

How will landlords and tenants on the High Street survive 2020?

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Introduction

- The UK retail sector, and the High Street in particular, was in the doldrums before COVID-19. However, the last eight weeks have seen a sudden 80% drop in footfall and a previously unmatched decline in retail sales, as shops have closed and customers have been practically confined to shopping online. As the UK begins to exit lockdown, there are significant question marks over the viability of many High Street businesses and the value and use of commercial property.
- This webinar will focus on some of the most pressing legal issues with which landlords and tenants will have to grapple as they return to the High Street and try to ride out the remainder of 2020.

Topics for today

- Insolvency
- Lease renewals
- Rent reviews and valuation

Insolvency

1. Current situation
2. Reform on the horizon: Corporate Insolvency and Governance Bill 2020
3. CVAs
4. Administration
5. Issues and solutions to consider

Virgin Australia enters voluntary administration. Richard Branson says it's 'not the end'



By Michelle Toh, CNN Business

Updated 0812 GMT (1612 HKT) April 21, 2020

British high street pleads for state help with rent

Covid takes bite out of Landsec as property portfolio value drops nearly £1.2bn

Travelodge eyes CVA in battle with landlords over rents

Goldman-backed hotel group claims it will go bankrupt without lower bills



Travelodge has taken out injunctions against landlords to delay legal proceedings over unpaid rent © PA

Alice Hancock and George Hammond in London MAY 13 2020

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Travelodge, the budget hotel operator, has stepped up its battle with landlords, saying it will be forced to launch bankruptcy proceedings unless they agree to slash its rent bill.

Green's retail empire could close over 100 stores

By Emma Simpson
Business correspondent, BBC News

18 April 2020

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Intu warns on collapse after £2bn loss

By Sahar Nazir - March 12, 2020

Byron Burger owner seeks to sell chain

Tue, 05 May 2020 | BUSINESS SALE

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Insolvency

1. Current situation

- Landlords' options are currently limited:
 - Moratorium on certain forfeitures
 - No forfeiture permitted for non-payment of rent until at least 30th June 2020
 - Suspension of Part 55 possession claims until at least 30th June (PD51Z)
 - This impacts landlords seeking possession from tenants holding over where peaceable entry is not an option
 - Unlawful eviction/relief from forfeiture claims are still being heard
 - CRAR (but only if 90 days' rent is outstanding)
 - Statutory demand & winding-up petition (but subject to the new Corporate Insolvency and Governance Bill)
 - Part 7 debt claim
- Tenants' options are wider:
 - Concessions / break / assignment / negotiated surrender
 - CVA or other insolvency procedures

Insolvency

2. Corporate Insolvency and Governance Bill 2020

- Main features
 - Breathing space to give time for a rescue/re-structure
 - Probably available to solvent companies only
 - Winding-up prohibited where inability to pay is a result of COVID-19
 - Interim moratorium (initially 28 days)
- “Cross-class cram down” Restructuring Plan
- Furloughed Space Grant Scheme? Watch this space

Insolvency

3. CVAs

- What is the purpose and effect?
- Does it favour tenants?
- (How) can a landlord challenge it?

Insolvency

Discovery (Northampton) Ltd v Debenhams Retail Ltd [2019] EWHC 2441 (Ch)

Facts:

- 95% of Debenhams' unsecured creditors approved a CVA
- The CVA reduced rents payable under some of Debenhams' leases by up to 50%, shortened terms, released Debenhams' liability for dilapidations, and abrogated landlords' rights to forfeit
- Some landlords (funded by Mike Ashley of Sports Direct & Newcastle FC fame) challenged the CVA claiming unfair prejudice & material irregularity

Insolvency

Held:

- Rent can be compromised as part of a CVA
- Landlords are bound by a CVA in respect of future rent
- Landlords were not unfairly prejudiced when compared with other creditors
- The right to forfeit cannot be abrogated as part of a CVA

Conclusion:

- CVAs are bad news for a landlord seeking to recover rent arrears, maintain future rental payments, or terminate a lease at a time of its choosing
- The *Debenhams* decision in many ways does not change very much: a tenant paying some rent is better than no tenant at all, and a landlord can still forfeit
- Landlords should:
 - Check the CVA; if a provision restricts forfeiture and cannot be severed, this could invalidate it
 - Consider challenging that the future rent is a market rent – this was not contested in *Debenhams*
 - Combine with other landlords of large retailers so that a CVA is not a fait accompli if it works injustice
 - Consider a long-term perspective; Debenhams is in administration for the second time in a year

Insolvency

4. Administration

- What is it?
- How might it be used in light of COVID-19?
- What should landlords be alive to?

Insolvency

5. Issues and solutions

- It is not in a landlord's interest to keep premises vacant
 - But business rates discounts available
 - Consider re-purposing retail premises towards other uses/re-development
- Dialogue and negotiation are more important than before
 - Agree a surrender or concessions to keep alive a lease
 - A CVA/administration is often not the end of the road
- Landlords should also consider:
 - Sureties / rent deposits
 - Pros/cons of CRAR
 - The difficulty of challenging pre-packs, administrations & CVAs

Lease renewals

Lease renewals

Lease renewals: the Coronavirus Act 2020 has no immediate impact on the procedure and timelines for lease renewals apart from section 82(11) which provides for the disregard of failure to pay rent during the period from 26 March until (unless extended) 30 June when considering a landlord's opposition to renewal of a lease because of persistent delay in paying rent. How should parties deal with expiring leases and claims for renewal or termination? In a dramatically falling market, how should landlords and tenants be advised in order to best protect their interests?

Lease renewals

- In a falling market, lease renewals will take on a very different flavour to that which was the case only a few months ago.
- Landlords will want to keep a tenant and, no doubt will offer generous terms to any tenant that has a reasonable prospect of being able to continue paying rent.
- What, though, of the situation where the parties cannot agree terms?

Lease renewals

- Assuming the tenancy has protection under Part II Landlord and Tenant Act 1954, it will be very much in the landlord's interests to delay any invocation of that Act and if the Act is invoked by delaying the proceedings by, perhaps, opposing the grant and forcing a preliminary issue. (How far such opposition might survive a challenge under Part 24 would depend on the nature and substance of the challenge).
- On the other hand, it may be very much in the tenant's interests to force the issue by serving a notice and starting proceedings as soon as possible.
- That is because, firstly if the matter came to court, the court would set the rent as at the market rent on the day of the hearing and (unlike in the vast majority of rent review clauses) the rent can be lower than the passing rent.
- Secondly, the court can set an interim rent (again potentially lower than the passing rent).

Lease renewals

- **34.— Rent under new tenancy.**
- (1) The rent payable under a tenancy granted by order of the court under this Part of this Act shall be such as may be agreed between the landlord and the tenant or as, in default of such agreement, may be determined by the court to be that at which, having regard to the terms of the tenancy (other than those relating to rent), the holding might reasonably be expected to be let in the open market by a willing lessor, there being disregarded—
 - (a) any effect on rent of the fact that the tenant has or his predecessors in title have been in occupation of the holding,
 - (b) any goodwill attached to the holding by reason of the carrying on thereof of the business of the tenant (whether by him or by a predecessor of his in that business),
 - (c) any effect on rent of an improvement to which this paragraph applies,
 - (d) in the case of a holding comprising licensed premises, any addition to its value attributable to the licence, if it appears to the court that having regard to the terms of the current tenancy and any other relevant circumstances the benefit of the licence belongs to the tenant.

Lease renewals

- Ordinarily, of course, the court will expect expert evidence with comparable from recent transactions.
- Such will, almost inevitably, be transactions that pre-date the current circumstances and, no doubt, there will be plenty of evidence available of tenants asking for rent holidays or reductions (and getting them).
- It is possible to envisage a case where expert evidence is that, at a given point, there is simply no market for a particular premises so any rent should be nominal

Lease renewals

- In *Northern Electric v Addison* (1999) 77 P&CR 168, the Court of Appeal refused to allow a landlord to extract an enhanced rent on the basis that he had the tenant to ransom as the rent had to be fixed on the assumption that the landlord was willing to let on the terms of the lease.
- Likewise, in these circumstances, the landlord cannot say to the court that it is unwilling to let at a rent below a certain level as that would go **against the statutory assumption.**

Lease renewals

- In those circumstances, it would be open for the landlord to argue for a shorter term or more frequent rent reviews.
- As regards the term of the tenancy, section 33 provides that the tenancy shall, in default of agreement, be such a tenancy as may be determined by the court to be reasonable in all the circumstances, being, if it is a tenancy for a term of years certain, a tenancy for a term not exceeding fourteen years, and shall begin on the coming to an end of the current tenancy.
- In deciding on terms other than rent and term, the court has regard to the terms of the current tenancy and all relevant circumstances (see section 35(1))

Lease renewals

- The courts do not always slavishly follow the terms of the existing lease as demonstrated by the cases concerning imminent plans to redevelop.
- See, for example *Davys Wine Merchants Limited v City of London* [2004] EWHC 2224 (Ch)
- In these extraordinary circumstances, the court might hear with sympathy an argument that setting a rent for, say, 5 years which was in practice nominal would be unusual and, therefore, present a reason for departure from what might have been the rent review period in the existing lease.

Lease renewals

- So far as interim rent is concerned, once a section 25 or 26 notice has been served, pursuant to section 24 either landlord or tenant can apply for an interim rent to be determined for the tenancy during the period of the statutory continuation of the tenancy.
- Where the landlord gave a section 25 notice, the interim rent will run from the earliest date of termination that could have been given in the notice.
- Where the tenant made a section 26 request, it will run from the earliest date that could have been specified as the date from which the new tenancy is to begin.

Lease renewals

- Sections 24C and 24D provide 2 different formulae for the determination of the interim rent.
- Section 24C applies where the landlord does not oppose and a tenancy is granted. In such cases, there is a resumption that the interim rent is the rent under the new tenancy. But that can be displaced on evidence, broadly that that is not appropriate.
- In every other case, section 24D provides for the same mechanism to determine an interim rent as a final rent.
- Either way, there is plenty of room for argument in a volatile market

Lease renewals

- Where the tenant is not protected, the landlord will, at least, have the possibility of saying that the proposed terms are simply unacceptable, whether as to rent going forward or any concessions as to arrears.
- Quite how such negotiations may play out remains to be seen but commercial landlords may well have to face up to a market where people have moved decisively away from traditional office usage and where retail is in the doldrums for a long time.
- Indeed, a tenant might even serve a section 27 notice to bring to an end any section 24 continuation tenancy to seek rent concessions (as has been done by Next Plc).

Rent reviews & valuation

Pre-crisis RICS Code of Practice

on leasing business properties

- 1st edition published in February 2020
- Rent review (at paras 4.1-4.4):
 - *Definitions of market rent should not result in a ‘headline rent’ unless that has been expressly agreed by the parties, such as where that is agreed in return for a financial inducement. Provisions for indexed rent reviews should not contain obscure formulae designed to produce a greater increase than is proportionate to the increase in the index over the appropriate period or outside any agreed caps or collars.*
 - *Leases should allow either party to start the rent review process and should not impose time limits intended to prevent a review or set a new rent through inaction by either party.*

Pre-crisis RICS Code of Practice

on leasing business properties

- Rent review (B5):
 - *Traditionally, commercial leases have imposed rent review provisions that are ‘upwards only’, which allow the rent to be increased but never decreased. If this applies the rent will not reduce even if there is a fall in the market rent or inflation index by the review date, and it is important for tenants to be aware that this can result in the rent continuing at a higher level than a new letting would achieve.*
 - *The tenant should also make sure that, if the parties cannot agree on what the open market rent is, either party refers this to an independent expert or arbitrator to settle. The way in which a rent review clause operates can be complicated and may have the potential to both create disputes and significantly increase the amount that the tenant must pay. For these reasons, it is important that the tenant understands what is being proposed and obtains professional advice on the implications.*

Rent review dates

- Before or after beginning of the pandemic?
 - Post-review date evidence not generally admissible: (*Ponsford v HMS Aerosols Ltd* [1979] A.C. 63)
 - Evidence of open market lettings and rent review agreements taking place after the review date is admissible (*Duvan Estates v Rossette Sunshine Savouries* (1982))
 - Evidence of rent review arbitrations and independent expert determinations taking place after the review date: inadmissible

Deferring rent reviews?

- Time of the essence?
- Practical concessions to negotiate an agreement?
- Liability of former tenants?
- Delayed reviews take effect retrospectively and rent is valued at the relevant review date.

Notices and counter notices



Assumptions and disregards?

- Lawful use?
- Open market rent and hypothetical willing tenant?

Valuation (1)

- Inspections and investigations:
 - Dispensing with an inspection because of COVID-19 restrictions does not automatically lead to the need for a declaration of material uncertainty in relation to the valuation opinion (see section 5), which in individual cases is a decision for the valuer (Red Book Global Standards VPS 3. 2.2 (o)).
 - However, the latest practice alert 15 April 2020 states:
If an RICS Regulated Member concludes that declaring material uncertainty is not appropriate, there should be a sound rationale to explain the decision-making process and this should be recorded for future reference.
- Reliance on third party information
 - Where a valuation using restricted information is to be undertaken, this must be agreed with the client in the terms of engagement, with the details set out in the valuation report.
- Impact of deferred inspection?

Valuation (2)

- **Material valuation uncertainty’ as per VPS 3 and VPGA 10 of the RICS Red Book Global.**
 - This does not mean that those members are currently unable to value - valuation under these circumstances provides a key function to support markets and stakeholders. However, ‘if a failure to draw attention to material uncertainty gave a client the impression that greater weight could be attached to the opinion than was warranted, the report would be misleading’ (VPS 3.2.2(o))
- **Market value v Investment worth**
 - RICS report some anecdotal reports of a misunderstanding of the difference between the market value of a property (VPS 4.4) and the investment value or worth of it to a particular owner or occupier (VPS 4.6).

Thank you for attending

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