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Lease terms in Spain compared to the UK

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Abstract

Creating a leisure centre, whether with or without any retail floorspace, raises similar problems to the creation of a shopping centre. There are plenty of shopping centres in Spain, but the concept of creating an investment with growth potential is a comparatively new one in the country. Most of the shopping centres built there until quite recently were either built by the hypermarket operators, who were owner occupiers of the majority of the space, or a developer who sold as much of the development as he could to owner occupiers so as to finance the scheme. The concept of keeping the centre as an investment, selling the completed centre to an insurance company or pension fund, until recently, was unknown or at least untried.

INTRODUCTION

Development in continental Europe is different to that in the UK as, with bank rates at around 4 per cent it is possible, with a 30 per cent equity contribution, to finance developments without having to sell to an end investor before even starting work. Spanish leases, at least until the arrival of British developers, did not contain open-market rent reviews. An owner of a shopping centre could therefore only expect the annual linkage to the consumer prices index and would have to wait till the end of the lease for any better increase. Such an investment is unexciting and, hence, the preparedness of Spanish developers to sell parts of the centre to occupiers. Now, however, there is an investment market in Spain and it is profitable to build a centre in which all the units are let. If an institution buys such an investment, it expects better growth than simply an inflation linkage, so the type of lease needs to be rather closer to the UK model than the old Spanish model. The leases which Spanish companies expect are, however, still based on the idea that the landlord was not expecting growth in rents, however well the centre performed. This paper will highlight some of the differences and seek solutions to those differences.

LENGTH OF TERM

If one buys a freehold property, one is stuck with it forever, and therefore one would have expected a Spanish company, used to that commitment, to be well able to live with a 20-year lease. The reality, however, is that Spanish tenants want 20-year leases with break

Financing

Rent reviews

Inflation linkage

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Lease length

clauses and no open-market rent reviews. There is simply no comprehension of the problems that this might cause a developer with his funding. A developer is trying to borrow money over a ten- or even 20-year period against the security of the property and of the leases to the various tenants. If the tenant is able to walk away after two or five years, say, the security of that lease is significantly reduced. It is possible to make break clauses mutual, which solves the problem of the rent reviews, but whether the developer will succeed in achieving mutuality will depend, as with most such matters, on the relative bargaining position of the parties.

Tenants coming from outside Spain, particularly from the UK, do not have this historic hang-up about rent reviews, but if one wishes to let a leisure or shopping centre, it is still necessary to let most if not all of the space to Spanish tenants. Many larger non-Spanish operators are looking to expand Europewide, but they still represent a tiny number.

What is the solution? If one is letting a centre which comprises perhaps 100 or more units, then one could live with a few shorter certain terms. If the anchors are tied up for 20 years that mitigates the problem. If the percentage of the income which is subject to shorter leases is less than say 25 per cent, then that should not be a problem for the bank. Furthermore, as shorter leases are the rule in Spain, as they are in most European countries, then Spanish banks do not seem to be concerned. On the other hand, Spanish banks are not accustomed to lending against value, only cost.

Are there any points in favour of a shorter lease? If it is genuinely a shorter lease and not a long lease with a break clause, then the advantage is that the landlord will have the opportunity to end the lease and negotiate a higher base rent. Alternatively, landlords may be able to negotiate an open-market rent review at the time of the break. In Spain tenants do not have rights of renewal at the end of a lease.

Whatever, any investor coming to Spain should be aware that not many of the leases will be certain for 20 years.

Is the market changing? The author believes so. Many of the larger Spanish operators are beginning to realise that, if they wish to be represented in some of the larger centres being developed by foreign developers, they will have to accept a new style of lease. However, all changes of culture take time.

RENT REVIEWS

Indexation

The British Isles is the only place where open-market rent reviews are commonplace. Perhaps because of the shorter lease periods, other countries have not heard of this concept. What they do have is annual revisions of the rent in line with inflation. In some countries this only affects the rent once a certain threshold has been reached, but in Spain they apply each year. However (and at

Indexation

Upward only

this time, when it is possible that prices may actually fall, it is relevant), it may not be enforceable in a Spanish Court to have such revisions in an upward direction only. Certainly it seems to be beyond the comprehension of Spanish tenants not to have rents which might move up or down in line with inflation. One may persuade them to agree, because the prospect of lower prices is still fairly remote, but whether you could enforce the clause in the court is open to doubt and has yet to be tested. What worries the long-term investor is the possibility, however remote, that his guaranteed income may fall. What you might get away with is a clause which states that, whatever happens, the rent will not fall below the initial rent.

Open-market reviews

Spanish and other continental tenants are not accustomed to open-market rent reviews. They are terrified by the idea that the rent might rise to some figure which they do not know and may be unable to afford. They are not accustomed, either, to the decision of arbitrators or independent experts; they do not really have a property profession in the way the British have. So it is very hard to persuade them that they should accept an open-market review. Of course, at the end of a lease the rent is fully negotiable and the tenant in Spain does not have security of tenure. Thus, the tenant is faced with an open-market review at the end of the lease, but this will be upwards or downwards and he can always leave at that stage. The other side of that coin is that the landlord can ask him to leave if he is not satisfied with the rent on offer. A rent review without a break clause is a wholly different matter for both landlord and tenant.

Turnover rents

TURNOVER RENTS

Turnover or percentage rents are comparatively new everywhere on this side of the Atlantic. They were touted as the universal panacea some years ago, but usage has destroyed the illusion. All developers assume that the sales in their new centre are bound to be at the highest level that rumour has ever told them. In practice, as our American cousins will tell you, it is a pretty good centre where even 50 per cent of the tenants have reached the threshold of sales where the turnover rent clicks in. That does not apply so much to factory outlet centres in Europe, where, because there are still not many of them, sales are almost universally good. However, while the Americans say they would gladly trade their turnover rents and short leases for the UK system of long leases and upward-only rent reviews, their attitude would be different if faced with longer leases with no open-market reviews.

In Spain turnover rents, subject to one exception, seem acceptable to tenants. Thus, if your centre is more successful than the level of initial rents prognosticated, the landlord can receive some benefit immediately and does not have to await the end of the lease.

Private traders

The exception referred to is the 'Mom and Pop' operators in Spain. Those the author has met are, to a man or woman, horrified by the thought of telling anyone what their true turnover is. 'I don't tell the taxman and if I tell you he'll find out' is the universal cry. They are so philosophically opposed to paying tax that no amount of logical argument seems capable of persuading them otherwise. However, their fears are more illusory than real, or at least surmountable. For most shops and restaurants a large percentage of their sales is made through credit cards or cheques. If, for example, the Mom or Pop concerned were to say 'what I tell the taxman is my credit card and cheque sales plus 20 per cent and the total represents 80 per cent of my sales', then instead of charging him or her a turnover rent of 10 per cent they could be charged 12 per cent. They would tell the landlord each year the same figure they tell the taxman and everyone would be quite happy.

Closure

PENALTIES

If a tenant decides to close down his unit in a centre, the landlord has two problems (or three if the tenant has gone bust). The first is that there is a black hole in the centre, which is never a good thing. The second is that, if the tenant was supposed to be paying a turnover rent, he certainly will not be if he is not trading.

The Spanish solve this fairly crudely by seeking to charge the tenant two or three times the basic rent during the time when the unit is closed. They also include a draconian power to retake possession of the unit in order to try to re-let it but still charge the original tenant the penalty rent until the unit has been re-let. Then, if the unit is re-let at less than the old basic rent, the difference is capitalised till the end of the lease and the original tenant pays a capital sum to be released from all further liabilities.

Certainly, if the landlord has turnover rents, there should be some penalty if the tenant is not trading. This needs to apply at the start of the lease if the tenant has not opened on the appropriate date, as well as later on if he closes down. A suitable penalty might be for the tenant to pay twice the base rent while not trading.

Deposits

RENT DEPOSITS

An interesting way of financing local government in Spain is the concept of all tenants having to lodge two months' rent with the regional government. This is called a *fianza*. The money is returnable when the tenant goes, and the landlord can draw on it if the tenant defaults. Otherwise, however, it is retained by the authority. If you want a deposit for yourself as landlord, because the covenant is a bit suspect, then you need to specify the months you need plus the two. It is common for these two months' deposits to be paid at the time of the exchange of contracts even if the opening of the centre is years away. However, the authority does not expect the money till the centre opens and the lease begins, so,

unless the covenant of the tenant looks poor, it is perhaps best not to take the money from the tenant until the unit is handed over.

SUBROGATION

This is a fancy word for assignment, and the only point to watch in Spain is that it is common for Spanish lawyers to include in the lease a clause whereby, if the tenant dies, the lease is immediately forfeited. Thus the tenant's wife or child would not become the tenant. This is not good for a landlord, but it is a two-way thing. If a tenant suddenly dies, the heirs have no rights or obligations and the rent ceases. The Spanish say that the heir may not be very good at running the business, and they may have something there. On the other hand, that argument applies to all tenants, who are free to employ a manager who might be no good or run off with the takings. It also seems a little unfair. The family business is terminated and the heirs are left with nothing. Anyway, the choice is the landlord's — do watch out for it. Landlords may not have asked a lawyer to include such a clause, but by default he may have done so.

Assignment

PROPERTY TAXES

The Spanish equivalent of rates is called IBI. The important thing to note is that it is payable by the landlord not the occupier. It is assessed on the capital value of the property. In a centre where there is a service charge or *gastos de comunidad*, the landlord can include IBI within the costs to be recovered — but make sure it is mentioned specifically. The amount of IBI is generally in the range of 1–2 per cent of the capital value.

Rates

SIGNING DOCUMENTS

This is much more formal in Spain than in England. Firstly, a director signing on behalf of his company has to be properly authorised by a deed which has to be signed in front of a notary (notarised). Secondly, every page has to be signed. Thirdly, as one can see if one examines the initial pages of any Spanish document, they begin with a recital about the individual who is going to sign and will include things such as his national identity document number and private address. The company also is fully described, including its register number and tax identity code number.

Signatures

The land on which the project is to be built is also fully described, including its land registry number.

Explanations

Having listed and described the persons to sign, the companies and the land, a typical document will then embark on a commentary which, among other things, will say, for example, 'the aforementioned Urbanisation combines in its conception, execution, termination and operation, a set of very complex characteristics, because of its size and varied composition and its harmonious development requires precise regulation ... for this reason strict

regulation ... which might in some respects seem excessive ... so that all of [the tenants] can reap greater benefits.'

This returns to the possibility mentioned earlier of a Spanish court setting aside a lease on the grounds that the terms were too onerous. These explanations seek to forestall any such action by justifying in advance what might otherwise be judged *onerous clauses*.

SUMMARY OF LEASE TERMS

Fair terms

The author's experience so far in Spain is that what drives tenants is not very different from what drives tenants elsewhere. They want opportunities to make a profit. The Spanish are very entrepreneurial, and it is not too difficult to generate interest in a good new scheme. Spanish law does not seem very different from English law but custom is different. They do have a system whereby, if the lease is deemed to be too onerous on the tenant, the lease or certain parts of it may be unenforceable — so there is no point in abusing your position as developer or landlord — the lease must be fair. Do employ a good Spanish lawyer but, if your Spanish is not fluent, do ensure that he speaks fluent English — it is very easy for what you thought were clear instructions to be misinterpreted. If the lawyer speaks even average English, ask him to write to you in Spanish and have it translated by someone really good. We all know that the use of different words can have dramatically different effects in a legal document.

TENANTS

Leisure

As in most Western countries there is a range of tenants in the leisure business. For cinemas there are indigenous companies as well as international operators such as Warners, AMC, Ster Century, UGC, Kinopolis and others. Size requirements are similar to the UK except that Kinopolis begin at 14,000m².

Cinemas

For family entertainment centres there are three multiple operators, Big Fun, Promo Bowling and New Park. The only international operator is Scottish and Newcastle with City Limits. Size requirements vary between 1,000m² if there is no bowling to 5,000m² for city limits.

Health

For health and fitness operators there are no multiple Spanish operators yet, and Fitness First, Holmes Place and Healthlands have the market to themselves. A couple of German operators are thinking of entering the market but have nothing open yet. Size requirements are similar to the UK, ranging from 2,000m² to 5,000m².

There are many restaurants. Many of the main international brands have franchisees or partners and there are a number of Spanish groups in the catering business, such as Grupo Zena, Grupo Sigla, Grupo Daiko and others. Unlike the UK there are thousands of Mom and Pop operations, many of which are good and add interest to a centre. Size requirements are as one would expect. One

can let as little as 25m² and as much as 900m². Around 200m² is a good average.

RENTS

In Spain the common thing is for rents to be charged on a monthly basis and for rents to be quoted as pesetas per square metre per month. The rule of thumb for quick conversion is that 1,000 pta per square metre per month equates, approximately, to £5 per square foot per annum. Thus 4,000 pta equals £20 per square foot.

The author's experience is perhaps different from others, but in letting developments in Spain, the rents which you might expect in a leisure-based centre are as shown in Table 1.

Because the weather is generally good, there is much more *al fresco* eating and restaurateurs expect an area of terrace to be their own. They will pay rent for this space, and 50 per cent of the rent per square metre for the building itself is acceptable.

Many of the larger retail warehouse operators are only accustomed to buying, and are not accustomed to paying a price for their plot which even approaches the residual land value from letting a retail warehouse at a market rent.

Clearly, as in any country, the rent one achieves will depend on a number of factors, but Table 1 is hopefully a reasonable starting point. These rents are very similar to UK rents in similar types of leisure centre. The difference to the tenant is that his total cost of occupation is lower as there are no rates in Spain, only IBI, as mentioned earlier which is possibly about a third of UK rates.

Retail rents for regular shops range widely on either side of the figure given in Table 1 depending on location. Retail warehouse rents are usually far lower than in the UK but, in the author's opinion, it can only be a matter of time before they move upwards sharply, particularly now that the Spanish have brought in the requirement for a commercial licence for retail units in excess of a certain size. That size varies from region to region, but the threshold can be as low as 500m² of trading area.

Table 1: Rents in Spain

Cinemas	1500pta for a shell (up to 3,000pta for a turnkey)
Large leisure boxes (2,000m ² to 5,000m ²)	1,500 to 2,500pta
Restaurants	
50m ² to 100m ²	5,000pta
100m ² to 200m ²	4,500pta
200m ² to 300m ²	4,000pta
300m ² to 400m ²	3,500pta
400m ² to 500m ²	3,000pta
Factory outlet units — base rents	
Up to 300m ²	4,000pta
300m ² to 500m ²	3,000pta
500m ² to 750m ²	2,500pta
750m ² to 1000m ²	2,000pta
> 1000m ²	1,500pta
Retail Warehouses	1,500 to 2,500pta
Turnover rents	5 per cent to 12 per cent