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The lease of your worries

BY JAY GARCIA

It's not uncommon to see a suburban strip mall plastered with vacancy signs. Major shopping centres are hurting local retailers. And the dynamics of the entire industry continue to shift as sub-sectors rise and fall.

Teenagers really love loitering at shopping centres. For adolescents, shopping centres are one of the few places you can escape the insanity of family life, chores, school and the frightening onset of puberty.

And while a recent visit to my local shops evoked nostalgia, it also made me realise how the centre is changing. With more than a dozen different hairdressers all within the immediate vicinity, the local strip mall having been overpowered by the massive shopping centre, and the increasing number of restaurants popping up, it's clear that the retail environment is changing.

This little observation of mine appears to be indicative of trends across Sydney and indeed most of the country. Westfield Group recently reported a 38 per cent increase in operating profit for 2011, which means major shopping centres are putting the squeeze on smaller neighbourhood retailers, particularly within suburban areas.

Many suburban strip malls across the country can't compete with big mall owners like Westfield and Stockland, and this has led to numerous defaults and store closures. Suburban areas are showing a rise in vacancy rates, and family businesses are struggling to stay relevant in this challenging retail climate.

The industry is watching a shift in demographics. The food and service sub-sectors appear to be the most robust in this retail economy, as consumers are spending less on discretionary items and more on personal services, entertainment and wellbeing.

Consumer electronics is coming under enormous price deflation, and as a result major industry players are putting downward pressure on rents. A report by Leaseinfo noted that in 2010–2011, chain fashion stores started to achieve considerable reductions on their renewal rents. Also, notable exits or restructures during 2011 included Fletcher Jones, Colorado Group, Red Group, Grab Jeans, Bettina Liano, Belinda International and Pink Zebra.

Many old formats have become outdated and several retailers have gone into administration, leaving massive gaps in strip malls and shopping centres across Australia. While vacancies from these failed chains have left some gaps within major shopping centres, many of these empty spaces have been filled by international brands, particularly in fashion, that have recently expanded operations to Australia.

With increasing pressure for landlords to reduce rents, many major retailers are threatening to close underperforming stores. Major retail chains, such as Myer and JB Hi-Fi, are negotiating with landlords to reduce rent rates and minimise annual increases, all in a bid to protect profit margins, which have been shaky due to increased online competition.

As online retailing diminishes the need for retailers to pay rent, it is evident just how integral lease terms can be to a retailer's prosperity.

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- Simon Fonteyn

Despite healthy reports of strong rental growth and profits, many retail landlords are still scrambling to maintain foot traffic with consumers shifting to online shopping. Stockland Group, along with its half-year results, reported increased incentives of up to 7.2 per cent for incoming tenants, and 16 per cent if the new retailer is replacing a business that has shut down.

According to Simon Fonteyn, Founder and Managing Director of Leaseinfo, common incentives include a rent and/or outgoings-free period, a contribution to fit-out, and cash.

"Incentives are most commonly used when a shopping centre is new," Simon says. "However, increasingly in the current difficult retail environment, incentives are being provided by landlords to new tenants, where a shop has been vacated by a tenant due to receivership, or where an existing tenant leaves a centre."

Simon believes new businesses need to be aware that incentives are often not registered on leases, and may involve confidentiality agreements and side deeds.

"It may be very difficult for a new business to find out what a market level of incentive is for a centre or new shop," he says. "New shops also need to be aware that incentives such as contributions to fit-out usually have conditions attached to them such as claw-backs, where a tenant does not stay for the full length of the lease."

Simon confirms this: "The rent you pay and the lease terms you enter into can have a huge impact on your profit, and can be the difference between success and failure. To successfully negotiate, market knowledge is power in this game. You need to be equipped with knowledge about the current retail rental market."

Simon has identified five key questions retailers must ask landlords:

- What are similar businesses paying, and what are their lease-agreement terms?
- What was the shop previously used for?
- What are the demographics of the area?
- Is the centre subject to redevelopment or refurbishment?
- Who are the anchors of the centre and when do their leases expire?

Retail landlords have proven quite resilient in light of the bleak outlook experienced by numerous retailers. With profits and growth still at healthy levels, new retailers need to really evaluate the industry and prospective locations before signing a lease. It's a fickle industry out there and it's constantly changing, so tenants need to watch for sector trends and be sure they understand their leasing terms.