

LEASE ADVISORY GETTING THE MOST FROM YOUR RENT REVIEW



How can commercial property tenants make the most of the rent review process?

If there is one thing we can be certain of in the world of commercial property, it's that the market is cyclical. At times this works in the favour of tenants, and at others the pendulum swings in favour of the landlord.

Right now? Rent reviews are back in fashion and it can often be a painful experience for the tenant. In recent years, the majority of rent reviews have looked at potential uplifts to rents that were originally set in the depths of the recession. As the business climate improved after the downturn, availability of property fell, driving up rents.

Now, across most markets, availability is still way below the long-term average. As an impact, in parts of London, settlements have concluded with rent increases of over 100%.



Cardinal Place, Victoria
Rent Reviews: 65,000 sq ft - Offices



Wallows Industrial Estate, Brierley Hill
Rent Review: 113,000 sq ft - Industrial



Apex Plaza, Reading
Rent Review: 21,000 sq ft - Offices



1 Lothbury, EC2
Rent Review: 117,000 sq ft - Offices



Prologis Park, Coventry
Rent Review: 56,500 sq ft - Industrial



Sterling Industrial Estate, Dagenham
Rent Review: 40,000 sq ft - Industrial

Landlords on the front foot

Not surprisingly we are also seeing landlords take a more aggressive approach. No longer are they just “happy to have a tenant paying the rent”. Over the last few years, the sheer weight of money chasing limited investment stock has caused an increase in capital values or “yield compression”. It’s been pretty easy for asset managers to ride this wave of increased values. In the main, yield compression has, however, slowed and even halted, so rental growth is one of the few ways that investors and landlords can “add value” to assets.

Nil increase over 15 years

Take for example a prominent, high-specification office building in West London (that I know well). Originally let in 2004 at just over £30 per sq ft, its first rent review - following a period of significant rental growth - was in 2009. The market was of course in freefall at that time and the rent review resulted in a nil-increase. Ouch! Five years later and the 2014 rent review went to arbitration.

As the market for such properties was still making up lost ground, the result was, again, a nil increase. Although this was good news from a tenant’s perspective, the landlord had no prospect of any increase in rents for 15 years. Now think about this – the next round of rent reviews will fall within the timescales of the UK leaving the European Union. However this plays out, we have to expect a period of uncertainty, impacting on business confidence and capital values. Landlords, keen to maximise rental growth, will throw significant resources at the review process.

William Blair

COMMVault

Pulse
Community Healthcare

Itaú BBA

中國銀行
BANK OF CHINA

Track record - Case studies



Unit 9100, Crosspoint, Coventry
Rent Review: 140,000 sq ft - Industrial



Meridien House, Watford
Lease Advice: 60,000 sq ft - Offices



Caledonia House, Kings Cross
Rent Review: 18,500 sq ft - Offices



Bermuda Park, Nuneaton
Rent Review: 90,000 sq ft - Industrial



Hoxton Square, Shoreditch
Rent Review: 5,000 sq ft - Retail

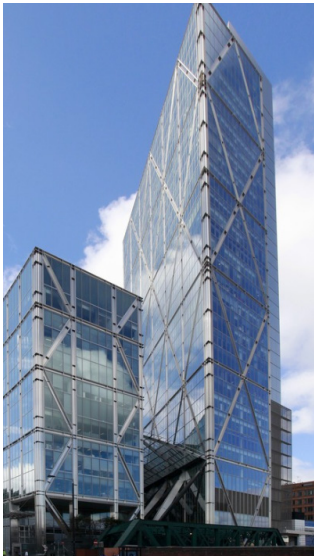


Central City, Coventry
Lease Renewal: 83,000 sq ft - Industrial

Timing

Unfortunately, the all too common response from occupiers when preparing for a rent review is: “We will wait for the landlord to quote a rent before we think about it.” The problem with this approach is that by the time the process gets to this point, the landlord will have been thinking about it the review for around 12 months: appointing surveyors, carrying out inspections, compiling comparable evidence, reporting etc. They will have reviewed all the market data, looked at what other properties are available and what lettings are on the horizon.

At those sort of levels, the landlord is raring to go so they will ramp up the pressure soon after they have quoted a



Broadgate Tower, EC2
Rent Reviews: 39,000 sq ft - Offices



2 Park Street, Mayfair
Rent Review: 5,000 sq ft - Offices

OFFICES

Transacted on
over 200,000 sq ft

INDUSTRIAL

Transacted on
over 1.3m sq ft

RENT ROLL

Transacted on
over £7m

figure. It's usually only at this point in the process that the occupier starts their due diligence. Selecting a surveyor, negotiating fees, and waiting for the surveyor's report: this all takes time. Landlords often become frustrated and end up forcing the issue by making a third-party application, as once arbitrators have been appointed they have a duty to proceed.

The result is that the landlord controls the timing, tenants are forced in to arbitration, costs escalate, relationships between landlord and tenants can turn sour and there is uncertainty over the result. In short, it's a lose/lose scenario. But, what if the occupier took a proactive approach?

Be proactive - "Think-Plan-Do"

At Avison Young, we have a process that we refer to as "Think - Plan - Do". The premise is that a little up-front thinking can save time and money in the long run and, in our experience, makes the negotiations smoother. Firstly, an early report from an advisor will allow tenants to have a clearer idea of the likely outcome before the review date. This will allow businesses to budget more accurately and provides certainty.

Timing is also important. Although valuation dates for reviews tend to be fixed, negotiations are "backward looking". City office rents have been rising by roughly 10% per annum. On a 10,000 sq ft office suite at £50psf, a six-month delay in the timing of a review could therefore mean a difference of £125,000 in contingent liability over a five-year period. How many widgets to you have to sell to make an additional profit of £125,000?

Being ahead of the process also gives tenants time to explore other opportunities. Most asset managers are financially incentivised to improve the asset value of their portfolio. Yet there are other ways of adding value; extending lease lengths, removing break clauses and investing capital into the property, without necessarily increasing rents. Taking a proactive approach to rent reviews can allow tenants to have a greater degree of certainty going in to the process, meaning it more likely the outcome of a rent review could benefit both parties and create a "win/win" scenario.

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M&G
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About the Team

Avison Young's Lease Advisory team advise landlords and tenants on all aspects of lease negotiation, including rent reviews, lease renewals and lease restructures. We are a team of experts with a proven track record of advising funds, investors, property companies, occupiers and corporates across the UK.



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