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RETURN ON INVESTMENT FROM SHOPPING CENTRES *GALLERIA STARA ZAGORA* AND *BURGAS PLAZA*, BULGARIA

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Abstract: *The topic of return on investment is of extreme importance and the one determining the building and the development of every shopping centre. This article reviews two malls in Bulgaria, each with its own peculiarities and advantages. The information comes from the official financial reports of the companies. It is crucial to bear in mind that the models of funding, building and rental rates of both centres were prepared in the years before the financial crisis of 2008. For that reason, the returns on the investment rate negative.*

Keywords: *shopping centres, investment, return, tenants, net present value, internal rate of return*

INTORDUCTION

Michael P. Kercheval defines shopping centres as so fundamental for American culture as the small bakery is for Europe[1]. According to John T. Riordan (Chief Executive Officer at ICSC, 1995-2001, and Executive Vice President of ICSC, 1986-1995) "A shopping center is not a building but a management concept, a way common management causes separately owned businesses to behave as one." [2]. In other words, the shopping centre is a gigantic umbrella under which the tenants coordinate their marketing, promotional and managerial activities. The shopping centre has a common communication and image strategy, and the tenants are strategically selected in such a way as to complement each other and to reflect the customer profile from the region where it is located.

Y. Zhelyazkova defines investment as any investment of funds in assets which guarantees certain return of the principal plus the expected profit [3].

Companies invest in real estate property, including shopping centres, in order to retain the value of their commercial funds and to protect them against inflation.

Some of the biggest investors in shopping centres are commercial banks, insurance companies, investment funds, pension funds, mutual funds, etc.

Like any other type of investment, investment in shopping centres is also prone to certain risks. According to Hr. Traykov [4] “In order to make an investment decision, we need to measure the expected result from the investment m0.against the return offered by financial markets at the time of the evaluation“.

The goal of this survey is to characterise the financial features of the shopping centres in Bulgaria and evaluate the rate of return of the investments.

MATERIAL AND METHOD

This survey was made in Bulgaria. Two shopping centres in the cities of Burgas and Stara Zagora are surveyed. The survey covers a four-year period, from 2011 until 2014. For that purpose, the annual reports of the companies published in the Commercial Register of the Registry Agency were used. According to V. Kasarova [5] “The balance sheet is a snapshot of the state of the assets used in the business and of the capital used to create them. It is a static document because it relates to a concrete, a fixed moment in time – the accounting date.”

RESULTS AND DISCUSSION

BURGAS PLAZA

Location	city of Burgas
Population	203017(NSI, 2015)
Opening	April 2009
Investment	60 mln Euro
Rentable area	30 800 sq m
Tenants	105
Parking spaces	1271
Public transport	bus
Floors	2 shopping floors 1 outdoor parking lot
Cinema theatre	by 30/09/2016 no cinema theatre

+

Burgas Plaza is the first modern shopping centre in Burgas. It was built in the midst of a number of other big supply chain stores (Metro, Kaufland, Lidl, Home Max), car dealers and filling stations. This is probably the one location in Burgas with the greatest number of commercial stores. Thanks to this shopping centre, a large number of shops opened in Burgas: Carrefour, Deichmann, New Yorker and many other sale businesses. The centre has seasonal attendance, due to the tourist season.

A slight fall in profits was observed, when Mall *Galleria* opened in May 2012. The difficulties of the Carrefour chain (one of the anchor tenants in *Burgas Plaza*) had a serious impact on the customer flow and profits, respectively. On the other hand, the world renowned company IKEA opened a store in the rival *Galleria* centre. Judging from the published financial reports for the period 2010-2014, the Company reports an average annual income of 10 547 thousand BGN, preserving relatively the same income trend for the next budget years, as shown in fig.1 below. The trend in the expenditure is analogous, as seen in Fig. 2 below.

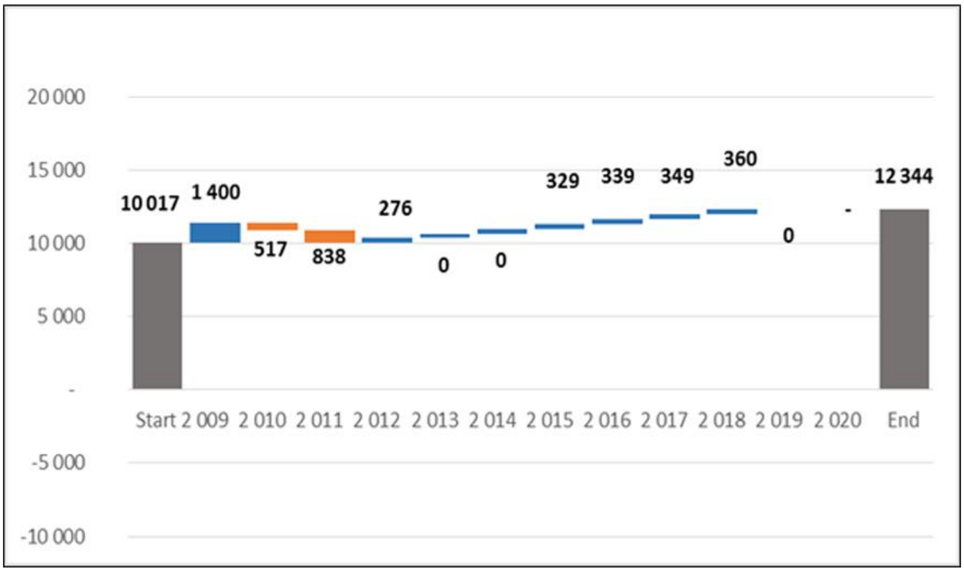


Fig. 1. Income of *Burgas Plaza* for the period 2010-2020

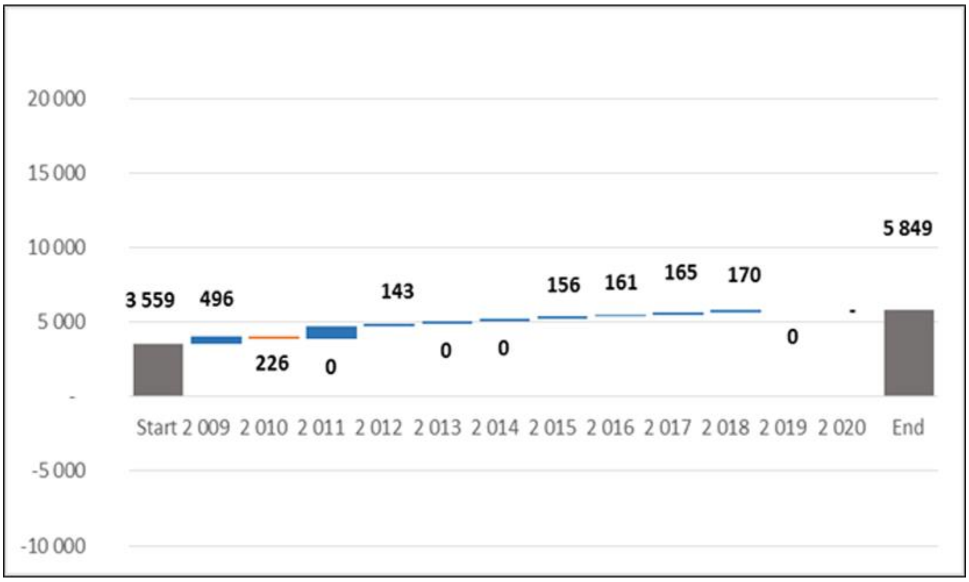


Fig. 2. Operational costs in *Burgas Plaza* for the period 2010-2020

The structures of income and expenditures remain the same, as given in the financial reports. (Fig. 3 and 4).

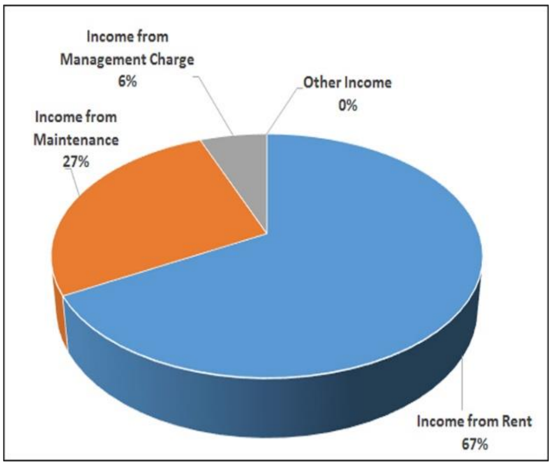


Fig. 3. Income structure,
Burgas Plaza

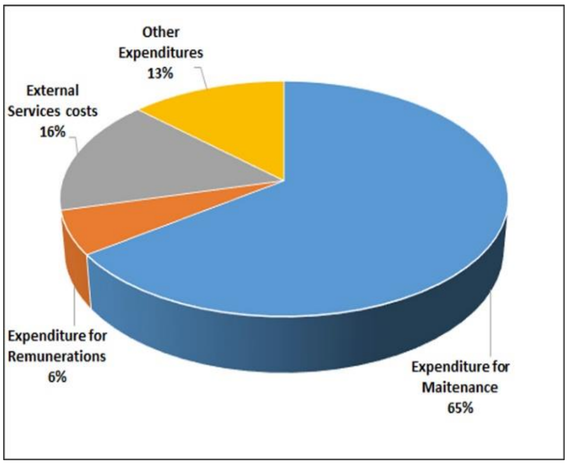


Fig. 4. Expenditure structure,
Burgas Plaza

For the first reporting period, the Company reports repayment of a debt of 7 882 thousand BGN (including: a principal of 2 430 thousand BGN and interest of 5 452 thousand BGN). In view of the impossibility to pay the loan at the agreed rate, after renegotiating the loan, in 2011 a debt of 3 614 thousand BGN was paid, and for the next reporting period, the Company continued to pay to the financial institutions a debt of 7 100 thousand BGN annually in average, and this trend persists when calculating future cash flow.

The financial analysis is made at a debt/capital ratio of 82%. On the basis of these financial indices, the NPV (-6 390 thousand BGN) and the IRR of 1.65% have been estimated.

GALLERIA STARA ZAGORA

Location	city of Stara Zagora
Population	136 807 (NSI, 2015)
Opening	November 2010
Investment	53 mln Euro
Rentable Area	27 000 sq m
Tenants	130
Parking spaces	800
Cinema theatre	Cinema City, 7 halls
Public transport	bus, trolleybus
Floors	4 shopping floors, 3 underground parking lots 1 outdoor parking lot

Galleria Stara Zagora is the shopping centre with the largest rentable area in the "City of the Lindens". It is located nearby the historical centre of the city, which generates pedestrian traffic. It is characterised by a good mix of tenants – some brands of the Inditex and New Yorker groups, Deichmann, LC Waikiki, Paolo Boticelli, modern cinemas, a gym and a carting track. They are a great attraction for the inhabitants of all Stara Zagora County.

In the years after its opening, the shopping centre has gradually improved the tenancy of its rentable areas and there is a slight rise in profit. Fig. 5 shows that the profit of *Galleria Stara Zagora* Mall starts from a level of 3 691 thousand BGN, and for past reporting periods they retained the average share of about 4 000 thousand BGN. Operational costs also retain relatively identical rates (Fig. 6).

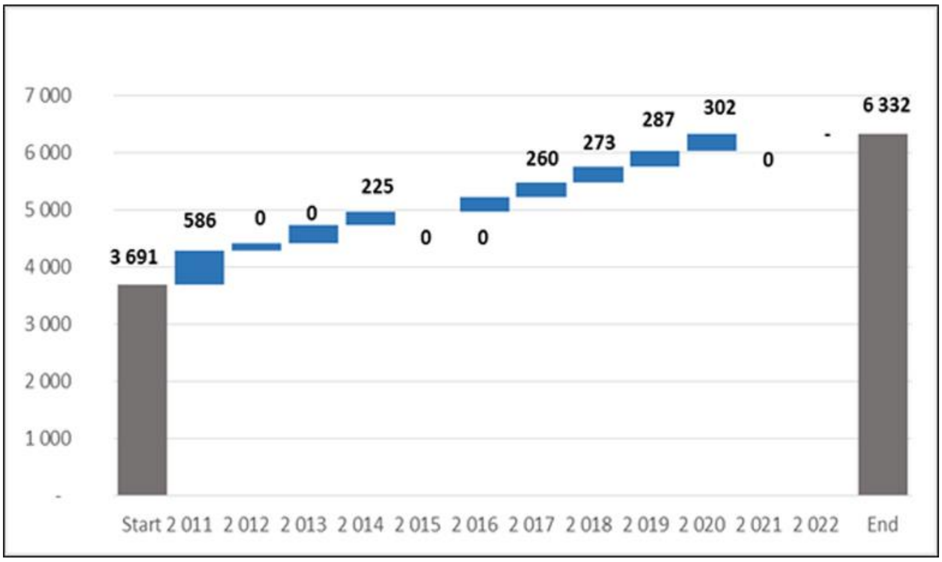


Fig. 5. Income of *Galleria Stara Zagora* for the period 2011-2022

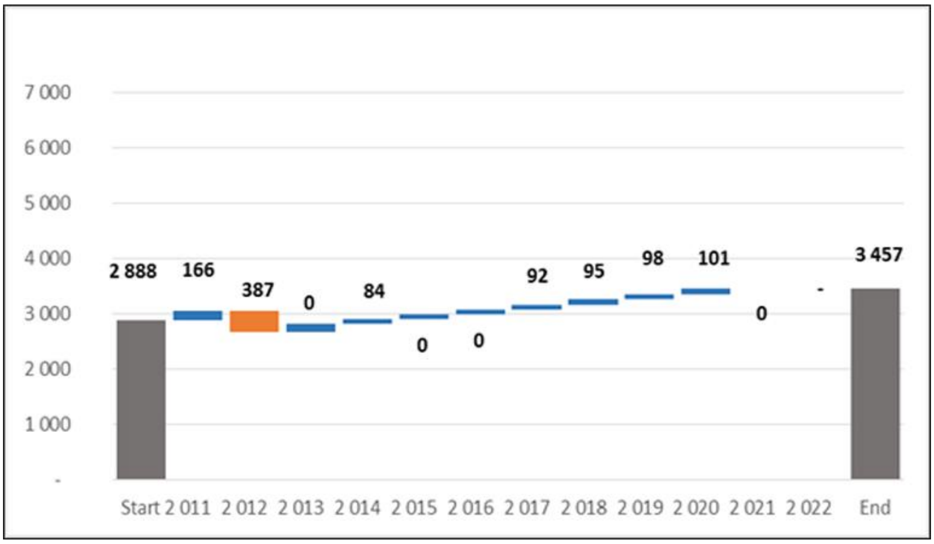


Fig. 6. Operational costs of *Galleria Stara Zagora* for the period 2011-2022

The structures of income and operational costs are given in Fig. 7 and 8, and remain almost the same in the following reporting periods.

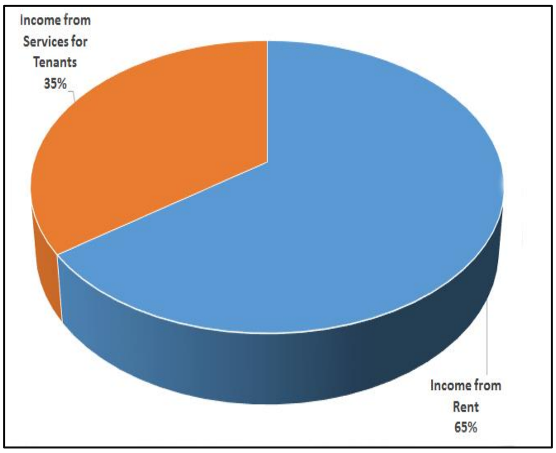


Fig. 7. Income structure, *Galleria Stara Zagora*

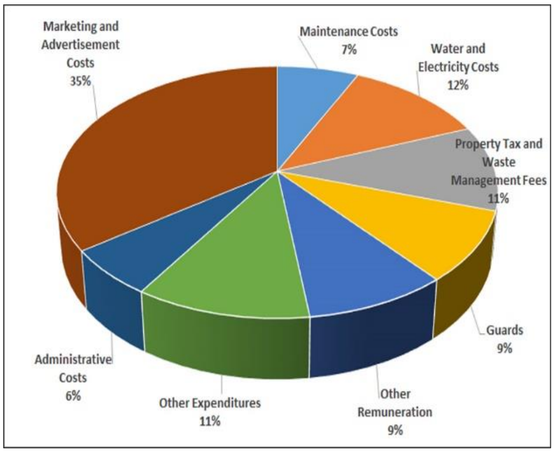


Fig. 8. Expenditure structure, *Galleria Stara Zagora*

The debt/capital ratio at the start of the project was 44/56, and between 2011 and 2012 the Company repaid a principal of 7500 thousand BGN on average annually.

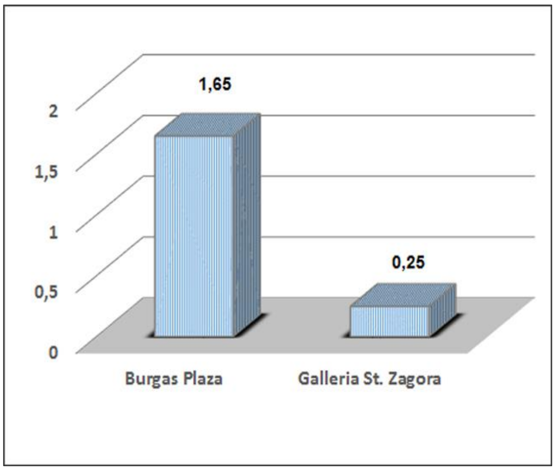
These financial parameters were the basis for estimating an NPV of -40 641 thousand BGN and an IRR of 0.25 % (Table. 1, Fig. 9 and 10).

Table 1

Financial indices of the surveyed shopping centres

Object	**IRR**	**NPV**	**Investment (in thousand BGN)**	**Debt**	**Invested own capital**
Burgas Plaza	1.65%	-6 390	75 714	62 096	13 618
Galleria St. Zagora	0.25%	-40 641	126 681	56 100	70 581

The above estimates of the reviewed shopping centres are made on the basis of the annual reports of the companies which own these investment properties, published in the Commercial Register at the Registry Agency. The referent values cover the period 2011-2014 (incl).



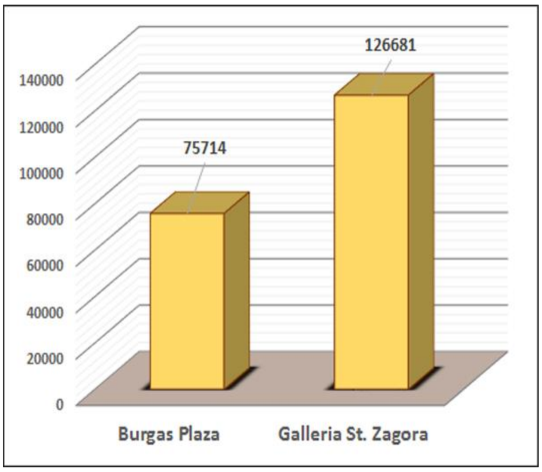


Fig. 9. IRR of shopping centres

Fig.10.Investment in shopping centres

In order to estimate the IRR and NPV, estimations covering a period of 10 years have been made. This Period covers the surveyed past reporting periods, starting from 2011 and a future projection until 2020 incl. Our forecast for the period 2015-2020 was made on the basis of extrapolated data and expectations concerning the future development of the shopping centres. This is due to the signed long-term agreements (mainly 10 years long) which the centres have with their tenants. The resultant NPV and IRR on the basis of the estimated models are a mere prognostication. Over the next reporting periods, the shopping centres may show financial results differing from the numbers given in the present forecast. We cannot predict exactly what the financial health of these shopping centres is going to be, nor can we say what managerial decisions will be made by their owners and managers.

Theoretically speaking, the estimation of the IRR shows the discount factor which is the most beneficial for investing in a given project, i.e. the IRR serves as a cornerstone for evaluation of the external and internal sources of funding of any one project, and the estimation of IRR helps investors to determine the efficiency/inefficiency of the project.

On the other hand, the estimation of the NPV is an additional method for prognosticating and estimating the profitability of an investment, with the goal being to reach an index which was found when calculating the forecast numbers and which helps the investor to make a decision whether to carry on with a project and/or investment.

It is crucially important for this analysis and the results from it to note that, under similar circumstances, the estimation of NPV and IRR is made before and during the decision making by the investors of whether the project of a given shopping centre is financially viable. When estimating the NPV in the pre-forecast period of the project, it is considered viable if the NPV is higher than and/or (in the worst case scenario) equal to 0. Correspondingly, the IRR shows the value of the profitability rate of the invested capital.

From the above, and from the estimations, extrapolations and suppositions for the development of the shopping centres, the following conclusions can be made:

The general trend with the surveyed companies shows lower levels IRR, varying from 0.25 % (of *Galleria Stara Zagora*) to 1.65 % (of *BurgasPlaza*).

The estimated rates of NPV for the surveyed shopping centres are negative, which means that the decision by the investors to realise these projects has led to a loss for them. Parallel to this, the amounts invested in these projects (based on the financial reports) are quite sizeable and at the estimated rates of income and expenditures generated by these centres, the return on these investments would be significantly prolonged in time.

Despite the huge difficulties and the problems relating to demand, we need to appreciate the professional effort of the managerial teams which managed to restructure and optimise the overall business model, including bank funding. The owners and managers of the shopping centres did not allow the closure of these huge complexes. The customers never felt the pressure from the hardships the managerial teams went through.

This is the place to give credit to the hundreds tenants of the shopping centres who managed to respond accordingly and stay on the market despite the severe financial crisis, the competition of online trasing and the advent of multinational companies on the Bulgarian market.

Shopping centres are huge complexes requiring millions of Euros of investment. In order to be able to make long-term and reasoned decisions, entrepreneurs and financing institutions use software programs. These are the internationally used Argus Software and Crystal Ball Software. They are multicomponent software models which take into account a number of indices, risks, trends and changes in the environment. Whenever there is a change in any one of the components, the software automatically calculates the final result. The essence of this software is based on mathematical models and algorithms. Each investor aims to maximise their profits and to decrease the risk from any one project. In the sphere of shopping centres, we need to gain as much profit as possible from the rented out space.

There are international companies specialising in consultant activities concerning large projects in the sphere of real estate. On the grounds of their experience acquired from hundreds of projects on different continents, each one of them has created their own software which can evaluate the risk of each of the projects they are consulting. It is important to add that each of the big banks, pension funds and insurance companies financing projects in the sphere of real estate, has their own departments for risk evaluation and on these grounds they structure the financing and support of the project.

The reasons for the negative financial results showing in the financial reports can be separated into several groups:

- The global financial crisis of 2008 (which affected mainly the real estate market) which started with the crash of the Lehman Brothers Bank in September 2008. According to expert analysis, this is the most severe and profound global financial crisis after the so called Great Depression of 1929-1933;
- The financial crisis hit all the sectors of the Bulgarian economy and led to higher unemployment and to a failure for some of the citizens to pay the loans they had got from banks mainly to buy a new lodging. This has additionally decreased the cash flow for the purchase of clothing, shoes or for other services offered by the shopping centres, and the so called "consumer demand economy" simply crashed;
- The easy access to financing, as well as the massive lending of unsecured loans in the period 2001-2008 led to the lending of huge new loans, part of which were meant for the real estate sphere and partially for shopping centres;
- The taking of unreasonable and unbacked risk by all the participants in the building and creation of shopping centres (entrepreneurs, developers, financing institutions, retail traders) when starting the project, with the aim of fast profitability;
- The high price of land and construction lead to unreasonable investments which influenced negatively the financial health of the shopping centres;
- The market for rentable areas grows every year. The market expectations are exclusively optimistic and forecast incessant growth each year. A so called "bubble" is formed on the real estate market, and in particular in the sphere of shopping centres. Investors are too overly optimistic and have unreasonable expectations for future profits and return on the investment;
- A large number of new shopping centres appear in quite a short period of time and this drastically changes the market of modern trading space. From the time in 2006, whene there were none whatsoever literally, a new extreme is reached – the market is practically "flooded". This leads to mutual destruction and unprecedented rivalry between the different shopping centres;
- The decrease of solvent demand from consumers. On the other hand, there is a constant decrease in the size of the population in Bulgaria and concentration of people in just a few large cities in the country. The so called "large opening of the scissors" appears – on the one hand the decreasing population, and on the other – the increased supply of trading space;
- The advent online trading. Hardly did investors, bankers and retail traders imagine in the period 2004-2006 that online trading in Europe and particularly in Bulgaria will grow at such an amazing rate. This trend was reviewed more as an opportunity for future sales, but mostly as an addition as "shop shelves". The development of new technologies over the 10 to 15 years literally overturned the shopping centre and retail trade sectors. The consequences are visible to all. Everybody is shopping online (including music, baby clothes, home appliances,

etc.). Thanks to modern technologies, part of the people have stopped going to the cinema and prefer to enjoy films from the comfort of their homes downloaded from specialised websites.

CONCLUSIONS

From the above numbers and negative financial trends, there is no managerial team which can make a decision to create a shopping centre under these conditions. Here it has to be said that these investment decisions were made in the period 2004-2008, when Bulgaria and the whole world enjoyed other financial indicators. As far as the shopping centre market in Bulgaria is concerned, we need to remind that the first truly modern shopping centre in Bulgaria was opened in May 2006 in Sofia. The market was thirsting for modern trading space and the foreign retail trade chains had not yet opened shops in Bulgaria (with a few exceptions like Terranova, Benetton, Tom Taylor and a few others).

The financial crisis of 2008-2009 had a huge negative impact on consumer demand and in particular on shopping centres. This brought about a crash in rental rates. This situation cardinally changed the financial models and expectations for future return from all the shopping centres in Bulgaria and in this case from the surveyed ones: *Galleria Stara Zagora* and *Burgas Plaza.*

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