RENT

The number of persistently empty stores is rising but prime shop vacancy is dropping as retailers prioritise key locations. Against an uncertain backdrop, are leases flexible and innovative enough to accommodate the changing landscape? **Mark Faithfull** reports

A new LEASE OF LIFE

In the wake of the economic storm post-2008 many retailers cried out for rental reform, railing against upward-only reviews and overly long leases and asking landlords to share their risk. As a retail shake-out began, the industry was also introduced to the CVA (Company Voluntary Arrangement), a vehicle employed to right-size store portfolios or avoid significant rental exposure, depending on your perspective.

While landlords and retailers spent plenty of time debating what constituted fair arrangements, where they did concur was that change was coming. Turnover rents, the designer outlet model where the sales data of individual stores is shared with the landlords or operators, the ability to shift under-performing retailers out of shopping centres and far more flexible leases were just some of the options mooted as the industry attempted to reform. Yet nearly a decade on, there has been arguably few outward signs of lease revolution.

So what's going on? The retail landscape has not yet recovered sufficiently for such matters to be put to one side. In June, N Brown posted rising sales but also revealed plans to close poorly performing stores and those likely to fall foul of business rate hikes.

In March, Blue Inc achieved a CVA shedding around a quarter of its 127 stores and achieving protracted payment terms for rent arrears. A number of landlords described it as a "stay of execution", the *Telegraph* reported, and need point no further than Store Twenty One's collapse into administration this July, a year after it secured its own CVA.

Rental rates on the rise

Amid further uncertainty, retailers are facing the largest yearly rent increases since 2008, up 1.8% on average across the UK, according to property firm Colliers International. However, the divide between the best and worst locations is growing, leading to huge variations for retailers from region to region.

Data from Colliers International revealed prime shop vacancy has decreased for the first time since 2014, the number of areas where rent is decreasing has doubled and London retail rents are cooling to 3% compared with previous double-digit growth. However, while there are fewer empty shop units, those that are vacant are staying empty for longer and some areas are experiencing rent increases of over double the average, such as prime Scottish retail units, which have increased by 4.5%.

Inflation in rents is also expected to be outpaced by inflation in business rates. Mark Rigby, chief executive of business rates and rents specialist CVS, warns: "Increases to business rates bills next year, at the level reported for May or higher, could lead to a tsunami of store closures."

Status quo shake-up

There have been attempts to shake up the model. Fashion giant H&M reportedly challenged the status quo in 2013 with a hefty set of lease demands similar to those it obtains in mainland Europe, including reducing the amount of rent it would pay if 15% of a host shopping centre fell vacant, and ultimately allowing H&M to terminate the lease if it still wasn't happy.

For landlords the bugbear is risk – H&M's demands skewed this heavily back towards shopping centre operators – but there is also concern about the more technical aspect of valuation. If a centre's income is viewed as unstable or uncertain then its valuation will lower, which has major investment implications.

"It is this institutional model that makes the UK so complicated," says Neil Hockin, director and head of shopping centre leasing at Lunson Mitchenall. "The major European retailers have looked at what they can get outside the UK and are still pushing hard. And because the likes of H&M and Inditex have numerous brands, they are increasingly powerful. But, like anything, it comes down to negotiation. In a prime slot they are likely to bend to the landlord, in a tertiary location it may be the other way round. The issue is with the stores in the middle ground."

"On the face of it the lease model has been very consistent over the past five years, yet this masks some fundamental changes," says Dan Simms, head of retail agency south at

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H&M has reportedly challenged lease terms

Colliers International, which tracks lease trends. "If we go back 20 years then 25-year lease lengths were the norm, then they dropped to around 10 years, and if there was further pressure to reduce these then we'd be seeing that coming through. But we're not."

However, he believes this masks a much more profound change – break clauses. He points out that before 2008 these were rarely present, yet in the aftermath leapt to 46% of new leases and now sit at above 50%.

"The classic is a fifth-year tenant-only break, while some will go for six years and others for three years," says Simms. "But the battleground is around penalty payments on the breaks, especially if there has been an initial 12-month rent-free period. Where we have seen this pushed is renewals, coming in at five years with three-year breaks."

So in fact, Simms feels that rental agreements have actually changed profoundly, albeit by creep. The base plus turnover models, where the rent is a lower fixed amount plus a turnover-based amount, that rose to prominence immediately post the economic crisis – reaching an "unprecedented high" of 19% on the high street in 2009 – have "virtually disappeared" says Simms. In shopping centres they peaked at 39% and have since dropped into the 20% to 30% range.

Queensberry asset management director Dan Mead adds that, while offering flexibility and being open-minded is crucial from a landlord perspective – "especially as we're mindful that regeneration developments may not be top of the list for a retailer" – it has to be a two-way street.

"With the influx of European retailers we have of course seen lease agreements come down in length but there has to be a quid pro quo. For example, while there is an ongoing push for turnover-related rents, there is still a lot of resistance among many – although not all – retailers about sharing sales data," says Mead. "We would really like to see that change, because daily sales information can help the landlord help the retailer. That sort of information is gold dust for us."

A flexible future?

Hockin also highlights the increasing complexity of sales, with in-store kiosks and click-and-collect confusing the true store sales picture. He feels landlords can only move so far given the investment model prevalent in the UK – which relies upon fixed income returns on the rent roll – but says more flexibility would be possible where retailers are prepared to move out of the Landlord and Tenant Act, which he says is overly protective to retailers in the modern day. "So long as the financial markets can keep up, there will be more scope for flexibility but that will have to come with giving up some rights under the Act," he reflects.

Meanwhile, Simms also points to the huge change in the data and complexity applied to agreements, which now take into account everything from mall performance to national averages, thresholds and catchments. "Going back 20 years, some of those lease agreements reached little more than two or three pages long, now they can be vast and incredibly detailed," he reflects. "That has probably been the most obvious change."

And Mead believes that, although institutional investment makes bringing lease lengths down further challenging, at the same time he feels the influx of European investors and developers to the UK may ease the way, as they are familiar with shorter rents in Europe. "That experience means they better understand this model and that could mean more relaxation of the financial norms," he says. "There's no doubt you have to be flexible and that the pace of change is quickening."