

Turnover Rents



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INFORMATION NOTE

TURNOVER RENTS

1. Introduction

Turnover rents are becoming more common place in the Irish market and at present no guidelines exist. As turnover rents become an inevitable part of retail valuations and a regular feature of many retail deals at present, it is necessary to have an established practice which ensures an efficient, well structured means of formatting and analysing turnover deals. To date this has proven challenging as many of the existing tenancies in place vary in terms of their turnover element.

This paper hopes to set out various aspects of turnover rents and has cognisance of the established practice in Europe. Today in Ireland turnover rents while being a product of uncertainty are (also a very real opportunity and are) demand and supply driven. Whereas previously almost all commercial lettings were carried out on an open market letting basis there has been a growing trend in the market of turnover linked transactions. Whereas initially, these transactions were predominantly granted to large foreign retail multiples to encourage them into the Irish market and were limited to shopping centre type locations they have quickly become more widespread. Turnover type transactions align landlord and tenants interests more closely where the goal from both sides is to encourage and promote increased trade.

To date turnover based transactions have been predominantly isolated to the retail/leisure sector of the market.

2. Basis of Turnover Rent

There are a number of ways in which rents with a turnover element can be structured. The most frequently used and best practice would be as follows:-

- 1) Pure Turnover Rent: x % of Sales
- 2) OMV plus Turnover Rent Top Up
- 3) Base Rent (% OMV) plus Turnover Rent (flat percentage or stepped percentage)
- 4) Base Rent plus Turnover Rent between varying thresholds

All of the above can be exclusive or inclusive of other costs which may be included in the rent. The vast majority of turnover percentages are exclusive of VAT.

1) *Pure Turnover Rent*

This normally has a headline rent to allow for regular invoicing and an adjustment is made at year end accordingly.

2) *OMV plus Turnover Rent*

The agreed Open Market Rental Value is applied to the property/unit with an additional agreed percentage of the turnover to be charged quarterly or yearly in arrears should the turnover exceed a stated cap.

3) *Base Rent plus Turnover Rent*

A base rent is agreed on the premises. This rent is paid quarterly or monthly in advance and is topped up by an agreed percentage of the turnover quarterly or yearly in arrears. The base rent can either be a fixed figure or a percentage of the agreed Open Market Rent on the unit.

4) *Base Rent plus Turnover Rent between varying thresholds*

The Open Market Rental Value of the property/unit is established and reduced to a certain agreed percentage (usually not below 60% but this figure may vary) once the turnover exceeds an agreed level. Parties are also free to agree turnover floors and ceilings before which and after which no turnover rent is paid or applies.

A transparent, regulated agreement between the landlord and the tenant is needed in terms of recouping monthly or quarterly turnover figures and this must be independently audited at year end. Usually, the landlord reserves the right to audit the turnover, should there be a dispute. It may also be appropriate for the landlord to link to the tenant's EPOS (Electronic Point of Sales), for monitoring purposes.

Should Letting/Managing Agents be involved in the rental advices and/or collection it is important that they are aware of the business models and sales densities of each individual tenant in order to assess the likely annual income. Landlords may also need to be cognisant or any internet sales driven by the business.

There are a number of elements which can affect the percentage of turnover. These can be standard negotiation issues such as covenant strength, quality and desirability of the tenant, quality of location etc. However landlords need to also be aware that different business' have different margins therefore different percentages can apply.

3. Advantages / Disadvantages of Turnover Rents

Some of the main advantages and disadvantages of turnover rents are set out below:

Advantages

- In a slow market it may help with the letting of a vacant property/unit
- Allows for pro-active management of the tenant mix in any scheme
- The tenant has the comfort of knowing that the rent payable is a component of the turnover achieved
- Ensures that a landlord is more pro-active in marketing/driving footfall – particularly relevant in a shopping centre.
- Any base rent is a fixed rent set at a lower rate than the Open Market Rent
- Alignment – brings the landlord and tenant working relationship closer. Both are dependent on strong/best results
- Fairness - in terms of risk it is more equitable; the risk sharing becomes more equal. Both are dependent on sales
- Responsive – rental growth is dependent on the return of the business and therefore more responsive
- Performance Orientation – business led approach, performance, metrics.
- Allows a landlord to assess both his tenant and his centres performance. Poor turnover figures might not necessarily be the failure of the tenant but may be a lack of demand or oversupply in that particular sector of the market.

Disadvantages

- Uncertainty – funding and valuation issues
- Volatility – market conditions/linked to consumer spend
- How to deal with periods of closure – refit etc
- Cash-flow – frequency, timing on account
- Potentially management intensive – data collection, calculation, analysis and reporting
- Data Reliability – audits, penalties
- Accuracy of Information provided – audited /un-audited accounts
- Electronic Point of Sale (EPOS)
- Difficulty for first time / start up business
- Reporting Structures – weekly, daily, departmental basis etc
- What is actually captured by turnover/Internet/wholesale sales etc
- Cost – Audited accounts may be required on a quarterly basis as against an individual annual audit.
- Assignments – Is the turnover provision personal to the tenant or can they assign it? Is there a mechanism for a fixed rent upon assignment? Tenant cannot pass on benefit of the turnover.
- Trust – Landlord may have concerns over whether the tenant is declaring all turnover.

4. Turnover based Rent Lease Structures

Lease to be formatted in the same way under the various landlord/tenant legislation with an added schedule dedicated to turnover rents. This schedule would include sections covering:-

- Account Records
- Broken Turnover Period
- Gross /Net Turnover Defined
- Account Records, Inspections, Audits etc
- Turnover Certificate *
- Rent reviews*
- Disclosure
- Determination of Disputes
- Confidentiality

A sample schedule on Turnover Rents is attached in Appendix A with all of the above headings explained in detail.

In the case of leases where the rent is based on a turnover element it may be found that landlords will look for shorter term lease agreements and this will be dictated by the market generally. The reason for this will be the landlord's desire for flexibility and it may be found that performance related break options shall be sought on five year cycles.

With turnover leases, particular consideration needs to be given to the Alienation clauses (assignment and sub-lettings to third parties).

Turnover clause does not transfer on renewal of leases.

* Retailers with a turnover under a certain threshold are not required by the CRO to have their accounts audited and returned to the CRO. Therefore Management accounts are acceptable.

Appendix A

Set out below is a sample Turnover based rental clause some points of which may be included in leases in addition to the other standard clauses. Independent legal advice should always be sought in relation to any wording being inputted into lease documentation.

Schedule 6 – Turnover Rent

1. Definitions

In this Schedule the following expressions shall have the following meanings:

“Account Records” means all books and other documents or records which are or ought in the reasonable opinion of the Landlord to be kept by the Tenant for the purpose of ascertaining and verifying the Gross Turnover or which are or may in the reasonable opinion of the Landlord be relevant for such purpose, including the results of electronic interfacing which may be installed on the Tenant’s cash register;

“Broken Turnover Period” means the period from the last anniversary of the Rent Commencement Date within the Term to the expiry or sooner determination of the Term;

“Gross Turnover” means the aggregate of all sums of money or other consideration received or receivable for all goods sold or otherwise disposed of and for all services sold or performed and from all business of any nature whatever conducted at in from or upon the Premises or any part of the Premises by the Tenant during the relevant Turnover Period.

2. Gross Turnover may or may not take into consideration the following:-

- (a) All amounts received or receivable from orders which originated or are received or accepted at or from the Premises notwithstanding that delivery or performance is made at or from any place other than the Premises and notwithstanding that payment is made to a person other than the Tenant;
- (b) All amounts received or receivable from orders solicited off the Premises by persons operating from or reporting to the Premises;
- (c) All amounts received or receivable from sales made or services provided by means of mechanical or vending devices at the Premises;
- (d) All amounts received or receivable from sales and services which the Tenant in the normal and customary course of the Tenants operations would or should credit or attribute to the Tenant’s business on the Premises;

- (e) All grants subsidies and fees of a revenue nature paid to the Tenant by national or local government or any public authority in consideration of or to defray in whole or part the cost of the supply of goods or services at or from the Premises but only to the extent that such grants, subsidies and fees actually defray costs, and provided that such grants, subsidies and fees are directly related to the supply of the actual goods and services being sold or supplied by the Tenant.
- (f) All amounts received from or receivable from mail, telephone or similar orders received or fulfilled at or from the Premises.
- (g) The value of all gift vouchers redeemed from the Premises.

PROVIDED THAT:

- (i) every sale on credit terms or on an instalment basis shall be deemed to be a sale for the full cash price at the date when the same is made irrespective of the time or times at which the Tenant receives payment;
- (ii) every hiring of goods to a customer with an option to purchase shall be deemed to be a sale of the goods for the full cash price at the date when the hiring is made (irrespective of the time or times at which the Tenant receives payment) and there shall be excluded from Gross Turnover any hiring charges in respect of such hiring;
- (iii) every deposit by a customer shall be included in the Gross Turnover at the time of receipt and shall only be deducted from Gross Turnover if and when repaid or credited.

The following amounts shall not be included in the Gross Turnover or if included shall be deducted:-

- A. VAT, purchase tax and any similar sales or excise tax imposed directly on the Tenant or charged by the Tenant to its customers in respect of the supply of goods or services;
- B. discounts customarily allowed to employees of the Tenant in respect of goods or services supplied to them by the Tenant;
- C. the amount reasonably and properly allowed on goods traded in by customers in the ordinary course of business;
- D. the amount of any cash refund or credit given to a customer when goods are returned provided that such cash refund or credit does not exceed the sale price of the goods included in the Gross Turnover;
- E. the sale price of goods returned by customers for exchange provided that:-
 - (i) such sale price has been included in the Gross Turnover; and
 - (ii) the sale price of the goods given in exchange is included in the Gross Turnover
- F. allowances or refunds made in respect of defective or unsatisfactory goods or services provided that such allowances or refunds shall not exceed the sale price of the goods or the charge for the services included in the Gross Turnover;

- G. the value of goods transferred whether by way of exchange or otherwise from the Premises to other premises of the Tenant provided that such transfer is not made for the purpose of consummating a sale which has been made at in or from the Premises nor deprives the Landlord of the benefit of a sale which would otherwise have been made at in or from the Premises;
- H. the value of goods returned to shippers wholesalers or manufacturers;
- I. tips or gratuities;
- J. the value of all gift vouchers sold from the Premises (but not their redemption);
- K. the price or the value of promotional items sold or given away whether wholly or in part and whether or not for charitable purposes;
- L. The value of or payment received for tailoring or alterations to merchandise (whether or not charged for as part of a free service to customers).
- M. Interest charges, credit account services or other such charges.

“Tenant” means the Tenant and any licensee franchisee or concessionaire of the Tenant and any other person in occupation of the Premises or any part of it but not, for the avoidance of doubt, assignees or sub-tenants;

“Turnover Period” means each period of one year commencing on the Rent Commencement Date and the Broken Turnover Period;

“Turnover Rent” for each year of the Term means if the Turnover in the immediately preceding Turnover Period is:-

More than €X,000,000 the sum of the rent payable shall be €Y,000,000 of Y% of the sum of the turnover

3. Account Records, Inspection, Audit etc.

- 3.1 The Tenant shall maintain the Account Records fully and accurately throughout the Term.
- 3.2 The Tenant shall keep safely the Accounts Records in such place reasonably accessible for inspection by the Landlord, and located in Ireland relating to the then current and two immediately preceding Turnover Periods. The Tenant shall make the Account Records relating to such Turnover Periods available for inspection at all reasonable times by an employee or accountant (duly authorised in writing by the Landlord to make such inspection) of the Landlord.
- 3.3 The Landlord shall be entitled to install a system of electronic interfacing on the Tenant’s cash register as a means of verifying the Accounts Records PROVIDED that such system or its installation does not adversely affect the proper and effective operation of the Tenant’s cash register or its interface with other equipment of the Tenant.

- 3.4 The Landlord may at its discretion cause an audit of the Account Records relating to the current Turnover Period and any preceding Turnover Period to be made by a professionally qualified accountant appointed by the Landlord and if it is established by such audit that the Turnover Certificate for any Turnover Period has understated the Gross Turnover for that Turnover Period by more than three per cent (3%) then the cost of the audit shall be borne by the Tenant.
- 3.5 If it shall appear from any such inspection or audit or from any other circumstance that any further Turnover Rent is payable then such Turnover Rent shall be paid by the Tenant forthwith together with all interest which may have accrued thereon at the Prescribed Rate in accordance with the provisions of this Lease.

4. Turnover Certificate

- 4.1 Within ninety (90) days after the end of each Turnover Period the Tenant shall deliver to the Landlord a certificate (the “**Turnover Certificate**”) signed by its professionally qualified and experienced auditor certifying the amount of the Gross Turnover during such Turnover Period and the Tenant covenants with the Landlord that the Turnover Certificate will state accurately the amount of the Gross Turnover for the Turnover Period to which the Turnover Certificate relates.
- 4.2 Upon receipt of each Turnover Certificate the Landlord shall calculate the Turnover Rent, if any, for the year after the Turnover Period to which the Turnover Certificate relates and shall serve a written demand on the Tenant for the Turnover Rent.

5. No Disclosure

- 5.1 The Landlord shall not disclose the Gross Turnover nor any other information obtained from inspection or audit of the Accounts Records except to such extent as may be necessary:-
- 5.1.1 In order to comply with any lawful requirement of any interested authority; or
- 5.1.2 For the enforcement of the provisions of this Lease;
- 5.1.3 For the proper conduct of the Landlord’s business;
- 5.1.4 For the sale or proposed sale or mortgage or proposed mortgage dealing with the Landlord’s interest.

6. Determination of Disputes

- 6.1 If any dispute shall arise between the parties as to the amount of the Gross Turnover or the Turnover Rent such dispute shall be determined by an arbitrator who is a qualified and practising chartered accountant agreed by the parties or in default of agreement to be appointed on the application of either party by the President of the Institute of Chartered Accountants in the Republic of Ireland and the arbitration shall be conducted in accordance with the Arbitration Act 2010 or any statutory modification or re-enactment thereof for the time being in force.

7. Confidentiality

- 7.1 The terms of this Agreement are otherwise confidential to the Landlord and the Tenant and shall not be disclosed to any third party unless:-
- (i) the same is required by Law or Stock Exchange or other regulatory requirement;
 - (ii) in the case of the Tenant to any person to whom it intends to dispose its interests in the Premises (in each case the Tenant ensuring that the relevant person to whom the documentation is disclosed gives a confidential undertaking requiring that person to comply with the terms hereof); and
 - (iii) to the Landlord's and Tenant's professional advisors, financiers, insurers or any investors.

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