

Retail leases: the new joint venture arrangement?



Retail is evolving but the question is: have retail leases been keeping pace?



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In the face of tough competition on the high street, retailers have been rethinking how to attract and retain customers. Often this requires flexible lease terms that allow for the creative use of space and the ability to adapt quickly to changes in the market. While these terms are not suitable for all, some landlords have embraced them, recognising that the success of retail units is not down to tenants alone, but is instead a joint venture which can give rise to mutual benefits.



The move towards a more collaborative approach

The traditional lease model frequently saw retail leases being granted for terms of 15 or so years with upward-only rent reviews and limited break rights for tenants. Keen to protect their assets and preserve the covenant strength of their tenants, landlords often imposed tight restrictions on use, alterations and alienation even in the face of tenants seeking more flexible terms. Once the lease was granted the tenant would be left to run its business in the (usually quite narrow) manner prescribed by the lease. The expectation was that this approach was the best way of securing a reliable income stream for the duration of the term. Lease negotiations therefore had a tendency to set up an adversarial relationship, with landlords and tenants pursuing different goals at the outset.

Increasingly we are seeing parties moving away from that adversarial model towards a more collaborative approach. In appropriate situations landlords are now ceding or even volunteering a degree of control and offering flexible lease terms to help their tenants maximise the use of the space. This follows on from the realisation that, in the current market, landlords and tenants need to work together to make a success out of retail since both their business models are reliant on footfall and customer spend.

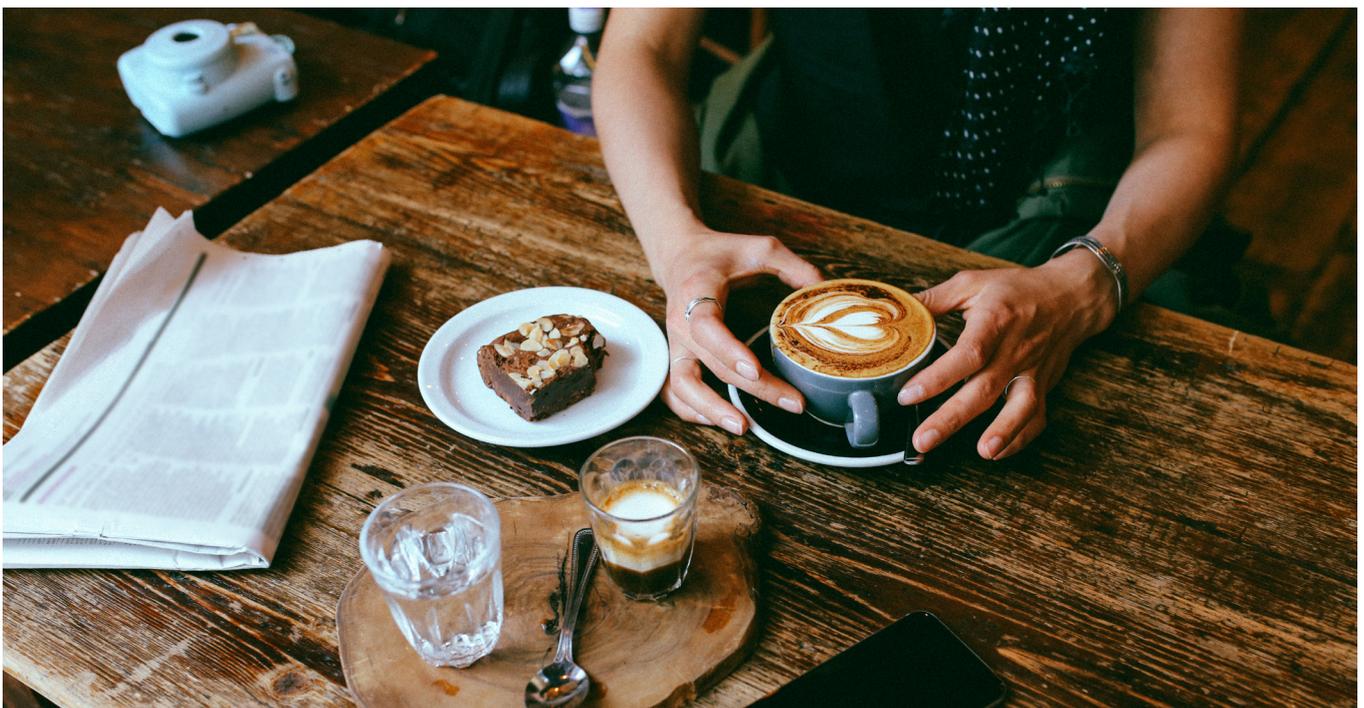
“Landlords and tenants need to work together to make a success out of retail.”

The role of CVAs

Undoubtedly the growth of flexible lease terms has, in part, been driven by the rise in company voluntary arrangements (CVAs) within the retail sector. CVAs can be, and have been, used as a tool by struggling retailers to force unwilling landlords to re-gear leases that may no longer reflect the realities of the market. Reduced rents, altered rent review patterns, greater flexibility and more frequent break rights are just some of the terms being imposed via the CVA process. The overall effect has been to undermine the assumption that the traditional lease model can, on its own, ensure a guaranteed rental income for the life of the lease. Now, more than ever, the fate of a landlord's income is tied to the success of its tenant's trade.

Generally the CVA process is driven by the tenant. Paradoxically, by being more open to flexible leases at the point of grant, landlords are taking back control of the conversation. For example, it is far easier for a landlord to deal with a planned break clause than one imposed by a CVA or a termination arising as a result of insolvency. If a landlord willingly grants a shorter lease with a turnover rent it recognises from the start of the relationship that it has a stake in the success of the tenant's business and that when times are tough the turnover rent may be depressed. Acting collaboratively and agreeing flexible lease terms not only sets the stage for a good landlord and tenant relationship but also factors in an ability to adjust to changing market conditions during the term of the lease rather than waiting until lease expiry, a break date or, worse, a CVA scenario to renegotiate.

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Changes to lease terms

The following are examples of changes to lease terms that promote the creative use of space or that potentially allow leases to adapt to changes in the market:

Alienation

To encourage a more vibrant mix of occupiers and to allow tenants room to reinvent their offering we are seeing clauses allowing greater scope for the sharing of space. Certainly the ability to include franchisees/concessionaires has been a feature of leases for some time; however, what we are seeing is alienation clauses going even further and allowing yet more scope for livening up the occupational mix. For example, we have seen clauses allowing concessionaires to use the premises for any use irrespective of any restrictions in the permitted user clause of the lease.

User

Connected to the greater freedom to share space comes a desire to dilute restrictions on use. Landlords and tenants may want to promote variety to create “destinations” where customers can enjoy a whole day out with both traditional retail and more experimental offerings (such as boutique cinemas, escape rooms and yoga studios) to drive footfall. After all, the physical aspects of these uses are something that cannot be replicated online. By allowing multiple uses landlords are giving tenants the chance to create a compelling multi-faceted reason for consumers to visit a scheme.

Whereas it might have been standard a few years ago to automatically include prohibitions on the use of retail space for public gatherings and/or residential, now such clauses are being reconsidered on a case-by-case basis. Such clauses could impede the use of space for public demonstrations of products, lifestyle classes or even the opportunity to “experience” a product overnight.

Signage

Advertising is an essential part of retailing and increasingly success is measured by speed of response, whether responding to an event or product going viral or a sudden shift in consumer demand. By lifting some of the tight controls on signage landlords are giving tenants greater scope to undertake timely marketing campaigns to capture a trend at the right time thereby increasing footfall.

Break rights

More frequent, simplified, break rights are another common tenant request. For landlords, it may be better to have a struggling tenant (who is likely to add little ongoing value to a scheme) exercise a break right and open up the chance of finding a better tenant than to allow a scheme to be dragged down by an underperforming retailer or face losing that retailer through a CVA or insolvency process. For a tenant, more frequent break rights allow scope to experiment with units and to have a clear exit strategy if something is not working.

Alternative rent arrangements

The obvious example is turnover rents, in which the fortunes of landlords and tenants are clearly tied together and more closely reflect the profitability of a store. A recent development is the growth of turnover-only rents (it has previously been usual to have a base rent plus turnover rent or a minimum turnover rent provision). We have seen variations of all-inclusive rents (for example, in which the landlord takes the risk of business rates going up or down) and we anticipate more imaginative ways for landlords and tenants to work together – perhaps even with a rent based on footfall.

Summary

The growth of more flexible lease terms illustrates that landlords are, where appropriate, willing to cede a degree of control over their properties to allow tenants greater room to experiment and flourish. That additional flexibility equips tenants with the ability to adapt quickly to changing customer demands and tastes during the term of the lease while also promoting collaboration between the parties. In the right situation, joining forces and collaborating may be the best strategy to keep up with the market, avoid CVAs and retain consumers and that is why this new breed of retail leases can be seen as moving towards a joint venture. After all, it is not just about having the right tenant in the right place; it is also about having the right lease.



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