

Lease renewals: Following the pandemic

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Forsters LLP



Jonathan Ross is a partner in the property litigation team at **Forsters**



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Primarily as a result of the pandemic, there have been an increased number of unopposed business tenancy renewals under the Landlord and Tenant Act 1954 reaching trial due to the failure of the parties to reach agreement as to either the new rent payable on renewal and any interim rent payable up to the date the new lease is to commence.

The *HPUT Trustee No.1 Ltd v Boots UK Ltd* [2021] case is the first of a batch of cases to determine the new rents payable by Boots in relation to their 123 stores let from the same landlord.

The judgments in these cases highlight the following:

Timing

- Lease renewals can take a considerable time to come to trial, with the potential to cause real issues as to the determination of the interim rent if the market is fluctuating between the end of the old lease and the new lease commencing, being three months and 21 days after the judgment. In the *W (No. 3) GP (Nominee A) v JD Sports Fashion* [2021] and *S Frances Ltd v The Cavendish Hotel (London) Ltd* [2021] cases below, the interim rents covered some four to five years.
- The trials are often complicated and can take up to five days.

A step change in rents

- Retail rents have fallen considerably due to the pandemic – some 20-30%. Consequently, no real reliance can be placed on pre-pandemic comparables. In *WH Smith Retail Holdings Limited v Commerz Real Investmentgesellschaft MBH* [2021], their store had to stay open as it contained a post office, but sales were down by some 90%. Clearly, many large tenants such as Debenhams and Arcadia have ceased trading and many shops are vacant.
- Retail rents have also fallen due to the growth of online shopping and other factors, such that tenants can sometimes achieve substantially lower rents on renewal, as in *JD Sports*.
- Because of the substantial fall in the market, in four of the five cases below, the court held that the interim rent should not be based on the new rent, but should be higher to reflect that market rents were higher for a substantial part of the interim rent period.
- As held in *JD Sports*, turnover rents are now very difficult to justify on renewal even where the old lease had a turnover rent. They will only be appropriate where they

would result in a rent that is consistent with the current market rental value of the premises, or where turnover rents are the absolute norm (such as a car park). Originally, the landlord proposed a fixed rent of £282,000 for a new ten-year lease and it was JD Sports who proposed a base rent of £160,000 per annum for a five-year lease with a turnover top-up based on 5% of the turnover. By the trial, the position of the parties had reversed due to the changes in the market. The landlord sought, in return for a capital contribution of £200,000, a turnover rent at 8% (which would equate to £496,000 per annum based on the tenant's current estimated turnover) and the defendant sought a rent of just £17,700 per annum (or 0.29% of turnover, if a turnover rent was ordered). The court determined a rent of £104,300 which was a reduction of some 80% on the previous turnover rent.

Comparables

- Assessing comparables in a shopping centre can be very difficult given all the incentives offered to tenants and the tendency for different terms relating to right to break, etc. In *JD Sports*, the experts relied on a total of about 40 comparables.
- In determining the new rent, judges tend to fix on one nearby comparable they find most relevant and then make adjustments for matters as to size, frontage and location. For example, in the *Saville-Edells v Jain* [2021] case, the judge based his rental determination of 174 Kensington Church Street on the rent agreed in December 2020 for 180 Kensington Church Street.

Fixed rents

- Fixed rent increases or stepped rents are also unlikely to find favour. In *HPUT*, the old lease provided for an annual 1.5% increase, but the judge held that there was no market for fixed increases and no comparable evidence that could be relied upon.

Valuations in context

- Valuation experts for each party can take polar positions, causing the court to doubt their independence. It is the very substantial gap between their rental valuations (as evidenced in the table below in relation to the rents proposed by each party) which causes matters to reach trial and, under cross-examination, certain views expressed by the experts are often found to be untenable and/or partisan. The actual rent determined by the court is often a long way apart from the figures proposed by the experts. Having said this, the judge in *WH Smith* was sympathetic to the valuers given the acute crisis of confidence in the market and the extent of tenant insolvency and the increase in online sales.

Rent suspension clauses

- Rent suspension clauses are now being agreed on new lettings, and in some renewals, to cater for any further lockdowns. In *WH Smith*, the parties are to share the pain 50:50 in relation to any further lockdown. However, in *Poundland Ltd v Toplain Ltd* [2021], the court emphasised there has to be good reason for any change and it refused to make various changes sought by the tenant to the terms of the original lease, including as to any rent suspension during any further lockdown and as to rent being paid in arrears. In this case, however, monthly rent payments in advance were agreed and this is now relatively common.

Restrictions can lead to discounts

- Landlords have to be careful about not imposing restrictions as to user or alienation which result in the rent being discounted. In 'round two' of *S. Frances Ltd v Cavendish Hotel (London) Ltd* [2018], the rent was discounted by 25% because of such restrictions.

A welcome break

- Because of the current uncertainty in the retail market, a tenant break clause can be more easily justified by the tenant given the need for flexibility. In *HPUT*, it was for the landlord to justify that there should be no right to break, given there were rights to break annually in the old lease. The court held a right to break after three years was fair as it gave the landlord sufficient security, while allowing for an improvement in the market post-pandemic, so that the premises would be re-lettable if the tenant did choose to exercise the break.

Rent-free periods: yes or no?

- There remains considerable uncertainty and inconsistency as to whether the rent on renewal should factor in a rent-free period for fitting out given the actual tenant is remaining in occupation. Some judges favour excluding it (as in *HPUT*), as it does not accord with the reality while others choose to ignore the fact the tenant is in occupation and base the rent on a hypothetical tenant who will need to fit out (as in *WH Smith* and *JD Sports*).

Shorter leases

- Save where the parties agree otherwise, the length of any new lease is likely to be only five years, thereby avoiding the need for any rent review. In *JD Sports*, the parties agreed a five-year term with a break clause after three years. In *HPUT*, the court refused to grant a ten-year tenancy as sought by the landlord because of the need for the tenant to have flexibility given the current market uncertainty. For a landlord to agree that a tenant has a right to break is likely to increase the rent payable, so landlords do not always oppose break clauses despite the lack of security this causes.

Set out below are five recent cases, and my thoughts on the rents agreed.

WH Smith Retail Holdings Ltd v Commerz Real Estate Investmentgesellschaft MBH (25 March 2021)

The premises in question were in Westfield Centre, Shepherd's Bush, London. The old lease was for ten years, ending on 30 September 2018 at a rent £953,000, based on £327.50 Zone A, set on a 2013 rent review. The landlord proposed a rent of £751,995 based on £255 Zone A, while the tenant proposed £177,500 based on £142.11 Zone A.

The outcome

The length of the new lease was set at five years. The new rent was determined to be

£404,666 (based on £205 psf Zone A), and the interim rent payable from 1 October 2018 was £758,785 (on £261.65 psf Zone A).

Comment

The substantially reduced new rent reflected the fragility of the retail rental market even before the pandemic and the application of a further 20% discount to reflect the pandemic. Adjustments to the rent were also made due to the location and size of the premises when compared to comparables. The judge allowed a three-month discount for fitting out, even though the actual tenant did not need to fit out. The interim rent reflected the changes in the market during the intervening period rather than being based on the new rent. A pandemic clause was included in the new lease to halve the rent during any further lockdown of non-essential shops.

S Frances Ltd v The Cavendish Hotel (London) Ltd (18 June 2021)

The premises in question were the ground floor and basement at 80 Jermyn Street, London SW1. The old lease ending on 2 January 2016. In this case, the old rent of £220,000 was set in 2011. The landlord was proposing a rent of £226,500 (based on £230 psf Zone A), while the tenant was proposing £96,500 (based on £205 psf Zone A).

The outcome

The new lease was determined to be for 15 years, with five-yearly rent reviews. The new rent was to be £102,000 (based on £212 psf Zone A), with an interim rent from 3 March 2016 of £160,000.

Comment

The new rent reflected a 30% discount on the rental value since the pandemic. There was also a discount to reflect a 12-month rent free period, including three months for fitting out.

Both experts' evidence was seriously undermined on cross-examination.

There was a 20% discount due to the restrictive user for art purposes and a 5% discount due to the inability to sub-let part of the premises.

HPUT Trustees No. 1 and 2 Ltd v Boots UK Ltd (24 May 2021)

The premises in question were numbers 9, 11 and 13 The Promenade and 10 Princess Street in Bridlington. The old lease was for a term of 15 years and four months, expiring on 21 July 2020, at a rent of £90,000. The landlord proposed a new rent of £64,420 (based on £26 psf Zone A), while the tenant proposed £37,800 (based on £19.40 Zone A).

The outcome

The court determined the new lease to be for five years. The landlord sought a 10-year term with no break, while the tenant sought a three-year term with annual breaks. Given the level of economic and market uncertainty at the time of the trial in May 2021, the court felt the reasonable balance, given the overriding need for flexibility, made a five-year term appropriate. The actual new rent is not stated in the judgment, but it was to be based on £26 psf Zone A with a 10% discount for size and 7.5% discount for frontage to depth adjustment due to disproportionate Zone A space. The court did not allow any rent-free period for fitting out. The interim rent from 22 July 2020 was to be the same as the new rent.

Comment

Tenant break clause

A right for the tenant to break after three years was awarded, as this struck a balance of providing flexibility to the tenant, which was needed in the uncertain retail market, while giving the landlord greater certainty of term than it previously had.

Fixed rent increases

The lease had fixed rent increases of 1.5%. There was no evidence provided to the court of fixed rent increases being common in the market and so the court determined the new lease should not have a stepped rent increase either.

Rent review

No rent review was ordered for a five-year term. Had a ten-year term been ordered, the court would have ordered an upwards only rent review after five years, to reflect current commercial practice.

Lettings to charities (or other businesses that do not pay rates)

These should not be discounted when looking at comparable evidence. No business wants to pay more for its premises than it needs to.

W (No. 3) GP (Nominee A) v JD Sports Fashion (22 October 2021)

The units in question were two at the Derbion Centre, Derby, with a lease for ten years ending on 23 June 2017. The old rent was based on an 8% turnover with a base rent of £205,723 (resulting in a rent exceeding £500,000 at the time of renewal). The landlord was proposing a new rent of £496,000 based on 8% of turnover again, while the tenant was proposing £17,700.

The outcome

The new lease was set at five years, with a break right after three years. The rent was determined to be £104,300 (based on £67.04 psf Zone Z), and the interim rent from 24

June 2017 was set at £160,300, the judge holding that a turnover rent was inappropriate in the circumstances (see below). The court applied a 20% discount due to the pandemic and 15% discount for frontage/depth.

Comment

The court does have jurisdiction under the Landlord and Tenant Act 1954 to order a turnover rent, but where this will result in a figure substantially above the open market rental value, it is likely to be inappropriate and not to be in accordance with the principles underlying the 1954 Act whereby any new rent should reflect market value.

Saville-Edells v Jain [2021] (15 December 2021)

The premises in question were 174 Kensington Church Street, London W8, with a lease dated 31 October 2011 and expiring on 23 July 2018. The old rent was £22,000 and the landlord was proposing a new rent of £41,500 (based on £140 psf Zone A), while the tenant was proposing £24,400 (based on £104.32 psf Zone A).

The outcome

The new rent was determined to be £28,350 (based on £112.14 psf Zone A), while the interim rent from April 2019 was £30,550.

Comment

The court made clear that reliance on pre-pandemic comparables was inappropriate, given the fall in the market since then.

Cases Referenced

- HPUT Trustees No. 1 and 2 Ltd v Boots UK Ltd [2021] unreported
- Poundland Ltd v Toplain Ltd [2021] unreported
- S. Frances Ltd v Cavendish Hotel (London) Ltd [2018] unreported
- Saville-Edells v Jain [2021] unreported
- W (No. 3) GP (Nominee A) v JD Sports Fashion [2021] unreported
- WH Smith Retail Holdings Limited v Commerz Real Investmentgesellschaft MBH [2021] unreported

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