

Why retail rents are still a sticking point

Declining sales not factored into rents, complain retailers

By **LYNETTE KHOO**
lynkhoo@sph.com.sg
@LynetteKhooBT

[SINGAPORE] Rents have been a sticky issue for retailers, even though consecutive data released lately shows that retail rents have eased and will be capped by the upcoming supply in retail space.

Retailers decry that rents have not factored in their declining sales. This runs contrary to the fact that most lease agreements have a variable rent component based on gross turnover (GTO).

Most landlords here, except for strata-titled owners, charge their tenants a base rent and a percentage of GTO. The rent structures vary across tenants and locations. Some tenants pay both a base rent and a turnover rent of 0.5-2 per cent; others pay by either that formula or purely turnover rent of 10-20 per cent – whichever is higher. There are other permutations in the rent calculations.

Whatever the case, having a turnover rent as part of the total rent computation should have made overall rents more susceptible to the revenues of retailers.

But here's the rub: small tenants are typically charged a higher base rent than the larger tenants – giving rise to the feeling in the retail industry that smaller tenants subsidise larger tenants in a mall.

A small tenant may be paying \$30-40 per square foot per month (psf pm) on Orchard Road compared to \$10-20 psf pm paid by a

large tenant, according to retailers. Base rents have been going up by some 5-10 per cent at each rental renewal, some retailers told BT.

“With the new supply coming in, landlords need to be realistic. But we have not reached that stage yet. This is still a landlord's market,” one retailer said. “Many retailers in new malls that opened in Jurong are not doing well because of the current lack of catchment but are paying ‘Orchard Road rents’ in some cases.”

Smaller tenants are also typically locked into 3-plus-3 lease agreements with landlords – meaning that their rents are due for renewal every three years, while anchor tenants typically have their leases renewed only 10-20 years after signing them.

According to Singapore Retail Association vice-president R Dhinakaran, base rents went up 10-50 per cent last year at lease renewals, with the Orchard Road area accounting for the higher end of the range. He is also managing director of Jay Gee Group of Companies, which markets international brands like Aigner, Nike and Levis.

Percentage lease agreements (PLAs) became popular here only after 2009 when real estate investment trusts (Reits) took off, according to Sing Tien Foo, associate professor at the National University of Singapore's real estate department. But it was already well adopted in the US and UK as a risk-sharing mechanism to align the interests of landlords and tenants.

“The idea is good. The rationale was to share prof-

Sticky rents

Rents that retailers pay to landlords (for illustrative purposes only)

Assumes:

Small tenant

- Earns \$75,000 a month
- Rents 500 sq ft at \$30 psf per month in Orchard

Large tenant

- Earns \$500,000 a month
- Rents 5,000 sq ft at \$15 psf per month in the same mall

Scenario 1 (base case)

Base rent + % GTO (assume 1%)	Small tenant	Large tenant
Base rent (\$)	15,000	75,000
1% GTO (\$)	750	5,000
Total rent payable (\$)	15,750	80,000
Rent as a % of sales	21%	16%

Either 1) Base rent + 1% GTO or 2) % GTO (assume 20%), whichever is higher

	Small tenant	Large tenant
Base rent + 1% GTO (\$)	15,750	\$80,000
20% GTO (\$)	15,000	\$100,000
Total rent payable (\$)	15,750	\$100,000
Rent as a % of sales	21%	20%

Scenario 2 (Sales drop by 20%)

Base rent + % GTO (assume 1%)	Small tenant	Large tenant
Base rent (\$)	15,000	75,000
1% GTO (\$)	600	4,000
Total rent payable (\$)	15,600	79,000
Rent as a % of sales	26%	20%

Either 1) Base rent + 1% GTO or 2) % GTO (assume 20%), whichever is higher

	Small tenant	Large tenant
Base rent + 1% GTO (\$)	15,600	\$79,000
20% GTO (\$)	12,000	\$80,000
Total rent payable (\$)	15,600	\$80,000
Rent as a % of sales	26%	20%

Note:

Rent structure varies. Other structures not presented here include having a sales threshold (breakpoint) and a tier-ed % for GTO

BT Graphics: Lynette Khoo & Sarah Loyola

its when the tenants are doing well and, when the tenants are not doing well, the landlord will receive less rent,” Prof Sing said. “If the rent is purely fixed, why would the landlord do more for the mall? With percentage rent, the landlord will take a share of profits of ten-

ants, and so will want to do more to increase footfall.”

But because of the higher base rents charged small retailers, their total rent does not change much even when their sales drop.

While there is perceived unfairness in charging large tenants a low base

rent, the counter-argument is that the loss of a large or anchor tenant in a shopping mall could have adverse effects on other tenants, Prof Sing said. Without an anchor tenant, it is hard to draw in the crowds – as was the case of Wheelock Place on Orchard Road

after Borders closed down.

Large tenants like H&M and Uniqlo have greater negotiating power in their rental terms as their higher sales make up for the lower base rent. Prof Sing said. Some landlords also partner with the bigger tenants when they open new malls. Such pre-commitments help the landlords to minimise their leasing risks by securing half or more of the space available.

While larger retailers have economies of scale to open more outlets and weed out competition from the opening of new malls, small retailers are constrained by their lack of capital and resources to add more outlets, Prof Sing said.

A recent study by the Ministry of Trade and Industry (MTI) drew flak from retailers when it showed that the effective increase in rent per annum for most rental renewals in 2012 and 2013 was in line with inflation over the period of the lease. There is no distinction, however, between leases renewed by the same tenants and leases signed by new tenants as data provided by the Inland Revenue Authority of Singapore (Iras) is anonymised.

“While it appears fair that rental increase are in line with inflation, it ought to be accompanied by an equal if not higher improvement in business opportunity (for example, foot traffic and sales) for the tenants,” said JLL's head of research for Singapore and South-east Asia Chua Yang Liang.

Savills Singapore research head Alan Cheong noted that in the interplay between gross turnover and rents, retailers may feel that “the current business environment could not justify paying even a slight increase in rents”.