

Investing in mall engineering improves efficiency

- **Investing** in engineering equipment is important to benefit operational efficiency

- **Good** design, installation and maintenance improves an asset's bottom line and eventually yield



Guest writer
by
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THERE is a saying that the worst decision is not making a decision. In the absence of a holistic appreciation of the engineering required for shopping malls, different stakeholders may make commercial or engineering decisions in isolation. It is a known fact that investments in engineering equipment are important for the benefit of operational efficiency.

However, other macro considerations do take precedence, such as access to funds or ownership of the building.

Let us consider the different types of retail formats and their general engineering configurations and facility life cycle patterns.

One of the struggles faced by stakeholders in an organisation is deciding the return on investment (ROI) with regards to any big or small engineering proposition before making a commitment.

In the 1980s and 90s, everyone's focus was to "build fast" and "cheap". That was the best engineering practice.

However, with increases in labour and utility costs, building owners and operators have felt the pinch, so things have now changed.

After many decades of massive growth in the construction industry, we have come a long way to appreciating the idiom "pennywise pound foolish", where modern building construction also involves going green, sustainability and efficiency throughout the design, installation and maintenance process.

Nevertheless, the appreciation is still at the level of

"understanding" or "theory" and hardly translated into solid ringgit and sen, which is what organisations make decisions on.

Cost of funds

The cost of funds (COF) comes in different forms. It could be through shareholders' equity injection, borrowings or advances, while returns are usually an outcome of yield or capital appreciation.

Examples of COF could be typical term loans in the form of COF +, for example, base rate of 6.5% + 1.5% margin by the lender/bank.

Simple mathematics tells us that the asset under such borrowings will require a return or yield that surpasses the COF. Only then will it be a viable financial model.

An asset that is "efficient" will lower operational expenses, hence, improving the bottom line and investment yield.

On the other hand, bad design, installation or maintenance leads to "defects", resulting in higher operational costs (profit and loss).

This will have an adverse effect on yield which then immediately impairs asset value (balance sheet).

Improving the bottom line

But good design, installation and maintenance improves an asset's bottom line and eventually yield. Therefore, it has better balance sheet value.

Now, let's breathe in the soul to these theories to make the concepts come "alive".

Look at the profit and loss of any typical asset and one will see that the operations cost of modern buildings will have 40% or more of its expenses attributed to electricity.

According to the Malaysia Shopping Malls Association 2015 survey, typical malls may consume electricity at between 80 sen to RM1.00 per sq ft of net lettable area.

A sizeable neighbourhood mall like Paradigm Mall or Tropicana City Mall in Petaling Jaya may consume RM500,000 worth of electricity monthly.

Larger malls such as Sunway Pyramid or Mid Valley Megamall could each spend RM20 mil or more on electricity annually.

Therefore, good engineering designs, applications or maintenance, will immediately translate into millions of ringgit in operational cost savings.

For a mall of 500,000 sq ft, a saving of RM50,000 in electricity charges translates to 10 sen/sq ft of equivalent improvement. In short, it means a transformation of an "expense" into "income".

An improvement in rent



File photo of 1Utama Shopping Centre. Electricity charges make up some 40% or more of the operational cost of a modern building

(income) proportionally benefits the asset value from the yield perspective.

If we browse the property listings on websites, we may come across advertisements that say, "1,226 sq ft office space with RM5,000 rent. More than 5% yield on sale for RM890/sq ft".

If we crunch the numbers, taking the gross annualised income over the asset disposal consideration price, academically, it shows a true yield of 5.5%.

But what is absent from the formula is service charge and cost of air conditioning. If we factor in such costs, say, at another 70 cents/sq ft, it will lower the yield by another few basis points to give a yield of 4.5%.

But that's not the end of the story, what about insurance, quit rent, assessments and occupancy?

Klang Valley occupancy

Statistics show that occupancy of Klang Valley office assets typically hover around 75-90%. This is certainly an important factor.

Some research papers suggest that purpose-built office space in the Klang Valley has exceeded 100 million sq ft, and in such an adverse and competitive environment, efficiently engineered assets will definitely become a factor for occupancy.

Multinational companies are tenancing green rated offices, and business operations prefer to rent space in efficiently operated buildings with lower maintenance costs.

So, after we factor in "operational efficiency" into the asset design, installation and maintenance process, we will surely know if these investments will

eventually harness yield.

How soon this "eventually" comes, leads to another inevitable financial modelling process to weigh the cost of funds against its ROI potential.

Some put the figure at 12 years, some say three years, while others say it does not matter and the balance sheet counts for more. It all depends on the institutions' appetite.

When one performs a valuation or facility audit of an asset, we must acknowledge that its true value goes beyond what we can see at that moment.

We need to assess the asset yield of today, considering past historical data, and also see beyond the numbers to understand the derivation and also potential improvements to the numbers.

This idea goes both ways – when we are presented with a set of numbers showing high income and low expenses, we should consider if the latter is below industry benchmarks, especially if it comes at the expense of the asset's life cycle.

Similarly, although we may come across assets with a poor yield at times, we must have the engineering wisdom to see if enhancements or re-engineering can be done to improve the bottom line.

In the final analysis, investing in an asset requires both financial and engineering wisdom. Asset purchasers must be very alert and aware when they invest in property. **FocusM**

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Tropicana City Mall in Petaling Jaya may consume RM500,000 worth of electricity per month

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