

US and Australian Shopping Centre Performance Comparison

*Sales per square metre and occupancy costs are compared and
explained using new data*

A report to the Shopping Council of Australia by Michael Baker
May 2009

EXECUTIVE SUMMARY

1. The most recent shopping centre operating performance data suggests that Australian centres maintain a significant advantage over their US counterparts with respect to average sales density.
2. In regional centres, specialty stores perform approximately 90% better in Australia than in the US on a sales per square metre (psm) basis.
3. There are at least four important reasons for this outperformance:
 - a. There is only half as much retail space per capita in Australia as in the US (2.12 sq.m vs. 4.20 sq.m), meaning that US retail spending per capita would need to be twice the level of Australia's in order for retailers to achieve the same average densities.
 - b. Analysis of retail space per capita in the US context must also take into account "virtual" space. Online sales in the US accounted for more than 11% of shopping centre-type retail sales in 2008. For additional perspective, this is the equivalent of roughly one-third of all the sales made in US regional shopping centres. The internet is therefore a formidable retail format in the US with a material and growing impact on shopping centres. This is not yet the case in Australia.
 - c. US regional centre specialty store sizes are on average much larger than Australian specialties. While an average Australian regional centre has approximately 208 specialty stores, a comparably sized US centre has only 108. Larger store sizes within a specific merchandise category typically result in lower sales densities.
 - d. Australian regional centres have a well-balanced mix of necessity-oriented and discretionary retailers. The presence of supermarkets and perishable food specialty stores in particular boosts traffic and performance. US regional centres are significantly more dependent on discretionary retail, particularly fashion specialty and department stores. This makes the performance of US centres inherently more volatile.
4. Regional centre occupancy cost ratios are higher in Australia than in the US. The issue is a controversial one and has sometimes been attributed to regional centre ownership concentration. However, the differential is more likely explainable by two factors:
 - a. The much higher retail space per capita in the US. The imbalance between supply and demand in the US (historically tilting toward oversupply) causes shopping centres to operate at lower average occupancy rates than in

Australia. This creates an environment where owners need to trade off more in rent to keep centres at acceptable occupancy levels.

- b. Many US regional centres, particularly in the southern and western states, are open-air and require lower utilities and common area charges. In Australia it is rare for regional centres to be open-air.
5. Neighbourhood centres in Australia also operate at higher sales psm levels than those in the US. The data compiled for this study suggests that Australian specialty stores operate at a sales psm premium of 63% over their US counterparts. Supermarkets in the Australian centres operate at an 81% premium.
 6. The explanation for the differential performance lies to a great extent with the fact that many of the strongest US supermarkets no longer operate out of shopping centres. Frequently, supermarkets operate from large formats in freestanding locations with their own parking. In many instances they are part of freestanding supercentres (e.g. Wal-Mart supercentres, which account for approximately 27% of all US food sales) or warehouse clubs such as Costco.
 7. Occupancy costs for neighbourhood centre specialty stores are found in this study to be higher as a percent of sales in Australia than in the US. The three most important factors to account for this are:
 - a. US neighbourhood centres are usually open-air and basic in their construction and design, resulting in much lower common area and utility charges than their (mostly enclosed) Australian counterparts.
 - b. The much greater retail space per capita in the US, as noted above
 - c. Diminished competitive strength of US shopping centre-based supermarkets

All three of these factors cause landlords at US neighbourhood centres to offer better terms to specialty tenants or to offer space to tenants of inferior quality.

8. The differential performance of shopping centres in the two countries suggests some interesting opportunities for both sides to explore. This includes, for consideration in Australia, the introduction of more varied store sizes and store configurations to reduce monotony and improve shopability, experimentation with larger and/or differently-configured supermarkets with more amenities, and research into the comparative performance of open-air and enclosed regional centres.
9. On the US side, regional centre operators could look at ways of introducing more necessity-oriented retailers into their tenant mixes to reduce dependence on fashion and smooth out performance volatility. Neighbourhood centre operators need to find ways of breaking out of their traditionally monotonous centre design formulae to create attractive shopping venues, rather than just functional ones.

1. INTRODUCTION

This paper provides a performance comparison between Australian and US shopping centres, based on a variety of recent data sources and author's estimates.

The two key metrics used as the basis for comparison are sales psm and occupancy cost ratios. The time period under consideration is July 2007 to June 2008.

There are a number of difficulties inherent in conducting such an analysis, of which the principal ones are:

- Data of poor or uncertain quality.
- The choice of exchange rates
- Differences among countries in how shopping centre tenants are categorised

In some instances it is important not to rely on a single source of data even when that source is considered to be an industry standard. This is particularly the case with the U.S. data where a meaningful analysis necessitates the use of alternative sources as cross-checks. However, by drawing on a variety of sources a reasonably good mosaic can be assembled that enables us to draw some useful conclusions.

Performance differences between US and Australian shopping centres uncovered in this paper illustrate differences not only in the quality of retail assets and the way they are managed, but also in the competitive landscape between the two countries. These, in turn, suggest areas of potential innovation and quality improvement.

This paper limits the cross-country comparison to two shopping centre types: regional centres and neighbourhood centres (the latter sometimes referred to as "supermarket-anchored" centres in Australia). There are two reasons for this self-imposed restriction:

1. The two centre types are sufficiently similar between the two countries that they lend themselves to fair and meaningful performance comparison.
2. Subregional centres in Australia have no exact match in the U.S. shopping centre typology. The author believes that a subset of what in the U.S. are referred to as "community centres" can be compared with Australian subregionals. However, this will require further research to deconstruct the U.S. data appropriately and is beyond the scope of this paper.

The structure of this paper is as follows. Section 2 compares regional centre sales psm; Section 3 compares regionals on occupancy cost ratios; Section 4 compares neighbourhood centres on sales psm; Section 5 compares neighbourhood centres on occupancy cost ratios; Section 6 concludes the paper with some implications of the data for development, asset management and public policy in both countries.

Note that all dollar amounts for Australian shopping centres shown in the tables that follow are presented in both Australian currency and in US dollars at average exchange rates over the July 2007-June 2008 time period. In the text, only the US dollar figures will be used for ease of comparison with the US shopping centres.

2. REGIONAL SHOPPING CENTRE SALES COMPARISON

Table 1 below provides summary data for US and Australian regional shopping centres. The US data is sourced from the latest edition of a publication produced by the Urban Land Institute (ULI) in conjunction with the International Council of Shopping Centers (ICSC), entitled “Dollars & Cents of Shopping Centers/The SCORE 2008.”

This publication is produced annually with a mission of providing up to date industry benchmarks for use by shopping centre industry professionals, retailers, investors and public officials. Unfortunately, the sample is a “convenience” sample only, which is to say that it is not scientifically drawn from the US shopping centre population. Moreover, the survey’s response rate fails to compensate for the unscientific nature of the sample.

To illustrate, there are probably more than 40,000 shopping centres in the US excluding unanchored “convenience centers”, of which data was received from 690 centres for the 2008 edition of Dollars & Cents of Shopping Centers/The SCORE.

Specifically with regard to super regional and regional centres, data was collected from 186 centres out of a national total of an estimated 1,379.

Due to the significant sampling error inherent in the US survey, the US results can be regarded as broadly indicative at best. With this caveat in mind, the table nonetheless suggests a large performance differential between Australian and US centres. Total Australian centre sales psm are \$5,602, compared with \$2,959 for a US regional centre and \$3,230 for a US super regional.

TABLE 1. REGIONAL SHOPPING CENTRE SUMMARY DATA
Averages by Broad Tenant Type

	US Super regionals	US Regionals	Australian Regionals	Australian Regionals
			(dollar amounts in AUD)	(dollar amounts in USD*)
Floorspace (sq.m)	95,214	61,858	83,488	-
Owned space (sq.m)	57,115	46,222	N/A	-
Department stores (sq.m)	51,225	24,586	19,238	-
Discount dept stores (sq.m)	9,706	8,666	13,877	-
Dept store sales psm	\$2,046	\$1,775	\$3,244	\$2,909
Discount dept store sales psrr	\$1,727	N/A	\$3,930	\$3,524
Specialty tenants sales psm	\$3,830	\$3,443	\$9,341	\$8,377
Total centre sales psm	\$3,230	\$2,959	\$6,247	\$5,602
Upper decile sales psm	\$5,036	\$4,401	N/A	N/A

Source: Urban Land Institute/International Council of Shopping Centers: Dollars & Cents of Shopping Centers The SCORE 2008; Urbis Retail Averages for Regional Centres 2007-8

*Australian dollars converted to U.S. dollars at the average market exchange rate from July 1 2007-June 30 2008

The performance differential between specialty tenants is quite dramatic: \$8,377 psm for Australia compared with \$3,443 and \$3,830 for US regionals and super regionals respectively.

The performance of specialty tenants is explored in more detail in Table 2. In this table, a different source has been used for the US. This source, also produced by ICSC, is the monthly US Mall Report that provides a detailed breakout of sales data for nearly 500 super regional and regional shopping centres.

The more robust US sample does result in higher numbers for US mall specialty tenants but does not alter the fact that Australian regional centres outperform them substantially.

TABLE 2. REGIONAL SHOPPING CENTRE SPECIALTY TENANTS
Sales psm comparison by selected tenant type

	US	Australia (in AUD)	Australia (in USD)	Australia's % advantage
Apparel	\$3,841	\$7,887	\$7,073	84%
Homewares	\$3,626	\$6,012	\$5,391	49%
Digital products	\$10,340	\$13,553	\$12,154	18%
Newsagents/stationery/gifts	\$3,206	\$7,659	\$6,869	114%
Books	\$2,303	\$9,605	\$8,614	274%
Sporting goods	\$2,658	\$7,273	\$6,522	145%
Pharmacy & cosmetics	\$5,272	\$12,125	\$10,874	106%
Jewellery	\$10,405	\$17,787	\$15,951	53%
Food catering	\$5,810	\$11,096	\$9,951	71%
Food	\$5,315	\$12,365	\$11,089	109%
Retail services	\$3,884	\$7,992	\$7,167	85%
Total specialty	\$4,379	\$9,341	\$8,377	91%
Total specialty incl. mini majors	\$4,379	\$9,230	\$8,277	89%

Source: International Council of Shopping Centers: US Mall Report August 2008

Urbis Retail Averages for Regional Centres 2007-8; author's estimates

*Australian dollars converted to U.S. dollars at the average market exchange rate from July 1 2007-June 30 2008

Given that the US shopping centre industry has a strong tradition of excellence, such a differential may at first glance seem surprising. Are US regional centres really that bad, or conversely are their Australian counterparts really that good?

There are a number of factors behind the performance differential. These are enumerated in sections 2-1 through 2-4 below.

2-1. Competing Retail Space

A commonly used metric for comparing the competitive environment across countries is retail space per capita.

Table 3 below provides a summary comparison of Australia and the US for regional centre space, total shopping centre space and total retail space.

TABLE 3. RETAIL SPACE PER CAPITA ESTIMATES (SQ.M)

	US	Australia	US % advantage
Regional centre	0.35	0.30	18%
Total shopping centre	1.79	0.85	111%
Total retail	4.20	2.12	98%

Source: ICSC, author's estimates

Directly competing space is an author's estimate of space per capita in each country that competes directly with regional centres by virtue of merchandise orientation

The difference in regional centre space per capita between the two countries is not large but the US has more than twice as much retail space per capita that is not in regional centres. We can assume that for both countries some of the non-regional centre space is not really competing directly with regional centres. For example, home improvement merchandise is sold mainly out of superstores in both the US and Australia, and in neither country is the category a significant player in regional shopping centres.

However, after considering the industry structure in both countries, there is no reason to expect the relative levels of competition to change that much even if total space per capita is “scaled down” to allow for non-competing space. The relatively much greater amount of space in the US that competes with regional centres partly explains their inferior performance.

2-2. E-commerce

Analysis of retail space per capita in the US must include virtual space. Online sales in the US accounted for just over 11% of shopping centre-type retail sales in 2008, or the equivalent of about one-third of all sales made in regional centres. The internet is therefore very much a material player in the US retail arena.

This is not yet the case in Australia where store-based retailers in particular have generally not pushed the channel hard.

2-3. Specialty store sizes

Specialty store sizes are much bigger in the US, on average, than in Australia. According to the Urbis Retail Averages, the average Australian regional centre has about 208 specialty stores. A US regional centre of approximately the same size as the Australian average would have only about 108 specialty stores.¹

Within a specific merchandise category there is a strong inverse relationship between store size and sales psm. The principal reason is that to match a small store on sales psm a large store must usually sell at a higher price point. It is true that many American specialty retail chains are more upscale in their market positioning and pricing strategies than Australian specialties. Nonetheless, with much more emphasis in US retail being placed on spacious interiors, wide aisles and uncluttered displays, all of which are believed to improve the shopping experience, sales psm are generally lower than in Australia for comparable tenant types in centres of roughly equivalent quality.

2-4. Tenant diversity

Australian regional centres have traditionally been less dependent upon department store anchors to drive traffic than their US counterparts. As Table 1 shows, the average amount of department store space in Australian regionals is less than in US regionals and significantly less than in US super regionals.

Instead, Australian centres have a mix of department stores, discount department stores and supermarkets. The latter generate frequent repeat visits and also drive traffic to the specialty stores, particularly perishable food specialties that are so prevalent in Australian centres but almost non-existent in the US.

The greater presence of necessity-oriented tenants in Australian regional centres makes them somewhat less cyclical in performance and contributes to the specialty tenant productivity advantage.

¹ ICSC, The SCORE 2004 (ICSC: New York, 2004), p.124

3. REGIONAL CENTRE OCCUPANCY COSTS

Table 4, using data from the ULI/ICSC survey and author's estimates for the US, and the Urbis Retail Averages for Australia, indicates that occupancy costs in Australian regional centres as a percent of sales are significantly higher than in the US.

TABLE 4. REGIONAL CENTRE OCCUPANCY COSTS
Percent of Sales, Selected Tenant Types

Store type	US Super regionals	US Regionals	Australian Regionals
Apparel	13.2%	13.0%	19.3%
Homewares	12.1%	14.2%	18.3%
Digital products	11.5%	9.6%	12.8%
Pharmacy & cosmetics	9.6%	N/A	13.3%
Jewellery	12.9%	12.8%	14.5%
Food catering	15.8%	15.1%	17.9%
Retail services	19.3%	16.3%	20.1%
Total specialty	13.0%	13.4%	17.1%

Source: ULI/ICSC: Dollars & Cents of Shopping Centers/The SCORE 2008;
Urbis Retail Averages for Regional Centres 2007-8; author's estimates
Figures include marketing income for both the US and Australia

To guard against the possibility that sampling error in the ULI/ICSC survey was causing an incorrect read on occupancy costs, data was assembled independently from the financial statements of five major US regional centre owners. These companies, which account for 763 regional centres, or approximately 60% of all US regionals, either provide total occupancy cost data explicitly in their financial statements, or an occupancy cost ratio can be estimated using rental information. The results are shown in Table 5. The author has weighted the individual company results to obtain an industry estimate of 12.5%, which is close to the 13-14% range extracted from the ULI/ICSC data.

TABLE 5. ESTIMATED OCCUPANCY COSTS FOR LARGEST US REGIONAL CENTRE REITS

Company	No. of centers (Dec. 2008)	GLA (mil. sq.m)	Ave GLA per centre (sq.m)	Occupancy costs as % of sales
Simon	386	24.4	63,322	12.9%
General Growth	204	16.9	82,914	11.1%
Macerich	66	5.9	88,712	13.0%
Taubman	23	2.3	101,018	15.1%
CBL	84	6.7	79,660	13.2%
Weighted average*	763	56.2	73,692	12.5%

Source: company reports and author's calculations

* Weighted by company GLA

Some have suggested that ownership concentration in the Australian industry has resulted in higher occupancy costs. This has never been proved. Moreover, increased concentration in the US mall industry as REITs have consolidated the industry over time does not appear to have resulted in an increase in US occupancy cost ratios.

Rather it is more likely that the major root cause of the occupancy cost differential between the US and Australia is the competitive landscape. Since there is so much more retail space per capita in the US than in Australia, “natural” occupancy rates in the US are lower and centre operators there tend to manage for occupancy rather than rent. Put another way, greater competitive pressures in the US may force owners to approach leasing differently to Australia (e.g. by giving up more in exchange for an outstanding tenant).

From the Australian regional centre tenants’ perspective, the situation may be thought of as higher payment in exchange for more protected, high-traffic and coveted locations. The proof of this lies in the vastly superior sales psm performance shown in Table 2.

An additional factor to take into account is that many US regional centres, particularly in the southern and western states, are open-air and require lower utilities and common area charges. In Australia it is rare for regional centres to be open-air.

4. NEIGHBOURHOOD CENTRE PERFORMANCE COMPARISONS

Comparing the performance of small shopping centres across countries is even more treacherous than comparing regional centres.

Data coming from the US is poor because the ability of any non-governmental entity to collect information from a representative sample of centres is severely hampered. Ownership of small shopping centres is much more fragmented than for larger centres, and owners often see little incentive in providing sensitive information about their operations.

Nonetheless, ULI/ICSC in the US do collect sales data from some neighbourhood shopping centres and these provide a measure of guidance with respect to retailer performance in these kinds of centres.

The ULI/ICSC sample consists of 233 neighbourhood centres out of an industrywide total estimated at over 26,000.

For Australia, the sample collected by Urbis for the Retail Averages is percentage-wise a more robust 97 centres out of a national inventory of around 850.

4.1. Sales Performance

Table 6 below presents a summary comparison of sales psm between the two countries.

TABLE 6. NEIGHBOURHOOD SHOPPING CENTRES
Sales psm comparison by selected tenant type

	US	Australia (in AUD)	Australia (in USD)	Australia's % advantage
Supermarkets	\$5,089	\$10,285	\$9,224	81%
Apparel	\$1,610	\$4,149	\$3,721	131%
Pharmacy & cosmetics	\$4,616	\$9,842	\$8,826	91%
Jewellery	\$3,411	\$7,667	\$6,876	102%
Food catering	\$2,873	\$5,656	\$5,072	77%
Retail services	\$1,754	\$4,943	\$4,433	153%
Total specialty	\$2,762	\$6,309	\$5,658	105%
Total specialty incl. mini majors	\$2,762	\$5,035	\$4,515	63%

Source: Urban Land Institute/International Council of Shopping Centers: Dollars & Cents of Shopping Centers/ The SCORE 2008; Urbis Retail Averages for Supermarket Centres 2007-8; author's estimates

*Australian dollars converted to U.S. dollars at the average market exchange rate from July 1 2007-June 30 2008

The story shown in the table is similar to that for regional centres—a dramatic productivity advantage to Australian neighbourhood centres.

Also like regional centres, a large part of the explanation for the sales performance differential can be traced back to the amount and type of retail space competing against these centres.

The situation with regard to supermarkets deserves special attention. In Australia, supermarkets can be found in shopping centres of all types, but the local neighbourhood centre is often the closest, most convenient and most accessible grocery sales channel. Moreover, Australian supermarkets are primarily in shopping centre locations and have relatively limited out-of-shopping centre competition. Sales psm generated by supermarkets in these shopping centres of all kinds is accordingly high.

Contrast this with the situation in the US. Supermarkets tend to be significantly larger on average, partly because US consumers prefer wider aisles and have a strong cultural bias toward the broadest possible product and brand choice.

While Australian supermarkets in the Urbis sample averaged 3,776 sq.m, those in the ULI/ICSC sample averaged 4,098 sq.m. This understates the differential between Australian and US supermarket sizes because many US supermarkets occupy freestanding locations and these tend to be much larger than shopping centre-based supermarkets. It is not uncommon to have freestanding supermarkets sized in excess of 10,000 sq.m (e.g. the Wegmans chain in the northeast).

Also note that US supermarkets are often housed inside supercentres (e.g. Wal-Mart) or warehouse clubs (e.g. Costco), which are typically not in shopping centres but which have high sales densities.²

4.2. Occupancy Costs

The data from both the Australian and US samples suggests that occupancy cost ratios for US neighbourhood centre specialty stores are lower than those for Australian centres.

The Urbis sample yields an average occupancy cost ratio of 10.9% for Australia while the ULI/ICSC sample suggests a ratio for the US of approximately 7.7%.

² Although conventional Wal-Mart discount stores often anchor shopping centres in the US, these are usually smaller formats than the supercentre and do not usually include supermarkets. Wal-Mart supercentres, which do include supermarkets, are typically 6,000-8,000 sq.m larger and freestanding. Costco also prefers stand-alone locations although sometimes they can be found in power centres.

One major reason for the differential is the fact that neighbourhood centres in the US are invariably open-air and fairly basic in their construction and design, meaning that common area charges are much lower than in Australia where a majority of neighbourhood centres are enclosed.

Another reason for the differential is analogous to that for regional centres—competing space both in and out of shopping centres is far greater in the US. Since supermarkets in US neighbourhood centres frequently do not have the same ability to dominate a local market as their Australian counterparts, US landlords, on average, are unable to offer neighbourhood centre specialty tenants locations of similar quality. This results in greater downward pressure on occupancy and rents in the US.

5. SOME IMPLICATIONS

Clearly, the superior performance of Australian regional and neighbourhood shopping centres to their US counterparts, at least on the sales psm and occupancy cost metrics, is not necessarily due to superior management or quality of locations.

The data suggests the following:

- Greater tenant diversity in Australian regional shopping centres and less dependence on fashion specialty and department stores confers less volatile performance. US regional centre operators need to look at ways of incorporating more necessity-based tenants into their centres.
- The more intense competitive landscape for both regional centres and neighbourhood centres in the US results in greater diffusion of sales. This, in turn, pressures landlords to offer space on terms more favourable to their tenants. There is nothing inherently wrong with the way that either US or Australian owners handle occupancy costs at their centres—both act rationally in response to the realities of their own respective marketplaces.
- The increasing prevalence of open-air regional centres with lower occupancy costs in the US begs the question of whether Australian developers should follow their lead. That decision must depend not on planning mandates but on sound economics. There is a pressing need in Australia for research into the relative performance of open-air vs. enclosed regional centres. Hundreds of case studies are now available to facilitate this investigation.
- Larger average specialty store sizes in the US also lower sales psm but generally offer a superior shopping experience. Aisles are wider, sight-lines are better, visual merchandising is more impressive and retailers are generally able to better display their products and promote their brand image in American stores. In certain circumstances it may render competitive advantage to both shopping centres and retailers in Australia to mix larger boutiques with smaller ones and thus present a fresh and differentiated configuration.
- Larger supermarkets frequently offer superior shopability and a broader array of amenities. Supermarkets in Australia are more constrained by land availability than in the US, but could nonetheless draw on the US experience to be more imaginative in their presentation and configuration. They could also provide a broader range of products and amenities in even a modestly larger format. Of course, stronger and larger supermarkets may imperil the competitive position of specialty food tenants in certain categories, such as pharmacy, flowers and produce. In-house cafes/eateries—another increasingly common feature of US supermarkets—would also compete with food catering establishments elsewhere

in the Australian shopping centre. However, the competition would be healthy and potentially raise standards across the board.