RW CONNECT

RENTS, RATES, REFORM

25 leading retailers on the blueprint to solve the industry's property crisis

IN ASSOCIATION WITH

Addleshaw Goddard

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AT A GLANCE

The coronavirus pandemic may not be over but everyday life appears to be returning to something like normal, with hybrid workers travelling into offices and greater numbers visiting stores.

Sure, the proportion of retail sales that is made online has increased from its standard level of 27% pre-pandemic to a new normal of 32% (though down from the dizzying heights of 37% seen in the midst of various lockdowns), but shops aren't going anywhere.

What has changed, however, as illustrated in this report, is where they are located and what purpose they serve. What hasn't changed are the problems retailers face: an outdated business rates system and the need for a partnership approach between retailers, landlords, agents and local authorities.

It is with this in mind that Retail Week brings you this groundbreaking new report *Rents, rates, reform*, produced in partnership with Bruntwood, Addleshaw Goddard and FRP Advisory.

Together, we wanted to get under the skin of the issues driving retail chief executives and property directors' strategies, investigate the challenges they face and identify potential solutions and opportunities.

To do this we approached every major retailer, as well as smaller and emerging brands, and spoke to 27 retail leaders across 25 businesses. Those in-depth strategic interviews included B&M chief executive Simon Arora, Frasers Group head of global leasehold properties James France, ScS chief executive Steve Carson, and Iceland managing director Richard Walker (see the full list on p6).

Those interviews reveal 56% of retailers believe they are working well with landlords but business rates are the biggest problem they face, on average accounting for 51% of rents (this means the total 'rent' for a unit, which includes rents, rates and service charge).

The research in this report includes a forecast of how the retailers we interviewed expect these trends to play out and, on page 27, Retail Week, Bruntwood, Addleshaw Goddard and specialist business advisory firm FRP Advisory present our manifesto for change.

CONTENTS

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In association with

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EXPERT VIEW

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This is a time of unprecedented turbulence, change and opportunity in retail property and the retail supply chain. All stakeholders in retail property have had cause to review their existing portfolio and their future plans for investment and development. The impact of the pandemic has further driven the pace of change in many areas of the market. The role of the physical store continues to evolve but their importance is undiminished.

Portfolio restructuring by occupiers has been widespread and many landlords and tenants are taking a fresh look at how the commercial terms of their relationships can better reflect a changed landscape where their partnerships may have been challenged, fractured or potentially deepened.

The use of turnover rent models either as a total source of rent or a hybrid form of top-up was already present in the market. Increasingly nuanced examples of these models are being agreed in deals designed to potentially offer protection in uncertain marketplaces and also shared benefits – that may outstrip previous notions of a "market rent" – when this mutual investment supports a retail success story.

Demand has soared from both occupiers and investors in some locations, for certain asset classes and for property to support supply chain infrastructure. However, there is still the need and demand for the redeployment of traditional retail space alongside regeneration of what were predominantly retail locations.

As the market shifts, the demand for an overhaul of business rates and government leadership on this occupancy cost remains. Changes in the planning regime, building safety requirements and pandemic-specific statutes continue to present potential issues.

We are privileged to continue to partner with key players in this marketplace as they seek our advice and expertise to manage, develop and innovate.

bruntwood

EXPERT VIEW

ANDREA GEORGE
DIRECTOR, TOWN CENTRE AND CONSUMER BRANDS

Bruntwood's focus is to form long-term consultation-led partnerships to revitalise town centres. Through a community-focussed approach to regeneration, Bruntwood aims to ensure social, economic and environmental sustainability and to create vibrant places that are dynamic, inspirational and futureproof

bruntwood.co.uk

The key to creating thriving town and city centres is collaboration. That is why we work in partnership with local councils and collaborate with retailers to understand their vision and negotiate the most appropriate lease terms in the right locations. And, with 40% of retailers surveyed wanting to open stores on local high streets, there has never been a better time to prioritise this approach.

Our purpose of 'creating thriving cities' recognises the need for continuous investment and innovation in the town centres that surround them. Our focus on town centres is to ensure social, economic and environmental sustainability and create spaces that are dynamic, inclusive and future-proof. Although shops will always be part of this mix, retailers are thinking more creatively about the use of their spaces.

> WE SEE RATES REFORM AS CRITICAL TO THE LEVELLING-UP AGENDA

We take a long-term view and investment approach, which allows us a unique perspective from which to shape the future of the cities and towns in which we operate.

Although landlords need security, we believe this can be achieved through open conversations that create a balanced relationship between owner and customers. We refer to our retailers as customers rather than tenants – we're partners.

Rates reform would be welcomed to help level the playing field between physical and online retailers. The report highlights the disproportionate impact of the current system on the North and Midlands, and we see reform as critical to the levelling-up agenda. It is this approach focused on mutual understanding and benefit that we believe will bring retailers to our regional town centres.

We are pleased to have been able to work with so many knowledgeable partners to share our collective expertise and drive change across this evolving sector.

FRP

EXPERT VIEW

Getting property 'right' is critical for retail success. As we've seen throughout the disruption of the past two years, unsustainable rent, rate and supply chain pressures are often a major factor in financial distress.

This report presents a fascinating overview of the opportunities and challenges retailers see when it comes to their property portfolios. It highlights two of the most important factors that will be key to brands' futures – the benefits of building strong, mutually beneficial relationships with landlords, and the fact that, when it comes to property solutions, there is no one-size-fits-all approach.

Retailers no longer need to contend with the store-shuttering measures of lockdown. But many will still be rebuilding financial strength, while juggling rate and tax liabilities, remaining pandemic debt and new pressures, including soaring input costs in everything from energy to labour.

> WHEN IT COMES TO PROPERTY SOLUTIONS, THERE IS NO ONE-SIZE-FITS-ALL APPROACH

In this landscape, it is vital retailers continue to review their property strategy and its contribution to operational health.

Quick, proactive action at the first sign of trouble will help secure the best outcome for all involved – whether that's starting a negotiation with a landlord over the structure or term of a lease, or exploring formal restructuring processes. We hear directly from brands that have benefited from each approach.

At FRP, we work with retailers, their landlords and their stakeholders day in, day out to help review property arrangements as part of wider restructuring efforts, advise on growth plans and raise and refinance existing debt.

A sound foundation, aligned with a strong and complementary online proposition, will open many doors – and is something no brand can do without.

PHIL REYNOLDS
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FRP is a leading national business advisory firm, specialising in restructuring, corporate finance, debt, forensics and pensions.

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WHO DID WE INTERVIEW?

The retail leaders who spoke candidly about their property strategies

Anda Rowland, director, **Anderson & Sheppard**

Dawood Pervez, managing director, **Bestway Wholesale**

Simon Arora, chief executive, **B&M**

Nicolas Barnoin, chief operating officer, **Famously Proper, owner of Byron**

Tom Beahon, co-founder, **Castore**

Will Crumbie, chief executive, **Fat Face**

James France, head of global leasehold properties, **Frasers Group**

Brett Parker, property director, **Gail's**

Paul Kraftman, chair and chief executive, **Gift Universe, owner of Menkind**

Richard Walker, managing director, **Iceland**

Darren Abbott, financial director, **Joe Browns**

Beth Emmens, head of acquisitions, **Leon**

Alia Hawa, managing director, UK & Ireland, **L'Occitane**

Mark Saunders, chief executive, **Mamas & Papas**

Graham Harrison, group property director **Pets at Home**

Mike Spencer, chief business development officer, **Pizza Hut**

Tom Meager, group director of property **Primark**

Caroline Crosswell, chief retail and development officer, **Rapha**

Marie Liston, corporate services director, **ScS**

Steve Carson, chief executive, **ScS**

Marcel Bordon, chief executive, **Soletrader**

Dan Browne, head of property **Ted Baker**

Rachel Osborne, chief executive **Ted Baker**

A property director at a specialist **cosmetics retailer**

Ian Williams, chief financial officer, **The Original Factory Shop**

David Wood, chief executive, **Wickes**

Jon Shaw, head of UK sales channels – retail, telesales, online and indirect channels **Vodafone UK**

RESEARCH SNAPSHOT

7 key statistics that reveal the developing trends in UK retail property

53%

of retail sales will be from stores in five years' time, vs 60% now and 65% pre-pandemic

44%

of retailers will have the same number of stores in three years' time and 28% will have more

52%

of retailers secured turnover leases during the pandemic, and 92% of those are permanent leases

40%

of retail sales will be online in five years' time and 37% in three years, vs 32% currently

40%

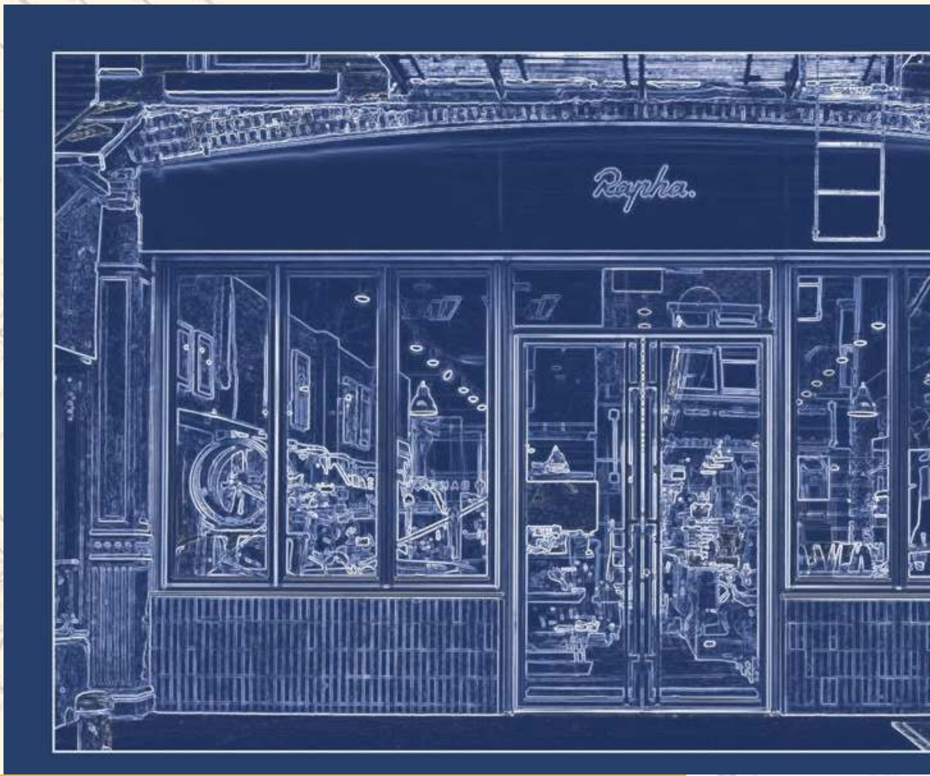
of retailers want to open stores on local high streets to reach remote workers

51%

of rents are business rates, on average (total 'rent' for a unit, including rents, rates and service charge)

56%

of retailers say they are working well with landlords



RENTS AND RATES: THE BIG PICTURE

The property challenges faced by UK retailers over the past decade are well known. Upward-only rent reviews, inflexible 20-year leases and a hefty tax bill that does not reflect the current value of the buildings being rented: retailers have been fighting for solutions to these for years.

While most onlookers could plainly see the situation was untenable, it took a global crisis for noticeable change to take place.

Pre-Covid, empty retail space had been slowly increasing for several years and rents steadily falling.

Commercial property firm CBRE reported in January 2020 that "prime rents for all retail sectors continued to fall in Q4 2019, with shopping centres registering the biggest fall of -1.3%".

Uncertainty has been a constant pressure on the UK economy since the 2016 Brexit vote, affecting confidence and trade.

In the first half of 2018, for example, property agent Savills reported that shopping centre investment turnover in the first half of 2018 was 39% down year on year; and this followed 2017 which registered the lowest volumes since 2008.

Against this backdrop the pandemic hit certain areas of retail very hard.

In the final quarter of 2021 the national UK vacancy rate stood at 14.4%, according to the BRC-LDC Vacancy Monitor, a slight improvement on the third quarter's 14.5% figure. The vacancy rate might have been even higher if thousands of units had not been reclassified as housing or alternative commercial use, but this was the first time vacant stores numbers had declined since the start of 2018 and is being heralded as good news for the sector.

Research from the Local Data Company and PwC found the number of new store openings declined 26% in 2021 compared with 2019. In total in 2021, 7,160 shops opened compared to 17,219 closures, a net decline of 10,059. Retail parks have fared the best, with net closures of -4% compared with high streets at -5% and shopping centres at -7%.

Rental market shift

Given all this, the dynamics of the property market have shifted.

"For the first time in a couple of decades, it's more of a tenant's market," says Dominic Curran, property policy advisor at the British Retail Consortium (BRC). "The balance of power is shifting."

Tenants no longer always have to accept terms that include upward-only rent reviews, and the length of new leases are falling. For many store operators, a new form of partnership is emerging.

Beth Emmens, head of acquisitions at fast food chain Leon, which operates 75 outlets, says maintaining good relationships with landlords has helped in its negotiations. "We're hitting our stride again and feel very positive about the future," says Emmens.

"These past few years have taught us that our great relationships with landlords are an even bigger part of future-proofing the business than we thought."

UK lagging in relationship management

Tom Meager, group director of property at Primark, which manages a store estate of more than 190 stores in the UK, says: "There's been a sea change during the whole period of Covid. It's made the industry more conciliatory and has acted as a catalyst for Landlords and Tenants to better understand each other's businesses."

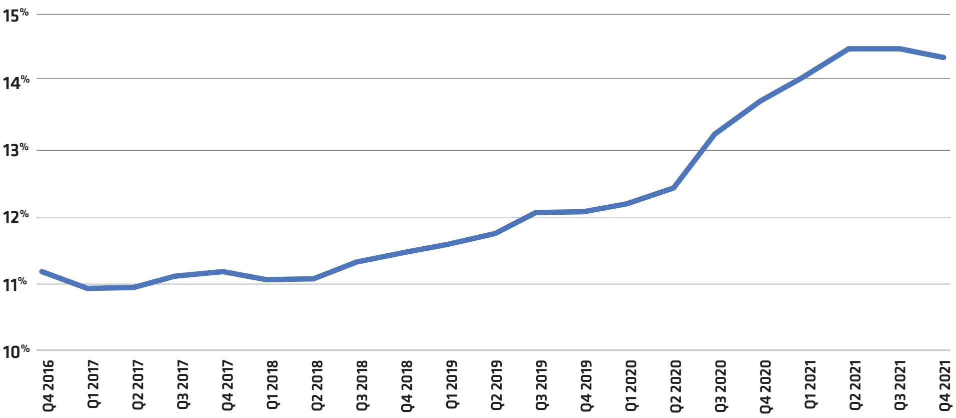
For many retailers, this new dynamic has been transformational. It's too simplistic

to say the whole sector has benefited – the retailers we spoke to all had different stories to tell of the past few years – but broadly speaking, the direction of travel is positive.

Fifty-six per cent of the retailers interviewed for this report say they are working well with their landlords; 36% say it is more of a mixed bag; 8% say negotiations have been contentious.

While some are refusing what they believe to be bad terms and insisting on turnover leases, others are still locked into long-term fixed rents with upward-only reviews.

Overall vacancy rate in the top 650 towns and cities in UK



Source: Local Data Company

October 2021 business rates reforms

In October 2021 Chancellor Rishi Sunak stopped short of fundamentally overhauling the £25bn business rates system, but announced a range of reforms that he said were worth £7bn.

The key changes were:

- More frequent revaluations starting in 2023, moving to every three years from the current five years from 2023 onwards.
- Green investment relief for initiatives such as installation of solar panels.
- Improvement relief, providing 12 months' relief from higher bills for occupiers where eligible improvements to a property increase its rateable value (such as CCTV or bicycle sheds). The government is consulting on how to implement this relief, which will take effect in 2023.
- Cancellation of 2022's planned increase in the rates multiplier.
- One-year 50% discount, capped at £110,000 – a low amount for most national chains that has drawn criticism from many retailers.

The burden of business rates

At the same time, retailers have continued to face other, age-old challenges.

As BRC's Curran says: "Some tenants are enjoying more favourable lease terms. But the rest of the property costs are not keeping pace with that."

Business rates continue to be a serious thorn in the side of every retailer we interviewed.

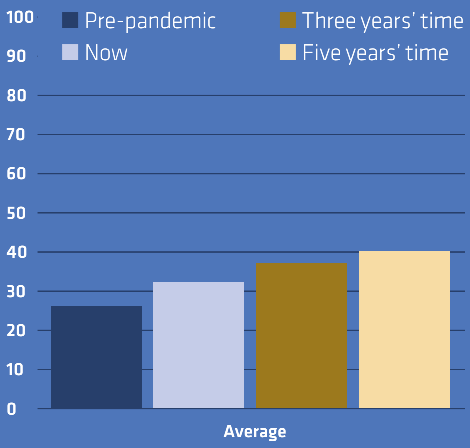
Graham Harrison, group property director of Pets at Home, which has a 450+ store estate, says one of the major issues with the system is that it can't react to pressures on different sectors: "Business rates are a property tax which is payable by all tenants irrespective of sector. However, it needs to be equitable and reflect the cyclical nature of the property market and react to the structural changes of each sector."

On average, our interviewees' rates bills work out at 51% of their rent bills and several mentioned the comparative heft of retail's overall tax burden: the sector pays a higher proportion of the UK's total business rates, at 25%, than it contributes to GDP, 5%.

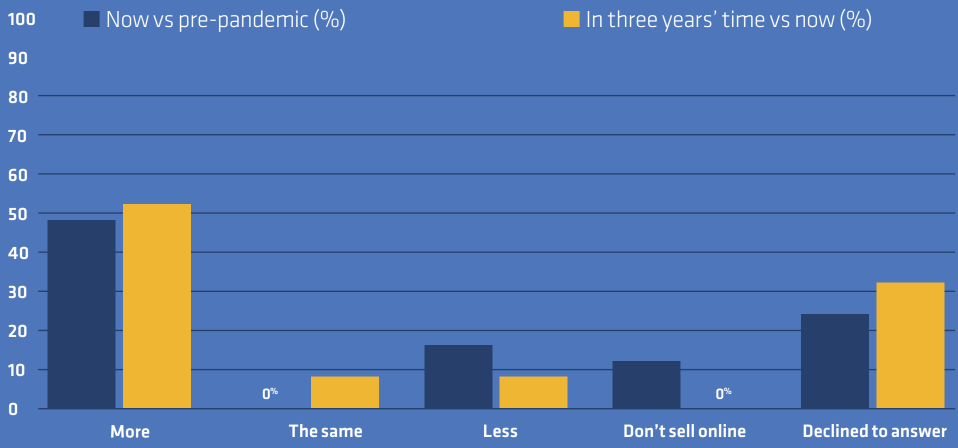
PLEASE TELL US HOW YOUR SALES WERE SPLIT ACROSS THE FOLLOWING CHANNELS AND TIME FRAMES?

ONLINE:

Percentage splits as an average across all 25 retailers for each time period

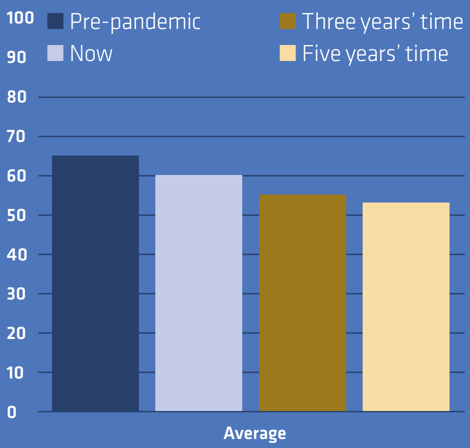


Channel percentage share of sales
a) now vs pre-pandemic b) now vs three years' time

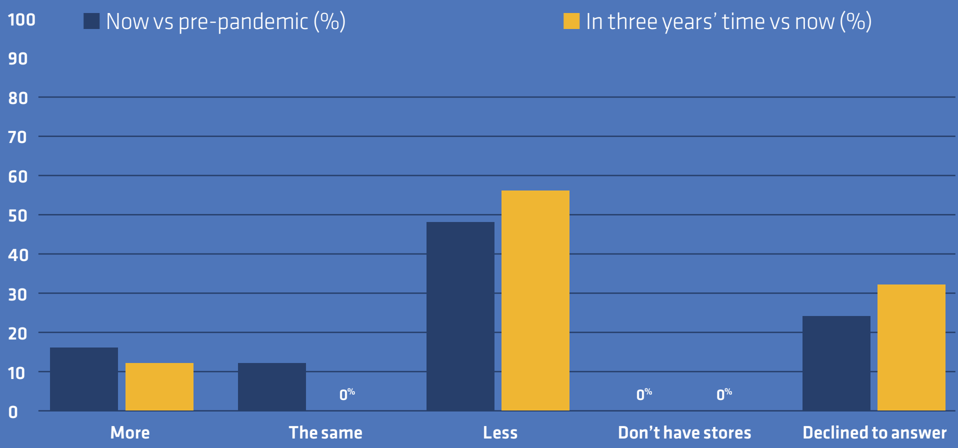


OFFLINE (STORES):

Channel percentage splits as an average across all 25 retailers for each time period

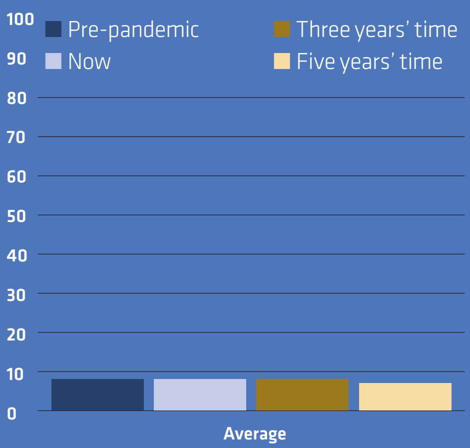


Channel percentage share of sales
a) now vs pre-pandemic b) now vs three years' time

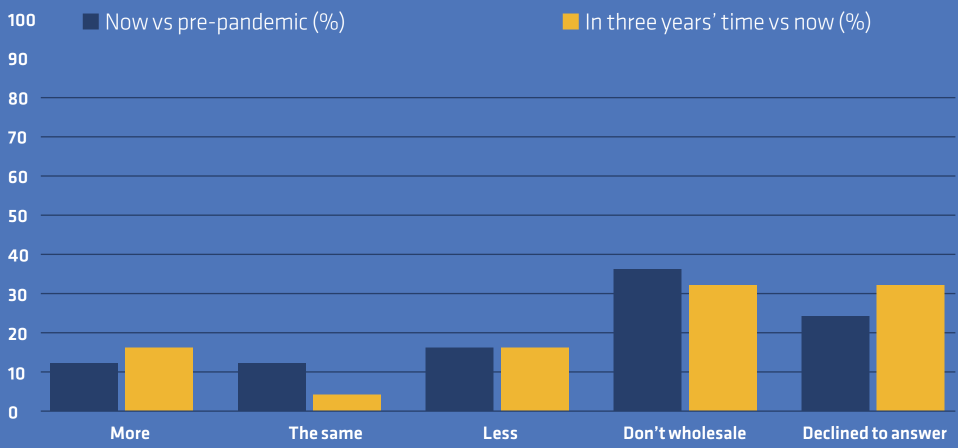


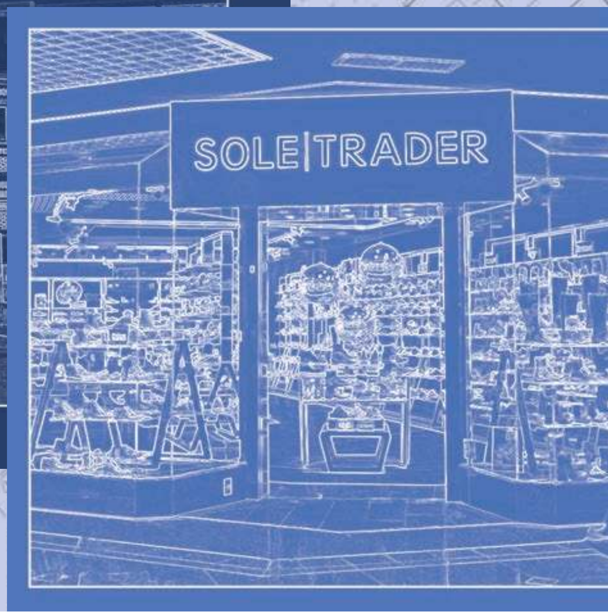
WHOLESALE:

Percentage splits as an average across all 25 retailers for each time period



Channel percentage share of sales
a) now vs pre-pandemic b) now vs three years' time





Plus, of course, online behemoths such as Amazon and Boohoo pay a far lower proportion of tax than high street traders with stores.

It is not just that the system seems unfair; it's also not working efficiently. A lack of resources means years of delays for any retailer contesting its rate given by the Valuation Office Agency.

Transitional relief – whereby reductions or increases are phased in slowly to avoid drastic changes – can mean retailers with lowered rents continue to pay a higher rate than their building is worth for several years. This is particularly problematic in the Midlands and North of England, where rents have fallen faster than the South over the past few years.

> THE AUTUMN RATES REVIEW ANNOUNCEMENT WAS LIMITED AND INSUFFICIENT TO MAKE A MEANINGFUL IMPACT
>
> DOMINIC CURRAN, BRITISH RETAIL CONSORTIUM

Then there is the biggest gripe of all: the long, slow process of revaluations. Today's rates are based on 2015 rents, a very different time for the retail sector. The next valuation, in April 2023, will be based on 2021 values.

While the retailers we spoke to agree some form of property tax is necessary, they also agree that there is very little about the current system that works.

James France, head of global leasehold properties at Frasers Group – which owns 35 brands and retailers and runs a store estate of 769, of which 510 are Sports Direct – says there is a lack of efficiency within the system which causes problems.

"A tax on property seems rational [but] if taxes or business rates were a fair system they would be revalued and reassessed on a much more frequent basis."

BRC's Curran is not hopeful of effective reform any time soon. "The review of rates that was reported in the autumn was disappointing. The things they announced are good, but limited, and insufficient to make a meaningful impact."

Even if valuations fall in April 2023, he explains, the government still needs to collect the same total amount each year.

"The kicker is that the business rates system, by law, has to raise the same amount of money each year. If retail's contribution falls and other sectors such as hospitality don't fill the gap, the multiplier might just go up."

Local authorities calculate rates by multiplying the location's 'rateable value' (set by the Valuation Office Agency, and based on the rental value of a property) with that year's multiplier, or uniform business rate (set by the government).

In 2002, it was 43p; this year it is between 49.9p and 51.2p, depending on the size of the business.

We explore further the issues retailers are facing with business rates, and the solutions they'd like to see, in the next chapter.

Snapshot of 2022

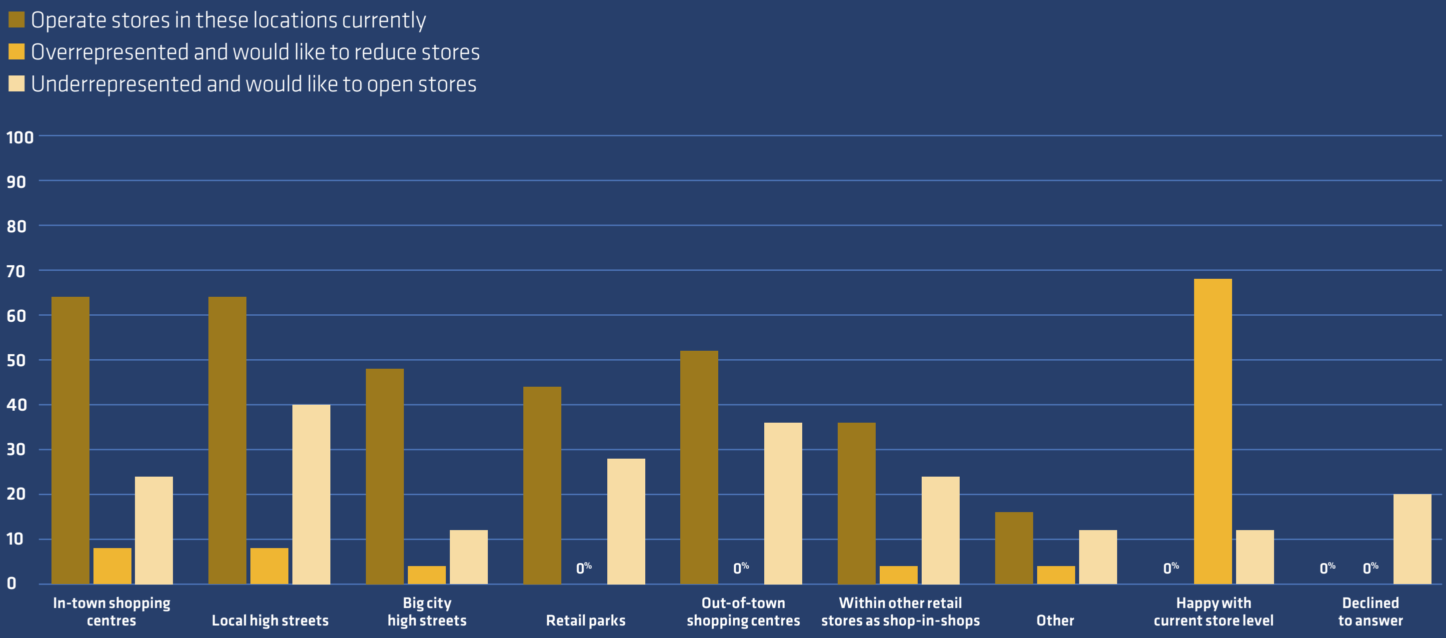
Given the amount of change that has taken place in the past few years, it's important to chart what the current landscape looks like and to what extent retailers are planning to open stores, what proportion of sales does online account for and what essentials retailers want leases to offer.

We put these questions and more to our 25 retailers to find out.

Broadly speaking, store opening plans for three years' time are looking positive. While 8% expect to operate fewer units, 28% expect to have more stores and 44% expect to have the same number.

When asked where these new stores

WHERE ARE YOUR STORES? ARE YOU OVER/ UNDERREPRESENTED IN THE FOLLOWING AREAS?



HOW LONG ARE YOUR AVERAGE LEASE LENGTHS VS HOW LONG WOULD YOU LIKE THEM TO BE IN THE FUTURE?

	Now	In the future
Retailer 1	2.2 years	1.5 years
Retailer 2	15 years	15 years
Retailer 3	3-4 years	3-4 years
Retailer 4	5-10 years	3 years
Retailer 5	5 years	3 years
Retailer 6	5 years	10 years (with option to renew at 5 years)
Retailer 7	10 years	2-3 years
Retailer 8	5-10 years	3-5 years
Retailer 9	7 years	7 years
Retailer 10	15 years	10 years
Retailer 11	Declined to answer	Declined to answer
Retailer 12	30-60 days	18 months
Retailer 13	Declined to answer	Declined to answer
Retailer 14	4 years	3 years
Retailer 15	10 years	3-5 years
Retailer 16	2.5 years	3 years
Retailer 17	10-15 years (with 5-year break clause)	10-15 years (with 5-year break clause)
Retailer 18	10-15 years	10-15 years
Retailer 19	Declined to answer	Declined to answer
Retailer 20	5 years	5 years
Retailer 21	2.7 years	2-5 years with breaks
Retailer 22	2 years	10-15 years based on turnover
Retailer 23	10-15 years	10
Retailer 24	6-7 years	6-7 years
Retailer 25	5-10 years	5-10 years

> SEVERAL RETAILERS SAY THEY WOULD ONLY TAKE LONGER LEASES THAT WERE TURNOVER-BASED AND MOST WANT BREAK CLAUSES ADDED, TYPICALLY AT THE FIVE-YEAR MARK OR BEFORE

might be, the results highlight a shift away from big city centres; the local high streets that had once fallen out of favour are now being eyed for further openings by 40% as they look to capture the work-from-home consumer who is now more likely to shop locally.

Easy to get to out-of-town shopping centres factor in the store opening plans for 36%, while 28% are looking to retail parks, popular for ease of access and their open-air nature appealing to a still Covid wary consumer.

Just 12% plan to open on big city high streets – the big loser in location popularity.

Online sales are, as expected, growing. On average, at the retailers we spoke to, online accounted for 26% of sales before the pandemic. This has risen to 32% today. In three years they expect it to hit 37% and in five years 40%.

With the inclusion of just one grocer, these average figures do not reflect the grocery sector.

It is worth noting that Iceland was the only grocer willing to speak to Retail Week for this report about its property strategy, rents, rates and relationships with landlords.

Pre-pandemic store sales represented 65% of overall turnover; that figure now stands at 60% and is expected to fall to 55% in three years and 53% in five years' time.

12%

of retailers plan to open stores on big city high streets – the big loser in location popularity

When it comes to lease lengths, only a few want them to be longer. The desired lengths range from 18 months to 15 years; several stipulate they would only take longer leases that were turnover-based and most want break clauses added, typically at the five-year mark or before.

Just over half (52%) of the interviewed retailers with turnover leases secured them during the pandemic, demonstrating again the shift in relationship dynamics between retailers and landlords.

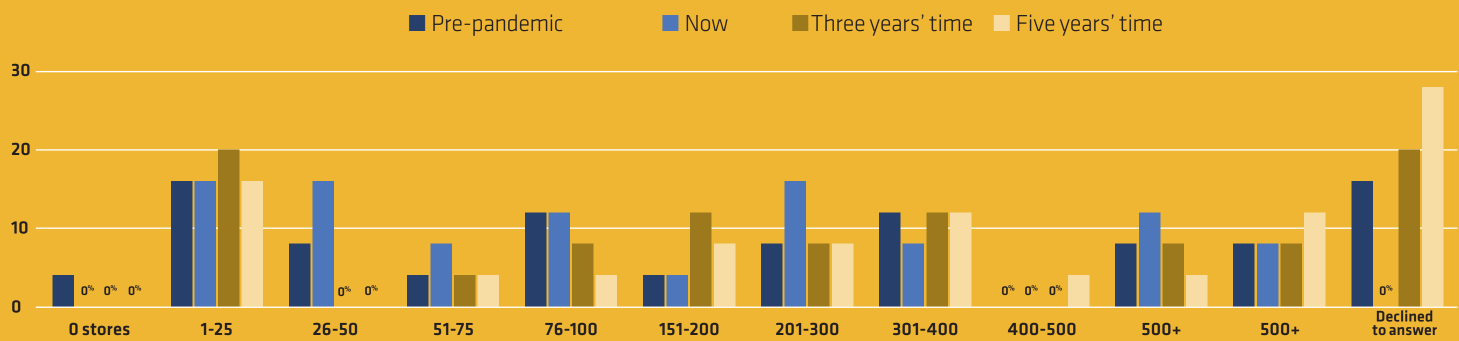
A number of the retailers we spoke to believe that obtaining a turnover lease means the landlord is as invested in making retail locations work, and that "sharing the pain" during difficult times would make the relationship fairer.

Retailers are in a new position, the pandemic having upended historic dynamics and accelerated the previously slow pace of change.

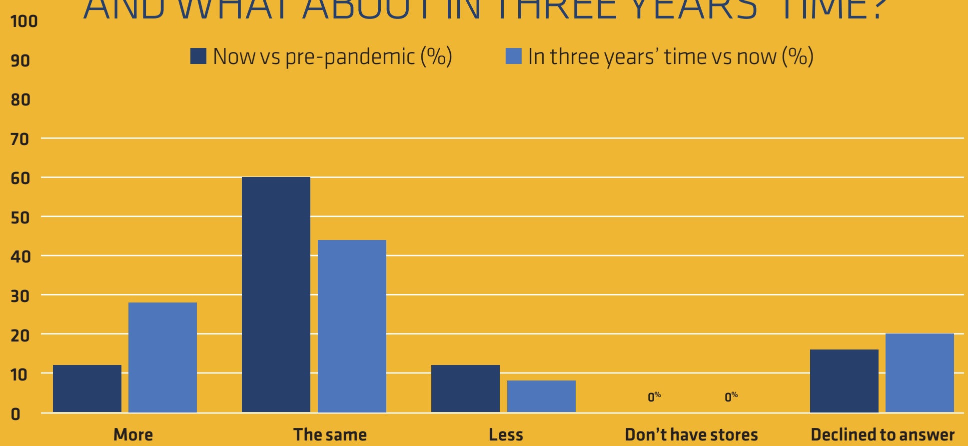
The big question is whether this is permanent or will we go back to business as usual?

HOW MANY STORES DO YOU OPERATE?

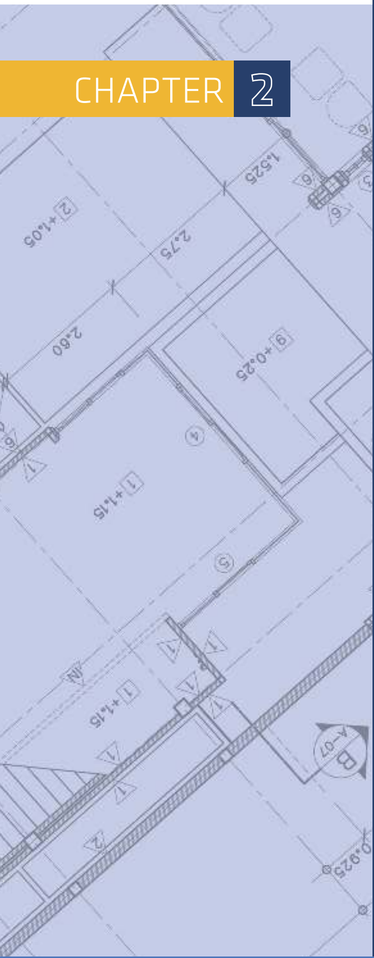
Total number of stores for each of the 25 retailers



DO YOU HAVE MORE, THE SAME, OR FEWER STORES THAN PRE-PANDEMIC? AND WHAT ABOUT IN THREE YEARS' TIME?



CHAPTER 2



SOLVING THE BUSINESS RATES CONUNDRUM

No one could accuse the retail sector of being reticent about business rates. For years the system has been a bone of contention, both in terms of the overall tax burden and the disproportionate load on traders that have stores compared with those that do not.

The numbers are stark. According to Jonathan Cole, investment director at retail investment management firm Ellandi, between 2001 and 2021 the growth in retail rates was more than five times greater than growth in retail rents.

In the North of England and the Midlands, according to research from the retail and leisure forum Revo, the rates rise has been almost 12.5 times greater than rental growth; this is compared with 4.1 in the South of England.

The retailers we interviewed pay, on average, rates equal to 51% of their rent bill and for some it was as much as 95%.

A property director at a specialist cosmetics retailer, which runs more than 200 stores, says: "We've got some stores where the rates are the same as the rents we're paying. How can that be? It's ludicrous."

Referring to the government's 50% rate relief scheme for 2022/23 that some businesses are entitled to, Anda Rowland, director at London's Savile Row tailor Anderson & Sheppard, which also owns a Mayfair haberdashery, says: "We're waiting and hoping that Westminster might realise that they are going to get even more empty streets if they go back to 100%."

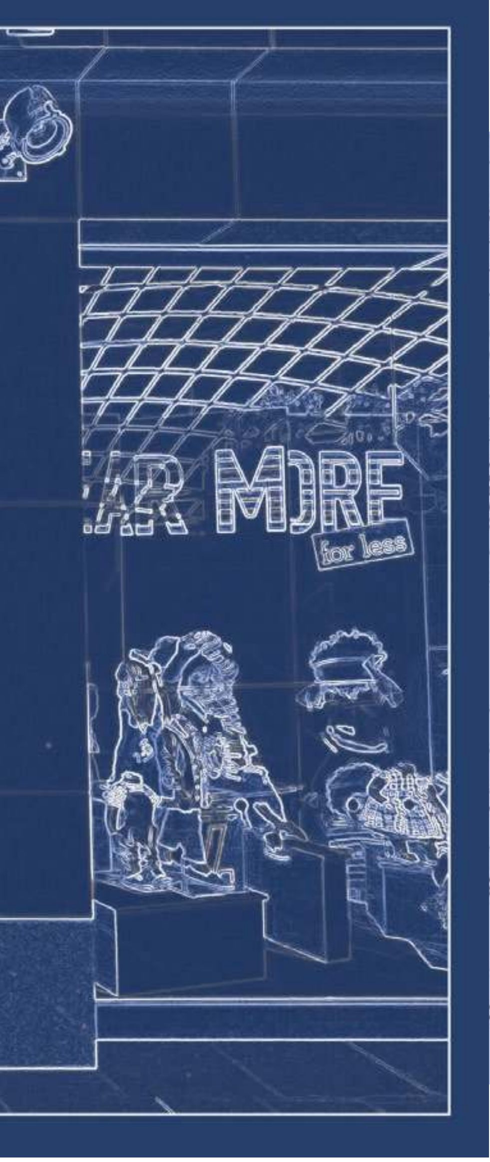
However, many businesses want to see an overhaul of the entire system for all rather than ad hoc tweaks, and suggestions for alternatives have been numerous.

Alternatives often broadly fall in four key areas – an online sales tax, a reduction in the business rates multipliers; a warehouse tax; and a uniform sales tax.

For and against an online tax

Two years of online revenues growing to previously unheard levels owing to the pandemic has meant the disparity between tax on physical stores compared with online-only players is growing; along with calls for this to be equalised.

Simon Arora, chief executive of B&M, which operates 706 stores, says: "Every day I drive past a huge Amazon warehouse and less than a mile away there is the traditional town centre of Altrincham. I suspect that the Amazon warehouse is doing more turnover than the entirety of Altrincham [retailers] and yet [pays] a fraction of the business rates



> WE'VE GOT SOME STORES WHERE THE RATES ARE THE SAME AS THE RENTS. HOW CAN THAT BE? IT'S LUDICROUS
>
> PROPERTY DIRECTOR, SPECIALIST COSMETICS RETAILER

that Altrincham in aggregate does." Yet, he adds, Amazon needs and uses the roads, street lights and rubbish services to the same extent as local businesses.

However, the Treasury's call for evidence for its review of the business rates system in England, which was published in October 2021, revealed that feelings about introducing an online tax remain mixed – many do think it's necessary to rebalance tax between physical and online retail, but others are worried it will simply increase the overall tax bill.

"What I don't want to see is an online tax and then they don't do something about rates, because that's just us paying more tax," says Mark Saunders, chief executive at nursery retailer Mamas and Papas, with an estate of 36 stores.

He adds that if the balance is right it won't make much of a difference to his overall costs: "We'll save a bit on the rates, but we'll pay a bit more on the online tax, and that's fine. But it will definitely level it up for those retailers not on the high street and not paying any of these taxes."

The current system is also a challenge for landlords, Saunders adds, because even if rents fall, rates can make the cost of a property prohibitive. "You'll get retailers just saying [to landlords] 'I want to talk to you about total cost of occupancy'," he says.

John Shaw, head of UK sales channels at Vodafone, which runs more than 400 retail outlets, is one of the few interviewees to voice support for the rates system. He says retailers need to assess whether a location is right for them with the rates in mind. "For us, we're happy to pay business rates. We're happy to have lots of stores in the UK and we continue to be proud to be part of local high streets trying to create productivity and bring people together and connect people."

He also challenges the idea that online retailers have the financial advantage, citing the costs of logistics as well as the potential of levies on emissions for deliveries in the near future.

The 'hidden' costs of ecommerce is something Darren Abbott, financial director of online and catalogue fashion retailer Joe Browns, which also has two stores, points out when discussing the possibility of introducing an online sales tax. "If you saw how much we have to spend on Google pay per click, affiliates, permissions, all that sort of stuff – 35% of our marketing is now spent on ecommerce. I think people don't see that. They think we just set up, put in a warehouse and chuck product out to customers. There are taxes already within ecommerce and it's getting more expensive."

Inhibiting investment

Warnings about empty streets and impediments to store openings were cited often in our interviews, with retailers pointing out the dampening effect the high tax burden has on local economies.

"We're looking at opening stores in new locations and sometimes that can be prohibited by the rates in those locations," says Ian Williams, chief financial officer at The Original Factory Shop, which has 180 retail units. "In some instances it will stop the high streets getting new retailers coming in."

The rates system can also impact investment decisions. "The current [rates] system creates a difficult investment environment into physical retail property," says James France, head of global leasehold properties at Frasers Group. "If we look at a store it's very difficult to assess where the rateable values will sit in three, four, five years' time. Yet maybe we are wanting to invest for 10 or 15 years."

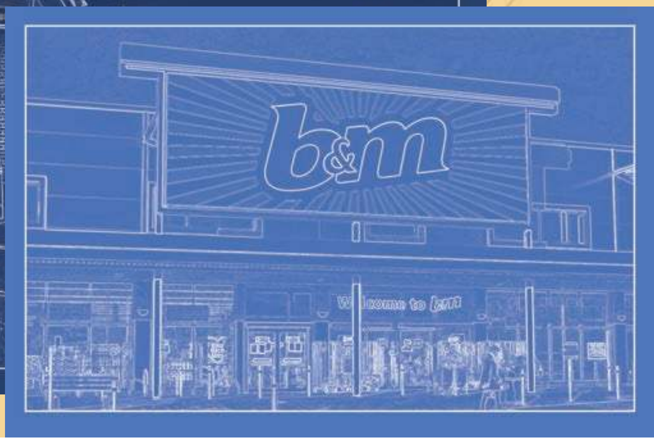
A matter of survival

The pandemic has accelerated the urgency to rethink rates for some retailers as a matter of survival.

Alia Hawa, managing director, UK & Ireland at cosmetic retailer L'Occitane, says that some stores in the 85-unit business are taking less than half the sales they were previously. "To have business rates reviewed is the first emergency for retailers like us to keep on having a sustainable retail business

Business rates alternatives

- **Online sales tax:** In early February 2021 the chief executives of 18 companies including Tesco, Morrisons, Asda and Waterstones wrote to the chancellor asking for a 1% online sales tax, with Waterstones boss James Daunt saying: "A tax on online sales would at least allow us to keep our shops open."
- **Reset the Uniform Business Rate:** Retail property organisation Revo has called on the government to reduce the UBR, or multiplier, to 30p from its current 49.9p/51.2p.
- **Warehouse tax:** Next boss Lord Wolfson believes tax should be cut on shops by 35% and raised on online warehouses by 50%.
- **Uniform sales tax:** High street campaigner Bill Grimsey, former Wickes and Iceland chief executive, and author of the *Covid-19 Supplement Report: Build Back Better*, published in 2020, has proposed abolishing business rates and introducing a 2% sales tax, whereby retailers would pay 2% of their total sales.



and I find it appalling that the government has not committed to now reviewing them."

She adds that equalising the tax burden between pureplay retailers and multichannel businesses is crucial "because otherwise [physical] retail is going to die".

UK portfolios at a disadvantage

Tom Meager, group director of property at Primark, agrees that high tax disadvantages UK divisions of retailers.

"The level of rates payable in our UK portfolios as a proportion of our total occupancy cost is significantly higher than anything in our European trading countries," he says.

The UK's rates system is unique; while other countries such as those in Europe and the US do have property taxes, nowhere else taxes retailers in the same way.

Caroline Crosswell, chief retail and development officer at Rapha, which has two stores in the UK, agrees the UK system is uniquely challenging. "In the US, you have property taxes that are inherently fairer and far more democratic than rates. The way the UK rates are calculated make it very tough for smaller, more interesting and vibrant concepts to work, which is the opposite of how physical retail should be supported."

Richard Walker, managing director at grocer Iceland, which has more than 900 supemarket premises, notes that in France, store-based retailers get tax credits for giving away food to food banks and charities.

The problematic transitional relief

B&M's Arora says his primary problem with rates is transitional relief, which means that if the rent – and therefore the rateable value – of a building goes down, the rate of tax paid does not immediately fall by the same amount. Instead, it goes down gradually, with limits on the change allowed each year, which means that areas where rents have fallen quickly – such as the North – end up paying disproportionately high rates. "So we have this Alice in Wonderland scenario where really struggling towns and cities, frankly in the North of England, are subsidising the affluent South East," Arora says. "The way I put it is that an occupier in Scunthorpe, Hull, Leeds or Whitehaven, just random places in the North West, are subsidising occupiers in Bond Street. It's absolutely bonkers."

> TRANSITIONAL RELIEF MEANS STRUGGLING RETAILERS IN THE NORTH ARE SUBSIDISING BOND STREET OCCUPIERS – IT'S BONKERS
>
> SIMON ARORA, B&M

Disproportionate burden on retail

Where the retailers mostly agree is that the overall tax burden on retailers is too high.

"If you look at the UK's GVA retail constitutes 5% but pays 10% of business taxes and 25% of business rates. It's highly disproportionate in terms of the amount that we're contributing," says Wickes chief executive David Wood.

The tax also presents a significant resource issue – whether that's the lack of resource at local authorities, or retailer time used in dealing with problems.

Frasers Group's France says that the relevant teams don't have enough capacity to deal with appeals.

"Those teams may be overloaded or just don't have the resourcing in place to actually deal with things in a timely manner. The backlog of appeals is massive."

The property director of the specialist cosmetics retailer agrees that the appeals process is flawed. "We opened a new store in Sheffield last year. The landlord downsized the unit for us [but] we had to pay the full rates until the council did its bit to get all its records updated to make it half the size. It's just wasting everybody's time."

The solutions pipeline

Many retailers acknowledge that there isn't an easy answer, but with a system at breaking point, many had solutions to offer.

"I think a banding system does make more sense," says Brett Parker, property director at bakery chain Gail's, which operates from 79 outlets.

"The current system is difficult to use and difficult to challenge. So, one – it needs to be clearer; and two – it needs to be a simple system that can be challenged without having to get expensive consultants involved."

Marcel Borden, chief executive at footwear brand Soletrader, which operates 30 retail outlets including concessions, says: "If you added 2% overall sales tax, meaning online and offline, you would level this whole playing field. That makes a lot of sense. In other words, abolish rates for retailers and just [tax] 2% of all retail sales."

There have been calls for landlords to

Retailers speak out about the rates crisis

"The system is prohibitive to certainly some of the acquisitions that we would like to make and I imagine if you were a smaller start-up business, it's even more worrying."
Beth Emmens, head of acquisitions, Leon

"There needs to be a whole levelling of the playing field and if there isn't, there'll be this inevitable slow death of the high street as online takes over."
Richard Walker, managing director, Iceland

"Despite strong revenue, when you factored the rates, the occupancy costs doubled and in effect drove us out. This adds to a lack of diversity and community experiences on the high street, which is the opposite of how customers want to shop."
Caroline Crosswell, chief retail & development officer, Rapha

"In some locations, typically larger stores, and particularly ones that have been negotiated more recently, you'll end up with the rates bills being higher than the rent bill. Your rates and your staffing bills are actually your biggest costs."
Will Crumbie, chief executive, Fat Face

"You need an online sales tax because traditional bricks-and-mortar retailers that serve a huge community purpose are subsidising Amazon."
Simon Arora, chief executive, B&M

share the burden of property taxes 50-50.

Tom Meager at Primark says: "The equitable position is to actually share the burden with the landlord, which is maybe controversial. At the end of the day the property is the landlord's asset and until they find a tenant, they are liable for the rates. Once a tenant is secured, the obligation to pay the rates completely swings, like a pendulum, to the tenant being suddenly 100% liable to pay them and the landlord then doesn't have any burden at all, it does not seem equitable."

Rachel Osborne, chief executive of Ted Baker, which has a 50+ store estate, says rates should be lower and should fluctuate according to the performance of an area. "They need to reflect if an area is declining or growing. Places that have more footfall and are growing are creating value which can be shared fairly. If an area is declining, then rates would decline and the local council would then be incentivised to be doing things to address this'.'

Others see inspiration in the way other countries manage their property taxes. Dawood Pervez, managing director Bestway Wholesale – which runs 59 depots and more than 200 directly operated stores, includes 33 Costcutters – says the Dutch model is appealing: "Our [system] is effectively an oppositional system – they put a position, you appeal, it goes down like that. The Dutch one is more akin to self-assessment, where the onus is on the occupier to complete a lot of very detailed information annually, [with] real penalties for not doing it in a timely manner. This allows the rates system to flex and change more quickly with the market. It's worth us looking at that kind of model."

When service charges don't add up

Overall property costs don't end with business rates; service charges can be another hefty addition to retailers' bills.

Most of the retailers we interviewed had little issue with them, flagging the importance of services such as waste removal and the creation and maintenance of a pleasant shopping environment.

But a few flagged some areas of concern. Steve Carson, chief executive at interiors retailer ScS, which has a 110-store estate, says: "I have no problem paying a service charge as long as I feel like it's value for money. If graffiti isn't dealt with, if the landscaping doesn't look right, the litter is not picked, if it's full of potholes, access and egress are not thought through as they open new retailers – all of those things mean that over time a customer will just go, 'I'm not going to go to such-and-such a place because it's just a nightmare'."

Marie Liston, corporate services director at ScS, says the retailer wants to introduce clauses to contracts that give it the ability to take action if landlords are not keeping up their side of the bargain.

> OUR AVERAGE SERVICE CHARGE HAS RISEN BY 26%, CPI HAS AVERAGED JUST UNDER 10%. WE'VE SEEN A BIG INFLATION BUT NO DISCERNIBLE DIFFERENCE IN THE SERVICE PROVIDED
>
> MIKE SPENCER, PIZZA HUT

Mike Spencer, chief business development officer at Pizza Hut, with a 548-strong estate, says that in recent years a growing number of landlords have outsourced service charges leading to additional fees. "Our average service charge has actually risen by 26% over five years, where at the same time CPI has averaged just under 10%. So we've seen a big inflation in service charge and no discernible difference in the services provided."

Pets at Home group property director Graham Harrison agrees: "The advent of service charges has created its own industry and the pressure is there to create income for stakeholders through the additional charges associated with management fees."

The Original Factory Shop's Williams would like to see more collaboration between retailers and landlords to ensure the service charge is working as it should.

"I think it's one of those where it's a little bit historic, and to work better I think it does need to be subject to a more regular review between the landlord and the tenant. I think it's something that just sits there and happens as and when, as opposed to collaborating together to improve the overall environment of the shopping experience."

Questions over insurance deals

B&M's Arora mentions insurance as an add-on cost that should be examined.

Landlords generally insure a retail park or shopping centre and then recharge that premium to tenants. Aurora says: "A number of landlords see that as an income stream and they take commissions and discounts from the insurance company that they don't pass on to the occupier. Forgive me for being

CHAPTER 3

PLOTTING A **PATH FORWARD**

For decades there has been unease in the relationship between landlords and retail tenants. Much of this is down to diverging goals.

Landlords need long-term security and guaranteed income so assets remain attractive to investors. This has led to contracts with long leases and upward-only rent reviews, a model that was acceptable to retailers when store turnovers followed a predictable path of growth, but less favourable after the seismic change that the pandemic wreaked.

A changing landscape

With store sales flatlining and the pace of change ever increasing, it is hard to know what things will look like in five years' time.

As a result, retailers have been pushing back increasingly hard against prohibitive contracts that tie them in at a fixed rate for long periods of time.

Pandemic-induced store closures dialled up the intensity. While some landlord-retailer partnerships have come out stronger, others have broken under the strain.

The property director at the specialist cosmetics retailer mentions a 23-year relationship that was undone by the crisis.

"We had never missed a payment," he says. "[Then] all our stores shut, and, not knowing when we were going to open, this landlord took us to court for the non-payment of rent."

Fortunately, many of the retailers interviewed for this report say the majority of their experiences have been positive.

Mark Saunders, chief executive at nursery retailer Mamas and Papas, says: "We were very quick off the mark, writing to people saying 'We want to have a dialogue,' and then writing every month if we weren't agreeing saying 'We still want to get an agreement with you'. And that has strengthened the relationships that we have with our landlords."

Retailers have also made a point of understanding the situation from the landlord's perspective.

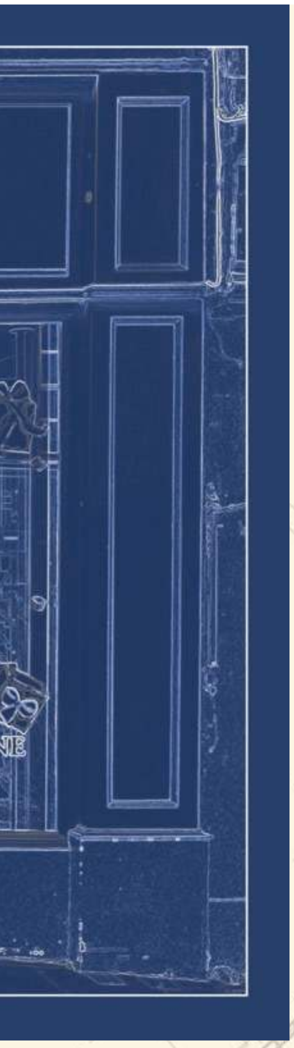
"Almost every landlord, without a doubt, has been really good, really supportive, wanting to talk," says Paul Kraftman, chief executive of Gift Universe, owner of gift and gadget retail Menkind, which has 48 stores.

"We always had a pretty good, decent relationship with landlords. We understand that they have got to make a living as well."

> THERE ISN'T ANYBODY THINKING ABOUT BRINGING ON THE NEW EXCITING RETAILERS OF TOMORROW
>
> TOM MEAGER, PRIMARK

Landlords who were deemed unhelpful during 2020 by our interviewees tended to be those wedded to traditional leases.

"We definitely have some that were absolutely closed to conversation during the pandemic and post-pandemic," says Alia Hawa, managing director for UK & Ireland at cosmetics retailer L'Occitane. "They are the ones sitting on the 10-year leases or the old leases that we have inherited. So I would say that the pandemic has just further deepened



the losses in those stores that were already a bloodbath. And these landlords have not given us one penny of rent reduction."

The big issue – long leases

The issue underlying most adversarial relationships is long leases with upward-only clauses.

Simon Arora, chief executive at value chain B&M, says it's unrealistic for landlords to expect long-term commitments: "I take the view that if a retailer commits to five or 10 years, that's plenty. You know, in how many spheres of commerce does a customer commit to five years? It's unusual. So when a landlord complains, it's just nonsense. Welcome to the real world."

"It's a historical problem that has led to a lack of innovation and fresh faces on the high street which isn't good for anyone," says Primark's Tom Meager. "There are a number of very good retail concepts out there that just can't get access to decent space because they keep being told they have to sign up to a longer lease with little flexibility. There aren't enough landlords thinking about these green shoot retailers and offering them flexible space, so that they may grow and become the new exciting brick and mortar retailers of tomorrow."

He adds that the success of these "incubation lets" could be based on pure turnover, or the landlord could use other KPIs to assess success for example, measuring diversity and differentiation of retail offering in the location they're managing, in a bid to make retail environments less homogenous.

Landlord investment

Do turnover leases – which mean less predictable income – impinge landlords' ability to invest in locations? Retailers think not.

"Landlords are always saying they need long leases to be able to invest. It doesn't seem to be a problem in Europe, for sure, and often the US as well. We're soon to be in 15 markets, 14 at the moment, and we don't have that conversation anywhere else, quite frankly, apart from the UK."
Tom Meager, group director of property, Primark

"They're just going to have to learn to operate in a more dynamic environment, really. Like us retailers, we invest in the stores, things change all the time, we have to react every day, and they maybe have to learn a little bit from the retailers that occupy their properties, to be a bit more nimble, a bit more agile. I'm sure they can make it work."
Paul Kraftman, chief executive, Gift Universe

Lease lengths on their own do not restrict a landlord's ability to invest – the best schemes will continue to be occupied. The key driver is falling rents and their impact on asset values; are landlords willing to invest which in the past would be justified by increased rents to get a return on capital investments?
Graham Harrison, group property director, Pets at Home

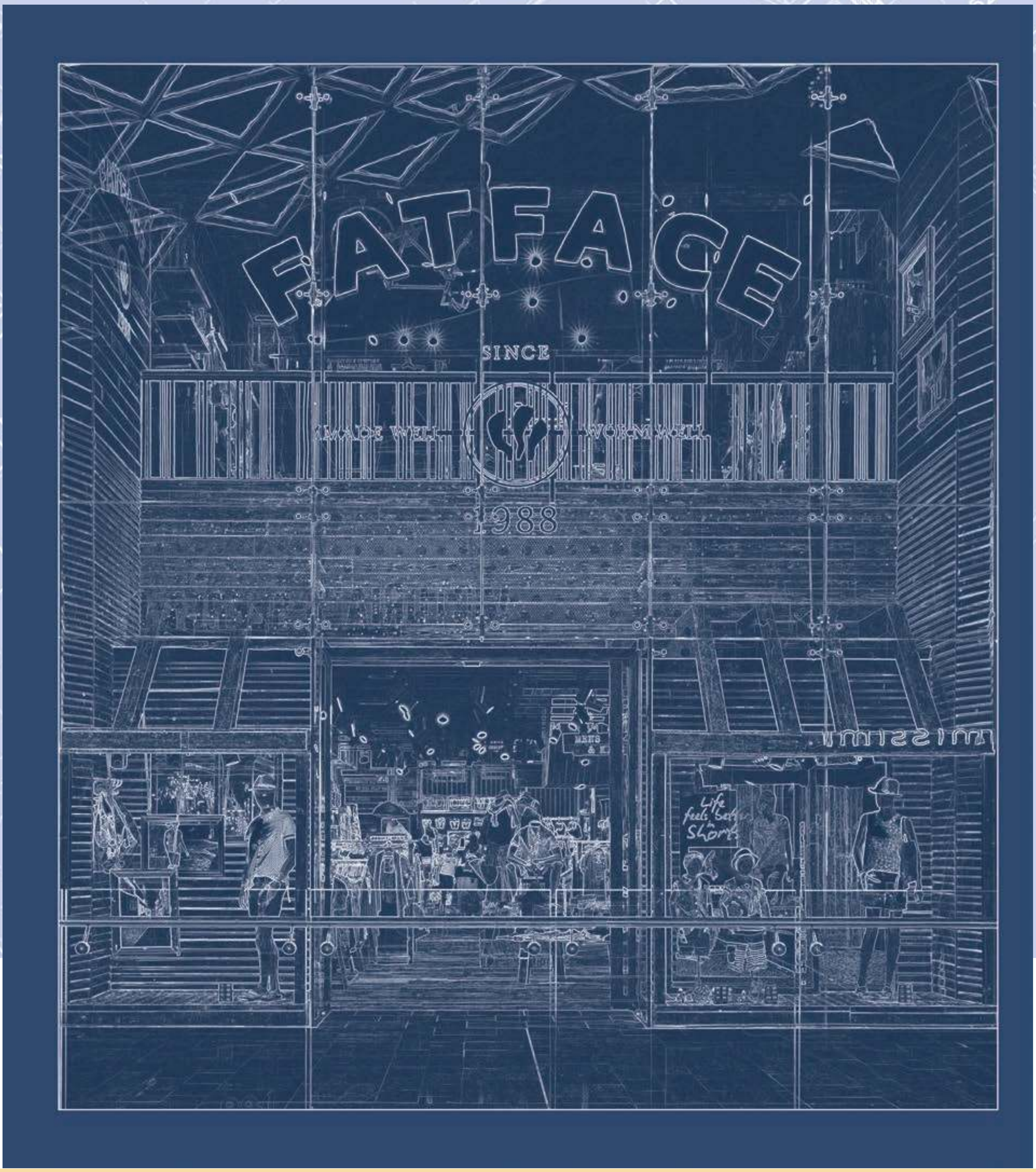
> ALMOST EVERY LANDLORD HAS BEEN REALLY GOOD, REALLY SUPPORTIVE, WANTING TO TALK
>
> PAUL KRAFTMAN, GIFT UNIVERSE

The sting in upward-only reviews

Upward-only reviews are particularly problematic for businesses where store turnovers may be migrating online.

These reviews often happen when a new tenant moves in and it has agreed a higher rent than the other current occupants – probably because it has higher sales volumes than its neighbours – then all tenants' rents will be increased to the same level.

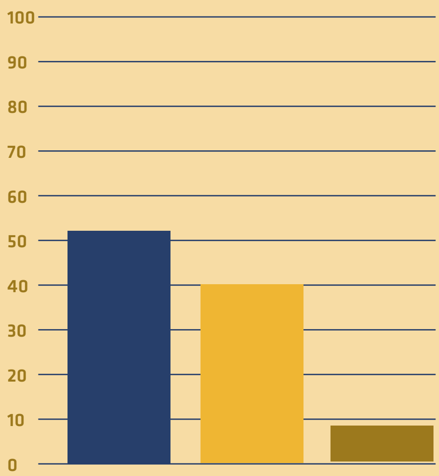
"The most penalising factor of the traditional lease structure is really the upward-only rent review," says Mike Spencer, chief business development officer at Pizza Hut. "You may get a landlord attracting a new tenant in with high incentives. That tenant may trade at a much higher level than you on a weekly or annual basis and their rent will be linked to that,



WHEN IT COMES TO TURNOVER/HYBRID LEASES....

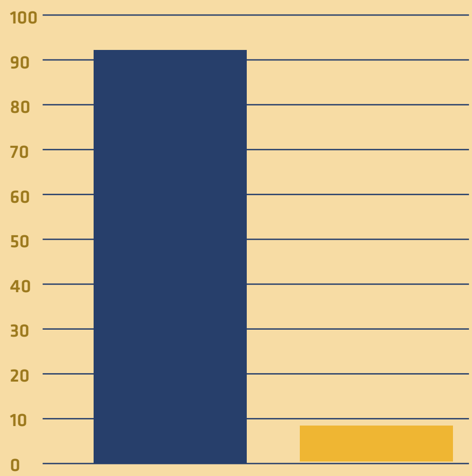
A) Did you secure them during the pandemic? (%)

■ Yes
■ No
■ We already had them



B) If yes, are they permanent?

■ Yes
■ No



> IF BRANDS WANT TO COME AND GO, I DON'T THINK THAT'S FAIR TO LANDLORDS OR BENEFICIAL TO RETAILERS
>
> TOM BEAHON, CASTORE

but yet then you're linked to the rent that they've agreed."

He adds that the pandemic has not stopped this happening.

"Many places have benefited from Covid and a lot of the locations that we're in have actually seen rents rise post-Covid rather than reduce – a good example being retail parks where we've seen inflation of potentially up to 20%."

The landlords' perspective

Many of the retailers we interviewed are sympathetic to landlords' points of view, and some even prefer leases of 10 to 15 years, or fixed terms.

"You need to be fair to the landlords," says Tom Beahon, co-founder of sports store Castore, which has seven retail units. "They raise capital for the long term and therefore want and need to receive a stable income in return for their investment. If brands want to do a year here, a year there, and then move on to the next one, I don't think that's fair to landlords or, frankly, particularly beneficial to retailers either."

Deals that work for both sides

Beth Emmens, head of acquisition at fast-food chain Leon, says: "In lots of places I'd much rather have a fixed-base rent than have a potential turnover and have to share in any upside."

Broadly speaking, retailers do recognise the need to work in partnership, and for many this means a move to turnover-based leases that proliferated during the pandemic.

For Pizza Hut's Spencer a hybrid model works best: "Both parties can benefit from having a base rent with a turnover top-up formula. Both have some certainty over rental income, which I think is important for landlords from a valuation perspective, but also they can then share in the upside of any sales growth that a business sees."

Castore's Beahon says: "I think for the vast majority, to have your rent and the cost that you're paying for a site directly linked to the revenue that site generates, that feels fair – and everybody has got an interest."

It's the flexibility of turnover-based leases that make them so appealing to retailers – and for some, it should be written into any base rents.

Ted Baker head of property Dan Browne says that base rents, which are normally subject to upwards only reviews, should be able to go down if necessary. "Upwards and downwards reviews are probably going to be part of this. We would rather have turnover-only rents, but I think if you have a base rent element, it has to take market conditions into account at some point."

What could be the game-changers?

Turnover-based leases have the potential to fundamentally change the relationship between landlords and retailers.

The property director of the specialist cosmetics retailer says: "I opened 16 stores last year and we're going to open more this year – all of them I've done on turnover deals and the relationship with the landlord is totally different.

"They're involved with our store opening, our marketing, advertising on their websites for us, saying a new store is coming, helping with recruitment.

"They're really keen to understand what will make our business better. We're in it together. Those stores have started off phenomenally for us. So you can see the relationship changes."

Phil Reynolds, restructuring advisory partner at FRP, adds: "We have seen many examples of relationships between tenants and landlords being strengthened over the pandemic – and this has been down to proactive conversations, concessions and most importantly flexibility by both sides.

"Often, it's in landlords' interests to accommodate brands' requests to review leases or charges, particularly if a retailer is in distress. But it's critical that tenants respect the landlords' needs too – a solution that's going to be effective and stay the course will need to be shaped to the challenges of all those at the table."

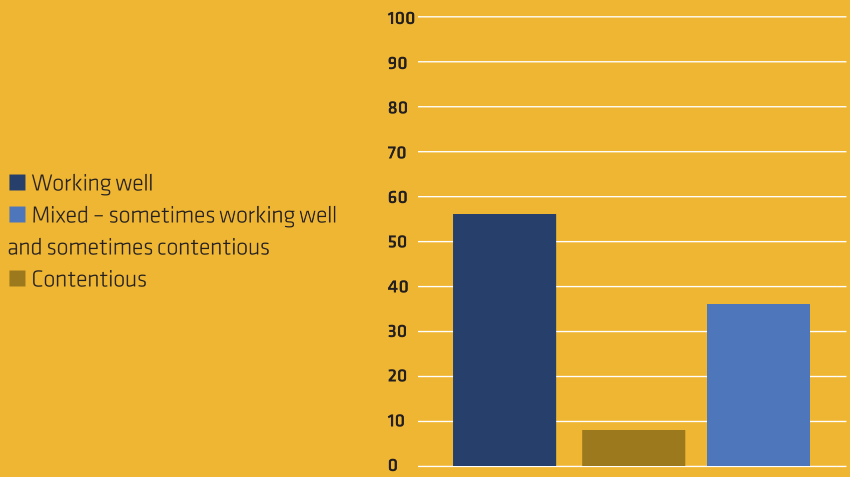
Strength in flexibility

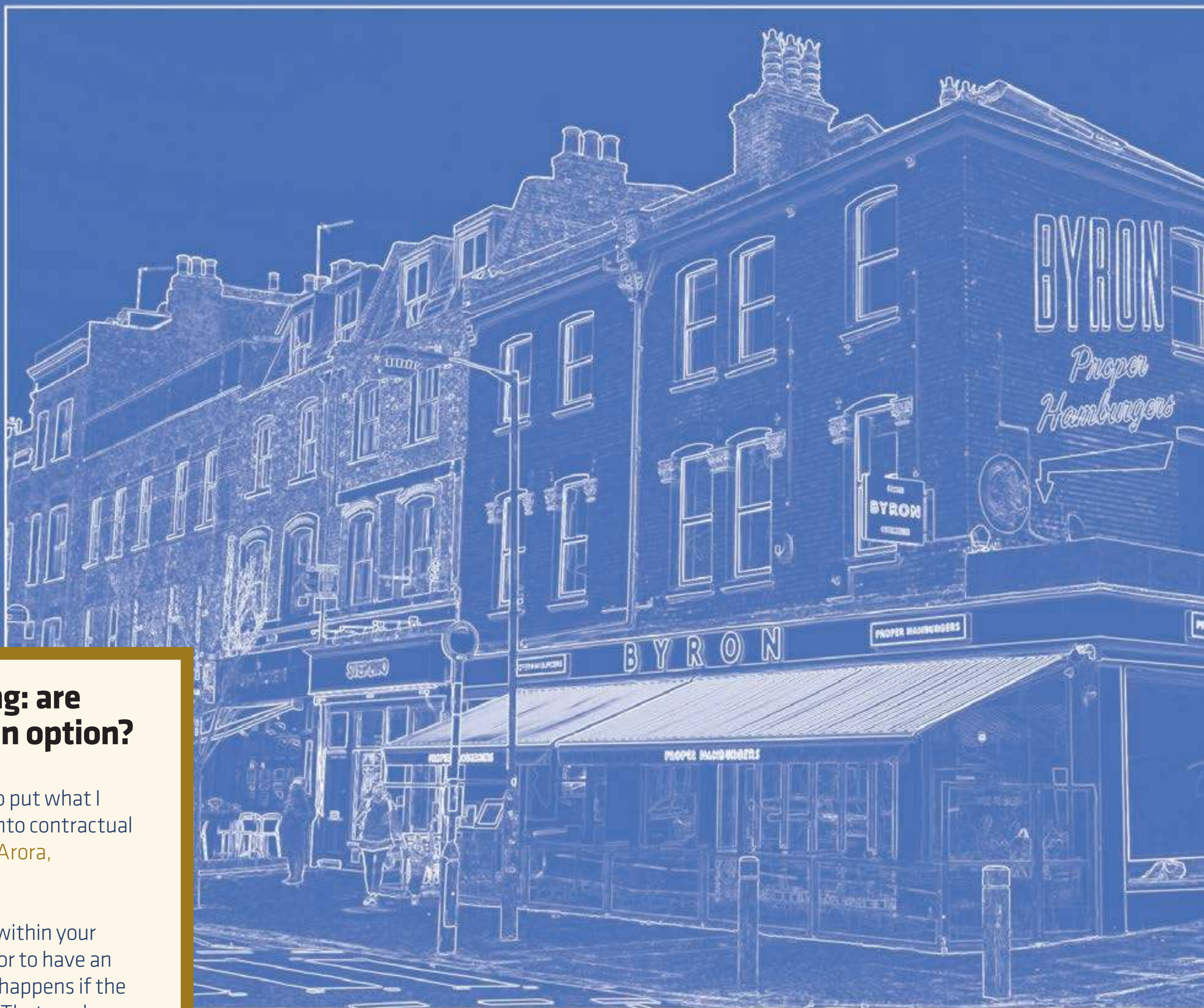
At the heart of the push for change is a desire for greater flexibility to react to changes in the retail landscape.

"We would look for a bit more flexibility in terms of potentially upward, downward rent reviews and also in terms of the management of the service charge," says Marie Liston, corporate services director at interiors retailer ScS. "Give the tenant the option to exercise a break where certain other conditions aren't fulfilled."

Break clauses are becoming an important part of achieving the flexibility

HOW WOULD YOU CHARACTERISE CURRENT DISCUSSIONS WITH LANDLORDS AROUND RENTS AND LEASE LENGTHS?





Future-proofing: are Covid clauses an option?

"I think it's hard to try to put what I call black swan events into contractual arrangements." Simon Arora, chief executive, B&M

"It's having something within your lease to protect people or to have an understanding of what happens if the government shuts you. That can be a pandemic. It can be all sorts of other things. It's about having this agreement in place so that we don't then have to sit there and have the moratoriums and the arguments and everything."
Brett Parker, property director, Gail's

"To get a clause in there would have prevented quite a lot of time and effort and uncertainty on all sides and it would help retailers know where they stand. It would have probably helped landlords collect more money as well because it wouldn't be everybody sat on money, negotiating." Mark Saunders, chief executive, Mamas and Papas

"We have tended to agree Covid clauses in our new leases, so should there be a government-enforced lockdown rent would move to turnover-only for a maximum of three months within any 12-month period." Beth Emmens, head of acquisitions, Leon

"We've asked for Covid clauses but we don't always get them. It's not a huge sticking point for us just because we got such good support anyway."
Ian Williams, chief financial officer, The Original Factory Shop

retailers want. This includes trying to get disaster-related clauses into their contracts, to help them if store closures are ever enforced again. Others are focused on changes to payment schedules.

"We would like to see a revenue element to all leases," says Gift Universe's Kraftman.

He is looking to shift the rent the business pays so that the bulk of it comes during the peak Christmas trading period.

"A payment phasing piece for seasonal retailers like us is very important to us."

Clothing retailer Fat Face is another retailer to have secured changes to payment terms. Three-quarters of the leases in its 203-store estate are now paid monthly, chief executive Will Crumbie says, instead of the industry standard of quarterly.

Value supermarket chain Iceland is also moving towards monthly rent, but managing director Richard Walker says the business is less keen on turnover-based leases.

"With consumer price index increases, we've been caught out by that historically. Turnover rents we don't really do."

Reynolds at FRP says: "When it comes to negotiating new arrangements, a strong place to start is setting out a range of options and concessions that would achieve the tenant's objectives, rather than pre-judging the landlord's preferences and offering one solution.

"This might include a turnover based rent, or a hybrid approach – part-fixed rent, part variable, combined with potential lease extensions or reductions.

"In some circumstances an offer to stay in a property rent-free, bar service charges, on a flexible exit basis while a landlord can find a new tenant may be far more preferable to both parties than an immediate exit.

"Ultimately, the retailer can reduce overheads, while the landlord needn't worry about an empty property or, crucially, rates. As always, flexibility and open, regular, dialogue is key."

> ARE RENT DISCUSSIONS EASIER AT THE MOMENT? YES – EVERYBODY WANTS TO MAKE DEALS, THERE ARE PLENTY OF VACANT PROPERTIES
>
> NICOLAS BARNOIN, BYRON

Back to reality?

The big question for many is how much of the change experienced over the past two years will stick. Given the extraordinary past 24 months, it's possible there will be pressure to return to 'business as usual'.

Dominic Curran, property policy advisor at the British Retail Consortium, says he expects the occupiers' market to last for a couple of years. "What sticks depends on the outcome of the government's delayed review of tenant legislation it is undertaking in 2022," he says, adding that a call for evidence is likely to be made in the summer.

Potentially this review could change the legal framework through which leases are agreed and, as a result, some common practices – such as upward-only rent reviews, or the way dilapidations (breaches of lease obligations or covenants) are treated – may be affected or even withdrawn.

Another key moment will be the resolution of outstanding pandemic rent arrears through the arbitration process. Depending on how this goes, we may see retailers being forced to pay rent they can't actually afford.

Whatever happens, any return to previous dynamics will be relatively slow. "It will take time for the surplus of supply to work its way through the market," says Curran.

Pizza Hut transitioned 75% of its portfolio into turnover-based rents as a result of its 2020 CVA, but these temporary leases end in September. Spencer says: "We've taken a lot of time to sit down with our landlords, talk through our strategy, understand the reasons for the CVA and try to move forward. In the vast majority of cases landlords do get it once you take the time to talk."

Nicolas Barnoin, chief operating officer at Famously Proper, owner of 27-strong restaurant chain Byron, says: "Are rent discussions easier at the moment? Yes, because everybody wants to make deals, there are still plenty of vacant properties."

However, he believes this may change now we are emerging from the pandemic and all restrictions have been dropped. ■

The retailer view – relationships with landlords

"For both sides slightly shorter lease lengths are a good thing at the moment. It gives the landlord flexibility to understand what their scheme's going to look like and how they might need to develop other areas, and it gives brands the opportunity to ensure they're in the right locations and they're doing the right things. Then we'll see what happens into the longer term."
Will Crumbie, chief executive, Fat Face

"I'm a bit of an old-fashioned person, I like to know where I stand, so an agreed fixed rate is always the best way to work in our view. The simple way to do things is just 'how much is that going to cost me for five years? Let's do a deal'."
Jon Shaw, head of UK sales channels – retail, telesales, online and indirect channels, Vodafone UK

"We can push for ever shorter leases, but if there's no certainty of cash flow for the landlord, they can't get the funding, they can't invest. I pity the poor landlord because it's not like it was with 25-year institutional leases and it does make it harder, of course."
Richard Walker, managing director, Iceland

"For us a traditional lease is satisfactory. What we would like to see is less restriction within leases for retailers to run their businesses efficiently – for example, container consents, and in the future, the ability to install mezzanine, air-conditioning units, click-and-collect spaces in car parks and electric vehicle charging points in service yards without constantly seeking landlord consent with associated agents and legal costs."
Graham Harrison, group property director, Pets at Home

"That landlord-retailer relationship is traditionally viewed as adversarial; in reality you're in partnership, so you've both got to make money."
Mark Saunders, chief executive, Mamas and Papas

CHAPTER 4

> ONLINE OFFERS A GREAT SOURCE OF GROWTH... THOSE ADDITIONAL CHANNELS ARE PART OF THE PHYSICAL RETAIL ENVIRONMENT RATHER THAN NEGATIVELY IMPACTING IT
>
> BRETT PARKER, GAIL'S

STORES: IMPACT AND INNOVATION

Physical retail's role in the modern channel mix

Stores continue to defy the predictions of their demise and they remain central to the retail experience many businesses offer.

Over a quarter (28%) of the retailers we spoke to plan to open more stores within three years, while 44% plan to maintain their current level.

Tom Beahon, co-founder at sports retailer Castore, thinks the pandemic "has been the catalyst for retailers to have to up their game and to look at their business models" to analyse what each of their store, wholesale and online businesses do and how they can be integrated to support each other.

The answer to those questions for some retailers we spoke to – particularly in fashion and lifestyle – is that each provides a different service: online often serves a customer who knows what they need and wants to buy quickly; stores are a more creative, sensory or educational process.

"[There's] always a role for physical and if… the buy button gets pressed online rather than in the store it doesn't really matter because the two work in harmony," says Mark Saunders, chief executive at Mamas and Papas.

"Physical retail, increasingly…needs to be more of an experience. It's really got to be good fun, good entertainment, rather than something functional."

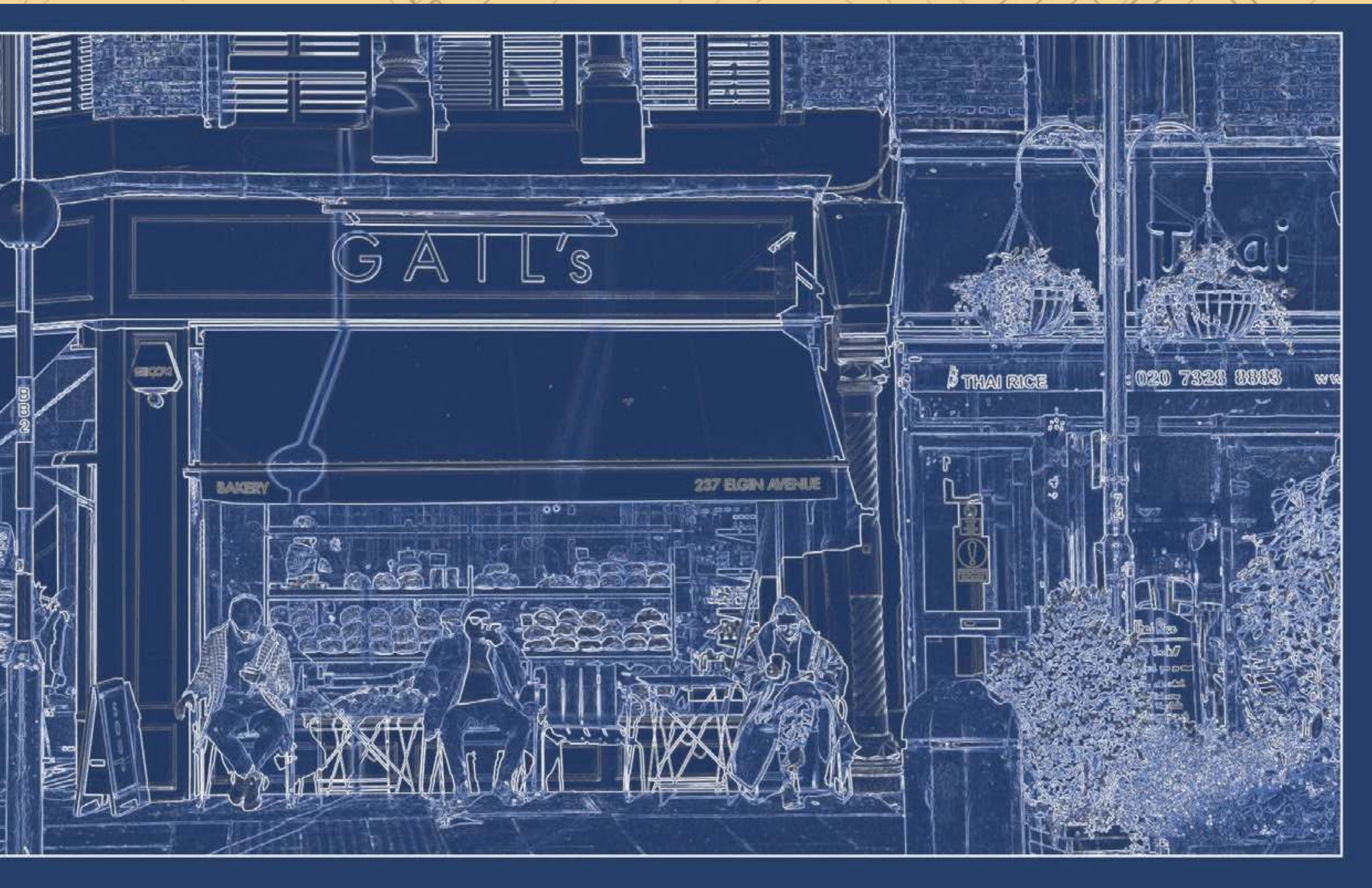
He adds that the business sees clear evidence that it has higher online market share than average in places where it has stores.

He also notes that Monday is often the third-busiest day of the week in terms of turnover, "which is evidence of people going into shops at the weekend, doing their research, coming back home, reflecting on a Sunday night and then on Monday pressing the buy button online".

Alia Hawa, managing director, UK & Ireland at L'Occitane, says: "Bricks-and-mortar for us this year has performed better than expected simply because people just wanted to have that physical experience and they were happy to speak to a store associate.

"Online will never completely replace the in-store experience because [it doesn't allow customers to] smell a fragrance."

For Paul Kraftman, chief executive at Gift Universe, the focus on experience means not over-digitising the store "because people can do that on their phones, in their houses [whereas] the retail store is designed to provide a personal service, one-on-one



demonstrations, look and feel of the product, instant availability, all those kinds of things".

Stores: community and convenience

For others, stores provide something more tangible in people's lives or communities.

Brett Parker, property director at bakery chain Gail's, says: "Online channels offer a great source of growth for our business, but we'll always be neighbourhood bakers. Each site is designed with that love of craft in mind and it's important for us to be able to preserve that experience."

While click-and-collect, decent wi-fi and immediate collection are all priorities, "those additional channels are part of the physical retail environment, rather than negatively impacting it," he adds.

At the furthest end of that scale, stores play a role that is unlikely to ever be fulfilled by online shopping.

Dawood Pervez, managing director at Bestway Wholesale, points to the thousands of convenience stores in towns and villages where online delivery wouldn't usually make logistical sense.

Bestway has partnerships in place with several delivery firms, but mainly customers go into the stores to shop. So while the digital strategy that makes stores discoverable in as many ways as possible is important, "it's not the be all and end all, because fundamentally, convenience stores serve a need, and that is customers needing to pop out and quickly get something", Pervez says.

"It's not that efficient for consumers who need a bulb of garlic and a tin of baked beans to order it with a £2.99 delivery surcharge. That wouldn't make sense."

Complementary channels

Every business is different and while each channel plays a role, most retailers are in the process of weaving their channels more closely together.

The so-called 'halo effect' a store has on online retail sales is hard to measure, but many are trying.

Marcel Bordon, chief executive at Soletrader, says: "The halo effect of a store on online sales is unbelievably difficult to analyse. We've tried postcode modelling, that doesn't work.

"So is there a halo effect? Possibly. Is there a halo effect that can be analysed to an individual store? Probably not. We just know

Investment plans

"We're investing in digital but not at the expense of the store portfolio – I actually see us extending the store portfolio. Both are super important in today's day and age, so we're focusing on both and for me it's about how we really join up that customer journey."

Steve Carson, chief executive, ScS

"I think that's the secret sauce now, for having a successful retail business is being really precise about exactly where you are…if we can't get to an exact location, we'll wait. You're better off waiting for a unit to become available exactly where you need it to be."

Jon Shaw, head of UK sales channels – retail, telesales, online and indirect channels, Vodafone UK

"I thinks it's incredibly important that the more community-led brands, the smaller brands, have a far more flexible base because otherwise how are you going to entice, and keep enticing, customers to the high street if it's all the same dull line-up."

Caroline Crosswell, chief retail and development officer, Rapha

that we have to have a certain number of stores for awareness."

However, Gift Universe's Kraftman says he has noticed a halo effect: "If you look at our internet customer base, they are weighted towards postcodes where we have stores. We are certain our retail store presence helps our digital business."

Digital boost

On the flip side, digital is being used to enhance and bolster retail's physical offer, and make it more frictionless.

At fast-food chain Leon, digital ordering kiosks are being retro-fitted into all existing stores and designed into new ones.

To work alongside these, the company is developing apps and examining other forms of engagement to expand the ways it can communicate with its customers.

"We've always had a large Leon club that we've spoken to via email and Instagram, so [we're] converting them over to digital apps, mainly because it's something that they have requested from us," says Beth Emmens, head of acquisitions.

> "OUR DIGITAL REACH CREATES AN EFFICIENCY FOR OUR PHYSICAL ESTATE – 66% OF SALES ARE GENERATED VIA DIGITAL CHANNELS, BUT 98% OF FULFILMENT OF THOSE SALES TOUCH THE STORE"
>
> DAVID WOOD, CHIEF EXECUTIVE, WICKES

Wood at Wickes says: "In a multichannel world bricks and clicks need to work symbiotically to drive efficiency and great customer service. In our business just over two thirds of all sales are generated in the digital space, with consumers researching online before heading into the store.

"Our digital reach creates an efficiency for our physical estate, because whilst 66% of sales are generated through our digital channels, 98% of the fulfilment of those sales touch the store."

The halo effect is therefore the other way around, from online to the stores.

The dynamic is similar at interiors retailer ScS, where 80% of purchases might start online but nearly always involve a store visit, with consumers wanting to see their furniture, even if they then return home to buy it online.

Measuring value

All of this makes it tricky, to say the least, to accurately measure a store's value, but educated guesses are still helpful.

"People may argue that it's impossible to track it with 100% certainty. And I think they're probably right," says Castore's Beahon. "But I do think you can get a very accurate understanding, looking at wholesale, physical retail and ecommerce together, whether an individual store or an individual location is value-creative."

James France, head of global leasehold properties at Frasers Group, says the business uses a number of KPIs to determine the success of a store, but profitability is paramount.

"The value of a store is a marketing piece as much as it's transactional. It's that shop window demonstrating the brands and breadth of products we have.

"We don't necessarily measure it on things like customer traffic. It's trying to get our basket spend up, remain profitable, and be a successful retailer in each of those locations."■

CHAPTER **5**

RENTS, RATES, REFORM MANIFESTO

3 SOLUTIONS TO RETAIL'S PROPERTY CRISIS

What has become abundantly clear from the research within this report, including our interviews with these 25 leading retailers, is that there is both clear common ground and areas where no agreement remains.

While turnover-based rents are preferred by the majority, they are not preferred by all, particularly retailers that fared better than most over the pandemic. Similarly, while most advocate for an online sales tax, those with large ecommerce businesses are more hesitant.

However, clear areas of consensus did emerge, particularly around the need for business rates reform and a true partnership approach.

Taking all of this into account, Retail Week, together with our report partners Addleshaw Goddard, Bruntwood and FRP Advisory, outline how each interested party will need to pull on the levers of change to unlock the path forward.

1. It is time for a true reappraisal of the business rates system

If one message came across loud and clear from this research report, it is that retailers see the business rates system as broken. Particularly, the retailers cite online rivals using the same infrastructure such as roads to deliver goods to consumers without paying rates to support investment in it.

Many argue chancellor Rishi Sunak's recent reforms (dialling down revaluation periods from five to three years) do not go far enough nor do they tackle the unbalanced burden on physical retailers.

The exact path forward here is one that requires further discussion, but one solution we identified is a potential sales revenue tax of 2% nationally, to include online retailers.

2. Landlords will need to accept more flexibility in lease terms particularly around tenant breaks and more use of a hybrid rent structure

The research shows a clear direction of travel: 59% of the retailers we interviewed want leases under five years, up from the 45% that currently have those lease lengths. With the increasingly rapid pace of change in consumer trends, this could be to landlords' advantage, with regularly refreshed retail assortments creating more vibrant shopping destinations. Failure to take this approach could risk longer-term decline.

Certainl, there is greater evidence of nuance and individuality of the needs of retailers when it comes to lease term. This will be influenced by changing markets, the cap/ex involved in opening each new store and their confidence in the location as a retail pitch

Our suggestion for retailers that want turnover-based rents would involve landlords agreeing a fixed base rent to provide them with some security and a turnover-based top-up, which ensures all parties are invested in a location doing well. This should also address some of the concerns retailers communicated, such as competitive service charges.

3. Retailers must be transparent and present full short and medium term store forecasts and business plans (subject to any limitations if the tenant business is listed)

This will enable landlords to then share those forecasts with their lenders and set realistic and affordable quarterly base rent payments, which are then topped up by quarterly performance payments with an audit reconciliation at the end of the year.

In order to build trust, this would require full transparency on the retailers' part in entering negotiations with detailed business plans a more partnership based approach. Partnering between landlords and retailers in the sharing of data and performance builds trust and drives towards a shared objective of a successful store location. It also assists the retailer in obtaining more flexible terms if the landlord (and their funders) can understand the commercial rationale for a particular request.

These are Retail Week, Addleshaw Goddard, Bruntwood and FRP Advisory's initial recommendations based on this research into a complicated subject with many areas of conflict of interests to be resolved. There will be more to come from our Rents, Rates, Reform campaign, and we welcome your feedback and dialogue on this critical topic.

IN ASSOCIATION WITH

ADDLESHAW GODDARD

bruntwood

FRP