



HELP! MY TENANT IS BROKE!

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The sight of administrators turning up at the doors of BHS, one of the most iconic names on the High Street, and then at Austin Reed, has placed the issue of tenant's insolvency back in the spotlight.

Since the downturn in the UK economy began, a number of high profile retailers such as Woolworths, Peacocks, JJB Sports and Jessops have fallen on hard times. However, the apparent demise of two established players has reminded everyone that trading conditions on the High Street remain difficult, partly due to the rise of online retailers such as Amazon and ASOS.

Tenant insolvency is a risk not just for retail property investors but across all classes of property investment, such as office, industrial and leisure.

So, what can you do if your corporate tenant is showing signs of being in financial difficulty?

Be Pragmatic

As rent tends to account for a significant proportion of a tenant's outgoings, the first sign that a tenant may be in difficulties is often a request for more favourable lease terms. Tenants may ask to pay the rent on a monthly rather than a quarterly basis, they may ask for a reduction in rent or a rent-free holiday. Perhaps they may even query or challenge their service charge in the hope of exploiting ambiguities in the lease.

If your tenant is facing financial difficulties, it is likely that the tenant will fall into arrears. Then you have to decide whether to take action such as suing the tenant for the arrears or forfeiting the lease.

If it will be difficult to find a new tenant for the property, then forfeiting the lease may be counter-productive for the investor and his funder. A prudent long-term view may be to agree to the tenant's concessions in the short-term, perhaps in return for a lease extension, removal of a break right or an increase in rent, when the tenant is back on an even keel.

If you are servicing debt from the rental income of the property, then you will usually need the consent of your funder to the grant of any tenant's concessions such as a reduction in rent.

Can I get the property back?

If you decide to take action against an insolvent tenant, you need to be aware of your rights, which vary depending on the insolvency status of the tenant. If the tenant is struggling to pay its debts, but an administrator has not yet been appointed, the landlord has the right to forfeit the lease and take possession of the property.

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Similarly, if a receiver has been appointed over the tenant, the landlord's right to forfeit the lease is not affected.

However, if a winding-up order has been made for a compulsory liquidation of the tenant, the landlord must apply to the court or the liquidator for permission to forfeit the lease.

If the tenant has been placed in administration (such as in the case of BHS and Austin Reed), there is a moratorium on new claims against the tenant. This means that the landlord cannot take possession of the property without the permission of the court or the administrator.

In practical terms this means that you may be stuck with an insolvent tenant and no legal remedy to take possession of the property. So, what next?

Can I get the rent from anyone else?

The tenant may not be paying the rent, but someone else may be liable. Therefore, you should check for the following options:

1. Is there a guarantor under the lease? The obligations of a guarantor are not usually affected by the appointment of an administrator or receiver;
2. Is there a rent deposit? Usually, where the landlord has taken a rent deposit as security from the tenant, the landlord can draw from the deposit if the tenant falls into arrears or the landlord suffers loss due to a tenant breach;
3. Are former tenants or guarantors still on the hook? Your lawyers should be able to check whether an authorised guarantee agreement was given by a former tenant or guarantor. In some cases, for older leases, former tenants and guarantors remain liable until the end of the lease, unless they have been expressly released by the landlord; and
4. Is there a sub-tenant? If so, it may be possible to serve a the sub-tenant with a rent diversion notice which requires the sub-tenant to pay rent directly to the landlord until the tenant's arrears have been cleared.

Why won't the administrator continue to pay the rent?

Unless the administrator is using the property for the purposes of the administration, then the administrator has no obligation to pay the rent. Even if the administrator is using the property, for example, by trading from it or preserving it for a sale, it is highly likely that they will seek some concession on rent. Such a concession would be inevitable where there are insufficient funds in the tenant's pot to pay the rent and achieve the purposes of the administration (for example the sale of the business).

It should be noted that any rent arrears for the period up to the appointment of the administrators will be an unsecured debt, so to expect any meaningful recovery of that debt would be unrealistic.

Surely something is better than nothing?

Well, not always. If the Tenant is in arrears and pays a proportion (perhaps 50%) of the rent, then the temptation is to accept the rent, continue to service any bank debt and seek recovery of the arrears at a later date.

That is fine, but if the landlord accepts a reduced sum as rent then there is a significant risk that the landlord will have waived his right to

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forfeit the lease. Therefore, it is vital to swiftly return any rent to the tenant where the landlord is taking action to forfeit the lease.

If the landlord applies to court to have the lease forfeited, you should be aware that the tenant has a right to apply for relief from forfeiture. The court has a wide discretion to grant relief to a defaulting tenant, where the tenant takes steps to remedy the breach (such as bringing arrears up to date).

This means that the tenant could appear in court with a cheque to pay the arrears, only to fail to pay the next instalment of rent. In such circumstances, the landlord may need to start the process over again, but the court would be less likely to grant relief in the case of persistent breaches by the tenant.

In brief

If you suspect that your tenant may be in financial difficulty, you should not sit back and hope that things will improve. It may be prudent to meet with your tenant to assess its long-term financial position and take legal advice as to your options.

If you wish to take your property back, then you should take swift action, before the appointment of administrators or receivers. By ignoring the problem, you could find yourself lumbered with a toxic tenant, no rental income, an angry funder and no immediate prospect of improvement.

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