Global Legal Guide for Luxury & Fashion Companies - Chapter 9: Negotiating and Securing Retail Lease Space

VI. Typical Rent Structures

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# Typical Rent Structures

Rent and occupancy costs are typically one of the highest expenditures in any retail operation.

The structuring of rents in retail leases across the key markets is typically characterized by a base rent component, which is referenced back to the area occupied by the retail premises on a per square meter or foot basis. In addition to base rent, it is usual that the retailer pays a component of the landlord’s operating and building outgoings for the complex or shopping center where the premises are located (see "Outgoings and Pass-through Costs").

In more sophisticated retail markets with larger shopping center retail precincts, institutional-type landlords also seek to recover, as sales or turnover rent, a percentage of the retailer’s revenue generated from the premises. Turnover rent typically kicks in at a prescribed threshold and may graduate in percentage terms as turnover increases. Needless to say, there are several administrative and accounting issues involved in effectively defining, capturing, calculating and auditing turnover rent.

Rent is paid at monthly intervals under most retail leases. Base rents are typically reviewed on an annual basis in many markets, benchmarked to an agreed percentage increase or to a cost-of-living index. Other markets use a review of the market at set intervals during the lease term, often on two-to-three-year cycles.

The assessment of fixed increases provides more certainty as to occupancy costs, while the assessment of market values can be a more involved process, as well as expensive and uncertain, particularly in markets where rent transparency can be an issue. This often requires that lease documents carefully specify the relevant criteria to be taken into account when undertaking a market-based rent review.

The right to dispute and challenge market review assessments of rent, and the scope and definition of what constitutes a comparable rent, often requires the assistance and service of experienced independent valuers.

With turnover rents, other issues arise, such as specifying with some precision in the lease a clear, unambiguous description of what constitutes turnover or gross sales. This has been particularly contentious with many leading retailers moving to e-commerce and online retailing, where product sales are seen as being generated from the retailer’s brick and mortar premises.

Other issues relevant to turnover rent include the controlling of and maintaining confidentiality around the availability of turnover information that is commercially sensitive to the retailers. At the same time, landlords often seek the right for evidence to be provided and audits to be conducted to verify the reported turnover and revenue information.

Landlords sometimes seek to prevent base rents from falling due to reviews involving markets or cost-of-living-index-type rent reviews. This can result in a retail rent becoming out of line with prevailing market rates of rent, particularly where long-term leases are involved, or there is a change in the economic trading conditions, such as the global financial crisis or where the fortunes of certain markets or the retail precinct where the premises are located have fallen.

In some markets, there are rent controls and limitations on how rent can be calculated, reviewed and charged under retail tenancies, including restrictions on turnover rent in some cases. Sometimes, the benefits of these rent controls do not apply to large international retailers.

The assistance of experienced independent local advisors in negotiating and settling rent determinations and advising on rent provisions to be reflected in retail leases is fundamental, given the many prevailing differences across global retail markets.

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