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Isleworth and Brentford Area Committee – Monitoring: 23 July 2009

Council's Retail Portfolio: Report on the Theory and Practice of 'Turnover' Rents

Briefing Paper by: Divisional Head of Corporate Property

Summary

To discuss the motion passed by Isleworth & Brentford Area Committee ('IBAC'): "Ensuring the economic sustainability and renewal of Brentford High Street and in particular plans for rents on Council-owned properties in Brentford High Street"

1.0 BACKGROUND

- 1.1 On the 21 May 2009, the Isleworth and Brentford Monitoring Committee raised a motion regarding the economic sustainability and renewal of Brentford High Street proposing inter alia that:-
- a) Working party proposals should include, but not be limited to, plans for rents on Council-owned properties to be set on the basis of *sustaining* tenancies – and thereby sustaining and maximising rents to the Council in the long term – rather than simply obtaining maximum income in the short term (see background note below);
 - b) Increasing the transparency of the Strategic Property Unit (*NB – no longer in existence. Functions carried out by Property Management, Corporate Property, Environment Department*) with annual revenue targets for Brentford High Street: these to be brought to the local area committee and then Executive for approval. This should be linked to a new, fairer rent-setting model.
- 1.2 There has also been an Audit Commission review of Economic Development, whose recommendation was to implement the good practice recommendations cited with the Council's Best Value Review of Asset Management.
- 1.3 With reference to the Best Value Review referred to above, the over-arching objectives for holding property are as follows:-
- a) All property is a shared corporate asset, owned by the Council not the service occupiers.
 - b) A cross-service approach to agreeing property priorities and asset utilisation should be adopted.
 - c) Property should only be held that meets the objectives of the Community Plan and/or the Council's Corporate Plan.

Council properties should be managed so as to satisfy defined service delivery needs while enhancing Council-wide benefits and gains from the Property Portfolio.

- d) Over time, all Council premises are suitable and sufficient for their purpose, in a satisfactory condition, accessible to all and able to meet statutory requirements.
- e) Existing and new property assets are managed in an efficient, sustainable and cost effective way in terms of their use of energy and other resources, their property management and other running costs. The return from non-operational property is optimised.

1.4 With regard to the proposal from IBAC, this has to be considered within the context of the over-arching objective referred to above i.e. that “the return from non-operational property is maximised.” However, in practice, this cannot occur unless the properties are let in the open market. The Council’s long-standing policy has been to charge market rents and this policy has stood during the most recent recessions. Therefore, if demand falls, new lettings and lease renewals reflect this. However, there can be a time lag and in a downward market it is acknowledged that ‘over-renting’ can occur but market forces then ensure a natural correction.

1.5 The IBAC motion calls for rents on Council-owned properties to be set on the basis of ‘sustainable tenancies’ and one method proposed is ‘Turnover Rents’ which is discussed at Section 2.

2.0 TURNOVER RENTS

2.1 Both large and small businesses throughout the United Kingdom are experiencing a decline in trading. Landlords whose rental income is no longer certain are considering methods by which they can assist their tenants through the hard times, without compromising the landlord and tenant relationship. Examples of such methods are the phasing or deferring of rents or changing the frequency of payment dates. It is difficult for landlords to be certain of their tenant’s true finance position without detailed accounts and whether any sort of intervention is likely to have any effect at all.

Some retail shops are closing down and since the landlord is not the only creditor, it is impossible for an outside observer to form a reliable opinion of the reason for their failure.

2.2 An uncommon method of valuing and collecting rents known as ‘turnover rents’ has recently been mooted as a possible means of avoiding the recessionary problems currently being experienced in the retail and property sectors. This indeed is possible, but unfortunately the methods of introducing and regulating the system effectively are not usually within the means of landlords with property portfolios outside of prime property.

2.3 Turnover rents first appeared in the USA in post-war shopping malls and later in Great Britain, with the early development of out-of-town shopping centres and the growth of retail shopping at large airports and railway terminals.

A turnover rent is simply a method of determining the rent as a percentage of the tenant’s gross turnover. The amount of the percentage is set by the landlord and is

usually, but not invariably, linked to a basic rent. The latter having some relevance to the prevailing 'market' rent.

Under this system, the landlord accepts the risk of a low rent in bad times but in times of economic expansion has the opportunity for a rental income well in excess of the prevailing market rent. The tenant's risks and rewards under turnover rents therefore reflect the landlord's position and in particular avoids the traditional system of cyclical rent reviews under which, if tenants are unfortunate, can lead them into the now familiar trap of agreeing a high rent under a review during a 'boom' period which is then followed by a 'bust' during which the tenant remains encumbered by the same high rent. However, equally, they cannot benefit from a low rent in a rising market.

- 2.4 It is therefore not always the case that a tenant can benefit from the turnover rent system. Such systems are not, however, usually found in circumstances where tenants operate in locations such as high streets, secondary and neighbourhood parades. The reason for this is the complexity, for the landlord (and indeed the tenant), of monitoring the tenant's turnover. The tenant's honesty is not the solution which most landlords would select and use of the system is confined to high-volume trading situations such as those mentioned above: large shopping malls in city centres and the like, where tenants' cash registers are directly linked to the landlords' computers. This use of technology not only provides the ability to accurately analyse the tenant income, but also to plan the mix of retail uses within its portfolio and to detect any attempts to defeat the landlord's monitoring procedure.
- 2.5 The turnover system requires the tenant to completely surrender its commercial privacy to the landlord, whilst the landlord has the burden and cost of managing and insuring its considerable liability for data protection. There are no reported instances where a landlord operates a turnover rent system, which depends upon traditional accounting methods and physical surveillance of the tenant to calculate the passing rent.
- 2.6 To attempt to introduce turnover rents into the Council's retail portfolio would require the agreement of the tenants to a legal variation of the lease to alter the provisions for valuing and collecting rents. This could be done for individual tenants but the cost of implementing and managing the system for an individual or a few tenants is likely to be disproportionately expensive in cost and resources. No compulsion to move to this system would be possible in terms of existing leaseholders.

The issue of loss of commercial privacy would be expected to be a significant obstacle, since small shopkeepers are likely to be more defensive in that area than a major retailer.

There are a variety of methods by which retail tenants can circumvent the vigilance of the landlord in monitoring the amount of turnover and only those landlords with advanced technology can be certain of an acceptable level of accuracy.

3.0 CURRENT SITUATION

- 3.1 The Council owns 29 retail units in the High Street, including the former Woolworth's unit at 120/122 High Street, which is subdivided into a number of units. Of these 8 are within the Housing Revenue Account (HRA) as are the 19 units at Albany Parade. The income from these units supports the HRA with the remainder of the income going to

the General Fund to support the Council's revenue budget. The income from the shops in Brentford has gone up by a third over the last 4 years (in part due to some historic leases coming to an end). The void rate has remained consistently low (currently only one shop owned by the Council is available to let). The turnover of tenants has also been consistently low over the last 20 years.

- 3.2 It is not clear yet whether the level of debt, as a percentage of rent receivable, has risen when compared to a year ago. This is due to the offer by the Council to move to monthly rent payments for tenants where this assists their cash flow. In any event the Council works with individual tenants to manage debt where issues arise.
- 3.3 The level of rental increase is not expected to rise by the same proportion in the next year or so and this will be reflected in the settlement of rent reviews and lease renewals.
- 3.4 If the rents become incompatible compared to other rents being offered by private landlords on the high street, then the void rate would be expected to increase and asking rents for vacant Council property will fall. By this mechanism, market forces will ensure the level of market rent which is sustained to tenants.

4.0 POSSIBLE WAY FORWARD

- 4.1 If it were considered practicable to introduce turnover rents, then this would have to be considered by the Executive and the Board of Hounslow Homes as part of a Borough-wide policy as it could not be applied to only one part of the Council's non-operational portfolio for equality reasons.
- 4.2 That if the Executive agreed to investigate this policy change, then additional revenue and resource consequences of implementing the change would have to be researched so that a costed proposal could be made to the Executive for their consideration.

EQUALITIES IMPACT ASSESSMENT

Equalities / Diversities Assessment

Local shopping parades form an integral part of local communities and are of particular importance to local residents who do not have access to private transport and those who have difficulty visiting larger shopping centres or supermarkets. The Council's policies should be open and not seen to offer an unfair commercial advantage to Council tenants when compared to the private retail investment sector

Background Papers: None.
This report has been or is due to be considered by:
This report is relevant to the following wards/areas: All.
This report has been cleared by: