

# Investment value in determining the rental rate for the anchor tenants of a shopping center

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**Abstract.** The article justifies the need to determine the investment value, rather than the market value of the rental rate for the anchor tenants of a shopping center that is the most appropriate approach to the principle of the most effective use of the property.

## 1 Introduction

Development of retail real estate is one of the most popular directions of development of contemporary Russian business. For 20 years, a whole direction of modern retail has been created: it passed the way from the chaotic reorganization of industrial buildings to retail outlets to the creation of conceptually thoughtful mega-complexes of modern formats. At the same time, there are a lot of unresolved and problematic issues in the industry, such as insufficient legislation, gaps in regulation of land relations, taxation specifics, and complex multi-level procedures for controlling the approval and operation of shopping complexes. Also corporate conflicts caused by ineffective mechanisms of management and control over property and distribution of profits should be mentioned.

How to build an effective economic mechanism, ensuring long-term profitability of the business is still the most important issue. Since the main source of income of shopping complexes is rent, the main goal is to determine objectively and correctly its sizes for different participants of the commercial lease market. This publication is devoted to the features of determining the cost of rent for one of the categories of tenants – the “anchor tenants”. Proper understanding of the role of the anchor tenants and the pricing mechanisms leads to a correct determination of the market value of shopping centers and prevents procedural errors.

The article of B. Peter Pashigian and Eric Gould [1] who interpreted the lowered level of the rental rate of the anchor tenants as a subsidy for externalities generated for small tenants is considered to be the classical work on the effects formed by the anchor tenants. E.V. Barybin, M.V. Barybina [2], V.S. Lyulkin, N.M. Lyulkina, and N.Ya. Kuzin [3] studied the activities of shopping centers and the rental rates market in shopping centers taking into account the Russian specifics. Edward S. Smith and Jr. Recs [4] analyzed the content of investment transactions in retail real estate. Studies of the legal practice of interaction between the anchor tenants and the owners of shopping centers were handled by Nicholas C. Glover [5] and Marianne Jennings [6]. O.M. Fetisov, and A.O. Kishchenko [8]

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et al investigated the issues of the architectural and construction placement of large tenants [7] Despite the variety of publications and a wide range of research interests, the problems of institutional justification of economic interactions between the anchor tenants and the owners of a shopping center require additional comprehension in terms of determining the cost of rent.

## **2 Shopping center and types of tenants**

In accordance with the national standard, a shopping center is defined as follows: a set of trade enterprises and / or enterprises providing services that implement a universal or specialized range of goods and a universal range of services located on a certain territory in buildings or structures planned, constructed and managed as an integrity and providing parking for cars on their territory [9].

The classical scheme for creating a shopping center includes the construction of a commercial building (or several buildings integrated by architectural and style unity), in which several large tenants are located, as well as many medium-sized and small ones, with different trade specialization, the set of which forms joint synergetic effects with the aim of increasing volumes of sales and a number of visitors.

Depending on the importance for owners of shopping centers and attractiveness for consumers, tenants can be divided into the following groups:

1. The “anchor tenants”, which usually occupy the largest area in the shopping center. These are supermarkets, department stores and national network units. Their task is to attract client traffic to the shopping center. An anchor tenant usually conducts an extensive advertising campaign, which provides benefits to all tenants of the shopping center. Thus, positive externalities are formed for the surrounding small shops: free access to visitors who come to shop and receive services of the anchor tenants (a store or a cinema).

In order to attract an anchor tenant, most owners reduce their rent for them, but are eager to sign a triple network lease agreement, according to which the anchor tenant will pay its proportional share of all property taxes and maintenance costs of the total area and will be responsible for repairs and maintenance of the building. Due to the attraction of the anchor tenants to the trading floor, other entrepreneurs will strive to accommodate in such a shopping center. They will benefit from the free advertising carried out for the mall by the anchor. The owner of the shopping center will be able to levy a higher rent from non-anchor tenants, which will form the bulk of its profits [4]. The area of such shops is estimated at 1500 - 5000 sq. m. [2].

2. Mini-anchors occupy a smaller area than the anchor tenants, but more than all other stores: 250-1500 sq. m. The mini-anchors perform the same function as the anchor tenants, that is, attract the flow of visitors. Their brand, in principle, is also known, but narrowly specialized. As mini-anchors, there are shops of cosmetics and perfumery, large pharmacy chains, and book supermarkets.

3. Medium-sized and small tenants may have brands, but usually they are little-known. Visitors of the shopping center rarely come specifically to such stores. They go there on the way and make impulse purchases. Such tenants have the form of shops and appropriately decorated counters, they are located in galleries, aisles and corners, make up the bulk of the sales point of the shopping center and provide its basic revenues. In addition, they have an important function: they provide the necessary variety of assortment to ensure synergistic effect. The rent of such tenants is higher than that of the anchor tenants.

### 3 Rental rates

The concept of the shopping center should help to achieve the main investment goal of the developer (the owner) – the earliest return on investment, overcome the break-even point and exit to a stable long-term income. The timing is critical. The payback period of 15 or more years is considered as prohibitive in making investment decisions for the implementation of a development project.

The main source of income for shopping centers is rent, the amount of which depends on the size of the leasable area that the shopping center has, as well as the rental rate differentiated for different tenants.

The rental rate is the volume of payments provided for renting the agreed retail space for a certain period of time. The size of the rental rate is affected by the following: supply on the market, the level of consumer demand, the technical condition of the facility, the location, the composition of tenants and their neighborhood, the visitor flow, the development of infrastructure and the availability of communications. The above factors affect the revenue of retail outlets based on one square meter of the area and, therefore, cause a different amount of rent. In this case specialization plays an essential role. So, in publications it is mentioned [] that food operators are ready to pay 4-5% of gross revenue for rent on average, and sellers of the household appliances and electronics are already ready to pay 6-8%.

Also, the negotiation position with respect to the value of the rental rate is affected by the term of the contract, the brand of the tenant, the floor on which the store is located, etc. Compared to the first floor, the rental rate is lowered for each next level after the ground level (both ground and underground). For the floor following the first one, the rate is reduced by an average of 25%, for the third levels, a reduction of up to 40% of the rate of the first floor is possible [2].

### 4 Rental rates for the anchor tenants

As a rule, the “anchor” tenants pay less than other tenants. Restaurants, food courts and other catering enterprises pay the maximum rate of operating costs. The size of rental rates of the anchor tenants is usually not disclosed in open sources, since the issue of their amounts is solved individually with each tenant. In this case, one cannot talk about establishing an average market value of the rent rate.

The market value of the valuation object is understood as the most probable price at which the given valuation object can be alienated on the open market in competitive conditions, when the parties to the transaction act reasonably, having all the necessary information, and the transaction price does not reflect any extraordinary circumstances [10].

From the point of view of the owners of shopping centers, the discount in the rent for the anchor tenants in comparison with the rent established for the enterprises of the shopping gallery is a special form of investment. This hypothesis was formulated and considered in the study of S.N. Bocharov and R.A. Samsonov. Such investments are justified and effective provided that the anchor tenants are able to generate an additional flow of visitors and, as a consequence, the emergence of additional positive economic effects (internal and external), both for the owners and for all other tenants, including the shopping gallery. This situation corresponds to the concept of investment value: “when determining the investment value of valuation objects, the amount of money that reflects the useful effect of using the valuation object for a particular person or group of persons” is calculated ... with the investment objectives of the valuation object established by the given person [11].

It should be borne in mind that the discount in the rent for the anchor tenants is only a form of investment, but not a loss, as for the shopping center the profitability of the transaction with the anchor tenant remains positive.

Refusing from a part of the current profit (from high rental rates for the anchor tenants), management actually “invests” these funds in developing the attractiveness of the shopping center. Increased attractiveness entails an influx of additional visitors, followed by the tenants of trade galleries with sufficient financial stability to pay higher rent (compared to unattractive shopping centers). Additional rent from tenants of shopping galleries is considered as a form of return on investment. Economic patterns are such that the aggregate value of the additional rent received (proceeds from investments) is substantially higher than the amount of less paid rent from the anchor tenants (investments), thereby creating a useful effect, which is the essence of such relations.

The useful effect of utilizing the valuation object can be realized in obtaining various economic benefits (for example, profit, additional increase in income, and increase in the value of property).

A property that can generate higher returns has a higher market value than a low-yield facility. This reflects the close relationship between the two types of value: investment and market ones. In fact, the management of shopping centers, making decisions on the investment cost of renting for the anchor projects, affects the market value of the entire development business.

The lower level of rental rates for the anchor tenants (as a special form of investment) in the investment management of the shopping center has as its objective an increase in the market value of the entire appraisal object (from the total area) rather than the maximization of profit in the short term only from a part of the retail space. It follows from here that leasing large areas for the anchor tenants is the implementation of the principle of the most effective use of the real estate objects of the shopping center.

Therefore, contracts with the anchor tenants are strategic and long-term ones in nature and are longer and more complex, in contrast to contracts with small tenants of trade galleries.

Thus, it is not possible to identify the average market rate level when renting shopping galleries with a rental rate for the anchor tenants. Misunderstanding this fact can lead to a significant overestimation of the value of the shopping center as an object of valuation.

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