

CapitaMall Trust: Renewing Leases at IMM[©]

CapitaMall Trust is a real estate investment trust that owns and manages five shopping malls in central and suburban Singapore. The Trust is listed on the Singapore Exchange. CapitaMall's portfolio comprises Tampines Mall, Junction 8, Funan the IT Mall, Plaza Singapura, and the IMM Building.

The IMM Building is a five-storey mixed-use (retail, office, and warehouse) structure located in the western suburb of Jurong. In June 2003, CapitaMall Trust purchased the IMM Building for S\$264.5 million (Singapore dollars). The title of the building was leasehold of 30 years with effect from 23 January 1999. The building had a gross floor area of 1,426,518 square feet, which included 877,252 square feet of lettable space and 1307 carpark spaces.

In 2003, total lease revenue was \$23.3 million, and at year end, the IMM Building had 510 tenants, amounting to occupancy of 76.7%.

At the time of purchase, CapitaMall announced plans to spend \$45.0 million to reconfigure the building in early 2005. The works included conversion of warehouse space on level 5 to a carpark, conversion of 53,700 square feet of retail space on levels 2 and 3 to warehouse, and construction of a new extension block with 53,700 square feet of retail space. While not increasing the lettable area, the works would make the retail spaces more attractive, and were expected to increase annual lease income by \$4.8 million.

The tenants of the IMM Building are diverse. They range from large stores, Giant Hypermarket and electrical and electronic appliance retailer Best Denki, to outlets of international, regional, and local chains like McDonalds, Starbucks, Guardian, Watson's, Giordano, and Osim, and to independent retailers.

Until 2004, the tenants of the IMM Building paid a fixed monthly rental. Then, for new or renewed tenancies, CapitaMall set a two-part rental, comprising a fixed monthly payment of \$35-38 per square foot and a variable payment of up to 1% of the tenant's gross revenue. The new tenancies last for two years.

Two nearby malls, Jurong Point Shopping Centre and West Mall, were also revising their rents, but on a fixed basis, to a range of \$30-38 per square foot.

When IMM tenants complained about the variable payment, a CapitaMall spokesman explained that it was a common practice that helped to align the interests of landlord and tenant. He added that the variable element helped the

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management to adjust the tenant mix and in favor of retailers who would attract more shoppers.

Pricing practices differ among the various retail landlords. Government-linked Mapletree Investments is developing VivoCity, a shopping mall at Keppel Harbor, just west of Singapore's central business district. Mapletree also plans to set a two-part rental. However, it plans to set the fixed monthly payment about 20% lower than rents at competing malls, and a variable payment of 3-8% of the tenant's gross revenue.

By contrast, Centrepoint Properties, owner of seven shopping malls, and City Developments, owner of three malls, typically charge fixed monthly rents. They charge a percentage of the tenant's sales only at the request of the tenant, and in that case, set a lower monthly fixed rent.

Discussion Questions

- (a) As manager of the IMM Building, how is CapitaMall subject to moral hazard with respect to its tenants?
- (b) How would the variable payment align the interests of landlord and tenant?
- (c) Should the variable payment be based on the tenant's gross revenue or net revenue (gross revenue less cost of goods sold)?
- (d) How should the variable payment depend on the landlord's attitude towards risk?
- (e) Consider the tenant's investment in a particular location. How might the landlord holdup the tenant?
- (f) What should be the length of the tenant's lease?
- (g) Compare the tenants who would be attracted to IMM Building, VivoCity, and malls owned by Centrepont Properties and City Developments.