

## **Rent Review - establishing the open market rent when no market exists**

### **1 Current issues**

- 1.1** It is a difficult time for rent reviews. Given the recent flat market, throughout most of the UK, there is an absence of transactions, and so, of comparable deals to help valuers determine the correct level of rent for a particular property on a particular date. And a valuation along these lines is required by most rent review clauses: what would a hypothetical willing landlord accept from a hypothetical willing tenant to let assumed premises? Without any comparable transactions, it is very difficult to say. Couple this inactivity with the volatile financial climate (and particular events such as Northern Rock being taken into public ownership on 17 February 2008 and the collapse of Lehman in mid September) and rent review disputes are proving increasingly difficult to resolve as each party stands firm.
- 1.2** Under most rent review clauses, the open market rent to be established at the review date is on the basis of various assumptions, including that the property is available to be let in the open market by a willing landlord to a willing tenant. But how does this work when there appears to be no market, with a glut of stubborn landlords and an absence of any willing reckless tenants? There is still the landlord which does not have the luxury of waiting for the market to pick up (perhaps offloading space it no longer occupies itself) and the tenant which is tempted by generous incentives. There are also the hypothetical deemed abstracts of the sensible landlord and measured tenant, willing but not foolish, content to let/take but not desperate. Even if there are no other parties, although this will affect the negotiations, there is deemed to be the willing landlord and at least one willing tenant who will strike a deal for the assumed letting - there is no option to walk away from negotiations. But if there is only one willing tenant in the market - why does he not negotiate a lease of £1 per annum? How does the assumption support the establishment of a 'market' rent?

### **2 Evidence and timing**

- 2.1** First, what real life evidence is there? Although evidence is often limited in current rent review disputes, valuers must still find comparable transactions to the extent that they can. Comparable transactions which occurred prior to the rent review date carry more weight if they are close to it, operating in the same market. But care must be taken. A letting negotiated through heads of terms to final draft documents may not be binding until the documents are signed - but the date of execution and completion may not truly represent the date of the transaction. A tenant may have the right to walk away but often will not do so if he has spent months negotiating a new letting - even if there is a shift in the financial climate just before he commits. But had he started to negotiate later (as the hypothetical parties are deemed to negotiate and complete on the rent review date), the deal might have been more to his advantage.
- 2.2** Comparable transactions occurring shortly after the rent review date may be useful when considered in conjunction with pre rent review date transactions to illustrate a trend in transaction values. Whatever the case, they should be considered very carefully in all contexts particularly if there is an absence of sufficient comparables prior to the rent review date. Obviously, any events affecting the market or change in sentiment between the rent review date and the date of a later comparable transaction must be taken into account.

### 3 Premises

- 3.1** It is not only the date of transactions which may give rise to difficulties in determining the rent. Given the absence of useful evidence, transactions which relate to quite different properties are being proffered as comparable. It is important to bear in mind the case law in these circumstances to ensure that neither side takes advantage of the shortage of relevant comparable evidence.
- 3.2** Further to *Marklands*<sup>1</sup>, the landlord cannot argue that, if a hypothetical landlord could have obtained much higher rent for parts of the whole premises if these were split, he could use this to bargain with a hypothetical tenant to increase the rent. The premises which are to be valued are those which are currently being let as a whole.<sup>2</sup> Even if there is a clever negotiating position that the landlord could take if he were to be marketing the premises in reality, in the realm of the rent review, he is not allowed to invoke such a position.<sup>3</sup>
- 3.3** Similarly, the hypothetical landlord cannot argue that if he let the premises for a use other than that permitted in the lease, he would obtain a higher rent, and use this to negotiate a higher rent with the hypothetical tenant.<sup>4</sup> The premises to be let are the premises determined in the lease for the purpose permitted in the lease.

### 4 Sentiment

- 4.1** Although the hypothetical premises to be valued must be those demised under the lease, the negotiations are otherwise assumed to be conducted “in the light of all the bargaining advantages and disadvantages existing on that [rent review] date”.<sup>5</sup> In a quiet market, the sentiment on the rent review date as to whether the economy is to suffer another dip, or alternatively, if there are green shoots sprouting, is important for the valuer.
- 4.2** If a willing landlord can show that the market was optimistic on the review date, it might be that he could negotiate with the hypothetical tenant a premium for the tenant having the benefit of what is likely to be a rent less than the open market rent for a proportion of the period until the next rent review date. And vice versa, if the market looked set to fall again, the hypothetical tenant may be able to negotiate a rent less than the open market rent on the basis that rents are likely to drop further.
- 4.3** It was reported on 12 February 2010 in *Property Week* that, an arbitration hearing recently concluded for a rent review dispute between Prupim as landlord and Toys r Us as tenant in relation to a retail warehouse in Stoke on Trent. The timing of the rent review date in the lease was of great importance - it fell 2 weeks after Lehman's collapse. Prupim argued that the full impact of Lehman's collapse had yet to make itself felt at the rent review date. Toys r Us said that it had made its impact. Using Prupim's argument, the rent after the review would be higher than Toys r Us thought it should be. The outcome of the hearing is confidential but there will undoubtedly be other disputes facing the same valuation issues. Thus, as well as comparable transactions, valuers must look to market sentiment on the rent review date to provide context for the bargaining position of the parties.

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<sup>1</sup> *Marklands Ltd v Virgin Retail Ltd* [2003] 2 EGLR 43

<sup>2</sup> *FR Evans (Leeds) Ltd v English Electric Co. Ltd.* [1978] 1 EGLR 93 at 94

<sup>3</sup> Unless the lease expressly contains a provision that the hypothetical premises can be assumed to be either in whole or in part(s) together with a “singular and plural” boilerplate clause as in *Level Properties Ltd v Balls Brothers Ltd* [2007] 2 EGLR 26

<sup>4</sup> *Northern Electric v Addison* [1997] 2 EGLR 111

<sup>5</sup> *FR Evans (Leeds) Ltd v English Electric Co. Ltd* at 94

## **5 Summary**

- 5.1** In difficult economic times, valuers and lawyers must consider a variety of factors and be ever more inventive in determining the correct rent payable at a particular rent review date. However, this inventiveness must be tempered with realistic expectations as to the compromise which the parties will have to reach either by negotiation or through an award. In *FR Evans*, Donaldson J stated that “it is not correct to adopt wholly the contentions of either party” in a rent review dispute. In these difficult times, this guidance is particularly important for all parties, however stubborn, to bear in mind.

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