Regular features

Pubs, bars and restaurants

Should and do operators pay for space occupied by plant?

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Abstract

This paper examines whether operators are paying for the space occupied by plant, in the light of increasing demand for plant and expanding plant areas.

Keywords:

plant space, rented or not?, rental value?, A3/A4 property, improvement to rent review classes and negotiations

INTRODUCTION

Twenty years ago air conditioning was not an issue that concerned surveyors dealing with pubs, bars, restaurants, nightclubs and leisure property in general. With global warming, very few modern units are now built without air conditioning. There is a need for warming premises in the winter and cooling them in the summer if business is to be maintained at optimum levels.

There is also increasing demand in kitchens for air cooling and extraction plant. Often theatre-style kitchens, open to the customer areas, need a cool air curtain to keep the heat from the customers while showing the theatre to maximum effect. Drinks are sold at ever-cooler temperatures. Line coolers for draught products and refrigerators both create heat which must be dissipated from cellars and storage rooms.

It is now unusual for plant areas to take less than 5–20 per cent of a total usable area, yet surveyors have been slow to decide how such space should be valued. High-street pubs, bars and nightclubs are, in the main, valued based upon areas measured to gross internal area (GIA). The Royal Institution of Chartered Surveyors (RICS) definition of GIA includes among other things columns, piers, chimney-breasts, stairwells, lift wells and other internal projections, thus a lot of non-productive or non-earning space is included in the definition of GIA. Vertical ducts and the like are also included in the space to be measured for GIA — everything within the four walls is included in the measurement. In practice,

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while paying lip-service to the definition of GIA, it is usual for surveyors to value pubs, bars and nightclubs excluding stairs and stairwells. This is often because fire precaution requirements determine that large areas of otherwise usable space have to be devoted to fire-escape corridors etc.

The important point to be considered is that *valuations should be made on the same basis as comparable deals are analysed*, ie if one analyses at true GIA then one values to GIA. If the comparables have been analysed excluding stairs and fire-escape corridors, then that is the way a valuation should be made.

When it comes to space occupied by plant then it is often not clear how a comparable has been analysed. This is covered in greater detail below.

Restaurants, especially where they are in units identical to retail shops, are often valued based upon measurements made on a net internal basis. In this case the RICS definition tells one to exclude from the measurement space occupied by permanent and continuous air conditioning, heating or cooling apparatus; also space where ducting has effectively rendered it unusable.

PRACTICAL CONSIDERATIONS

So far, so good. One now comes down to practical consideration of several examples. Practice seems to vary according to whether a building is self-contained or in multiple occupation. The author has spoken to a number of acquisition surveyors and from them obtained the practical requirements in order to take a building.

Essential customer area

Most acquiring companies will have a minimum size required for customers.

Essential back-up space

Similarly, operators will have a minimum space needed for kitchens, public and staff toilets and liquor and dry stores. Often this space can be located in a basement or at first-floor level, although there is an increasing current demand for restaurants to have theatre kitchens overlooking the customer area.

Business plans

An operator will prepare trade and profit projections for a potential unit having regard to its location, nature, size and configuration. After allowing for anticipated operational costs together with a return on the capital investment required to trade from the unit, an operator will form an opinion as to the level of rent it can afford to pay. If the tenant can afford to pay what a landlord requires a deal will be struck. If the figures are marginal, negotiations will take place.

Space required for plant

Generally very little consideration is given to the space required for

plant. More often than not plant is placed on a flat roof, sometimes on a 'plant shelf' at the back of the building. These areas are not included within the demise, but rights are granted for the space to be used (often shared with other operators within the building) and for ducting on the rear of the building or through dedicated 'chimneys' that are outside the demise of occupiers on upper floors.

Discussions around this subject are often problematic, as there may be a number of parties all with competing requirements for limited space. But disputes are generally resolved, as landlords are appreciative of the fact that this equipment is now fundamental to an operator's business and no deal will be forthcoming unless the requirements of the operator can be met.

Once these negotiations are concluded very little further consideration is given to the question of the space occupied by plant. Future rent reviews will concentrate upon the space occupied within the demise. The author has never come across a settlement that has been described as 'including an extra x per cent for the right to use plant space on the roof and the right to affix ducting to the rear wall'.

Plant within the demised premises

But what about self-contained buildings let as a whole, eg former banks or retail buildings that have no flat roof space for plant or no rights to affix ducting to separately owned office or residential accommodation above? In these cases developers must devise a scheme whereby plant is found a home within the demised premises.

In many cases there is space surplus to the areas calculated for essential customer area and essential back-up space (ie for trading purposes), and the operator will be unconcerned as to the housing of plant in excess and otherwise unusable space on an upper floor or in the basement. The operator will make the same rental calculation based upon his business plan as described above. This assessment of an affordable rent will be the same whether the plant is outside the demise, on the roof or within the demise.

Unless the lease is clear as to the basis of the rent review, the problem will come at the first review. The property with plant within the demised area may pay more than the property with plant on the roof (assuming both properties have a rent otherwise based upon the space required for the business).

Surveyors need to be more specific as to the basis of analysis of comparables. For example, there are two identical 4,000-square-foot buildings to be valued. One has 500 square feet on the roof used for plant at no cost; the other has 500 square feet within the demise devoted totally to housing plant. It thus has only 3,500 square feet available for trading purposes. Assuming both need 2,000 square feet for kitchens, toilets and storage then one is left with one unit that has 2,000 square feet for customers and another that only has 1,500 square feet available for customers, ie the potential earning capacity for the second unit may be only 75 per cent of the first unit with plant on the roof.

SOME EXAMPLES

These are examples of what has been negotiated or set by third parties in some recent rent reviews.

Plymouth circuit bar

This unit had approximately 11,000 square feet on the ground, basement, first and second floors. There was a further 2,800 square feet on the third floor which was totally unused except for plant, which occupied less than 50 per cent of this space. Arguably it was space a landlord should have retained and let for, perhaps, offices. An independent expert put a spot figure of £5,000 on this space, ie under £2 per square foot, which pleased neither the landlord nor the tenants.

Bristol circuit bar

This was a purpose-built unit, more of a nightclub, with a total of nearly 30,000 square feet, including 1,575 square feet of eaves space occupied as a plant room. An arbitrator put a value of £3 per square foot on this space, ie £4,725: not a lot given that the total rent was nearly £350,000, but the tenant felt it would have paid nothing for the plant if it had been on a flat roof or even suspended from the rafters on a plant shelf.

Fast-food restaurant, London suburbs

This was a rather unusual situation. There were approximately 5,000 square feet on the ground floor, which resulted in a flat roof area above of approximately 2,000 square feet. Plant occupied approximately 1,500 square feet of this space. The author was the independent expert, and neither surveyor asked that any rent should be applied to this area. There was a small area at first-floor level, however, adjoining the flat roof, measuring approximately 650 square feet and used roughly 50 per cent for plant and 50 per cent for storage. Both surveyors agreed that rent should be applied to this area, and it was valued at £3 per square foot.

High-street bar, Swindon

Similarly, a self-contained ground-floor bar in a multiple-occupied building had a small plant room (400 square feet) that had been rentalised at the same rate as the rest of the 4,850-square-foot unit, ie approximately £18 per square foot, giving £7,200 in rent. The majority of the plant was on the flat roof, however, and no extra rent was allocated in respect of this.

Bar/restaurant, Cardiff

The unit was part of a multi-occupied building with a remote plant room. Most of the plant was in this area and no rent had been applied to the space used. But there was a small area within the demise (approximately 300 square feet) that was also used for plant, and this had been valued at the full £19 per square foot as applied to the rest of the building, ie an additional rent of £5,700. This

hybrid arrangement would appear the most common from the author's research.

New town — A number of premises with identical rent review dates

This example really confirms the confused position. One of the author's co-directors has dealt with four properties within the same town-centre circuit. In each case the plant space has been dealt with differently.

- The plant area was 1,750 square feet of a 7,700-square-foot unit, ie nearly 23 per cent of the total space. £2 per square foot was allocated to this space to avoid arbitration, compared to £24.50 per square foot for the trading area. The tenant believed an arbitrator may have awarded zero on this area, ie £3,500 less in rent.
- These premises were very close by. The plant area was in an area of low ceiling height which otherwise may have had no value or might possibly be used for storage. The area was 1,500 square feet of a total 10,600 square feet, ie 14 per cent of the total area, and £2.50 per square foot, ie £3,750, was applied to the plant area.
- The third premises were in the same trading location. Plant was 100 per cent on the roof so no additional rent was paid.
- In the fourth bar, also in the same centre, only 460 square feet were used for plant out of a total of 8,500 square feet, ie 5 per cent of the total space. In this case, £5 per square foot was agreed on this small area, ie £2,300 per annum. It was not investigated why this bar only needed 460 square feet for plant while the other bars utilised 1,500–1,750 square feet. It would be interesting to know the reason why, and what areas would be required by the hypothetical tenant.

AS AN ASIDE

Is there a hidden cost of having plant in an exposed position on a roof or in a remote location in a plant room? That is to say, does the plant last longer if it is in a protected location or does it perform more efficiently with lower 'trunk runs'. In other words, are lessees better off by housing plant within the demise? The author has not yet received a reasoned answer from a mechanical engineer.

SUMMARY

There is no consistent approach to the valuation of areas used for air conditioning and other plant.

- If plant can be housed on a flat roof or plant shelf the area is generally not valued.
- If a modern building in multiple occupation has a shared plant room, the use of the space within this room (and space taken for ducting, wiring, pipework etc between the plant room and the demised premises) is not valued.

- If plant is housed within the demised premises, it is usual for the area that it occupies to be rentalised. This is sometimes at a full rate if, for example, the demised premises are all at one level and the quality of the space cannot be differentiated from other trading space. Sometimes it is rented at a 'spot' figure or a rate that might otherwise be applied to storage if plant is in a basement or on a remote upper floor.
- If plant is housed within the demised premises but in space which would otherwise be superfluous, tenants are aggrieved at having to pay any rent at all. There would appear to be little analysis of whether rents of comparable premises had 'rent-free space' for plant or whether they too had been obliged to incorporate plant within the demised premises.
- Landlords may also feel aggrieved when they receive only £2 per square foot or a spot figure of (say) £5,000 for space they believe could have been beneficially let to alternative occupiers for more valuable use.
- Where space for plant *is* considered, it is usually when parties are considering *what* space is needed for plant. The author was independent expert in respect of a restaurant in Camden Town. The lease specified the area that the lessee required for a plant room. Yet there was still argument as to whether the area stipulated would be required by a hypothetical operator or whether the actual occupier, by virtue of their theatre-style kitchen, used more air conditioning plant than most people would regard as necessary. There was then a second argument as to the comparables, and the author was required to check which units had plant rooms on site (for which they paid rent) and which units had plant in separate areas (for which they paid no rent).

SO WHAT IS TO BE DONE?

The author believes this to be a two-stage operation.

On initial letting

Landlords and tenants need to be more open as to the basis of their bargain, and perhaps record the future requirements for review in the agreement for lease or the rent review clause. Examples of what might be agreed are as follows (although solicitors would need to improve upon this wording).

- 'The parties agree that it is not possible for the tenant to house air conditioning, liquor cooling etc plant on the roof, on a plant shelf or in a central plant room. It is agreed that the hypothetical tenant on an A3/A4 letting would require not less than [500] square foot of accommodation to house such plant and this space will be given a value at future reviews of [zero] so long as at least [500] square foot is devoted solely to the accommodation of plant and for no other purpose. Comparables to be considered on an equal basis of none of the lettable area being occupied by plant.'

- ‘The parties agree that [500] square foot of the demise on the [second] floor is to be used solely to house the [...] plant. It is agreed that this space could otherwise be let by the hypothetical landlords for alternative use as [offices] and is therefore to be valued as such. The remainder of the premises are to be valued on the assumption that plant space is available at a rent as calculated and this is to be compared to comparable units having regard to the cost (if any) of space allocated to plant in such units.’

At rent review

In the author’s experience rent review surveyors have paid insufficient heed to the cost and value of space used to house air conditioning and other plant. In analysing all comparables, rent review surveyors should specifically check the following.

- Is an area to house plant separately available outside the demise at zero cost?
- Is part of the demise used to house air conditioning and other plant? If so, to what size and how has this been valued? (To compare otherwise identical buildings it may be necessary for a rent review surveyor to reanalyse a rent paid excluding the space allocated to plant in order to compare a unit with one where the plant area is provided totally free of cost.)
- It is to be noted that many units are let on a hybrid basis with some plant located outside the demise and some within the demise.
- Where a service charge is made in a multi-occupied building it should be checked that a rent is not charged to the various occupiers for space occupied by central plant rooms etc as part of the service charge.

CONCLUSION

The author’s conclusion is that a tenant is not bidding rent for plant accommodation. It will pay the same rent for a unit with internal plant as it will for external plant, providing its location does not impact upon business performance and profit. Plant space is a necessity just like gas, electricity, water, drainage etc. It follows that analysis of A3/A4 rents should be for GIA excluding any space within the demise that the hypothetical tenant would require for air conditioning and other plant. This conclusion is reached on the basis that the majority of A3/A4 units have been allocated space for air conditioning and other plant outside the demise, and this method of analysis will create a level playing field. It follows that A3/A4 premises should then be valued using GIA areas excluding any area that the hypothetical tenant would use for such plant.

The author would be very happy to receive contributions from landlords and tenants (and their agents) as to their experiences concerning this problem. To this end a questionnaire has been created (see Appendix) which can be used as the backbone of any contribution.

APPENDIX

Questionnaire

Return to B. J. Gillham, Fleurets, 4 Roger Street, London WC1N 2JX, UK.

Air conditioning and other plant — on the roof or within the demise? Do you pay/collect rent for the space used by air conditioning, toilet and kitchen extraction or cellar cooling plant? The author’s firm has seen no consistent approach to this in rent reviews and has decided to commission this short questionnaire to see how various landlords and trading companies in a wide range of restaurant, bar and nightclub premises approach the matter. The aim is to publicise the results by way of industry trends but without giving details of any particular company or location.

Part 1 is general and need only be completed once by any contributor.

Part 2 is property specific, and as many responses as required should be made in respect of each property that demonstrates a different query or problem.

Part 3 relates to acquisition criteria and should only be completed by those who acquire properties on behalf of operators of A3/A4 leisure or nightclub premises.

It would be helpful if respondents could supply details of several of their most recent lettings/acquisitions/rent reviews in the second section of replies. It is necessary only to complete company information and details of acquisition criteria once (in Part 1). The objective of this questionnaire is to make the subject of the space occupied by plant more transparent, which in turn is likely to assist rent review negotiations.

£5 will be donated to a prostate cancer charity for every company response. All responses will also qualify for a draw, with a magnum of champagne being awarded to the winner. The results of the survey will be shared with all participants.

Part 1 (general)

Respondent name:

Respondent company name:

Address:

.....

E-mail:

Phone:

Fax:

Type of premises: Bar ☐ Restaurant ☐ Nightclub ☐
 Leisure ☐ Other ☐

Please specify if ‘other’
.....

Part 2 (property specific)

Please complete any number of these questionnaires so as to provide good market evidence of differing approaches to this question.

Respondent company name:

Reply number (eg 1/2/3 etc) Type of premises

1. Size of plant area (GIA square feet)
2. Size of entire premises (GIA square feet)
3. Is plant area within the demise? Yes ☐ No ☐ In part ☐

If the plant is part within the demise and part outside the demise, please answer both (a) and (b) below.

(a) If the plant area is within the demise, does the lease include any reference specific to this area defining if the area is to be fully rented ☐ partially rented ☐ or not rented? ☐
No reference in lease. ☐

(b) If the plant area is outside the demise, is there any rent/licence fee to be paid for use of a shared area?

Yes ☐ No ☐

Is the question of rent left blank?

Yes ☐ No ☐

Have you been asked to pay more or have landlords achieved a higher rent for the trading area to reflect the existence of a 'free' plant area?

Yes ☐ No ☐

4. Where you have specifically paid or received rent for use of a plant area, what is the range of values?

From £ to £ psf GIA or from % to % of the value of the ground-floor trading GIA.

5. Have you ever been involved in a rent review where the question of whether a comparable was analysed inclusive or exclusive of plant area was paramount in the negotiations?

Yes ☐ No ☐

If yes, please briefly expand.

.....

.....

Part 3 (acquisition criteria for trading companies only)

1. How much space do you need for plant area? sf GIA
2. What proportion is this of your total area requirements? %
3. Do you insist on a 'free' location on a flat roof, plant room or plant shelf?
Yes ☐ No ☐
4. Has this resulted in some abortive negotiations? Please describe briefly.
.....
.....
.....
.....
5. If the only space for plant has been within the demised area, have you ever negotiated a discount in rent?
Yes ☐ No ☐
If yes, what proportion? %
6. Have you ever negotiated 'free' space for plant within the demise under the terms of future rent reviews in the lease?
Yes ☐ No ☐
7. Is the issue of plant space ever discussed during new lease negotiations?
Yes ☐ No ☐
8. What is your preferred (operationally) location for plant?
Internally ☐ Externally ☐ No preference ☐
9. Do you consider your rent bid to be all-encompassing, ie as long as provision for plant is made which does not hinder/impede potential trading performance you will not bid any more or any less rent?
Yes ☐ No ☐
10. At what stage do your development team get involved in an acquisition to consider the simple logistics of whether a unit is suitable/can be adapted and where plant needs to be located?
.....

**Thank you for your time. Please return your questionnaire
by e-mail to lynda.mason@fleurets.com
by fax to 020 7280 4700
by post to 4 Roger Street, London WC1N 2JX**