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PROPERTY LITIGATION

Britel Fund Trustees Limited v B&Q Plc

May 2016

This case is an unusual specimen. It is a rarely reported unopposed lease renewal claim under the Landlord and Tenant Act 1954 **("LTA '54")** with a tenant-friendly outcome.

Background

B&Q is a tenant at Tottenham Hale Retail Park, occupying a purpose built retail DIY warehouse of approximately 37,000 sq ft with a passing rent of £776,139 (£20 per sq ft). Britel is the landlord of the Retail Park.

The parties had agreed a lease renewal of 10 years from 2015, together with a mutual rolling break clause exercisable after 3 years. However, the rent remained in dispute - B&Q argued for £281,000 (£7.60 per sq ft), whilst Britel sought £698,500 (£18.90 per sq ft).

It was commonly accepted that Britel had plans to redevelop the site and had already obtained outline planning permission, hence the need for the mutual rolling break.

The law

Section 34 of the LTA '54 provides that the new rent will be assessed on the basis of the rent that the premises *"might reasonably be expected to be let in the open market by a willing lessor, there being disregarded:*

a) any effect on rent of the fact that the tenant has or his predecessors in title have been in occupation of the holding;
b) any goodwill attached to the holding by reason of the carrying on thereat of the business of the tenant (whether by him or by a predecessor of his in that business;
c) any effect on rent of an improvement..."

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The issues

Section 34 makes it clear that B&Q's prior occupation of the premises had no bearing on the rent – the true test being what a hypothetical tenant would pay if the premises were let on the open market. As part of this question, the court concentrated on 2 principal preliminary issues:

i. Should allowance be made for a three month rent free period for fitting out (as that was what was available in the market for a new letting)?
ii. What is the effect of the landlord's right to break in 2018 on the open market rent and the type of tenant who would take the premises?

Issue i) – Should a rent free period be taken into account?

The court held that, if a hypothetical tenant taking a new lease would require and be granted a rent free period (e.g. a DIY warehouse where substantial fit out would be required), this should be factored into assessing the new rent as S.34 assumed the premises were vacant and the tenant had never occupied. B&Q was therefore entitled to a 2.5% rental deduction to reflect a 3 month rent free period, even though in reality B&Q was already in occupation and had already fitted out.

Issue ii) – What is the effect of the landlord's break clause on the open market rent?

The parties' experts had agreed that the likely hypothetical tenant for the premises would be a DIY retailer. However, during the trial, it became clear that no DIY retailer would take a lease with a mutual 3 year rolling break, as DIY retailers require substantial fit out works and it would be uneconomically viable to make such an investment under such a short lease. This led to the parties' experts agreeing that the only hypothetical tenant who would take the premises on the agreed lease terms would be a discount retailer (a retailer such as Poundland who sell high volume discount goods and only require a basic store fit-out).

The impact of who would be the hypothetical tenant had a significant impact on the market rent. The court held that:

- The market rent for a DIY retailer would be £603,100 per annum (as above, the tenant was asking for £281,000 and the landlord was asking for £698,500);
- The market rent for a discount retailer would be £466,940 per annum;
- The discount to be applied to the market rent for the 3 year break would be 25% for DIY retailers and 20% for a discount retailer;

As a result of the court deciding that the hypothetical tenant would be a discount retailer, the market rent was assessed at £373,700 per annum (£466,940 per annum, reduced by 20%).

The effect of the break clause was therefore a £93,240 per annum rent reduction.

The court was critical of the valuation experts for focusing too much on being advocates for their clients and it held that the major factors to consider in this case when relying on comparable evidence were :-

i) Location - out of London comparables were held irrelevant and it was held that the Retail Park had a smaller catchment area than the area where the London comparables relied on are;
ii) The level of demand for such premises - this was held to be limited and the Judge held rents for DIY premises had not increased since 2007/8;
iii) Service charge level - there was a high level at the Tottenham Hale Retail Park which justified a 0.75% rental discount;

iv) Planning permission and user clause;
v) Car parking - there is 1 space per 453 square feet at the Retail Park as compared to the normal standard of 1 space per 225/250 square feet;
vi) Service yard and loading facilities - there is no dedicated service yard or turning circle at the Retail Park;
vii) The basis their rents were fixed - open market lettings being the best evidence available (rather than agreed or determined rent reviews).

Costs

As B&Q effectively "won" the litigation, the court held that it was entitled to recover 2/3 of its costs. In addition, as a result of a generous Calderbank offer of £480,467 per annum, B&Q was entitled to its full costs on an indemnity basis for the period from the last date for acceptance of the offer.

Learning points

- The courts are willing to give allowance for a rent free fitting out period even though the premises are actually already fitted out;
- Landlords should give careful consideration when seeking to insert an early break given the potential reduction in the rent then payable; and
- Well-pitched settlement offers should always be made to protect a party's position and put the other party under pressure to settle.

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