Devonshires

IT'S THE LAW: COMMERCIAL PROPERTY

Don't bury your head in the sand if your tenant defaults

Whether you blame Boris or Brexit (or both), our commercial sector is looking more bust than boom just at the moment and tenant defaults are on the up. That's bad news for commercial landlords. But it will be worse for those that don't take prompt action when the need arises.

It's good to talk

If a rent payment date arrives, but not the rent, don't bury your head in the sand. Immediately engage with your tenant. Maybe it's just an admin slip. In that case, stern words are appropriate. But if the tenant is in difficulty your best option, as a landlord, may be to be their flexible friend. Options might include:

A payment plan: Your tenant may not be able to cover the rent cost right now, but have confidence that it's just a matter of time before they get back on an even keel. A payment plan could be agreed to stagger the arrears over time. If all goes well, you'll keep your income stream (albeit not in quite the regular way set out in the lease). Clearly, however, there are risks. If the tenant has a number of creditors and you are seen as the soft touch, you may find you lose out the most if things don't recover. Consider whether a new guarantee might be extracted as a quid pro quo.

A rent variation: If you conclude that your tenant isn't ever going to be able to afford the full rent and that, in reality, market conditions have worsened to the point that no one else is going to pay you that much either, it may be better to accept the inevitable and agree a formal rent reduction by varying the lease. You continue to derive income and at least your tenant continues to be responsible for other property ownership costs such as rates and insurance. The tenant doesn't then rack up so much debt that it's not worth going on.

But if you operate as a charity you should not do this lightly. In the same way that you would take valuation advice on granting a lease, you should do so before formalising a rent reduction – to make sure you're not being over generous.

The time for talking is over

An amicable solution may be impractical or simply fail. Worth a go, but now you need to see what's in your landlord's armoury based on the lease and supporting documents:

Rent deposit: The tenant may have paid a rent deposit when they took the lease. Who holds that and on what terms will likely be governed by a rent deposit deed. If the tenant has missed a rental payment, the terms of the deed will likely permit you to dip in to the deposit. Usually, the deed then requires the tenant to replenish the deposit straightaway. You should try to enforce that. Seeing whether they are able to make that payment will help you tell whether there was a one off blip or whether, in reality, you have a basket case for a tenant.

Guarantor: The lease may have been guaranteed by an individual or a company. Commonly if the lease has, in the past, been transferred from one tenant to another the outgoing tenant will have guaranteed the incoming tenant's obligations under what is known as an authorised guarantee agreement (AGA). If so, you could look to that guarantor to make payments due under the lease. Depending on the wording of the guarantee, you might be able to require the guarantor to take a new lease - so you have a nice shiny new tenant (albeit possibly a grumpy one) who is good for the money. If you pursue a former tenant under either an AGA or a former tenant under an old (pre 1995) lease they may require you to grant them a new lease under section 19 of the Landlord and Tenant Covenants Act 1995 (LTCA 1995).

When pursuing a former tenant or their guarantor you will need to serve a s.17 notice on them under the LTCA 1995 before you can get your hands on their money. That Act specifies the form that must be used and says that it must be served within 6 months of the arrears in question first arising. So get your skates on! Failure to adhere to this deadline will mean that you can't pursue the guarantor for that money.

Note that the sums that can be recovered from a former tenant or guarantor in this way are limited to 'fixed charges' which are rent, service charge and any liquidated sum payable under a tenant covenant of the tenancy.

Undertenant: If your tenant has granted an underlease but then defaults on its obligation to pay you rent, you could seek future rent payments from the undertenant directly. This is achieved by serving the undertenant with a notice under s.81 of the Tribunals, Court and Enforcement Act 2007.

Neil Toner
Partner, Head of Real Estate
020 7065 1823
neil.toner@devonshires.co.uk

Dan Moan
Partner, Commercial Property
020 7880 4336
dan.moan@devonshires.co.uk

Oliver Grech
Solicitor, Real Estate & Projects
020 7880 4201
oliver.grech@devonshires.co.uk

Forfeiture (also known as re-entry) (also known as the landlord's last resort): If the lease includes a forfeiture clause then, subject to following any requirements in that clause (such as giving notice), the landlord is permitted to re-enter the property. This will terminate the lease.

Whatever the lease says, a tenant can then apply to court to seek relief from forfeiture. If relief is granted, the tenant regains possession of the property. Where forfeiture is for non-payment of rents a tenant has up to 6 months after the landlord's re-entry to make an application for relief. This can cause difficulties for the landlord as they are left in a period of uncertainty, not knowing if the tenant will be back. Whilst the court has wide discretion, it is only likely to rule in favour of the tenant if they have settled all outstanding arrears and can evidence financial standing to pay the rent moving forward.

My lease doesn't help

It may be that your lease does not have any of the mechanisms explained above (albeit this would be unusual). However, there are some other options:

Implied right of forfeiture: Even if you do not have a forfeiture clause written into your lease, you may still seek to forfeit for a tenant breach e.g. by breach of an implied condition which goes fundamentally to the relation of landlord and tenant relations. In these circumstances, forfeiture would have to be sought by application to the court who would determine the matters based on the facts.

Commercial Rent Arrears Recovery: CRAR is a statutory power which replaced the common law principle of 'distress'.Formerly, distress allowed a landlord to instruct bailiffs to attend a tenant's premises (without any prior warning) and take control of the tenant's goods to sell them and offset against any rent arrears.

Under CRAR, landlords still have this power, but various notices must be served on the tenant at key stages. So, the tenant will be aware of what's coming. It is not unheard of for tenants to relocate all of their expensive kit far far away at this point.

Sue for rent: Perhaps the most obvious remedy is simply suing the tenant. However, this is not usually the most efficient enforcement method. Courts take time and are often more expensive than alternative routes. It may be that you choose to bolster your position with the threat of serving a statutory demand if payment is not received within a specified period. This could ultimately lead to the tenant, if a company, being wound up - so it can be quite a big stick.

Are you winding me up?

So, your tenant is in arrears and you are about to take action when you find out, by whispers in the market, that they are negotiating a Creditors Voluntary Arrangement, have entered into administration or receivership or are being liquidated. What does this mean and what can you do?

CVAs: This means that your tenant is seeking to enter into an arrangement with its unsecured creditors, to deal with their debts. A proposal will be put forward by the tenant (with the assistance of an insolvency practitioner) and the creditors will have an opportunity to vote on it.

If the proposal is agreed by 75% (in value of the debt held by those creditors who vote) the proposal will be binding on all creditors. Therefore, if the rents you are owed represent just a small amount of your tenant's debts in total, you could find yourself having to accept a reduced rent with potentially little say.

You may have a right to challenge the CVA if you have been unfairly prejudiced or there was material irregularity in the procedure followed.

Administration: This is a framework to rescue an insolvent company. An administrator takes control of the company with the aim of enabling the company to improve its financial position and trade its way out of difficulty. When in administration, there is a moratorium in place which would prevent you, as landlord, from exercising CRAR, forfeiting or beginning (or continuing) any court proceedings, unless you obtain permission from the court or administrator. In effect, the moratorium puts a protective blanket around the tenant whilst it tries to trade out of its difficulties. Companies will often enter into administration to gain the moratorium protection whilst they plan for a CVA.

Receivership: An administrative receiver may be appointed by a chargee in relation to the enforcement of a fixed or floating charge. The administrative receiver will attempt to realise the security of the charge to repay the debt. The good news is that you can still exercise CRAR, sue for rent or forfeit the lease during the period of receivership.

Winding-up (also known as liquidation) (also known as 'the end'): Winding-up can be instigated by shareholders or, where a company is insolvent, its creditors. It is a process whereby the company (i.e. your tenant) ceases to exist.

Voluntary: In the case of a voluntary winding-up, the tenant is still liable to pay rent under the lease until the company is dissolved. Where a voluntary regime applies, a landlord can still exercise CRAR, sue for rent or forfeit the lease without leave of the court.

Compulsory: The process of compulsory winding up is started by a creditor petitioning the court for liquidation on the basis that the company is unable to pay its debts. The petition is then served on the company and advertised in the London Gazette. It is heard by the court who make the winding up order (if appropriate). The company remains extant until the appointed liquidator has worked their magic and gathered all the assets and distributed to the creditors.

A landlord can sue for rent without leave of the court for the period between the presentation of the petition and the making of the order. But, once the order has been made, leave of the court is required to take steps to recover any arrears. A landlord cannot exercise CRAR nor sue for rent nor forfeit the lease without court permission. Courts have traditionally been reluctant to grant such permission. Any creditor, liquidator or contributory (someone liable to contribute toward the assets of the tenant) may apply to court to restrain landlords from taking court action.

Once the liquidator has been appointed, the current rent can be claimed as an expense of the liquidation. If successful it will rank before the claims of unsecured creditors or floating charges.

Note that the effect of what is known as 'a disclaimer' by the liquidator is that the rights and liabilities of the insolvent party for the property are crystallised at that point but do not continue. However, the landlord may claim against a guarantor if there is one. It is just the insolvent party's rights and liabilities that determine.

The tiny print

Find out more

Neil Toner
Partner, Head of Real Estate
020 7065 1823
neil.toner@devonshires.co.uk