RESEARCH
Retail Trends Report
Key Research Findings

South African shopping centre trading performance as measured by the MSCI South Africa Quarterly Retail Trading Density Index, recorded another period of positive growth for the quarter ended March 2019.

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), came in at +3.2% year on year (y/y) to March 2019 in current price terms– up from a revised +2.5% recorded for the quarter before. This is the highest level of annualised trading density growth since the last quarter of 2017.

The 3.2% yly increase in trading density was a function of a positive 5.1% sales growth & an 1.8% increase in the amount of occupied trading area (i.e. a dilutionary impact).

On an aggregate level, trading density growth of +3.2% comprised a 5.1% growth in sales while occupied trading area was up 1.8% (i.e. a dilutionary impact).

Looking at it from another perspective, trading density growth was a function of spend per head increasing by 4.0% while aggregate footcount/sqm declined by an estimated 0.8%.

Over the long term, the growth in the amount spent per visitor is the primary driver of trading density growth. Spend per head growth has been slowing over the past 3-4 quarters as footcount growth has recovered faster than the headline growth in sales.

Despite increasing at an aggregate level, annualised trading density growth has been levelling off in all segments with the exception of Neighbourhood shopping centres.

The neighbourhood segment in particular had a strong quarter in growing its annualised trading density by 8.3% on a year before - up from 3.2% in December. (Excluding neighbourhood centres would see the average ATD growth drop from 3.2% to 1.1%).

The Super Regional shopping centre segment appears to have lost some steam after topping the growth charts in Q3 2018. Small Regional and Regional centres continue to lag and recorded annualised trading density growth of 0.6% and 0.0% respectively for the year ended March 2019.

This highlights the difficulty faced by some mid-tier centres, many of whom face high levels of competition from large Super Regionals and smaller, modern convenience centres. Remaining relevant to their catchment area requires a fine balance between convenience and experiential shopping elements- further amplified by the constrained consumer economy.

Among the five largest merchandise categories, Food service & Electronics outperformed with double digit growth in their annualised trading density for the year ended March 2019. The Food category (mostly comprising Grocery/Supermarket tenants) reported a respectable 7.4% y/y while Department Stores and Apparel retailers lagged with 4.7% and 2.1% respectively.

Retailer’s cost of occupancy, as measured by the ratio of gross rental to sales, continued its upward trend with a 28bp y/y increase to March 2019. This was the result of a 5.1% growth in overall sales and a 5.7% y/y increase in aggregate gross rental.

While cost of occupancy in the Super Regional segment remains the highest (11.4% as at March 2019), the largest increase was seen in the Small Regional segment (+40bps y/y to March 2019).

The current retail sector vacancy rate of 4.2%, is above its long term average of around 2.9% with the Super Regional segment being the major driver of the current level. The latest quarter’s 30bp improvement now sees the Super Regional vacancy rate back below that of the Neighbourhood centre segment.

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. While not the only factor, the segment’s ballooning cost of occupation have been strongly correlated to the increasing rate of vacancy.
Headline Performance

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The 3.2% y/y increase in trading density was a function of a positive 5.1% sales growth & an 1.8% increase in the amount of occupied trading area (i.e. a dilutionary impact).

The sales growth figure of 5.1% is higher than StatsSA’s nominal retail sales growth of 2.8% y/y for the year ending March 2019 implying that the sample of mall-based retailers outperformed the larger retail market for the period from a sales growth perspective. This underlines the relative defensiveness of shopping centres in a challenging operating environment.

While centres in the MSCI sample reported negative footcount/sqm growth of -0.8% y/y as at March 2019, it is up off its January 2018 low when footcount/sqm growth bottomed out at -6.0%. In absolute terms, footcount has trended broadly sideways but it has not kept pace with the increase in occupied retail GLA.

Fig 1: Trading density growth – MSCI South Africa Retail Trading Density Index
Annualised sales/sqm growth; Current price terms; y/y

Source: MSCI Real Estate
Key Economic Drivers for the Retail Sector

Fig 2: Retail sector – macroeconomic fundamentals
2003 up to & including 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: StatsSA; South African Reserve Bank
Drivers of Trading Density Growth

On an aggregate level, trading density growth of +3.2% comprised a 5.1% growth in sales while occupied trading area was up 1.8% (i.e. a dilutionary impact). Looking at it from another perspective, trading density growth was a function of spend per head increasing by 4.0% while aggregate footcount/sqm declined by an estimated 0.8%.

Over the long term, the growth in the amount spent per visitor is the primary driver of trading density growth (Fig 4 below). Spend per head growth has been slowing over the past 3-4 quarters as footcount growth has recovered faster than the headline growth in sales.

While the amount spent per shopper is currently growing at a rate just below inflation, footcount/sqm continues to decline as the amount of shoppers haven’t increased in line with the level of occupied gross lettable area (GLA) which has increased as a result of improved occupancy and mall extensions. Since mid-2016, negative 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. As at March 2019, the growth in footcount/sqm was -0.8% y/y.

Fig 3: Trading density growth attribution – March 2019
Weighted contribution to Trading Density Growth

<table>
<thead>
<tr>
<th>Component</th>
<th>Contribution</th>
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</thead>
<tbody>
<tr>
<td>Trading density growth</td>
<td>+3.2%</td>
</tr>
<tr>
<td>Impact of change in trading area</td>
<td>-1.8%</td>
</tr>
<tr>
<td>Sales growth</td>
<td>+5.1%</td>
</tr>
<tr>
<td>Footcount growth/m²</td>
<td>-0.8%</td>
</tr>
<tr>
<td>Spend per Head growth</td>
<td>+4.0%</td>
</tr>
</tbody>
</table>

Source: MSCI Real Estate; 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 4: Trading Density Growth mainly driven by spend per head growth over longer term
Weighted contribution to Trading Density Growth

Source: MSCI Real Estate
**Sales Performance**

South African household budgets remain constrained by higher personal income taxes, sharp fuel and electricity price hikes and rising unemployment rates. Despite this, trading density growth as measured by the MSCI South Africa Quarterly Retail Trading Density Index, has now been positive for 13 consecutive months on a year-on-year basis and more importantly has continued to accelerate.

Despite increasing at an aggregate level, annualised trading density growth has been levelling off in all segments with the exception of Neighbourhood shopping centres. The neighbourhood segment in particular had a strong quarter in growing its annualised trading density by 8.3% on a year before - up from 3.2% in December. (Excluding neighbourhood centres would see the average ATD growth drop from 3.2% to 1.1%).

The Super Regional shopping centre segment appears to have lost some steam after topping the growth charts in Q3 2018. The mid-tier segment (Small Regional and Regional centres) continue to lag and recorded annualised trading density growth of 0.6% and 0.0% respectively for the year ended March 2019. This highlights the difficulty faced by some mid-tier centres, many of whom face high levels of competition from large Super Regionals and smaller, modern convenience centres. For mid-tier centres, remaining relevant to their catchment area requires a fine balance between convenience and experiential shopping elements- further amplified by the constrained consumer economy.

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The next section of this report analyses the impact of muted sales growth on the cost of occupancy of the different retail segments.
Retailer’s cost of occupancy, as measured by the ratio of gross rental to sales, continued its upward trend with a 28bp y/y increase to March 2019. This was the result of a 5.1% growth in overall sales and a 5.7% y/y increase in aggregate gross rental.

The gross rent to sales ratio of all retail formats were up on 12 months ago but there was some variation in the quantum of the increases. While cost of occupancy in the Super Regional segment remains the highest (11.4% as at March 2019), the largest increase was seen in the Small Regional segment (+40bps y/y to March 2019).

The Super Regional and Small Regional segments in particular have seen pronounced increases in their cost of occupancy since the start of 2016 (Figure 6) as sales growth have struggled to keep up with the rental growth. The Regional shopping centre segment (centres between 50k & 100k sqm) has also seen its gross rent to sales ratio creep up – but not to the same extent.

At 9.0%, the cost of occupancy in Regional centres is now 240bps below that of Super Regional centres- the widest spread in the series' history. This superior cost of occupancy could underpin demand in well-located Regional centres that are able to maintain relevance in their catchment area.

While cost of occupancy in the three larger retail formats are at all time highs, that of the Community & Neighbourhood centre segments remain well below 2016 levels with the improvement driven by an improvement in occupancy levels.

Among the underlying merchandise categories, the Entertainment category saw a significant year-on-year increase of 170bps in its gross rent to sales ratio. While the Entertainment category isn’t directly the biggest driver of trading density growth it has a positive impact on footcount.

Fig 6: Overall Gross Rent to Sales ratio up 30bps y/y- driven by large format centres

<table>
<thead>
<tr>
<th>Gross Rent to Sales ratio 2012-2019</th>
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<tbody>
<tr>
<td>Community</td>
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<td>2012-2019</td>
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<tr>
<th>Current gross rent to sales ratios- March 2019</th>
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<tr>
<td>Super Regional</td>
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<td>Regional</td>
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<tr>
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<tr>
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<tr>
<td>Neighbourhood</td>
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<th>Change in Gross Rent to Sales ratio- March 2019</th>
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<tr>
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</tr>
</tbody>
</table>

Source: NICO Real Estate
Retail Vacancy Rates

The current retail sector vacancy rate of 4.2%, is above its long term average of around 2.9% with the Super Regional segment being the major driver of the current level. The vacancy rate of Super Regional centres, while improved on the highs of mid-2018 needs to decline further to catalyse a meaningful improvement to the segment’s trading density growth. The latest quarter’s 30bp improvement now sees the Super Regional vacancy rate back below that of the Neighbourhood centre segment.

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. While not the only factor, the segment’s ballooning cost of occupation have been strongly correlated to the increasing rate of vacancy (Fig 7).

The latest period saw quarter-on-quarter increases in the vacancy rate of the Neighbourhood (+20bps), Small Regional (+20bps) and Regional (+10bps) segments.

The smaller retail formats have seen their vacancy rates dip significantly over the course of the last 3-4 years. While these two smaller retail segments have experienced sharper moves in vacancy rate, 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 WALE profile (weighted average lease expiry) courtesy of a larger proportion of space occupied by large anchor tenants.
Decoupling Trading Density & Sales Growth

In the current tough operating environment, trading density growth is as much a measure of sales efficiency as it is a measure of efficient space utilisation and tenant mix management. There are currently many examples of categories posting positive trading density growth despite negative sales growth.

An example of this is Electronics, one of the leaders from a trading density perspective over the last 5 years, despite a period of negative sales growth through 2015 and 2016. During the period of slowing sales growth, the category reduced its average store size by around 15% which kept its trading density growth in positive territory. (see Fig 8).

The category’s gross rental growth slowed down as a result but remained above-inflation while growth in the tenant’s occupancy cost also slowed — a good example of active management resulting in a win-win outcome despite the challenging operating environment. Thus, it’s key for retail managers to have access to accurate data that enable them to identify sales trends early and act decisively to right size tenants where needed.

![Fig 8: Trading density growth: a function of sales and space growth](chart)
RESULTS FOR THE PERIOD
ENDED MARCH 2019
JUNE 2019

About the Sample

MSCI Real Estate’s Retail Benchmarking 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 realestate@msci.com

SHOPPING CENTRE DEFINITION TYPES

<table>
<thead>
<tr>
<th>Type</th>
<th>Size Range</th>
</tr>
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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>
</tr>
<tr>
<td>Community shopping centre</td>
<td>12,000-25,000sqm</td>
</tr>
<tr>
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<td>5,000-12,000sqm</td>
</tr>
</tbody>
</table>
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