

AG&G

CHARTERED SURVEYORS • LICENSED LEISURE SPECIALISTS

Pubs Consultation
Consumer and Competition Policy
Department for Business, Innovation & Skills
3rd Floor, Orchard 2
1 Victoria Street
Westminster
SW1H 0ET

14th June 2013

Dear Sir

PUB COMPANIES AND TENANTS – A GOVERNMENT CONSULTATION

On behalf of AG&G, a Chartered Surveying practice specialising in the pub property sector, I am hereby taking up the offer of responding to the consultation document dated April 2013.

Attached is a copy of the response form, in respect of the respondent 'type' box I have ticked Other. As Chartered Surveyors specialising in the pub sector this Company undertakes rent reviews for landlords and tenants, of both tied and free of tie pubs, we also undertake transactional work, selling and buying pubs of the full spectrum of tenure including freehold, free of tie and tied. Furthermore myself and one of my co-directors sit on the President of the RICS's panels, able to accept appointments as arbitrators and independent experts for dealing with disputed rent reviews for the subject property type.

Below I set out what I consider are a number of key observations which I wish to put forward followed by my replies to the 17 questions posed within the documentation.

Key Observations

Apparent Hostility To Pub Companies – I am concerned that the consultation document is drafted with a hostile tone towards pub companies. Within the first paragraph of the opening explanation the statement is made '*for example through large unjustified rent increases*', this statement is not justified and purports to be fact. In the following paragraph the wording is set out '*...gives an additional route of abuse...*', again an unsupported statement which purports to be fact. My concern is a document which I consider to be worded in such a hostile way against the sector new legislation is proposed for the regulation of, has the prospect of making bad law.

Market Workings – I do not consider that the wording of the consultation document gives sufficient credence to the fact that the landlord and tenant relationships that the tenants and the pub companies enter into are only as a result of the parties acting out of their own free volition, neither side is compelled to enter into the letting bargain. As a result of industry examination most pub companies now operate a Code Of Practice which extends to those tenants to which it applies, a material number of concessions as against those available to occupiers of other business premises. Personally I do not believe Government should meddle with the workings of the market.

Lack of Balance – A number of statements set out within the document, including *'tied tenants are more likely to face serious hardship'*, are not presented in an objective fashion. The observation should also be made that some tenants of tied pubs have become millionaires a consequence of the operation/sale of tied pubs.

Tied Tenants Should No Worse Off Than Free Of Tie Tenants – This is an attempt to compare two distinct markets. There is a broad base of evidence of rents for pubs let incorporating a tie, this is the basis on which the greatest percentage of pubs are occupied, there is less evidence available of pubs let on a free of tie basis. Both markets operate independently of one another subject to their own market forces.

Adjudicator Arbitration Function – It is proposed that any tenant dissatisfied with how their rent has been calculated can look to the Adjudicator to arbitrate the rent review. It would be very one sided that only the tenant could seek the assistance of the Adjudicator and the consultation document proposes the rent can be revisited after it is agreed. Tenants currently have available third party resolution processes within the lease and most Codes of Practice operated by the pub companies. If the Adjudicator is to conduct an arbitration in accordance with the Arbitration Act 1996 then this is no different to an arbitration being undertaken under the terms of the lease. I am of the view that the current arrangements for third party rent review resolution, including the PIRRS option, are quite effective and the options for third party resolution are already more varied than for the wider commercial property market.

Mandatory Free Of Tie Option – For various reasons including those I identify below with reference to SCORFA, a free of tie lease is more attractive to a tenant than a tied lease, assuming in each case the properties are appropriately rented. Therefore if the tied estates of more than 500 pubs are forced to offer a free of tie option I foresee a significant impact on those companies with fewer than 500 pubs, particularly the family and regional brewers, who rely upon their tied estates to sell their own produced products. Tenant's will only wish to take leases from the large ownerships which will reduce the attractiveness of taking a tied lease from the smaller ownerships, significantly impacting their brewing/pub owning business model with the likely outcome of an increase in closures of both pub and possibly brewing facilities.

SCORFA – As presently proposed the method of comparing tied rents with free of tie rents by way of the special countervailing or financial advantage adjustment is materially flawed. It provides only for certain benefits provided to tied tenants by the pub company and an adjustment for the enhanced gross margin available to a free of tie tenant. This fails to reflect several factors which would represent material considerations to the hypothetical tenant and would be reflected by way of a higher rental bid, not reflected by the proposed benefits/enhanced gross margin calculation approach. These factors include:-

- a) It is reasonable to assume that the majority of tied tenants would prefer a free of tie lease however there are certain tenants who will only take free of tie leases, including larger multiple site operators, national pub companies and brewers. A bigger pool of potential tenants leads to more competitive bidding, larger multiple site operators can afford to bid more than single site operators for free of tie opportunities due to their purchasing powers increasing with a growth in overall barrelage volume.
- b) The landlord of a free of tie pub has no knowledge of the levels of trade being conducted by the tenant and this potentially places the tenant in a more advantageous position at rent review than would be the case under a tied letting. This is reflected in the tenants' rental bid.

- c) The market will pay a higher Capital Value per £ of free of tie operating profit than they will of tied operating profit. For example in reasonable parts of London a tied lease assignment may attract a premium bid at 2 to 3 times net profit, for the equivalent profit from a free of tie operation the market may pay 4 or 5 times i.e. for the same level of net profit a free of tie lease has a materially higher Capital Value.
- d) A free of tie lease is a more 'liquid' asset than a tied lease i.e. it is always the case that a free of tie lease will sell more speedily than a tied lease.

As presently proposed the method of reflecting SCORFA is only on a revenue basis i.e. ensuring that the profit creation from being tied or free of tie is equal however the reality is there are other material benefits of being free of tie which are not reflected by way of the 'revenue' adjustment proposed.

The following replies are to the 17 questions set out on the Response Form. Please note that there are some matters upon which I do not feel able to give an informed reply in which case I have inserted IRNP (informed reply not possible).

- 1) No, I consider further intervention constitutes meddling in a sector where market forces should be allowed to prevail, particularly in light of the prevailing Codes of Practice operated by most pub companies.
- 2) If there is to be a Code then I consider it should be applicable to all companies operating tied letting agreements.
- 3) I agree. I consider franchises should be treated in the same way under any Code.
- 4) In respect of the costs of implementation of the Code as per the consultation document, IRNP in respect of the pounds, shillings and pence cost. However, I would expect the impact on the industry to be significant and ultimately this cost will be reflected in pub closures, enforced losses on shareholders, bondholders and job losses within the pub companies and those working within pubs. In respect of benefits, again IRNP regarding the pounds, shillings and pence benefit. However I would foresee a 'windfall' benefit to tenants of any pubs affected by the Code as it is currently drafted if they are able to call to be made free of tie. This will immediately increase the capital value and liquidity of their leasehold assets.
- 5) On the basis that I am a believer in market forces I consider the self-regulation which has come about in recent years, particularly the ability for tenants' to ask for a review of their rent outside of the cyclical review period, that cyclical reviews can be upward or downward irrespective of the lease wording and the introduction of the PIRRS independent expert referral provision, are all significant relaxations of the letting provisions prevalent in the commercial property market, pubs being a commercial property type.
- 6) I am not aware of such Government pressure/intervention in any other area of the commercial property market and landlords and tenants do enter into lease agreements of their own free volition. I therefore consider the current basis of self-regulation, guided by the Codes of Practice adopted by most pub companies, is eminently workable and requires no further intervention.
- 7) I agree with the first overarching principle, of fair and lawful dealing. In respect of the second overarching principle I do not believe that this is a well-founded/well defined/easily quantifiable set of words/aim. As noted elsewhere herein I consider there are distinct markets for free of tie lettings and for tied lettings, there being a

much greater body of evidence of tied lettings. The consultation document's approach to quantifying the difference between the two types of letting, having regard to SCORFA, I consider poorly founded as it seeks to identify 'revenue' items but has no regard of the enhancement of capital value and increased market attraction/broader market for a free of tie letting and as a consequence thereof the rental bid warranted.

- 8(i) So long as the landlord also has the right to request an open market review if there has not been one in five years, then I do not think that would be an inappropriate provision. As regards reference to '*...significantly increases drink prices...*'. This needs to be defined, perhaps by reference to any increases in excess of those reflective by way of central government duty increases and the retail prices index. In respect of the ability to seek a rent review in the event of an occurrence outside the tenant's control, this is at odds with the remainder of the commercial property market, for example, this is not available to retail tenants, and accordingly I do not consider should prevail within the pubs market. Furthermore, there should also be the provision for the landlord to implement a rent review in the event of an occurrence outside the tenant's control which actually enhances the trading opportunity, if one is being fair and reasonable.
- (ii) As I have rehearsed elsewhere herein there seems to be a wish to view the position of the tied tenant and the free of tie tenant on a revenue basis, without having any regard to the capital value/increased liquidity of the leasehold asset. Accordingly I do not consider the pub companies should be required to produce parallel rent assessments.
- (iii) Machine ties are a long term component of the tied letting model and I do not consider this provision should be meddled with.
- (v) Given the product range available through most tied estate operators these days I do not consider there is any need to give a mandatory guest beer option if the aim is to broaden the range of products available to the consumer. If the is to provide the tenant with a 'windfall' benefit, then it will have the desired effect.
- iv) The Code should not prevent flow monitoring equipment being used to determine whether a tenant is complying with purchasing obligations or as evidence in enforcing such obligations, the alternative is to open the floodgates for tenants' 'buying out'.
- 9) As set out elsewhere herein I do not consider that the second overarching principle, that a tied tenant should be no worse off than a free of tie tenant, is a well-founded/definable/quantifiable/fairly workable aim and therefore should not be incorporated. In respect of the sample calculations put forward attempting to quantify SCORFA, as noted herein, I consider these attempt to address the 'revenue' variations, although will not reflect the increased buying powers of certain multiple tenants as against an individual tenant, however the proposals are woefully inadequate in failing to recognise the capital value/increased liquidity benefits to a tenant of having a free of tie agreement. Therefore I do not consider this element of the draft is fit for purpose. I also consider that the current prevailing provisions for dealing with rent reviews are fully adequate, to introduce the ability for the Adjudicator to undertake an arbitration will actually introduce a higher cost/more complex process to the resolution of disputed rents than does the PIRRS system.
- 10) Yes.

- 11) No. As set out elsewhere herein, this is likely to have significant, negative, unintended consequences for the pub sector increasing closures, forcing loss of value on parties through government intervention, loss of jobs, etc.
- 12) I consider that the Government is trying to compare apples with oranges, there are distinct markets for free of tie lettings and for tied lettings and as a market practioner dealing with capital and rental valuations of the two types of leasing, also acquiring and disposing of such leases, I do not consider there is 'formula' that can be applied to compare the two types of leasing. The widest body of evidence of pub rents in the country is of tied lettings and therefore so long as a tied rent compares with tied rents amongst its peer group then there should be no further requirement. The current system of dealing with rent reviews fully addresses this.
- 13) If there is a new Code then it will have to be administered so yes, an Adjudicator will be required.
- 14(i) If the Adjudicator is to arbitrate in accordance with the Arbitration Act 1996 then this will introduce a whole new tier of costs/bureaucracy to dispute resolution.
- (ii) Yes.
- 15(i) Yes.
- (ii) No.
- (iii) Yes, in the event of failure to comply with any recommendations made under (i).
- 16) Yes.
- 17) I do not agree that the Adjudicator should be funded by an industry levy. Ultimately if the Government wishes to intervene further in this sector, presumably for the benefit of the general population, then the Government should sponsor such an arrangement through the taxation system, thereby the cost of the Government fulfilling their aims fairly falls on those they are seeking to bring benefit to.

Yours faithfully,

David Gooderham