The death of the mall is exaggerated

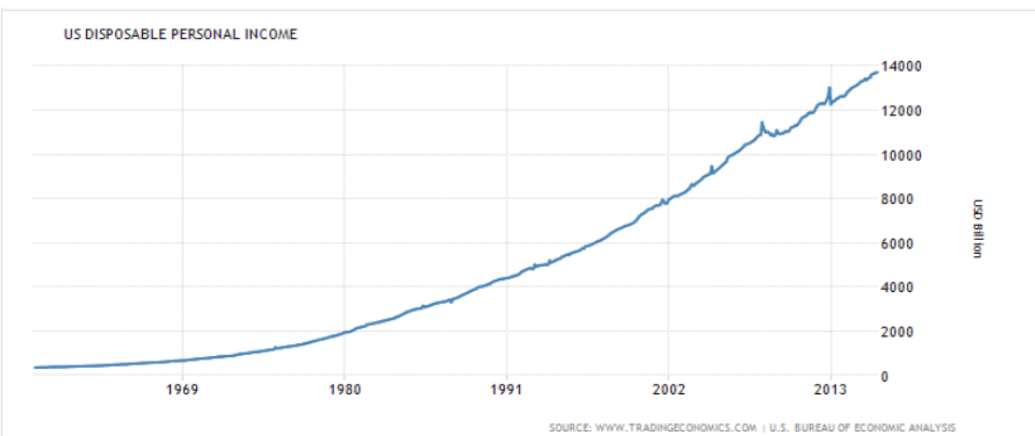
By Grant Lowton, CFA

The latest headlines in REIT world are about the death of the shopping mall. Indeed, there are indications that lower quality (B and C) malls are set to suffer long term strife due to the progression of e-commerce. However, high quality "A malls" will continue to thrive as they provide consumers with experiences as opposed to the mere essentials.

Our article entitled "Online Shopping a Boon for Logistics REITs" (http://www.reitwayglobal.com/our-company/our-blog/online-shopping-a-boon-for-logistic-s-reit-s.html) discussed how e-commerce (online shopping) has changed the retail landscape. In recent years, growth in the number of shopping centres in the US has tapered dramatically, even in an environment of steady retail sales growth driven by a relatively healthy consumer.

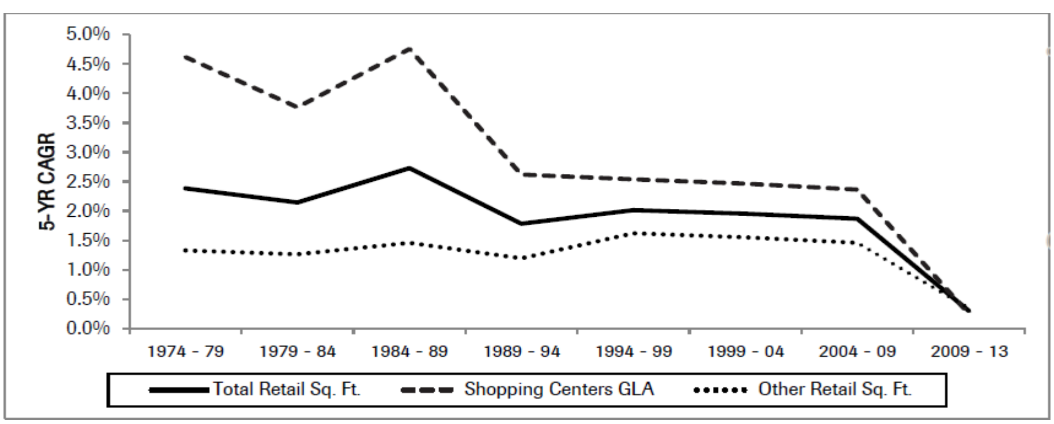
Increase in e-commerce has contributed toward muted shopping centre growth, even though the consumer has been relatively strong

As seen below, US personal disposable income has been increasing steadily over time.



Source: www.tradingeconomics.com

Despite this, growth in shopping centre gross lettable area (GLA) has fallen dramatically in recent years.



Source: ICSC, Cowen and Company

One of the major contributing factors towards declining growth in shopping centre GLA, despite a healthy consumer, has been the increase in e-commerce as a proportion of total retail spend.

The chart below shows that online shopping as a proportion of total retail spend has increased from approximately 3% in 2007 the early 1990s to almost 8% currently.

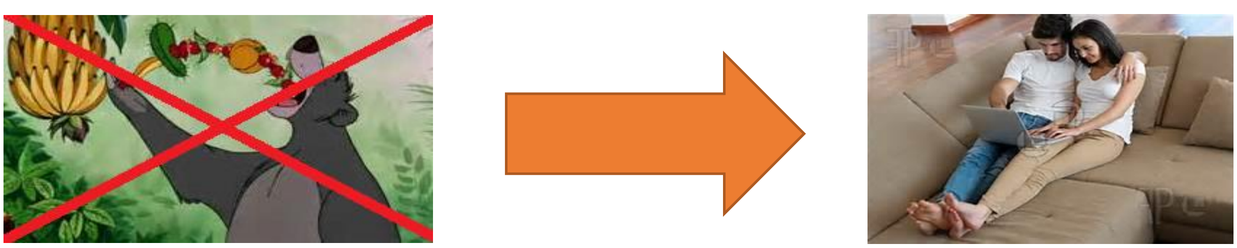
Source: https://www.census.gov

This has increasingly led many investors over time to question whether the shopping mall is dead?

Shopping centres that cater to the necessities are at particular risk of becoming obsolete

A distinction needs to be drawn between shopping for necessities versus shopping trips that are experiences or outings.

Shopping centres that provide not much more than the bare necessities are at particular risk. There is little reason for a menial trip to buy everyday items, when they can be ordered with minimal cost and great ease online. A few clicks and the bare necessities will come home to you…



The low cost of this convenience is one of the major factors that has steadily been decreasing the appeal low quality, necessity-orientated shopping centres.

The danger, however, goes beyond necessity-based outlets – certain physical stores are under attack

Macy's is a prominent US department store that is an anchor tenant at many malls. In their latest published results, they reported operational headwinds due to more competition from online participants. They cited the fact that technological advances have allowed greater pricing transparency for customers. In addition, customer preferences are shifting towards spending less on apparel and more on experiences.

The danger that e-commerce poses to physical stores is no longer a mere potential threat – it is starting to have a real impact!

Not all malls, however, are created equal – a brief look at A versus B-malls

A-malls are generally classified as such if they generate >$500/sq. ft. in sales.

These top performing malls are often situated in affluent areas where superior consumer spending power enables a mall to be more productive. A disproportionately large share of the healthy consumers' dollars are therefore being spent at A-malls.

Inferior B and C-malls will suffer, higher quality A-malls will continue to thrive

It is our view that low quality/necessity based malls and shopping centres will continue to come under attack by e-commerce for some years to come.

There are a number of reasons, however, why A-malls, with tenants including high-end fashion and jewellery stores, are set to continue to thrive.

Consumers view a visit to a high quality mall, with its luxury items and other experiences, as an outing. In addition, restaurants/food courts and other activities at these malls have and will continue to sustain foot-count at these venues. Toy-shopping, something that excites children for a trip to the mall, is also noteworthy in this regard.

Mall REITs own 15% of total US mall inventory, but they own 80% of the high quality malls. This focus on quality assets is highlighted by the world's largest REIT operator Simon Property Group, who *only* owns A-malls. In cases where there are certain store closures, it won't have a meaningful impact on Simon. This is mainly because Simon will have little difficulty re-leasing the space at even higher rates when compared to in-place rentals.

Only three of Simon's top ten tenants in 1993 exist in their same form today. This demonstrates that high quality malls have a history of flourishing amidst change.

Simon's operating history also supports the notion that A-malls have thrived over the last few years by servicing select clientele. This indicates how successful Simon Property Group has been in converting consumer demand into retail landlord profitability.

Financial years	Revenue (USD) CAGR (%)	Free cash flow/share (USD) CAGR (%)	Dividend per share (USD) CAGR (%)
2010 – 2015 (actual)	6%	15%	18%
2015 – 2019 (forecast)	5%*	7%	8%

Source: Thomson Reuters Eikon, Reitway calculations
**2015 – 2018*

Even though profit growth is forecast to decelerate over the next few years, this must be seen in the context of slower economic growth generally. Forecasts for upper-single-digit dividend growth (in USD) are still attractive.

We at Reitway Global hold Simon Property Group in our fund as we seek to profit from the favourable prospects of this superior quality A-mall REIT.

For more information about Reitway Global Property Funds, please visit our website at www.reitwayglobal.com or contact us at 021 551 3688.