Key Research Findings

South African shopping centre trading performance as measured by the IPD Trading Density Index recorded a second consecutive quarter of slowing growth for the period ended June 2017. The index is based on data collected by MSCI Real Estate's Retail Performance Benchmarking Service which quantifies sales performance as well as other key retail performance metrics across 24 merchandise categories in more than 100 retail centres, covering in excess of 4 million square meters.

Trading density growth (sales per square meter; annualised), slowed to 0.3% year on year (y/y) in current price terms for the quarter ending June 2017— down from +2.7% y/y recorded for the quarter prior.

The latest trading density growth figure is lower than StatsSA's retail sales growth of 7.4% y/y for the year ending June implying that the sample of mall-based retailers underperformed the larger retail market for the period.

While trading density growth, as measured by the IPD Trading Density Index, slowed to 0.3% year on year to June 2017 on an aggregate level, the performance of individual centres continue to vary significantly as they are subject to varying levels & quality of competition as well as different growth drivers and characteristics which may play a role in their sensitivity to the economic growth and consumer spending cycles.

On an aggregate level, trading density growth of 0.3% comprised a 4.0% decline in sales while occupied floorspace was down 4.3%. Looking at it from another perspective, trading density growth was a function of spend per head increasing by 4.3% while aggregate footcount/sqm declined by an estimated 3.9%.

Over the longer term, the amount of spend per head is the primary driver of retail sales growth (~75% of total trading density growth) while the impact of footcount growth is secondary (~25%). Since mid-2016, footcount growth has detracted from trading density growth suggesting that -on aggregate- consumers are currently visiting malls less frequently but spending more per visit when compared to the same month last year.

Annualised trading density growth has been slowing across all retail segments since December 2016. For the period under review, the Super Regional segment was the only segment to record a negative year on year growth rate at -6.3%. Community centres remain the top performing segment in terms of year-on-year trading density growth but has seen growth sliding since Q1 2016.

Retailer's cost of occupancy, as measured by the ratio of gross rental to sales, was almost unchanged on the quarter before. Given that overall sales per square meter increased by +0.3% y/y, it can be deduced that the gross rental increased at a slightly faster rate despite an increased vacancy rate. Though the aggregate rent to sales figure was stable there were some divergent moves in the underlying segments.

The current retail sector vacancy rate, while still low relative to Office & Industrial property, is above its long term average of around 2.5%. The latest quarter saw increases in the vacancy rate of all retail segments the exception of Small Regional centres which recorded a 10bp improvement over the previous quarter.

Some merchandise categories have been performing better relative to others - thereby gaining market share as a percentage of total sales within these segments. The largest market share movements seen over the last three years was in the Department Store category, which lost market share across all segments. Other categories — most notably Apparel and Health & Beauty — gained market share across all retail formats.

Analysing the food category provides some interesting insights into the argument that consumer are currently favouring convenience centres for specific type of purchases.
South African shopping centre trading performance as measured by the IPD Trading Density Index recorded a second consecutive quarter of slowing growth for the period ended June 2017 (Fig 1). The index is based on data collected by MSCI Real Estate’s Retail Performance Benchmarking Service which quantifies sales performance as well as other key retail performance metrics across 24 merchandise categories in more than 100 retail centres, covering in excess of 4 million square meters.

Trading density growth (sales per square meter; annualised), slowed to 0.3% year on year (y/y) in current price terms for the quarter ending June 2017— down from +2.7% y/y recorded for the quarter prior. The 0.3% y/y increase in trading density was a function of a negative 4.0% sales growth & an 4.3% decline in the amount of occupied trading area trading density area.

The latest trading density growth figure is lower than StatsSA’s retail sales growth of 7.4% y/y for the year ending June implying that the sample of mall-based retailers underperformed the larger retail market for the period. Worth noting is that the StatsSA retail sales sample is heavily weighted towards general dealers, specialised food & clothing outlets as well as retailers of pharmaceuticals/medical goods, cosmetics and toiletries (a combined 80%). These four categories saw retail sales growing at 8.5% y/y — underpinning the aggregate growth of 7.4% y/y.
Key economic drivers for the retail sector

The South African economy expanded an annualised 2.5% quarter on quarter (q/q) in the three months to June 2017, ending two quarters of contraction. It is the strongest growth rate since Q2 2016 with agriculture, forestry and fishing making the largest upward contribution, driven by an increased production of field crops and horticultural products. GDP growth in South Africa averaged 2.8% from 1993 to 2017 meaning the latest reading is approaching long term trend levels. The latest upick had a marginal impact on the year-on-year growth rate which increased 10bps to 1.1% y/y.

South African consumer confidence, as measured by the FNB/BER Consumer Confidence Index (CCI) dropped to -9 in the second quarter of 2017 from -5 in the previous quarter, highlighting households’ concerns about short to medium term economic growth. The depressed consumer confidence is weighing on household consumption expenditure which at Q1 2017 was only marginally positive at +0.8% amid poor credit extension and higher food prices.

As at June 2017, the prime overdraft rate remained unchanged over the quarter before. This turned out being the peak of the current interest rate cycle with a 25bp cut following in July. The commercial property sector will keep a close eye on the SARB’s next rates decision as well as the likely future impact of this on household debt service costs and debt as a proportion of household income (Figure 2).

The latest ratio of debt service cost to disposable income remain below 10% while household debt to disposable income continues to decline slowly ending the first quarter of the year at 73.2% - the lowest level since March 2006 indicating that consumers are still deleveraging some of their debt.

Retail sales growth, as measured by StatsSA, remains positive on a constant price basis — increasing 2.9% y/y to June 2017 (7.4% in nominal price terms). On a category level there is some variance with retailers of Pharmaceuticals and Hardware recording negative growth year-on-year with a noticeable dip in the month of March. Household furniture, a traditionally interest rate sensitive category, recorded a strong recovery, growing sales 8.3% y/y after negative growth recorded year-on-year to February and April 2017.

While trading density growth, as measured by the IPD Trading Density Index, slowed to 0.3% year on year to June 2017 on an aggregate level, the performance of individual centres continue to vary significantly as they are subject to varying levels & quality of competition as well as different growth drivers and characteristics which may play a role in their sensitivity to the economic growth and consumer spending cycles. Additional analysis by MSCI Real Estate Research has shown that outperforming centres have widened the gap over underperforming centres in recent years with respect to its trading density growth and rent to sales ratio. This suggests that the intense battle for market share in the current challenging trading environment is seeing successful centres maintain or improve visitor counts while at the same time eking out gains in spend per head.
Key economic drivers for the retail sector

Fig 2: Retail sector — macroeconomic fundamentals 2003-2017 (or latest available)

- Real GDP Growth
- Consumer Price Inflation (Core)
  Excl. food, non-alcoholic beverages and petrol
- Final consumption expenditure by households
- Ratio of debt-service cost to disposable income

Source: South African Reserve Bank
Drivers of trading density growth

On an aggregate level, trading density growth of 0.3% comprised a 4.0% decline in sales while occupied floorspace was down 4.3%. Looking at it from another perspective, trading density growth was a function of spend per head increasing by 4.3% while aggregate footcount/sqm declined by an estimated 3.9%.

Figure 3 below illustrates this trend for the period 2005Q1 to current. Over the longer term, the amount of spend per head is the primary driver of retail sales growth (~75% of total trading density growth) while the impact of footcount growth is secondary (~25%). Since mid-2016, footcount growth has detracted from trading density growth suggesting that -on aggregate- consumers are currently visiting malls less frequently but spending more per visit when compared to the same month last year. This assessment should be viewed against the current background of high unemployment and slow economic growth — thus successful centres are the ones that can both attract shopper numbers and maximise their dwell time and spend.

Source: MSCI; Note: numbers may not add up due to rounding
This graphic illustrates the weighted contribution to Trading Density Growth of changes in Sales, Trading Area, Number of Shoppers and Spend per Head.

Source: MSCI; Note: numbers may not add up due to rounding. This graphic illustrates the weighted contribution to Trading Density Growth of changes in Sales, Trading Area, Number of Shoppers and Spend per Head.

Fig 3: Trading density growth attribution — June 2017. Weighted contribution to Trading Density Growth

Decline in occupied trading area
+4.3%
Sales growth
-4.0%
Footcount growth
-3.9%
Spend per Head growth
+4.3%

Fig 4: Trading Density Growth mainly driven by spend per head growth over longer term
Sales Performance

Annualised trading density growth has been slowing across all retail segments since December 2016. For the period under review, the Super Regional segment was the only segment to record a negative year on year growth rate at -6.3%. This means that Super Regional sales per square meter is now down to mid-2014 levels after a steady decline since the second quarter of 2016. The next section of this report takes a deeper look at Super Regional trading performance & what has been driving its underperformance relative to the other retail formats since Q1 2016.

The annualised trading density growth of the other four retail segments remain positive but have also now dipped below the rate of consumer price inflation.

Community centres remain the top performing segment in terms of year-on-year trading density growth but has seen growth sliding since Q1 2016. Since 2015, community centre trading density growth was aided by a significant improvement in vacancy rate (8.8% down to 3.4%). However, with the vacancy rate of community centres stabilising and starting to edging back up to 4%, trading density growth has come under pressure — ending June 2017 on 2.8% y/y.

Neighbourhood centres was the second best performing segment after community centres by recording a +2.7% year on year annualised trading density growth for the year ended June 2017. On an index basis, the Neighbourhood segment still lags behind the larger retail formats on an index basis but has closed the gap since 2015. Community centres remain the top performing segment with regards to indexed annualised trading density growth. On a cumulative basis, annualised trading density has grown by 44% for the 6 years to June 2017.

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**Fig 5: Trading Density growth — Community centres still outperforming but cooling**

- Annualised Trading Density Growth for June 2017
- Category level - Year on year to June 2017

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*Source: MSCI Real Estate*
What’s driving the underperformance of Super Regional centres?

As illustrated in Figure 5, the Super Regional shopping centre segment has been underperforming the other retail segments with regards to its trading density growth since Q1 of 2016. The declining trading density has been closely correlated to a weakening occupancy rate which suggests a higher proportion of store closures among higher density trading categories with predominantly smaller trading formats.

The performance of Super Regional centres have been contrasted by an outperformance in the Community centre segment which suggests that consumers might be preferring the convenience offered by the smaller retail formats for an increasing number of mall visits.

In addition to a declining occupancy rate, the underperformance was further driven by a structural shift in the underlying merchandise category composition. The two largest Super Regional merchandise categories - Apparel and Department stores (a combined 50% of GLA) — has seen trading densities decline significantly since Q4 2015. While these two categories underpinned Super Regional trading density growth between 2012 and 2015 it has dragged aggregate growth down since then.

Fig. 7 below illustrates the annualised trading density growth of apparel and department stores together with the change in average store size since 2015. While the average Super Regional department store is now 66% bigger than it was in 2015, the average turnover per store only increased by 41% during this time resulting in annualised trading density declining by 15%. The same applies to the apparel category which has seen store sizes increase by 26% since 2015 with only a 12% increase in sales to show for it — the net result a 14.2% decline in annualised trading density.
What's driving the outperformance of Community centres?

**Fig 7: Super Regional department and apparel: Store size growth outpacing sales**
Cumulative change in Trading Density & Average store size since 2015Q4

**Fig 8: Dwindling visitor counts hurting Super Regional trading density growth**
Footcount and Spend per Head growth; 2005-present
Retailer cost of Occupancy

Retailer’s cost of occupancy, as measured by the ratio of gross rental to sales, was almost unchanged on the quarter before. Given that overall sales per square metre increased by +0.3% y/y, it can be deduced that the gross rental increased at a slightly faster rate despite an increased vacancy rate. Though the aggregate rent to sales figure was stable there were some divergent moves in the underlying segments.

The Super Regional segment saw a pronounced increase in its cost of occupancy to end the quarter at 10.6%. (Figure 9). The Community and neighbourhood segments saw year-on-year improvements in their rent to sales ratios courtesy of vacancy rates declining on the year before.

Drilling down into a category level, Entertainment, Health & Beauty and Luggage were among the categories recording improved cost of occupancy ratios on the back of growing trading densities. Among the main categories from a usage perspective, Apparel saw its cost of occupancy deteriorate by around 70bps over the past 12 months while Services and Accessories/Jewellery/Watches were among the smaller categories recording deteriorating gross rental to sales ratios.

Fig 9:**Gross Rent to Sales ratio stable on aggregate but Super Regional up sharply**

![Gross Rent to Sales ratio chart]

Source: MSCI Real Estate

Category level change (y/y) Gross Rent to Sales; Top 5 categories by sales

<table>
<thead>
<tr>
<th>Category</th>
<th>12 month change (percentage points)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Apparel</td>
<td>0.7</td>
</tr>
<tr>
<td>Department Stores</td>
<td>0.0</td>
</tr>
<tr>
<td>Food</td>
<td>-0.2</td>
</tr>
<tr>
<td>Food Service</td>
<td>-0.1</td>
</tr>
<tr>
<td>Electronics</td>
<td>0.0</td>
</tr>
</tbody>
</table>

Source: MSCI Real Estate
Retail Vacancy Rates

The current retail sector vacancy rate, while still low relative to Office & Industrial property, is above its long term average of around 2.5%. The latest quarter saw increases in the vacancy rate of all retail segments the exception of Small Regional centres which recorded a 10bp improvement over the previous quarter.

The Super Regional vacancy rate is now at its highest level since the series started in 2003 and 2.5x its long term average of 1.6%. While the Super Regional vacancy rate trend traditionally has had a seasonal element to it, the movement since mid-2015 has been a departure from its longer term trend. During this period, the Super Regional vacancy rate converged from other retail segments as illustrated by Fig 10 below.

The community centre vacancy rate has declined from 8.8% in 2015Q3 to end the latest quarter at 3.8%. The neighbourhood centre segment (centres between 5000sqm and 12000sqm) vacancy rate has declined from 9.0% in 2016Q1 to 6.1% as at the end of June 2017.

Community & neighbourhood centres have followed a similar trend since 2009 with both segments experiencing noticeable double dip moves in vacancy rate. Post the 2008/09 recession these segments have gone through two clear cycles. Super regional and regional centres meanwhile have tended to have a shallower trend through the cycle, by virtue of a larger & more diverse tenant base and more drawn out expiry profile.
Interesting to note is that retail centres below 25,000sqm (Community & Neighbourhood) have lead the vacancy cycle on the way down and up (Figure 11). This highlights smaller centres increased sensitivity to economic activity and consumer spending cycles. Smaller centres also experience steeper moves in vacancy rate change — whether as a result of their smaller tenant pool or the defensiveness thereof (lower percentage of national tenants as an example).

The Community & Neighbourhood centre vacancy trend led the Regional & Small Regional segments by 3-9 months on the downside which in turn led the Super Regional segment by 12-18 months. This serves as proof to the widely held notion that larger centres are more defensive through the cycle while smaller centres tend to be more sensitive to pullbacks in consumer spend.

While the historical trend suggests that Super Regional vacancies may be close to peaking it will be of interest to see if improvements in occupancy comes at the expense of rental growth (given that the Super Regional segment’s cost of occupancy ratio has already increased significantly over the past 12 months).
Merchandise Category Trends

An ongoing trend is the widespread with regards to in annualised trading density growth on a category level. Category performance is not tied to centre type and in fact there were zero merchandise categories that recorded above-inflation growth across all retail segments. This suggests that consumers may be preferring to visit specific retail formats for certain types of purchases with factors such as convenience, drive time and comparative shopping possibly at play.

When analysing the five largest categories (measured as a percentage of spend), only the food category recorded positive trading density growth across all segments. The recent strong performance of the Food category matches the trend reported by StatsSA which also reported double digit sales growth in nominal price terms.

Other notable insights from the table below is the underperformance of Department Store trading density across centre types larger than 25k sqm. The main driver of this decline is an increase in the average store size — as illustrated in Figure 7 earlier in the report. While the average Department Store in Super Regional and Regional centres has increased significantly in size, this has been in the absence of a commensurate growth in sales which has resulted in declining trading density.

### Fig 12: Annualised Trading Density Growth for selected categories
**Selected categories; year to June 2017**

<table>
<thead>
<tr>
<th>Merchandise Category</th>
<th>Super Regional</th>
<th>Regional</th>
<th>Small Regional</th>
<th>Community</th>
</tr>
</thead>
<tbody>
<tr>
<td>Food</td>
<td>3.05%</td>
<td>8.99%</td>
<td>4.89%</td>
<td>-5.57%</td>
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<tr>
<td>Department Stores</td>
<td>-12.37%</td>
<td>-10.54%</td>
<td>-11.39%</td>
<td>3.30%</td>
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<td>Apparel</td>
<td>-15.06%</td>
<td>-0.13%</td>
<td>0.90%</td>
<td>1.26%</td>
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<tr>
<td>Food Service</td>
<td>-3.78%</td>
<td>4.16%</td>
<td>4.92%</td>
<td>-5.74%</td>
</tr>
<tr>
<td>Books/Cards/Stationary</td>
<td>0.19%</td>
<td>-0.69%</td>
<td>0.22%</td>
<td>-3.90%</td>
</tr>
</tbody>
</table>

Source: MSCI Real Estate
Merchandise Category Trends continued

Some merchandise categories have been performing better relative to others - thereby gaining market share as a percentage of total sales within these segments. The largest market share movements seen over the last three years was in the Department Store category, which lost market share across all segments. Other categories — most notably Apparel and Health & Beauty — gained market share across all retail formats.

Analysing the food category provides some interesting insights into the argument that consumer are currently favouring convenience centres for specific type of purchases. Figure 13 illustrates the three year change in the percentage of total sales per retail segment.

For the three year ended June 2017, food retailers increased its share of sales in Community centres by 6.7%. This mirrors the market share losses reported in the three larger retail segments suggesting that community-centre food retailers have been gaining market share at the expense of food retailers tenanting larger centres.

The biggest loser with regards to the food category seems to be Regional centres which reported a 3.5% market share loss for the three years ended June 2017 which suggests that consumers are doing less grocery and food shopping at mid-tier centres, instead preferring smaller, convenience type centres.

Fig 13: Market Share gain/loss - three years to June 2017

Food category driving community centre gains

Food retailers gained market share in small retail formats

Source: MSCI Real Estate
Rejuvenation of IPD Retail classification

About the Service

The IPD Retail Performance Benchmarking Service tracks the performance of more than 100 individual shopping centres spanning over 4 million square meters as at the fourth quarter of 2015. The service provides clients with a detailed quarterly report that enables property & asset managers to accurately benchmark the performance of their assets relative to the market on a number of key metrics — ranging from trading performance and rental to spend per head and foot flow— enabling proactive decision making.

Data collected as part of the service also underpins the South African Council of Shopping Centres (SACSC) sponsored Trading Density Index — providing a valuable quarterly insight to the broader retail community into the performance of the formal retail property sector.

Data is collected on a tenant level, allowing a bottom-up view of the performance of merchandise categories, centre and portfolios. Tenants are currently categorised into 27 primary & 65 secondary merchandise categories, a level of detail that established the service as a world leader in retail benchmarking and analytics with a history going back to 2002.

Why update the categorisation?

Notwithstanding the success & pioneering work of the service, South Africa’s dynamic retail environment has necessitated changes to the service’s categorisation, driven to a large degree by an engaging & increasingly sophisticated retail management community.

The enhanced categorisation enables more accurate benchmarking of key performance indicators as it is underpinned by an improved like for like sample. Changes in the technological and competitive landscapes have also necessitated the need for owners and managers to accurately benchmark non-GLA income streams which are becoming increasingly important as the fight for market share intensifies.

Changes to the data series is effective from quarter 1 2016.

What was done?

Following roundtable discussions & individual consultations with industry players, a new categorisation has been drafted with implementation set for mid-2016.

The new categorisation consists of 72 detailed merchandise categories that roll up into 20 simplified primary categories. The 72 secondary categories include 21 new categories that allows for a more accurate classification and thus more accurate benchmarking on a like for like basis.
Rejuvenation of IPD Retail classification

Major impacts of new categorisation

The merchandise category changes can broadly be split into two categories:
1. categories that had gained sufficient critical mass to justify their own primary category and;
2. categories with a diversified mix of tenants that necessitated a more granular breakdown

Among the more significant category changes are Department Stores where stores are no longer categorised according to their gross lettable area but rather according to their orientation towards Food/Apparel/Home or Electronics/Appliances. We believe this will improve the relevance of the service to landlords and managers across all retail formats. However, as IPD collects the GLA of each store, it is still possible to overlay GLA with the categories if needed.

Food Service is an example of a category where a greater degree of granularity was introduced. This will enable more accurate benchmarking on a like for like basis since the different trading formats typically has different business models, overhead structures and store formats. The Food Service category will now be broken down into the following categories: Restaurant and Bar, Fast Food, Coffee shop, Ice-cream and frozen yoghurt & Drive Thru.

Similarly, the Health & Beauty category will benefit from improved granularity which will see Pharmacy & Personal care retailers such as Clicks and Dischem being separated from Hairdressers, Nail & Beauty Therapists and Cosmetics retailers from a benchmarking point of view.

A comprehensive list of tenants will also accompany the new category list to make it easier for data contributors to correctly classify their tenants.

Not only does the new set of merchandise categories better reflect the current South African retail environment, it s also better aligned with that of the International Council of Shopping Centres (ICSC) classification and can only benefit the South African retail industry in years to come. We would like to thank all industry participants who contributed towards the drafting of the new categorisation and look forward to our future engagements as we drive the retail sector forward.
About the Sample

The IPD Retail sample consists of around 100 shopping centres across all geographies & centre types owned by listed real estate investment trusts, life & pension funds as well as private property funds.

The full quarterly results from 2003 onwards are available for 24 merchandise categories across 5 retail formats — from super regional down to neighbourhood centres. To subscribe to this quarterly publication please contact sa@ipd.com

SHOPPING CENTRE DEFINITION TYPES

<table>
<thead>
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<th>Type</th>
<th>Size Range</th>
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<tbody>
<tr>
<td>Super Regional shopping centre</td>
<td>&gt; 100,000sqm</td>
</tr>
<tr>
<td>Regional shopping centre</td>
<td>50,000-100,000sqm</td>
</tr>
<tr>
<td>Small Regional shopping centre</td>
<td>25,000-50,000sqm</td>
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<tr>
<td>Community shopping centre</td>
<td>12,000-25,000sqm</td>
</tr>
<tr>
<td>Neighbourhood shopping centre</td>
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</tbody>
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