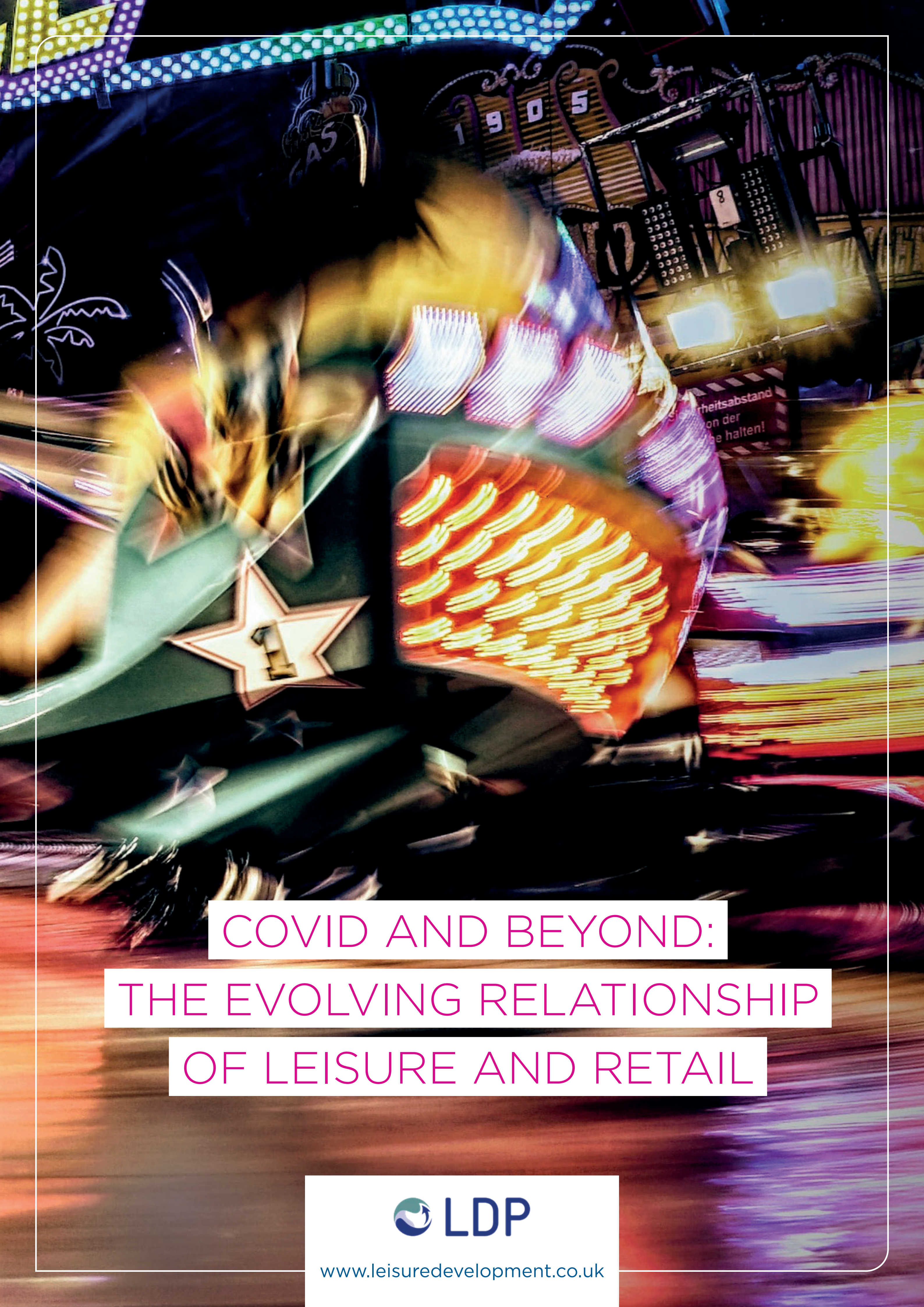

COVID AND BEYOND: THE EVOLVING RELATIONSHIP OF LEISURE AND RETAIL

LDP

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The new normal

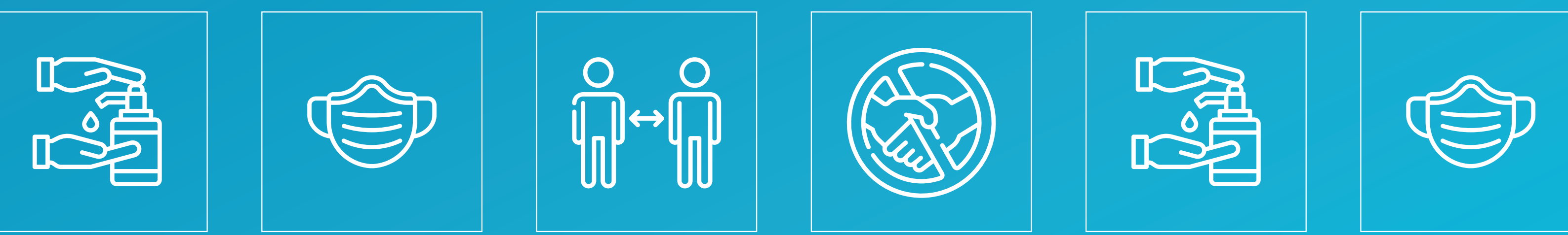
COVID is here and no one is untouched. We see retail having a tough time and leisure might be able to help as communities open up. However, this needs long-term strategic planning and vision. Quick fixes should be avoided. Opportunities to differentiate with entertainment definitely exist, but should be assessed carefully and strategically.

In this whitepaper LDP discusses the impact COVID has had on the leisure and attractions sector and how this could impact the retail and leisure relationship. Last year, we discussed the trend of decline across much of the physical retail sector due largely to the rise in ecommerce and we demonstrated the growing importance of leisure in retail environs, as a draw for new and repeat visits. We believe coronavirus impacts these trends and merits analysis.

That being said, we should not fixate on the current state of play due to COVID and must continue to plan long term in order to leverage the benefit entertainment can bring to retail destinations. We shouldn't only think about short-term 'quick fixes', but rather long-term solutions.

To aid the reader take a long-term strategic view, we also discuss a subject that we are often asked about post-feasibility; reviewing the types of business models and partnerships that retailers can adopt for successful mixed-use retail and entertainment projects.

Entertainment is becoming increasingly integral to creating 'destinations' due to its impacts and benefits which are also highlighted.



COVID IMPACT

The virus emerged towards the end of 2019 and took a hold in Europe early in 2020. The consequent lockdown of economies to tackle the pandemic has had grim repercussions on economies. At the time of writing, the virus would appear to be relatively under control in Europe (although there are some clear hints of a 'second spike') but across other parts of the world the growth in cases is exponential.

The lockdown has had a cataclysmic impact on the retail and dining sector, with many major mall owners and retailers going bust: in the UK Intu fell into administration in July and there have been a rash of casualties such as Laura Ashley, Debenhams and Cath Kidston. The dining sector, where social distancing and face masks represent a particular challenge, is also suffering with Pizza Express recently announcing the closure of 67 outlets across the UK. John Lewis announced the closure of 8 outlets including two full size department stores.

The lockdown has seen the necessary closure of leisure and entertainment venues. In Europe at least, many attractions have been re-opened or are at least on the cusp of re-opening. As with the retail and dining sector, the safety of customers is front and central of the re-opening strategies and opposite we show some of the measures being employed to make leisure safe. It is hoped these measures will give the necessary confidence for guests to return.

From a leisure owner or operator's perspective, the most damaging of these safety measures is density and capacity management. Performance at most attractions, particularly larger attractions such as theme parks and waterparks, is driven by attendance and therefore social distancing is anathema to operators. However, safety concerns are paramount, with one recent survey showing that 63 percent of frequent attraction visitors would not return to an attraction if there were no controls on the number of people in each area. But many leisure operators have been thinking creatively on how to follow the guidelines and keep attractions safe, whilst also driving as much throughput, ergo revenue, as possible.

For every attraction there is a breakeven point in visitation which must be achieved for the variable costs of opening to be covered and if this is below the attendance level allowable with social distancing, then of course the attraction cannot operate.

Outdoor venues, such as theme parks and zoos, are in a relatively strong position as social distancing is clearly much easier, whereas at indoor entertainment venues such as cinemas and soft play, this is harder to manage: many outdoor venues have opened before the summer holidays, while still many indoor facilities only recently opened or, in some areas, remain closed.

Based on recently completed research at LDP, we feel the attractions sector could weather the storm relatively well in comparison to the wider hospitality sector and even other forms of real estate such as office. The hospitality sector in general has been one of the worst hit by the pandemic, but our research suggests the attractions sector tends to perform well during times of economic strife. The resilience is in part due the staycation effect, which is particularly pertinent in the current climate due to travel restrictions. Many people are spending their money closer to home and delaying more extravagant international or even domestic holidays. Apart from several notable city centre attractions, as a general rule, attractions draw the majority of visits from residents rather than international tourists.

MEASURES BEING INTRODUCED TO 'COVID-PROOF' ATTRACTIONS

Online ticketing and dedicated time slots for arrival

The reduction of guest density and ride, show and overall attraction capacity

Introduction of hand washing / sanitizing facilities

Encouraged use of protective face masks

Reduction in touch points (such as interactive screens) and frequent sanitation; or the creation of in-park apps to replace touch screens

Protective barriers and distancing where possible

Solid guest communication

Adjustment and control of visitor flow

Price and promotion to flatten demand patterns and attract guests at traditional low periods

And a well considered action plan in the event of a guest or employee falling ill

While we anticipate resilience amongst attractions, with safety still an underlying factor in household decision making, coupled with the economic shock, it will be important for attractions to entice customers out of the home. Not only has online shopping rocketed during the pandemic, but in-home entertainment has also seen unprecedented growth. Netflix gained around 16 million new subscribers in the first quarter of 2020 and Disney+ launched in November 2019 growing the number of subscribers to 60.5 million by August 2020 (reaching its five-year target in eight months). A recent survey from Nielsen suggests the 60 percent of people are engaging more with in-home entertainment such as movies, TV series, music, books and of course video games.

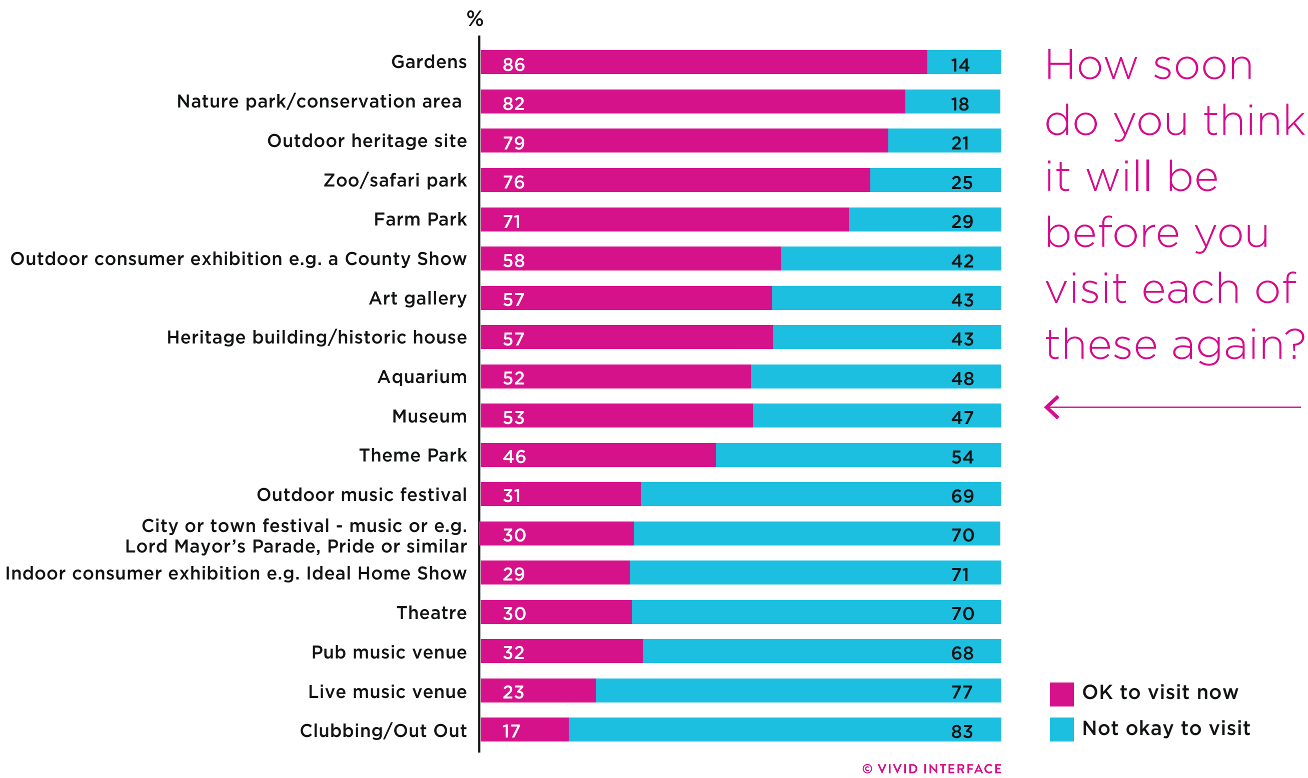
Physical attractions are up against the dual threat of a nervous population which is increasingly more comfortable with in-home entertainment. Attractions will therefore need to actively tease out existing and potential guests with targeted and time limited offers and pricing deals.

As well as the traditional outdoor attractions such as zoos and amusement parks, there are some innovative new leisure concepts emerging, such as outdoor / drive-through cinemas with strict social distancing or social bubble restrictions, where you bring-your-own food & beverage and have phased arrival and departure times.

Indoor attractions, such as indoor parks and family entertainment centres, may find it more challenging to allow for social distancing. There are some simple-to-implement online booking and tracking services that could improve efficiencies. Some indoor attractions that could lend themselves more to the current climate might include competitive socialising such as bowling (All Star Lanes), darts (Flight Club), golf (Topgolf) as they could be enjoyed in groups or bubbles. Some adventure sports activities such as standing-waves and zip wires (both of which could be indoor or outdoor) are high value, low throughput attractions and so it is easier to control guest flow and sanitize equipment between users. ■

How do people feel about leisure and entertainment attractions?

A very recent consumer sentiment poll completed the last week of August in the UK, clearly demonstrates the strength of outdoor attractions in the current COVID-19 climate. It is interesting to note that even indoor attractions maintain a stronger appeal over live entertainment venues, clubs and theatres. Perhaps this is due to the greater ease of maintaining social distance within the attraction.



Implications for retail and mixed-use developments

- People are social and love to interact. The recent experience of attractions re-opening has shown the pent up demand for leisure experiences. Guests, in large part, are willing to take the new capacity and other safety guidelines on board in order to visit.

- Additionally, although the economy and travel might be restricted for the foreseeable future, we have seen that during past recessions, people stay and spend closer to home and might also feel more secure going to attractions near them.

- Adding attractions to the mix can add to the overall appeal of the development and offer an opportunity to re-engage with local and regional residents.

- With the growth of online retail sales in the past months, the importance of entertainment as part of the mix has grown!

- Entertainment should not be viewed as a way to ‘fill space’ but rather a way to enhance the offer and broaden market appeal.

- It is important to view entertainment and leisure attractions as a partner rather than a more typical tenant.

CHOOSING THE RIGHT PARTNERSHIP

There will be a post Covid-19 time, and we all hope this will come sooner rather than later. During the lockdown many mall developers and operators have been working hard towards re-opening but also have continued to plan ahead. A first step in the introduction of any leisure and entertainment development within a retail environment should be to identify the key attractions and leisure activities best suited to the market and the developers goals and then understand potential attendance, financial viability, space requirements and the potential positive impact on the retail – all of which would be addressed by a comprehensive feasibility study.

Assuming a positive outcome, the next step would be to reach out to potential partners and identify the right business model for your own business and the leisure partner. Unlike the retail market where the developer / owner and tenant relationship is typically well defined, across the attractions sector it is often more complex. There is no single attraction business model that can be applied to all attraction types. In fact, the more impact expected from the potential attraction, the more likely it is to be a partnership structure vs a pure tenant.

Attractions with strong drawing power tend to have higher levels of capex required to create unique and strong content. In order to deliver reasonable returns, tenant improvement allocations may well be necessary but could be very worthwhile for the developer given the positive impacts.

In most cases a mall owner / developer will need to make some capital contribution, even if it is only building the shell and core for the attraction. The outside partner might take on all the attraction capital costs; however they would typically pay a very low peppercorn rent. In other cases, the partner may not invest but may take on a management role for a fee, leaving the developer or another investor to enjoy any return. Again, some groups may vary their model by market and by negotiation. In the figure below we summarise some of the models that could be employed. As seen, there are a myriad of options that can be implemented.

In addition to the models shown there may be unique attractions that need a certain degree of operational expertise as well as a bespoke building. In this case the outside partner will build and operating everything, take all the profit and own the building, and only pay a ground rent.

The type of model selected will be a function of a number of variables such as:

- goals of the developer/owner and why they are adding entertainment to the mix
- interest of the mall owner/developer in operating a facility or outsourcing it
- the type of entertainment or attraction being considered
- riskiness of the venture given local market conditions
- the forecast throughput and financial performance
- the skills required to conceive, deliver and operate
- the potential tenant and image impact for the wider development
- the appetite of the developer to step out of their comfort zone
- and others

All of these should be considered carefully when selecting the direction of the partnership structure.

Business Model Type		Description	Capital Structure	Operations	Rent / Payments
Pure Rental / 3rd Party		Existing operating companies become tenants – usually smaller attractions	Building costs by developer, tenant pays fit out	Tenant responsible for operations	Anchor rent paid to developer + franchise costs
Owner Operator		Developer invests and takes on operations	Developer is sole investor	Developer sets up own operating company. Consultant operating companies can be used	No rent, as pure ROI model
Franchise		Local investor invests and organises operations. Support from Corporate	Local investor provides capital	Local franchise sets up operations	Anchor rent paid to developer + franchise costs
Joint Venture	A	Global operating company with IP rights and concept partners with local developer	Local developer pays capital costs	Global operating company sets up operations	Guaranteed base rent to developer, profit share with developer
	B	Operations and development company with IP licensed developed concepts partners with local developer	Local developer pays capital costs with contribution from development / operating company	Operating company builds and develops the attraction and operates	Anchor rent paid to developer and company takes management fee. Profits shared based on capital contribution
	C	Local developer invests and contracts outside operator – certain expertise needed	Local developer provides all capital	Outside operator sets up operations + continues involvement in operations	Set up consultancy fees and ongoing management fees
	D	Developer pays for a license to develop and operate an IP branded attraction	Developer pays all capital costs	Developer sets up own operating company to run operations of attraction. Consultant operating companies can be used	Profits to developer, ongoing license fees

WHY ENTERTAINMENT?

Entertainment is an ever more important component of the retail and mall experience. LDP believe the general trends we mentioned earlier in regards to the decline in demand for physical retail coupled with the fusion of leisure and retail will not just continue, but will be accelerated by the pandemic, increasing the importance of leisure within the mall mix. A well thought entertainment strategy, coupled with the F&B offer and retail, can transform a more typical retail centre into a 'lifestyle destination' which can draw from further afield, and achieve a higher frequency of visitation.

Measuring the benefits of entertainment in a retail environment is not as straightforward as looking at the typical retail metrics such as sales densities and rents. Attractions should be treated as anchors, be it in a mall or any other retail setting. Retail investors and developers should aim to understand the impacts holistically and what leisure brings to the overall performance of the development not just the performance of the use itself.

The diagram below shows some of the reasons for including leisure in a planned or existing retail environment. Many of the impacts - such as extending your catchments beyond the typical shopping centre drive time, increasing new and repeat footfall, evening out visitor patterns across the week (for example with school groups), and even positively impacting other tenants such as food & beverage tenants and the overall retail spend - can be estimated beforehand through the feasibility process.
Some of the less tangible impacts such as being able to differentiate your centre and improve the overall experience are perhaps less easy to measure before opening (although can be imagined and used in early marketing campaigns) although intercept surveys once attractions are open will give good insights in these areas and can help shape the further development of leisure.

Final points to consider

- As the demand for physical retail decreases, leisure and attractions offer a solution to strengthen the overall appeal of any development.
- Leisure may not reap the straight returns as retail on a sqm basis but it can help differentiate a development and appeal to multiple markets beyond the typical 'shopper profile' and catchment area of a retail mall.
- It is important that we don't just think about 'filling space'. Although leisure can be a solid substitute in some cases, it is important that the concept chosen is adding value to the overall drawing power of the development. Having a leisure, dining, entertainment and hospitality concept and strategy that is thought through for the entire mall or mixed use schemed is vital.
- There are numerous ways in which leisure attractions can add value to a development as discussed above.
- Leisure and attraction concepts should be viewed as partners and not just simple tenants.