

Retail Sales Set Rent Levels

BY RAYMOND T. CIRZ, CRE

RETAIL PROPERTIES HAVE A UNIQUE RELATIONSHIP WITH THE businesses they house. Location and physical features of the property play integral roles in the customer experience. How this will influence a retailer's sales creates a correlation between sales and rent levels. Using a large regional shopping mall as a study subject, this article presents an example of how rental rates can be determined through an analysis of retail sales and rents for comparable (peer) properties.

Rent levels for all commercial property classes are influenced by local, regional or even national supply and demand factors. There are many factors that affect a tenant's decision on where to locate, some of which include physical aspects of the improvements, location, access, visibility and rent or price levels. An additional element for retailers that is unique to this property class is a consideration of how much business can be generated at a particular site.

Compared with the needs of retail, office buildings can house employees whose business products as well as customers are located far away. The choice of office space, generally speaking, does not directly affect tenants' business generation. Another comparison can be made with warehousing. Distribution facilities are commonly selected based on location and physical aspects, without consideration to competitors' having similar facilities in the area. If it is a good location, competitors are typically nearby.

On the other hand, retailer location decisions are tied directly to the amount of business they expect to generate at any given location. They must consider their proximity to directly competing businesses, their existing locations,

and rental and occupancy costs, as well as other factors. The retailer typically will enter into a lease—or for that matter, buy or build—only if the location will likely contribute to profitability.

Studying the relationship between retail sales levels and achievable rent levels can help in estimating rent potential, and hence market value, for retail properties. While the study presented in this article involves a complex regional mall, the methodology can be applied to all types of retail properties.

IDENTIFICATION OF THE SUBJECT

The subject of this analysis is a regional mall located in the Eastern region of the United States. A regional mall is defined as: “a shopping center that offers a variety of general merchandise, apparel, furniture, home furnishings, services, and recreational facilities and is built around one

About the Author



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or more full department stores. This type of shopping center is usually enclosed, with an inward orientation of the stores connected by a common walkway, and parking surrounds the outside perimeter”¹

Regional malls can be quite complex, offering a wide range of retailers from apparel stores, restaurants, jewelry stores and kiosks, each operating under somewhat different economic parameters. However, all have the same goal of making a profit, and real estate occupancy costs constitute one of the largest expenditures for a retailer.

The types of goods sold in a regional shopping center are classified as general merchandise, apparel, furniture, and other retail goods (GAFO). An analysis and understanding of GAFO sales potential is critical to the mall valuation process. The analysis compares key factors relating to the subject mall with those of a competitive set of similar regional malls in order to glean market parameters. These factors include recent leasing activity, achieved retail sales volumes for tenants, and the existing composition of tenancy within each mall. Figures 1 and 2 provide primary characteristics and photo representations of the subject property. In the chart, “in-line” refers to all stores other than the department store anchors.

Figure 1

Subject Property Characteristics

- Enclosed regional mall
- 930,000 SF gross leasable area (GLA)
- 3 department store anchors
- Opened 1984
- Last renovated 2003
- Part one and two level
- In-line GLA: 310,000 SF
- In-line occupancy: 88%
- In-line/anchor ratio: 33%
- In-line retail sales: \$360 per SF

Source: Integra Retail Database

Figure 2



Photos courtesy of Raymond Cirz, CRE

PEER GROUP SELECTION CONSIDERATIONS

A database was assembled from thousands of assignments involving various retail properties located throughout the U.S. over the past decade. Based on a review of the subject mall, search criteria are entered into the database to assist in the peer group selection. Such factors as property class, overall size, market segment characteristics, in-line mall shop occupancy, and in-line mall shop retail sales levels are important factors to consider. The ratio of in-line shop space to department store space can also have an impact on mall performance. Data gleaned from similar centers permits these comparisons. Figure 3 contains the criteria for selecting a peer group.

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Figure 3

Peer Group Selection Criteria

- East region
- Class B
- Enclosed regional malls
- Primary market, non-dominant
- Total mall size: 750,000 to 1,200,000 SF
- In-line occupancy
- In-line/anchor ratio: 30% – 40%
- In-line retail sales: \$300 – \$375 per SF

Source: Integra Retail Database

PEER GROUP ANALYSIS AND OBSERVATIONS

The database search resulted in the selection of 28 enclosed regional malls encompassing more than 11 million square feet of in-line space. Further, 553 leases have occurred in the past twelve months within the centers. These leases encompass the full spectrum of shop space typically found in regional centers. The average rent from these leases is \$34.62 per square foot and the average in-line retail sales are \$355 per square foot, indicating an average rent to sales ratio of 9.8 percent. This is a critical ratio needed to support the economic viability conclusions made in any market rent analysis.

Figure 4

Peer Group

- 28 regional malls
- 11,208,311 square feet surveyed
- 553 market leases
- Average rent per SF: \$34.62
- Average retail sales per SF: \$355.00
- Rent to retail sales ratio: 9.8%

Source: Integra Retail Database

MERCHANDISE MIX CONSIDERATIONS

If it were only a matter of maximizing rental revenue, a mall operator would just rent all store space to fast food and jewelry tenants, as these tenants tend to pay the highest rent levels. However, such a strategy is not practical as a proper merchandise mix must be maintained. Therefore, tenants within the subject and peer group are separated by NAICS code² into various categories such as ladies' apparel, jewelry, restaurants and electronics, as each of these tenant types operates under different economic parameters.

Existing tenants from the subject and peer group are divided into the thirteen different categories shown in Figure 5. A comparison can then be made of the amount

Figure 5

Tenant Mix Analysis (In-Line Non-Anchor Occupied Space)

Category	Subject % of Total SF	Subject Sales PSF	Peer Group Malls % of Total SF	Peer Group Malls Sales PSF
Ladies' Apparel	18.1%	\$299	16.0%	\$341
All Other Apparel	30.3%	\$304	24.3%	\$389
Specialty Apparel/Accessories	7.4%	\$430	7.7%	\$470
Women's Shoes	0.5%	\$407	0.9%	\$338
All Other Shoes	10.0%	\$240	7.0%	\$270
Food Service	7.2%	\$582	8.7%	\$549
Jewelry	2.1%	\$713	1.6%	\$760
Services/Cinema/Entertainment	2.5%	\$229	3.0%	\$194
Electronics	2.6%	\$506	5.8%	\$670
Cards & Gifts	8.0%	\$345	3.7%	\$335
Sporting Goods	0.9%	-	2.4%	\$229
Home Furnishings	2.1%	\$221	7.3%	\$267
Other	8.4%	\$368	11.6%	\$293
Totals/Average	100.0%	\$360	100.0%	\$355

Source: Integra Retail Database

Figure 6
Recent Leasing Activity
(* In-line gross leasable area)

Total ILGLA (*)	Subject 310,000	Peer Group Malls 11,208,311	Subject Market Rent Estimate
Zero to 1,499 SF			
Low	\$70.00	\$23.20	
High	\$70.00	\$174.99	
Wtd Average	\$70.00	\$56.10	\$50.00
Typical Sales PSF	\$432.57	\$541.28	
Num of Tenants Reporting	1	123	
1,500 to 2,499 SF			
Low	\$40.00	\$13.03	
High	\$48.00	\$135.00	
Wtd Average	\$43.84	\$42.19	\$40.00
Typical Sales PSF	\$434.69	\$473.15	
Num of Tenants Reporting	2	111	
2,500 to 3,999 SF			
Low	\$45.38	\$20.50	
High	\$45.38	\$85.00	
Wtd Average	\$45.38	\$33.17	\$32.00
Typical Sales PSF	\$242.93	\$387.13	
Num of Tenants Reporting	1	90	
4,000 to 6,499 SF			
Low	-	\$35.70	
High	-	\$88.84	
Wtd Average	-	\$38.19	\$30.00
Typical Sales PSF	\$343.86	\$360.17	
Num of Tenants Reporting	0	93	
6,500 to 9,999 SF			
Low	-	\$29.19	
High	-	\$44.05	
Wtd Average	-	\$31.50	\$28.00
Typical Sales PSF	\$214.12	\$311.72	
Num of Tenants Reporting	0	89	
Jewelry			
Low	\$74.00	\$63.20	
High	\$74.00	\$131.89	
Wtd Average	\$74.00	\$71.20	\$75.00
Typical Sales PSF	\$712.78	\$669.08	
Num of Tenants Reporting	1	22	
Food Court			
Low	\$148.76	\$99.99	
High	\$148.76	\$403.73	
Wtd Average	\$148.76	\$191.01	\$50.00
Typical Sales PSF	\$652.80	\$1,060.30	
Num of Tenants Reporting	1	25	
Total: In-Line Tenants			
Total In-Life SF Included	10,235	210,990	
Wtd Avg Rent PSF	\$57.56	\$34.79	
Mall Shop Sales PSF	\$360.00	\$355.00	\$30.00
Tenants Reporting	6	553	

Source: Integra Retail Database

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of in-line space dedicated to each category. Deficiencies or overrepresentations can be easily identified to determine whether the existing mix is proper. A comparison of achieved retail sales volumes within each category is helpful in the analysis.

Each retail category can be isolated for analysis. Figure 5 suggests that the subject may have too much apparel related uses as it has more space dedicated to this category than the peer group, and it experiences somewhat lower sales volumes. However, the subject is located in a taxing district that has sales tax on clothing while nearby competitors do not. Overall, retail sales for in-line mall shop space averages \$360 per square foot for the subject, which compares well to sales within the peer group of \$355 per square foot. It is concluded that the existing tenant mix at the subject is reasonably market oriented.

TENANT SEGMENTATION

Since store size can have an influence on achievable rent levels, the tenants within the centers are arranged by various size categories in Figure 6. Certain tenants can be isolated from this analysis such as food court, kiosk and jewelry merchants as factors unique to each can skew results. The average retail sales for the subject and the peer group are identified in Figure 6 along with the achieved rent level from recent leases within each category. Also presented is the range in rent levels per square foot within each category as well as the number of recent leases.

This comparison of leasing activity is very helpful as there may not be recent leases within the subject for a certain category, such as the 6,500 to 9,999-square-foot category, while the peer group has 89 recent leases. There are only six recent leases to include in the subject center data, but more than 500 from the peer group, which greatly enhances the analysis.

After reviewing the data, the analyst can make an estimate of market rent for the subject center. This appears in the right-hand column of Figure 6. These estimates are then aggregated into the chart in Figure 7, which provides an estimate of the gross potential market rent for the center. The analysis yields a gross potential rent of \$10.7 million dollars or \$34.62 per square foot of in-line space.

OTHER CONSIDERATIONS

For the purpose of this article, the analysis has been simplified to exclude factors relating to overall occupancy costs. Such factors would include tenant payments in addition to rent such as common area maintenance charges and real estate taxes, as well as other charges. Retail tenants

Figure 7

Weighted Average Market Rent Calculation

Type	Total Occupied SF	Market Rent	Gross Potential	
Regular In-Line:	Zero to 1,499	27,890	\$50.00	\$1,394,500.00
	1,500 to 2,499	35,656	\$40.00	\$1,426,240.00
	2,500 to 3,999	38,479	\$32.00	\$1,231,328.00
	4,000 to 6,499	97,841	\$30.00	\$2,935,230.00
	6,500 to 9,999	88,909	\$28.00	\$2,489,452.00
	Jewelry	7,800	\$75.00	\$585,000.00
	Food Court	13,425	\$50.00	\$671,250.00
Total:		310,000	\$34.62	\$10,733,000.00

Source: Integra Retail Database

certainly do not base their leasing decisions solely on the amount of base rent to be paid. Rather, they must consider all occupancy related charges in order to determine if the location is viable for their business purposes.

TEST OF CREDIBLE RESULTS

The final step is to test the reasonableness of the \$10.7 million rent estimate, considering that it is based on a number of estimates applied to approximately 150 tenants at the subject center—which certainly adds a degree of subjectivity and complexity. This is done by comparing the average subject market rent estimate of \$34.62 per square foot with the achieved retail sales volume of \$360 per square foot previously detailed, suggesting a market rent to retail sales ratio of 9.6 percent. In comparison, the peer group analysis, which was based on 28 regional malls, 11.2 million square feet of mall shop space and 553 recent leases, resulted in a ratio of 9.8 percent. Given the large sampling of lease data from the peer group, these comparable rent to retail sales ratios support the viability of the market rent estimate. Absent this peer sample of leasing activity, an estimate would rely solely on six recent leases at the subject center. The analyst can feel confident that the rent estimates for the subject mall property are reasonably market oriented. ■

Figure 8

Market Rent to Retail Sales Ratio

- Subject market rent: \$34.62 per SF
- Subject retail sales: \$360.00 per SF
- Ratio: 9.6%
- Peer group ratio: 9.8%

Source: Integra Retail Database

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ENDNOTES

1. Appraisal Institute, *The Dictionary of Real Estate Appraisal*, 5th Ed., Chicago, 2010, p. 164.
2. Ibid., p. 136. North American Industrial Classification System (NAICS): The system of six-digit codes for classifying business activities developed jointly by Canada, Mexico and the United States; replaced the Standard Industrial Classification (SIC) system in 1999.