



# Estimating Rent Sustainability

Retail Pulse – Product Focus

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## Estimating Rent Sustainability

Best practice in shopping centre valuation has changed. Valuations should now reflect the long term sustainability of passing rents. The willingness of retailers to pay the passing rent is the key to the valuation. This fundamental change follows the 2008 financial crisis. The BCSC Asset Pricing Guide issued last week gives little emphasis to lease terms and much to rent sustainability.

FSP has developed databases and analysis systems to best inform estimates of rent sustainability. It is sometimes assumed that knowing the achieved retailer turnover is alone sufficient however, the recent failure of so many retail businesses shows that the industry adage that sales is vanity and profits sanity has never been truer. In FSP's experience turnover can be inaccurate, does not always translate to profit and needs to be supplemented with more detailed assessment of store operating profit. It is also important that this 'local' assessment is accompanied by analysis of corporate financial health.

Rent sustainability has been a core FSP skill for more than 10 years. FSP therefore welcomes the official endorsement of its approach by the principal industry organisation.

The net turnover has first to be weighted by the store's achieved realised gross margin (RGM). The RGM varies from product to product, so an understanding of the merchandise mix of the store sales is required. Having arrived at a credible figure for RGM, the store's operating costs have then to be estimated and deducted from the RGM. Only then can the net profit contribution be calculated and the return measured against the retailer's average store return. To improve company performance, retailers need continuously to prune from the chain loss-making and low margin stores.

This calculation of the net profit contribution for each retailer provides data for one axis of the Retailer Risk Matrix, labelled by FSP as the Unit Risk. The other axis, the Corporate Risk, measures the overall financial health of the retailer. For example, some Focus DIY stores, at the unit level, made a healthy return. Unfortunately, the problems at the corporate level have overwhelmed these stores. It is therefore prudent to monitor both Corporate and Unit Risk across the portfolio.

For more information or to talk to one of our consultants please contact FSP via e-mail [fspretail@fspretail.co.uk](mailto:fspretail@fspretail.co.uk) or call 01494 474740



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