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UK Landlords and Tenants
Turnover or Roll Over?

27 August 2020

The prospect of empty hotels, restaurants and retail space is not one that landlords, or the businesses that occupy those premises, want to contemplate. Turnover rents are enjoying a place in the spotlight as one solution to the challenges posed by the current crisis.

The short-term effect of the COVID-19 pandemic has been dramatic, but what about longer-term prospects for landlords and tenants where online shopping has become the norm and eating out and staying away from home is perceived by many as a risk rather than a pleasure? Landlords and tenants do not have to roll over and give in to an unpalatable fate. Flexibility, and seeking opportunities where traditional approaches do not now work may pay dividends, as a swing towards turnover rents could well prove.

Turnover Rent – The Challenges

Turnover rents have traditionally been perceived as tenant-friendly, but the historical problem of persuading landlords that turnover rents are a good idea is becoming less of an issue. As both parties seek genuine solutions to the challenges presented by the current market, what was once the exception is now trending towards the norm.

Administrative Burden

Tenants are more willing to overcome the administrative challenges that come with turnover rents, long considered a burden for those with multiple units. Detailed, accurate records are essential, and with large numbers of properties comes a corresponding administrative headache. However, faced with the choice of going out of business or dealing with the pain, tenants are becoming far more willing to meet the challenges head on.

Key in the process is identifying exactly what the parties intend to define as "turnover". Clarity around which figures are to be included and trust between the parties avoids the necessity for landlords to call for regular, full audits.

Turnover Clarity – What Should Be Included?

The starting point is deciding if there will be a base rent in addition to a turnover rent or if the rent will be based on turnover alone. In either case, parties will need to agree what percentage is appropriate, with 10% being something of a "starter for 10". For existing arrangements, parties may agree a base rent that is a proportion of the current rent payable, or move entirely over to a turnover rent.

Whatever the fundamentals are, critical to the success of any turnover arrangement is agreeing what, exactly, will be included as "turnover", as the definition can strongly favour one party over the other, creating an imbalance that does not sit comfortably with a genuine move towards fairness and sharing of risk and reward. It is very easy to be caught out if not all payments to a business are given individual consideration.

The following are just a few examples of payments that parties may overlook when calculating turnover but which need careful thought when negotiating terms:

- **Reduced rates, or goods sold "at cost", perhaps to family and friends:** Parties need to agree whether to disregard or account for the discount.
- **Online/other sales:** This is likely to be one of the most controversial aspects of negotiating turnover. However, it is particularly important in light of customer tendency to use high street shops as showrooms but actually make their purchase online ("showrooming"), which means that footfall does not necessarily reflect turnover. Landlords may well want access to online orders and "click and collect" figures.
- **Deposits** paid and retained where full payment is not made.
- **Service charges and tips/gratuities:** Consideration will need to be given to whether payment is made direct to employees or processed through the tenant's accounts and whether each attracts different treatment.
- **Different brands** within a group may attract different levels of interest from consumers. Landlords may want to consider adapting turnover requirements for more popular brands – although, of course, this may balance out overall and may be perceived as unfair by the tenant.
- **Seasonal fluctuations:** These should not present a problem where the calculation of the turnover rent payable is annual, even where on-account payments are made throughout the year.

Frequency of Calculation and On-account Payments

Calculation of the turnover rent is likely to be made on an annual basis, ensuring that the final figure is a fair reflection of trade throughout the year. Landlords may still require on-account payments, which are usually made on a monthly or quarterly basis.

Interim payments may be fixed, or based on the turnover for the relevant period. Fixed payments are likely to be attractive to landlords, with tenants potentially favouring those that reflect turnover.

What's In It for Landlords?

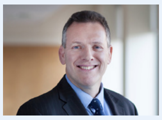
The case for turnover rents for tenants is fairly clear-cut. Do landlords see a similar benefit? Agreeing a turnover rent to sustain tenants' businesses with a view to promoting a long-term arrangement will, of course, be infinitely preferable to having no tenant at all. Although, in the current crisis, it may seem that the tenant holds all the cards, in a genuinely co-operative relationship tenants may be prepared to concede other negotiating points, such as longer lease terms and mutual or landlord-only break options, if actual turnover over an agreed period of time does not deliver. In addition, landlords can further protect their long-term investments by requiring that:

- The arrangement is personal to the current tenant, achieved by restricting a tenant's ability to assign or underlet on the basis of a turnover rent
- They benefit from an "offer-back" clause in the event of assignment or subletting, enabling them to consider whether negotiating a turnover rent with a new tenant or reverting to a market rent would be more beneficial
- The tenant provides turnover certificates and makes accounts records available, to preserve transparency and trust

A Shared Future for Landlords and Tenants

Transparency and fairness are key to turnover rents being seen as a viable strategy in promoting a genuine relationship of collaboration between landlords and tenants and securing the future for businesses in a number of challenged sectors. In a climate that will not sustain historical approaches to rent structures, turnover rents could well save the day.

Contacts



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