

One of the most significant legacy debts remaining post-pandemic is rent. Many tenants have been unable (or unwilling) to pay, and landlords have been unable to take their usual action to recover rent due to temporary restrictions in place prohibiting winding up and forfeiture proceedings.

The hardest hit sectors have been retail, hospitality and leisure, which since early 2020 have been closed more often than not due to restrictions in place.

Ahead of the UK government introducing new legislation that will require landlords and tenants to arbitrate, this quick guide gives an overview of the options currently available to landlords and tenants when it comes to rent recoveries and payment, as well as summarising other considerations.



Winding Up Petitions

A landlord cannot currently present a winding up petition on the basis of an unsatisfied statutory demand. However, a petition based on the inability to pay debts as they fall due can proceed but only if the landlord can prove that (a) COVID-19 has not had a financial effect on the debtor company and (b) if it has, that the company would still not have been able to pay the debt regardless of the COVID-19 impact.

It is fairly easy for a tenant company that has been closed during the pandemic, or one that has had to furlough workers or seen a reduction in turnover, to demonstrate that COVID-19 has had a financial effect on its business but quite difficult for a landlord to then evidence that the tenant would still not have been able to pay even discounting the impact of the pandemic. Therefore, although petitions are not completely “off the table,” they have been of limited use to a landlord seeking to recover rent arrears.

The current restrictions on presenting a winding up petition end on 30 September 2021. However, in its recent announcement regarding the proposed new rent arrears arbitration legislation, the government announced that *“Further measures on the ability of landlords to use insolvency measures to recover rent arrears will be announced in due course.”* As such, it is expected that the prohibition may be extended, at least in respect of the pursuit of COVID-19 rent arrears.

Claims Against Sole Traders

There are no corresponding restrictions on bankruptcy petitions. Therefore, a landlord whose tenant is a sole trader (or where there is a personal guarantor of a lease) can pursue a petition against that individual.

On the other side of the fence, a tenant defending a petition may find some assistance from the Debt Respite Scheme, which allows an individual to apply for breathing space from their debts, for a period of up to 60 days (or possibly longer if applying for a mental health crisis breathing space). This scheme does apply to some, but not all, business debts, so whether this could be used to defeat or delay a bankruptcy petition for unpaid rent will need to be considered.

Forfeiture and CRAR

Until 20 March 2022, landlords are prohibited from taking any steps to forfeit a lease or exercise CRAR (unless 544 days’ rent is outstanding from a tenant). This restriction is likely to remain in place until the UK government brings into force the proposed new rent arbitration legislation. This could be earlier than 20 March 2022, but if later, this restriction may be extended. Unless a tenant agrees to surrender its lease, a landlord currently does not have any of the usual options to recover its premises.

Court Proceedings

Restrictions on forfeiture and winding up petitions have severely limited a landlord’s options to recover unpaid rent (and possession). However, there are no restrictions on a landlord commencing court proceedings to recover unpaid arrears. This has resulted in some landlords pursuing claims and obtaining summary or default judgment for unpaid arrears.

If a landlord obtains judgment, this gives the landlord the option of seeking a third-party debt order (an order that requires a third party, such as a bank, to pay over money it holds for the tenant to the landlord), a charging order (useful if the tenant owns freehold property or shares) and the ability to rely on that judgment debt to pursue a winding up petition when (or if) restrictions lift.

On the flip side, tenants have sought to stay court proceedings (and succeeded in doing so) on the basis that the government intends to introduce new rent arrears arbitration legislation to address COVID-19 rent arrears.

Arbitration

The UK government has, for some time, encouraged landlords and tenants to talk to one another to attempt to reach a mutually agreeable position on accrued rent arrears and how/when these should be paid. The government intends to update the voluntary Code of Practice for Commercial Property Relationships shortly and then, to reinforce this requirement, will introduce legislation that will require landlords and tenants to arbitrate if they are unable to reach an agreement regarding the payment of arrears. This legislation will, however, only apply to rent arrears that have accrued while restrictions on that specific sector were in place.

The draft legislation is awaited, but it is clear that any rent falling due following restrictions on businesses being lifted should be paid in full and in accordance with the terms of the lease (or any agreement the tenant has reached with the landlord). Pending the legislation coming into force (which is likely to be before March 2022), the revised code of practice will set out the principles that the government expects landlords, tenants and arbitrators to adhere to.

Restructuring

There are a number of available options for tenants who have accrued pandemic debt. Indeed, landlords themselves may benefit from these mechanisms where cash flow has been squeezed because of the prohibitions on rent recovery. These range from *ad hoc* agreements with key creditors (such as landlords, mortgagees and HMRC) to more formal insolvency processes, such as company voluntary arrangements (CVAs), restructuring plans or administration.

CVAs have been in the spotlight because of their use to compromise rent payments, resulting in a number of high-profile challenges. However, they remain a useful restructuring tool for those tenant businesses with significant lease portfolios, because they offer a mechanism to re-gear real estate portfolios, deal with rent arrears and restructure future rent payments.

HMRC Debt Recovery

While not directly impacting landlord and tenant negotiations, the actions and attitude of HMRC to recover outstanding tax and other liabilities should be factored into any landlord and tenant discussions, and any recovery or restructuring activity either party intends to take.

Unlike the suggestion that restrictions on winding up petitions are likely to remain in place to prevent recovery of COVID-19 rent arrears, there has been no suggestion that the restriction will continue to apply to other creditors. Therefore, at the beginning of October 2021, with its recently reinstated preferential position, it is likely that HMRC will recommence petitioning for Crown debts, in particular where businesses have failed to engage with HMRC to try to reach a time to pay agreement.

Aside from rent liabilities, tax liabilities are likely to be one of the other major debts incurred during the pandemic. Notwithstanding that HMRC will support businesses that cannot pay (rather than will not pay), there is no guarantee of support. If HMRC will not enter a time to pay agreement in relation to deferred tax liabilities, it may well take enforcement action, potentially undermining any agreement that a landlord and tenant has reached or other proposed recovery plans. For more information about settling tax debts, see our [previous alert](#).

Mortgagees

Landlords must be careful to consider the impact that delays in receiving rents due, and potentially receiving significantly less rent than forecast, will have on their own position. Ensuring that their own lenders are engaged in discussions and will support, or continue to show forbearance pending receipt of rents, is also an important consideration in the context of landlord and tenant negotiations.

Tenants are already likely to be fully engaged with their own funders. However, again, it is important to keep funders onside and informed of negotiations with landlords, as the outcome may well have an impact on a business's funding model.

Directors' Duties

There are options for both landlords and tenants when it comes to re-gearing leases, restructuring property portfolios and dealing with arrears, but both parties must be mindful of their duties as directors while doing so.

The temporary suspension of wrongful trading rules ended on 30 June 2021 and failure to comply with statutory duties, particularly when there are cash pressures on a business, could result in personal liability for directors without proper consideration and justification for their actions and decisions. Professional advice, alongside taking the right steps and managing the landlord and tenant relationship, is an important consideration that should not be overlooked.

Contacts



John Alderton

M +44 788 505 8896

E john.alderton@squirepb.com



Russell Hill

M +44 792 160 0409

E russell.hill@squirepb.com



Dave Holland

M +44 113 284 7014

E david.holland@squirepb.com



Michelle Adams

M +44 785 006 2128

E michelle.adams@squirepb.com



Nick Green

M +44 774 092 4799

E nick.green@squirepb.com



Karen French

M +44 782 520 4637

E karen.french@squirepb.com

