

Reading a sales report before believing it

Appendix D and Chapter 1. The whole method rests on a number the tenant supplies. Establish these for every unit before a single ratio is computed.

Centre		Analyst	
Fund / buyer		Date	

Item	Answer	Source document / note
The seven things to establish		
Gross or net of VAT? The lease definition, what the tenant actually submits, and that they are the same (at 20% VAT a ratio on gross turnover reads a sixth lower)		
Certified by the tenant's auditors annually, or a monthly email?		
Does turnover include online orders fulfilled from, or collected at, the store?		
Are returns netted off, including online returns processed in store?		
Are concessions and shop-in-shops inside or outside the host's figure?		
Per unit or per tenant across several units? Can it be split?		
Does footfall x conversion x basket reconcile, and is the basket measured from till data (a test that can fail) or derived from sales (a test that cannot)?		
The three mixture errors		
Area bases: rent on lettable area, sales on sales-floor area. The ratio comes out too low. One basis, in writing, for both		
Occupancy cost conventions: rent only, rent + service charge, or rent + service charge + rates. This book uses the third		
Lease conventions between markets: who bears common-area costs, and any statutory cap on recovery		
Coverage		
Which units are exempt from turnover reporting, and what share of the rent roll do they carry?		
Penalty in the lease for late or non-reporting		
Any unit whose sales fell while its footfall held: what explains it?		

Falling sales, steady footfall: merchandising or online fulfilment. Falling footfall, steady conversion: catchment or competition. Falling conversion, steady footfall: tenant mix.

The occupancy cost table

Chapters 3 and 24. One row per unit, rebuilt every quarter from four files the owner already has: rent roll, service charge budget, rates list, sales report. Ratio = (rent + service charge + rates) / sales.

Centre		Analyst	
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[illegible]

Totals	Value
Passing rent	
Rent at risk (sum of positive gaps)	
Reversion (sum of negative gaps)	
Rent at risk, share of passing rent	
Units over their ceiling, out of	

Sustainable rent = ceiling x sales - service charge - rates. The book's centre: 10 of 16 units over, 904,826 at risk (16.2% of the rent roll), 102,240 of reversion. Test the ceilings by asking three operators in each trade.

Rent at risk: three rankings and four warnings

Chapters 3, 4 and 16. Percentages say who moves first; euros price the asset. Compute both and never let the percentage column choose where the year is spent.

Centre		Analyst	
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Ranking	Worst unit	Second	Third	Use it for
Relative breach (ratio / ceiling)				
Overpayment per m2 (rent - sustainable)				
Euros at risk a year (gap x area)				

The four dated warnings, in the order they arrive (date each one observed)

Unit	1. Stops investing (refit deferred, staff, stock)	2. Asks (cap, rent-free, turnover-only)	3. Uses the lease (break, assignment)	4. Uses the law (restructuring)

Headroom band	Units	Rent	Share of excess surrendered	Rent lost
Inside the ceiling				
Up to 20% over				
20 to 50% over				
More than 50% over				
Total				

England (CVA, Part 26A) can compromise future rent on a store kept trading; StaRUG and sauvegarde do not in the same way. Scale the band table to the law governing the lease. Offer the re-base before the process opens: afterwards it buys nothing.

Capacity and the service charge

Chapter 5. Rent capacity = ceiling x sales - service charge - rates. A residual whose deduction grows faster than its base shrinks while sales grow.

Centre		Analyst	
Fund / buyer		Date	

[illegible]

Item	Answer	Source document / note
The service charge as a valuation item		
Service charge per m2 against the competing centres in the catchment		
Budget against certified actuals, three years; the fixed and the variable share		
Landlord's share from vacancy and from caps, in euros		
Energy lines and their exposure to a price move		
The marketing levy: who controls it and what it buys (footfall bought through the levy is paid for twice)		
Caps granted at letting, their level, and what each costs the landlord today		
Sinking fund balance and what it is earmarked for		

Sales growth needed to stand still = $((\text{capacity now} + \text{charges} \times (1 + \text{inflation})^{10}) / (\text{ceiling} \times \text{sales}))^{(1/10)} - 1$. The book: 1.81% for the discounter, 0.37% for the jeweller.

The turnover clause, tested before signing

Chapter 6. Two different questions about the same two columns: will the clause ever pay, and will the rent ever be paid?

Centre		Analyst	
Fund / buyer		Date	

Unit	Fixed rent	Base (x %)	Turnover %	Natural breakpoint	Sales	Breakpoint / sales	Years to reach it	% a turnover-only deal can carry

Reading	Rule
Breakpoint / sales above 1.0	
A discount to the base rent dressed as an option: the clause pays nothing until sales catch up	
Breakpoint / sales below 0.8	
A genuine share of upside, to be priced as one	
Percentage a turnover-only deal can carry	
Ceiling less (service charge + rates) / sales. Set per unit, never one percentage across the tape	

Item	Answer	Source document / note
Keep, whatever the percentage		
The reporting obligation: the single most valuable line in a retail lease, even at a zero turnover percentage		
Certification, the definition of turnover (online, returns, VAT), audit right		
Price the trade-off		
A valuer may capitalise turnover income at a wider yield; a lender will exclude it from interest cover		
Moving wholesale to turnover-only trades rent quality for retention: make it a decision, not a drift		

The anchor and co-tenancy

Chapters 7 and 8. What the anchor does not pay, what it buys, and what its departure costs through clauses nobody values.

Centre		Analyst	
Fund / buyer		Date	

The anchor	Value
Area and share of lettable area	
Share of reported sales	
Rent paid and share of the rent roll	
Specialty average rent per m2	
At the specialty rate it would pay	
Implied subsidy (what the specialties pay for its traffic)	
Its own occupancy cost ratio against the grocery ceiling	

If the anchor goes	EUR a year
Anchor rent lost	
Co-tenancy abatements: specialty rent x share protected x abatement	
Rent at risk before, unprotected share only	
Rent at risk after the sales fall, same share	
Total exposed, and as a multiple of the anchor rent	
Probability over the hold, and expected cost	

Item	Answer	Source document / note
Diligence: none of this is in the rent roll		
Which leases have co-tenancy; trigger = named anchor, any anchor, a category, or an OCCUPANCY PERCENTAGE?		
Remedy: abatement, conversion to turnover-only (permanent), or termination?		
Cure period and cap: does the abatement stop when the anchor unit is re-let?		
Are the clauses aligned, so that half the specialties can walk on one trigger?		
Anchor lease: can it shrink the store, sublet part, reconfigure? Approval rights over mix, hours, conversion?		
Has the anchor closed comparable stores in this format in three years?		

The book: 1,985,894 exposed against 561,600 of anchor rent (3.5 times). Carry it as a line in the underwriting, with the probability named, not as a footnote.

The re-letting cycle, and the negative-space test

Chapters 10 and 17. One square metre, from one expiry to the next. If the net per year is negative, the space is subtracting.

Centre		Analyst	
Fund / buyer		Date	

One cycle, one m2	Unit A	Unit B	Unit C	Unit D
Sustainable rent (EUR/m2 a year)				
Rent collected: term less rent-free, in years x rent				
Less non-recoverable costs (% of rent collected)				
Less service charge and rates carried while empty (void years x EUR/m2)				
Less landlord's works on hand-back				
Less letting and legal fees (% of first year's rent)				
Net over the cycle				
Cycle length (void + term, years)				
Net per year				
Capitalised at the exit yield, x area				

Item	Answer	Source document / note
What the landlord really carries on a dark unit		
Service charge share that continues (lighting, heating, security, cleaning, management, insurance)		
Rates: no lease makes a neighbour pay them; any empty-rates relief, and for how long		
The part that genuinely stops (metered use, refuse, promotional levy)		
What moves the cycle		
Shorter void: market the unit twelve months before expiry, pipeline by trade, shell spec agreed in advance		
Longer term certain: fewer cycles. Priced in Chapter 22		
Cheaper shell: usually a false economy, because a poor shell lengthens the void		

Three yields and the bridge from the appraisal

Chapters 11, 12 and 24. Put the quoted yield next to the two that price the tenants, then walk the valuer's number down to the cash flow, rung by rung.

Centre		Analyst	
Fund / buyer		Date	

Line	EUR a year
Passing rent	
Less rent no tenant can sustain	
Plus reversion on units inside their ceiling	
Sustainable rent roll	
Less non-recoverable costs	
Less service charge and rates on vacant space	
Stabilised net income on the sustainable rent	
Less the annualised re-letting cycle	
Capital-adjusted net income	

Yield (on price including acquisition costs)	Value
Net initial yield quoted (passing rent)	
On the sustainable rent, before the cycle	
Capital-adjusted	
Retention ratio (let space, for comparison between formats)	

Bridge rung	Value	Change	Evidence the vendor cannot dispute
The appraisal, on comparable rents			
Less rent no tenant can sustain, plus reversion (from each expiry)			
Less the market rent assumed on the empty unit			
Less what each re-letting costs (works, void, carry, fees)			
Less the timing, the second cycle and the exit			

Compare multiples at the same yield: a loss charged from its expiry date is worth fewer years' rent than the same loss in perpetuity, and a lower yield raises both. The book's centre: 11.5 in perpetuity at 8.25%, 8.7 dated at the same yield.

The ten-year cash flow: construction and omissions

Chapters 13 and 14. Each unit pays its contract to expiry, then works, void, re-letting at the sustainable rent of that date, rent-free, fees, term, and again.

Centre		Analyst	
Fund / buyer		Date	

Item	Answer	Source document / note
Before modelling		
Sort the rent roll by expiry and colour it by occupancy cost: is the problem in your hold or in the next buyer's?		
Which lines go round twice inside the hold, and which are dark at the exit?		
The exit, priced as a buyer would		
Contracted rent in place plus the rental value of what is empty, each unit at the ceiling of its own trade		
Less the buyer's cost of letting it: carry for the rest of the void, rent-free, fees (not the works again)		
Net initial, reversionary and capital-adjusted yields of the year-ten buyer, against yours today		
The six things the base case does not contain (state each in the paper)		
Centre-wide capital expenditure: plant, roof, malls, compliance. Put the surveyor's number in		
Indexation of passing rent		
Co-tenancy cost (carried beside the value, with its probability)		
Turnover rent		
Credit loss (price arrears from the ageing schedule)		
Relief on empty rates		

Sensitivity, one at a time	Value	Change
Base case		
Sales level -10% / +10%		
Sales growth 0% / 3%		
Exit yield -100 bp / +100 bp		
Term certain 10 years; void 6 months		
Service charge -10 / +10 EUR/m2		
Centre-wide capital plan		

Right-size, convert or sell

Chapters 17 and 18. Value the decision by rebuilding the cash flow, never by adding a steady-state gain to a base that already carries the space.

Centre		Analyst	
Fund / buyer		Date	

Line	EUR
Base case: the whole centre as retail	
The centre re-run without the space in question	
What that space contributes as retail (difference)	
Space already vacant, converted on day one	
Let space: contractual rent to expiry, discounted	
Let space: converted at expiry, discounted back	
What that space contributes, converted (net of acquisition costs)	
Gain from right-sizing	
The same with the converted space at the retail exit yield	
Alternative-use rent at which conversion ties with retail	

Item	Answer	Source document / note
Three warnings before pricing it		
Planning and use class: does the local plan protect retail frontage? Consent first		
Access, servicing, separation: own entrance, hours, yard and vehicle route		
Co-tenancy and exclusivity clauses on the use of the centre or the anchor unit		
Sequencing		
Convert what is already empty first; hold let space to expiry rather than buy out a lease that still pays		
Re-run the negative-space test every year, on every unit		
Selling		
The asking price less disposal costs, against the right-sized value. If you can sell at a number your own model cannot justify, sell		

What a lender will lend

Chapter 19. Three tests run together; the loan is the smallest. Then size it again on the sustainable rent roll, which is what a lender does after the first restructuring.

Centre		Analyst	
Fund / buyer		Date	

Basis	Price	By LTV	By ICR	By debt yield	Loan	Binding test
Asking price, passing income						
Underwritten value, passing income						
Asking price, sustainable income						
Underwritten value, sustainable income						

Test	Working
All-in rate (base + margin)	
Interest cover x all-in rate = the debt yield the ICR implies	
Debt yield covenant: if smaller than the line above, it can never bind	
Covenant headroom: net income less (ICR x interest), and the vacancy (m2) that uses it up	
Trailing ICR year by year on the cash flow of Chapter 13: first year below covenant, and the equity cure it would need	

Item	Answer	Source document / note
Four provisions worth more than the margin		
Cover tested on a look-forward basis, signed lettings included		
Capital expenditure and letting incentives carved out of the cash trap		
Net income defined to exclude irrecoverable service charge on space vacant less than twelve months		
An equity cure with a defined mechanic and a stated number of uses		

What would have to be true

Chapter 21. Hold everything else, move one assumption, and find the value it must take to justify the asking price at the required return. Then move several together, to the edge of what is arguable.

Centre		Analyst	
Fund / buyer		Date	

Assumption	Underwritten	Required for the asking price	Move	The sentence someone must say out loud
Tenant sales against today				
Exit yield				
Sales growth a year				
Cost inflation a year				
Void				
Term certain				

The vendor's most generous bundle	Assumed
Sales level	
Sales growth	
Cost inflation	
Void	
Exit yield	
Value on the bundle, and share of the gap it closes	

Check the sentence against the tape: at the sales level required, which units are still over their ceiling? (The book's centre: at +44% the discounter is still 17.52 EUR/m2 over; every unit is inside only at +54.5%.)

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The paper and the bid

Chapters 20, 22 and 24. Six items a committee can check, the bid paragraph, and the levers ranked by what the model says they are worth.

Centre		Analyst	
Fund / buyer		Date	

Item	Answer	Source document / note
The six items		
1. The occupancy cost table, on the first page		
2. Rent at risk as a euro figure and a share of passing rent (and of net income, labelled)		
3. The co-tenancy exposure with a probability attached		
4. The three yields together: quoted, sustainable, capital-adjusted		
5. The bridge from the appraisal, rung by rung		
6. The decision if sales fall, written before approval: re-base and buy term, hold and take the vacancy, or accelerate conversion		

The bid paragraph: We are paying ... (net initial yield on our price ...) for ... m2, ...% let, ... years of income. We are underwriting ...% of passing rent as unsustainable because ... of ... units trade above their ceiling. Void ..., works .../m2, carry .../m2 a year. We earn ...% unlevered; at the asking price, ...%.

Lever	Value in the model	Owner can decide it?	Action and date
1. Move the sales line: let the mix, not the unit			
2. Longer terms, paid for			
3. Shorter voids			
4. Cost out of the service charge			
5. Re-base early and buy something for it			
6. Settle dilapidations properly			

On losing: name, for each lost process, whether the winner had a lower cost of capital, a shorter hold, a different view of the sales line, or no view at all.