiated variables on rent levels in both regional and super-regional shopping centers in Canada. The dataset, gathered between 2000 and 2003, includes detailed information on 1,499 leases, 5.3 million square feet (sf) of gross leasable area (GLA), in 11 regional and super-regional centers, divided between Montreal and Québec City.

[2] François Des Rosiers and Marius Thériault. "Agglomeration Economies and Retail Concentration as Determinants of Shopping Center Rents," Working Paper # 2004-013, Faculty of Business Administration, Laval University, 2004.

Other Factors Impacting Rent

Additional hypotheses related to agglomeration economics[3] and retail concentration:

Population: Contrary to expectations, this study found that a higher metropolitan population did not necessarily produce higher rents. The study suggested that other variables related to retail rent have a stronger influence on the rent level, such as the local market structure, the landlord's approach and the tenant's limitations.

Core Retail Categories: Many retailers and landlords think that higher contract base rents will result from more "core retail categories" (e.g., fashion clothing, footwear, leather goods, accessories, jewelry, gifts, art goods, telecommunications, electrical products, computer goods, books, fast food, specialty food stores, pharmacy, beauty stores, and financial services). Conversely, if this is true, lower base rents would be produced by "lower-order goods" (e.g., discount department stores, sewing stores, dry-cleaners, and footwear repair shops). When the tenant make-up/concentration of the center was analyzed, this study discovered that a higher percentage of core retail categories correlated with higher contract base rents and a lower percentage of core retail categories correlated with lower contract base rents.

Intra-Retail Concentration: In most cases, real-estate professionals believe that if retail concentration is high—that is, there is a lack of retailer or tenant diversification—then the contract base rent will be low. The authors confirmed this hypothesis for the centers under analysis. That is, results provide evidence that a more diverse tenant mix will attract more shops to the center; therefore, dominant tenants possess more bargaining power in negotiating a lower rent with the landlord.

Conclusion

This article provides a helpful review of what is most and least important for landlords in setting rent at regional or super-regional malls. But as is true of any study, it is a snapshot in time and place, and more studies will need to support these conclusions for these findings to become styled facts for the industry.

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[3] The term "agglomeration economics" refers to the clustering or concentration of related sectors in a geographic area due to some externality—such as localization or urbanization. For more details on this concept, see: Mercedes Delgado, Michael E. Porter and Scott Stern, "Clusters, Convergence, and Economic Performance," Working Paper, Institute of Strategy and Competitiveness, Harvard Business School, August 2010, http://www.isc.hbs.edu/pdf/DPS_ClustersPerformance_08-20-10.pdf, retrieved April 12, 2012.

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