THE REAL COST OF SETTING UP SHOP

How occupancy costs compare
Research & Forecast Report

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Colliers
INTERNATIONAL

Analysis of retail occupier costs across key European cities shows a wide variation in costs additional to rent.

It is clear that retailers consider total occupancy costs relative to the actual and potential amount shoppers spend in a specific market, in order to focus on where they can derive the best value from their physical retail presence in relation to cost.

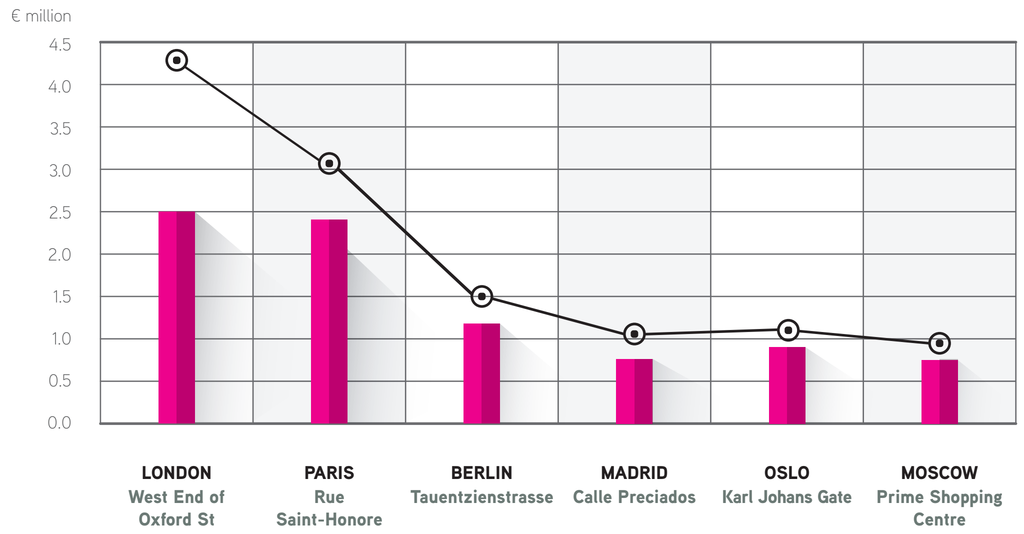
However, despite the high occupancy costs incurred by retailers in the key tourist and business cities of London and Paris, they remain the top destination choice for international retailers given the high volume of retail spending in these cities.

- Total occupancy costs are being driven up by local taxes
- These differ widely from country to country
- Sales tax on rents varies from 18% in Russia to 27% in Hungary
- London is still achieving the highest retail rents despite having proportionately the biggest local tax burden
- If London tax burden could be alleviated there would most likely be an upward shift in rents
- Retailers are ultimately most influence by profitability than occupancy cost
- Domestic and tourist retail spend heavily influence retailers' decision where to trade

Headline Rent vs. Occupancy Cost

[For a 300 sq m Store* in Prime Location per Year]

Headline rent · Occupancy cost



*Calculations based on a 10-year lease of a 300 sqm store (12m wide and 25m deep); the costs exclude fit out and additional charges such as key money, internal insurance and turnover rent.

When comparing competing locations, the property industry tends to look at rental levels while retailers consider total occupancy cost, the true annual bill for 'setting up shop'. Retailers also consider the flip-side of this cost - the actual and potential amount shoppers spend in a specific market. In essence, they focus on value in relation to cost.

In this report we look at the composition of total retail occupancy costs across key European cities. Depending on the market, additional costs that need to be taken into account include the service charge, marketing fee, VAT, property tax, other taxes, 'contents' insurance, lease registration costs, deposit and/or bank guarantee and so called "key money".

And this is before you get to the labour costs which make up a major chunk of retail operational expenses. The lease structure and degree of flexibility of occupancy are also key factors that need to be considered as they can differ significantly from market to market.

In some of the markets, the percentage of total occupancy costs made up by these additional costs is startling - notably in London, where total costs increase by an additional 70% above their base rental price. However, from a broader perspective, the total occupancy cost level is testament to how attractive a location is to retailers, based on the real value of trading in those locations.

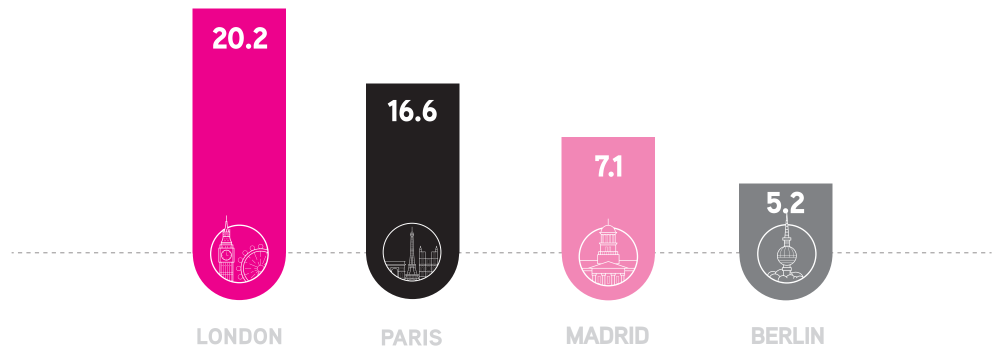
London is the world's most visited city and the total annual spend by international tourists reached over US$20 bn in 2015. Paris is the third most popular city (second only to London in Europe), attracting over 16 million international tourists in 2015 who spent $16.6 billion.

So despite the high occupancy costs, key tourist and business cities remain the top choice for international retailers. In any location, it is the profitability metric which retailers are ultimately guided by. In terms of total retail occupancy cost, it would be interesting to see where rents in cities with high occupancy costs would rise to, if they were freed of the burden of additional local costs and taxes.

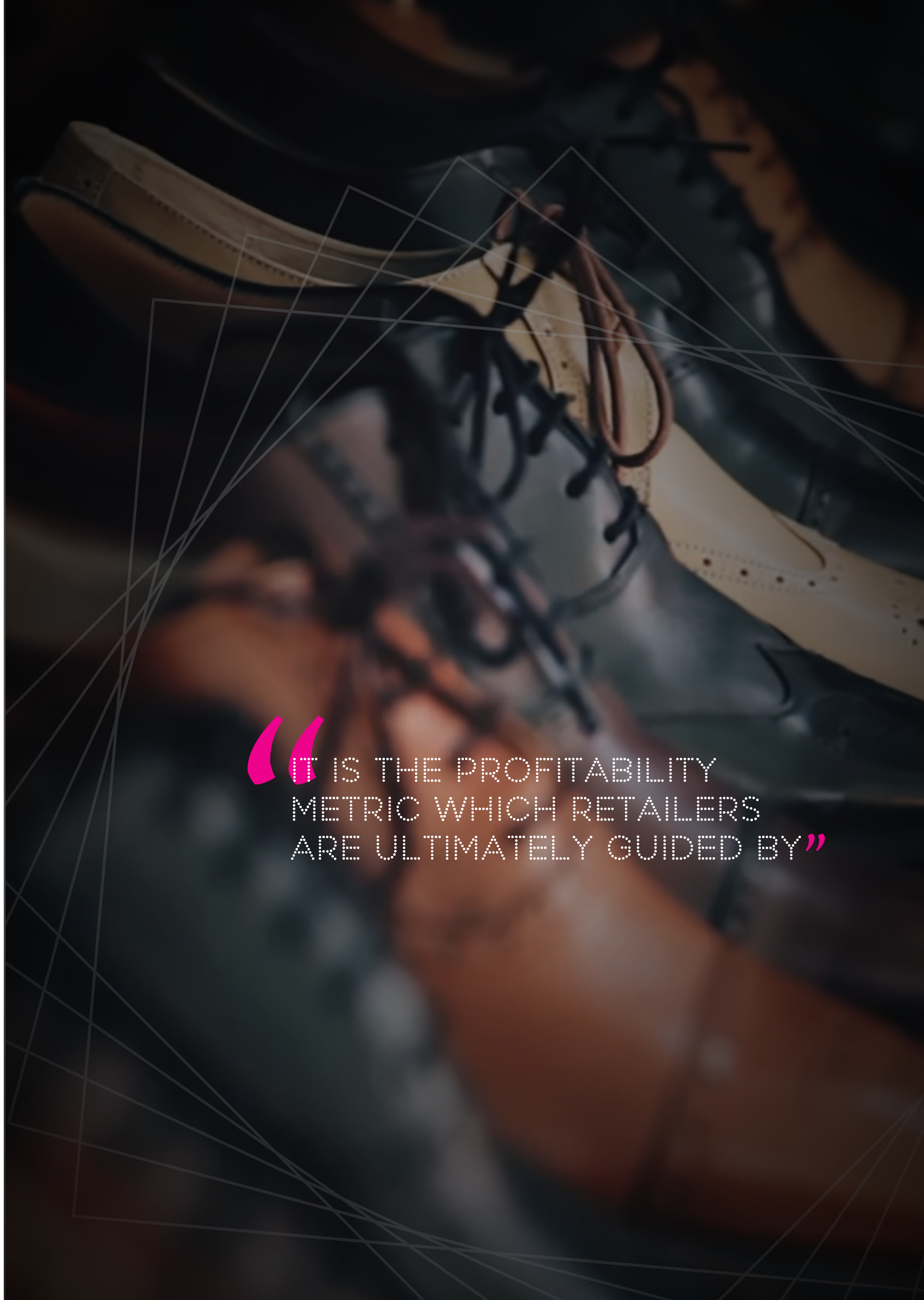
It is clear that retailers need to consider many factors before embarking on building a retail operation in a market. Differing economic conditions, consumer behaviour and spending patterns clearly drive decisions, but occupancy costs are critical to the optimum retail footprint for a specific retailer. As our brief overview shows, these occupier costs, and their potential application, vary significantly from country to country and from scheme to scheme.

Despite high occupancy costs, France and the UK remain top expansion choices for international retailers, along with Germany. Many retailers consider that having a presence in a particular, key market generates value in itself, courtesy of improved branding and visibility despite the lower localised profits/high cost base. While this might be the case for the mainstream fashion brands, high occupancy costs can be a serious obstacle for other retailers - the smaller the margin, the lower the probability of opening a store in an expensive location.

International Overnight Visitor Spending in 2015 [$bn]



Source: Statista/ Colliers International



> “In most of the analysed markets rent is subject to sales tax, ranging from 18% in Russia to as much as 27% in Hungary.”

While rental structures have many similarities across the European markets in particular, the non-rent additional cost burden that retailers face across territories differs widely.

In the markets across the 19 European countries which were studied for the research, rent is either paid in advance, monthly or quarterly. Having your rent annually indexed to a Consumer Price Index or similar is not uncommon.

The German and Russian markets are characterised by stepped rents – although in the latter market we are now seeing more rent review options inserted into leases.

The rent review culture predominates in the UK and Ireland where open-market reviews are usually conducted on a five yearly basis.

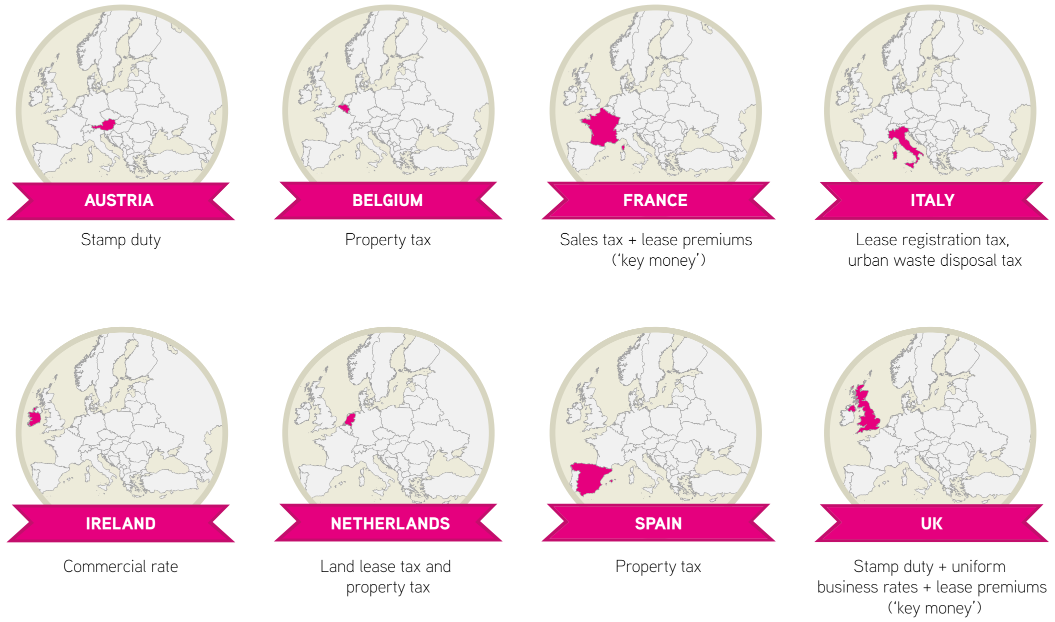
However, the big variation between locations is the non-rent additional costs that occupiers are liable to in addition to the rent.

In most of the analysed markets, rent is subject to some form of Sales Tax which ranges from 18% in Russia to as much as 27% in Hungary. However, there are anomalies in how it is levied. In Portugal, Sales Tax applies to shopping centre rents only while in the UK the burden is usually recoverable. However, retailers in the UK do have to pay Uniform Business Rates which can represent up to 40% or more of total occupancy cost.

In Ireland commercial leases are exempt from this type of tax, but the landlord may opt to tax a letting. Retail occupiers in Belgium do not pay Sales Tax.

Aside from some form of Sales Tax, the occupation of a shop can involve paying a variety of additional taxes and charges which encompass everything from urban waste tax to obligatory ‘key money’ – a premium that must be paid to take control of an existing lease.

Examples of common non-rent additional costs for retailers



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in annual revenue

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Under management

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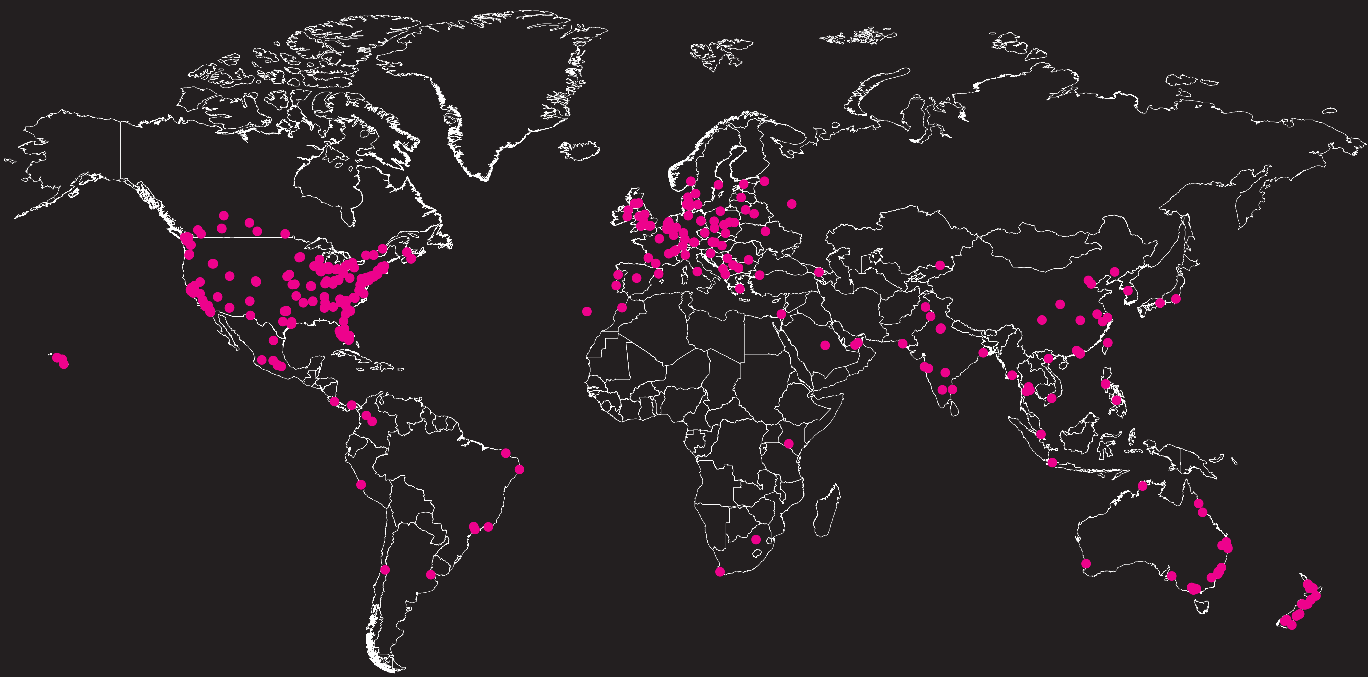

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