# Eversheds Sutherland property column: January 2021

**by *Adele Pogmore*, Principal Associate, *Eversheds Sutherland***

Articles | Published on 07-Jan-2021 | England, Wales

Adele Pogmore of Eversheds Sutherland discusses the implications for landlords and tenants of entering rent turnover deals.

## Should landlords and tenants turn to "turnover"?

The commercial real estate market has been disrupted by COVID-19 and the Coronavirus Act 2020, and no sector more so than the bricks and mortar of the retail industry. Footfall has plummeted to 15% of pre-pandemic levels, and retailers have been forced to close, re-open and close again, and to operate under the strangest social restrictions ever imposed. Landlords and tenants attempting to find a way to share the economic struggle often agree a rent based on a percentage of the turnover generated by the store. What should landlords and tenants know about the legal and mechanical framework before proceeding with a turnover rent deal?

The implications of the Landlord and Tenant Act 1954 (LTA 1954) must be considered. For landlords intending to fix a short-term turnover-only rent arrangement, such arrangements should be expressed to be personal (perhaps extended to other companies in the tenant's group) and outside the protection of the LTA 1954 to avoid blessing the tenant's assignees with the same privileges or the tenant with a right of renewal on uncertain rent terms. Landlords who are keen to ensure the confidential nature of the arrangement will want to go further and impose a duty of confidentiality on their tenants, but will need to consider the very practical difficulty of proving breach and quantifying the loss arising.

Very careful consideration should be given to what is "in" turnover and what is "out". Improved tenant performance should result in greater remuneration for the landlord, so drafting should anticipate all potential avenues of income from all potential occupiers and should reflect the permitted use as well as the scope for change of use. The most contested issue here is "online sales" or "click and collect" and to what extent the landlord should share in those revenue streams. The debate often centres around the actual practice of the tenant, but considerations include:

- Whether or not store stock is used to satisfy online orders depriving the landlord of in-store sales.
- Whether the sale is placed at or facilitated by store staff or in-store technology.
- Whether there is any value in visitors collecting goods from the store.
- The time and place for payment.
- Whether income is actually, or should be fairly, credited to the store's income as it may be for some retailer models.

Pure online brands with a "pop up" shop may have a greater case to argue for the exclusion of the value of online sales from the store's turnover.

 

Landlords must try to protect their turnover-only rent by requiring their tenants to sign up to a "keep open" covenant. Tenants will need to argue for acceptable exclusions to that obligation, to cover situations where they simply cannot trade, such as the traditional carve out of damage to the premises by insured or uninsured risks. As a result of this year's restrictions on non-essential retail, a tenant will certainly require permitted closure where the law requires it to close, but landlords must be careful that this does not allow a tenant to benefit from its own breach of the law.

In any closure scenario, the tenant's turnover will likely sink to nil, so the parties should agree who should bear that risk. Should rent continue to be payable and if so how much and on what basis? Issues of breach or fault are likely to be determining factors in that debate. Where the tenant is in breach of its keep open covenant why should it not pay any rent? Where the tenant chooses to close, for staff training, stock taking or alterations perhaps, should the landlord lose out?

Once each closure scenario has been chalked up to a rent suspension period or not, the parties will need to agree the rate at which "rent" is paid to the landlord where there is no rent suspension but the tenant is not trading. This is often calculated on the basis of deemed or substituted turnover. So even though the tenant might actually be closed in a given scenario and not generating turnover, a daily income will be assigned to the tenant's turnover figures. This daily rate might be based on past trading averages at the premises, or alternatively set at a predetermined fixed amount (essentially liquidated damages). A landlord will want to set the rate at a level sufficient to cover its cost base, particularly where the turnover-only rent arrangement is inclusive of insurance or service charge. A tenant will want to set the level at affordability. In the case of thresholds which must be passed before any turnover becomes payable, the parties will need to allow for pro-rata increases or decreases where the duration of a turnover period fluctuates or where the tenant is closed for business.

Having settled on a turnover-only rent arrangement, the landlord and tenant will need to agree when payments are due. Landlords will likely require regular on-account payments to ensure cash flow and to guard against tenant insolvency. This could be fixed at an amount based on the tenant's anticipated sales, or as the term progresses based on a proportion of the previous year's calculated turnover rent. A struggling tenant may only be willing to pay in arrears based on actual receipts, although the landlord may not have the appetite for the administrative burden or time lag before payment that will be the consequence of that arrangement.

There are other hurdles for the landlord and tenant to clear along the way, including:

- What happens where the tenant fails to provide a turnover certificate.
- How to value a shopping centre generating turnover-only rent.
- The impact on rent review evidence.
- Policing and auditing turnover figures.
- The potential operation of the commercial rent arrears recovery regime.
- Possibly the complications of rates-inclusive deals.

In turning to turnover-only rent, both parties should ensure the lease deals with these issues. That way the drafting will generate the income stream the landlord anticipates, as well as allowing the tenant a sustainable business.

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