



Turnover Rents

Geoff's View

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Although globally the standard approach to setting retail rents, turnover rents have become significant in the UK only during the last 20 years. When Capital Shopping Centres (CSC), opened Thurrock Lakeside in 1990 with turnover rents it marked a sharp change from the prevailing norm. The use of turnover rents in the UK has tended to increase in times of recession, when demand for retail space is less. The arrangement allows the trading risk to be shared between investor and occupier. The basis of any turnover rent is that the rent payable is determined as a specified percentage of the sales achieved by the retailer in that outlet. The appropriate percentage is critical to the success of such rental arrangements and varies between operators, dependent on the realised gross margin – the difference between buying and selling prices.

In the UK, turnover rents have generally been introduced in hard-to-let schemes, to enable the trading risk to be shared between investor and occupier. They are disliked by valuers because there is no definite income stream.

The basic t/o rent is often modified to limit the range across which it can vary - often called a cap and collar. The "collar", the lower limit may be the greater of a fixed rent or a percentage, say 80 pc of the rent paid in the previous year.

The 'cap' the higher limit, may be the lower of a fixed rent or a percentage of the rent paid in the previous year.

The linking of the interests of occupiers and investors is a benefit that will become increasingly important as town centre retailing comes under growing pressure from supermarkets, Out Of Town retailing and the internet. For the occupier turnover related rents provide certainty of costs and does away with expensive, time-consuming and non-productive rent review negotiations. The drawback of turnover rents for occupiers is that the agreed percentage is based on an assumed gross margin. When sales are slow, and sale prices and gross margins have to be reduced, the rent goes up in line with t/o rather than realised gross margin. For investors, turnover rents require a greater understanding of the business models of their occupiers and of the t/o they are likely to generate. This aspect also makes t/o rents difficult for valuers. The future income stream is uncertain, so the t/o element cannot be included in their valuation model.

The rise of internet retailing has been highly disruptive. It is a potentially a fatal wrinkle to the use of turnover related rents. There are confident predictions that the non-food market share taken by on-line retailing will rise from its current sub 10 pc to between 20 pc and 30 pc over the next 10 years.

The problem is created not by the internet penetration itself but by its changing level of penetration.

The internet is changing the role and function of retail stores. In terms of supplying merchandise, physical stores have few advantages over the best websites. However, in terms of providing an experience or a service, a store can do more than sell the fragrance or the lipstick - it can provide a beauty service. One consequence is that the distinction between store sales and online sales is



becoming increasingly arbitrary. The sale process may start on one medium and be consummated on another. The John Lewis experience is that multi-channel shoppers on average spend twice as much as a store-only shopper. Finding a way for stores and the internet to live in a symbiotic, not a competitive, relationship is a challenge that will absorb significant time and effort by retailers and their advisers over the next 10 years.

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