

EMERGING STRONGER – RESTRUCTURING

# COVID RENT ARREARS CAN'T PAY OR WON'T PAY?

**A key issue for commercial landlords during the COVID-19 pandemic has been unpaid rent leading to the build-up of substantial rent arrears. During this period there have been many anecdotes of dominant tenants not paying rent when due. Commercial landlords do not operate in a vacuum and will either be part of pension or investment funds with mandates to make returns for the fund and/or will have secured debt owed to lenders which are ordinarily serviced by rental income. Consequently wholesale tenant default on rent has far wider implications for UK Plc.**

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## 1 TENANTS WHO CAN PAY SHOULD DO SO IN FULL

On 9 November 2021 the Government published a new Code of Practice on negotiating Covid-related commercial rent arrears allied to draft legislation to ringfence certain commercial rent arrears and set up a system of binding arbitration for cases where landlords and tenants are unable to agree how these should be resolved.

The ringfenced arrears to be dealt with under the Code are those that relate to periods of enforced closure and therefore the tenant suffered a serious negative impact due to the COVID-19 crisis.

The starting point of the Code can be summarised as - tenants who can pay their rent should do so in full. The burden of proof is on the tenant to show that they cannot afford to pay in full and in doing so they need to pass two key criteria:

- they must demonstrate that they are viable businesses (this is not clearly defined in the Code); and
- they must meet an “affordability” test.

The Code sets out a binding arbitration process for unresolved ring-fenced arrears. If a tenant cannot show the Arbitrator that they are viable then the Arbitrator could allow the full rent to be enforced and end any moratorium on enforcement with disastrous consequences for the tenant. Conversely if the tenant can persuade the Arbitrator the rent is reduced and the landlord has to accept.

While this sounds like an attempt to strike a fair balance between landlords and tenants this does not deal with the entire rent arrears problem as rents also remain unpaid for substantial periods where tenants were able to trade from premises but were only doing so with drastically reduced footfall and/or turnover.

## 2 SO HOW BEST TO DEAL WITH THESE RENT ARREARS

Firstly landlords and tenants may be able to reach or have reached binding agreements regarding accrued arrears – relating both to closure periods and periods they have been open and trading.

Secondly commercial landlords have access to a range of remedies that have always been open to them. These include:

- claiming under rent deposits
- claiming against guarantors
- claiming against former tenants
- seeking debt recovery via court proceedings
- seeking possession
- issuing a winding up petition where the tenant is a corporate entity

Some of these routes have been moderated by legislation during the pandemic, the current state of play on these is:

- there is a moratorium in place on possession actions for commercial landlords under commercial leases for non-payment of rent (which includes any sums due under the lease) which will end on 25 March 2022
- commercial landlords are able to exercise rights of commercial rent arrears recovery (CRAR) but presently only where over 554 days of arrears has accrued
- the moratorium on winding up petitions ended on 30 September 2021 however from 1 October 2021 to 31 March 2022 landlords continue to be prevented from presenting winding-up petitions in respect of commercial rent arrears and other sums due under business tenancies which are unpaid by reason of a financial effect of coronavirus. The burden is on the landlord to show that arrears are not unpaid because of this reason and this is likely to be difficult to establish in practice.

# 3

## WHAT DO WE EXPECT TO SEE NEXT?

During the COVID-19 pandemic overall numbers of company and individual insolvencies have remained low when compared with pre-pandemic levels. This is likely to be partly driven by government measures put in place to support businesses and individuals during the pandemic, including:

- Temporary restrictions on the use of statutory demands and certain winding-up petitions (leading to company compulsory liquidations).
- Enhanced government financial support for companies and individuals.

However, as these measures are gradually withdrawn we expect a significant change of creditor sentiment. This is evidenced by a 139% increase in County Court Judgments during Q3 of 2021 which indicates creditors are already taking a tougher stance on recovering debts, even before the easing of restrictions on statutory demands and winding up petitions.

Notwithstanding the ringfencing of certain arrears we expect that substantial commercial rent arrears have accrued since the start of the pandemic that cannot be pegged solely to periods of enforced closure. As landlords look to recover these arrears expect to see directors of corporates seeking advice as to their duties and the risk of personal liability for wrongful trading which will inevitably lead to an increase in insolvency appointments.

Creditors Voluntary Liquidations - which are instigated by directors - have recently reached unprecedented levels and this trend is likely to continue as the various moratoria come to an end. This increase in CVLs is worrying, because it means there is no business worth saving via administration and the company is closed down.

CVL numbers have now returned to pre-pandemic levels. Numbers for other insolvency procedures, such as compulsory liquidations for companies and bankruptcies for individuals, remain lower.

We have recently seen an increase in administration appointments week on week and we expect to see this trend continue as the pressure mounts on trading businesses.

Commercial landlords are therefore likely to see more and more of their tenants going into insolvency processes. Unless further accommodations can be agreed such as debt for equity swaps on rent arrears or more traditional CVAs. Landlords should also consider their own contingency plans for empty units, could an interim solution be allowing "pop-up" stores into occupation to mitigate holding costs.

Commercial landlords without pockets deep enough to absorb persistent tenant default and a materially reduced rent roll, may find themselves unable to service their own borrowing commitments, and at risk of their loans being accelerated by secured creditors. Landlords who find themselves exposed in this regard are encouraged to seek early engagement with their lenders, perhaps agreeing a "stand-still" on existing payment defaults whilst a longer term restructure is negotiated.

One thing is for certain, engagement is key. Those Landlords and Tenants who fail to engage with one another and other key stakeholders will face a very difficult time in the coming weeks and months as we emerge from the pandemic.

**FOCUSED UPON CREDITORS, INCLUDING INSTITUTIONAL LENDERS, BONDHOLDERS AND SPECIAL SITUATIONS, WE ARE ONE OF THE LARGEST RESTRUCTURING TEAMS NATIONALLY WITH OVER 40 DEDICATED LAWYERS.**

**If you would like a more comprehensive view of what we're seeing in the current environment and what steps you should take to maximise your chances of success, please get in touch.**

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