

The Rent “Dilemma”

What’s next for landlords and tenants following the extension of the Government’s rent moratorium and proposed new legislation?

Introduction



The enforced closure of retail and hospitality stores from March 2020 had a material, and in some cases devastating, impact for all with a physical store presence. Whilst many operators managed to pivot their offering to delivery, or online, lower footfall and demand materially impacted site revenue and profitability, and a tenant's ability to pay rent.

Contractual obligations to pay rent remained, therefore absent consensual agreements between tenants and landlords to waive or defer payment, tenants became vulnerable to a landlord taking enforcement action to recover the rent due.

Initial Government support provided protection for tenants from evictions and forfeiture of leases for unpaid rent ("the forfeiture moratorium") to 30 June 2020, as well as other measures to assist retail and hospitality businesses, including:

- Moratorium on statutory demands and winding up petitions for COVID-related debts ("the winding up moratorium") to 30 June 2020;
- Business rates relief (to 31 March 2021, now extended to 30 June 2021);
- Coronavirus Job Retention Scheme (initially to 30 June 2020, now extended to 30 September 2021); and
- Reduction in VAT for hospitality operators (initially to 30 September 2020, now to 30 September 2021).

The forfeiture and winding up moratorium were each extended by the Government four times to 30 September 2020, 31 December 2020, 31 March 2021 and 30 June 2021, which covered periods of enforced closure and periods when operators were permitted to open. This has now been extended to 25 March 2022, which is discussed opposite.

The impact of reduced footfall resulted in a number of operators choosing not to reopen sites when they were able to do so, in some cases permanently closing sites, or, where sites were opened they were unable to trade at full capacity due to the social distancing requirements enforced by the Government.

Ultimately the period of the pandemic has accelerated the structural changes which were seen in the retail and hospitality markets pre-pandemic, such as a shift to online and delivery models. In addition, a change in customer values and behaviours has led to a move away from what was previously considered to be prime locations. This has resulted in a number of tenants reconsidering what is an optimal site footprint and lease structure, which has also factored into the permanent closure of sites.

The Rent "Dilemma"

On 16 June 2021, the Government extended the forfeiture moratorium for the fifth time to 25 March 2022 and the winding up moratorium to 30 September 2021. The Government also announced new legislation to ringfence "COVID debts" and provide guidance to tenants and landlords to agree repayment plans.

There are a number of aspects of the extension to the moratorium and announcement of new legislation which are unclear, the impact of which we will consider in this insight.

What is clear, however, is the Government's expectation for tenants to start paying rent once restrictions have been lifted, which for many on the high street is now the case.

However, the problem is already here. The British Retail Consortium estimates that total rent arrears built up by retailers during the last fifteen months is £2.9 billion. UKHospitality estimates the corresponding figure for hospitality operators is £2.5 billion.

The British Property Federation estimates up to £7 billion of rent arrears is owed to landlords in total (a figure which is sector agnostic), of which £1.6 billion (23%) its members are still subject to negotiations with tenants. They have reported that £1.5 billion has been agreed with tenants to either reduce, write off or defer payment to a later date, and £3.5 billion has been repaid by tenants.

"In order to ensure landlords are protected, the Government is making clear that businesses who are able to pay rent, must do so. Tenants should start paying their rent as soon as restrictions change, and they are given the green light to open."

UK Government Press Release
16 June 2021

Current timeline of COVID Government Support measures

30 June 2021

- Wrongful trading suspension expires
- Business rates holiday ends for retail and hospitality businesses

1 October 2021

- Moratorium on statutory demands and winding up petitions related to "COVID debt" ends
- Coronavirus Job Retention Scheme ends
- VAT on hospitality / leisure businesses increases from 5% to 12.5%

25 March 2022

- Moratorium on Commercial Rent Arrears Recovery ("CRAR") action and forfeiture of commercial leases for non-payment of rent ends

What is a “COVID debt”?

It is not clear if the new legislation will apply to all commercial rent arrears from March 2020, or only arrears accrued during periods of Government enforced closure.

The Government announcement on 16 June 2021 indicated that legislation could be restricted to periods of enforced closure only.

Enforced closure of non-essential retail accounts for c.7 months since March 2020 (being just over 40% of the pandemic).

If the definition of “COVID debt” per the legislation applies to rent arrears accrued during this period only, landlords will have full remedies available to them (such as forfeiture and or issuing a winding up petition) for the remainder of any unpaid rent.

The Government announcement also indicates that legislation may distinguish between essential and non-essential tenants, with a further distinction for tenants where restrictions have only recently lifted on 19 July 2021, such as nightclubs.

“In order to give places such as nightclubs and other hospitality businesses the help they need to recover from the pandemic, Communities Secretary Robert Jenrick has announced that legislation will be introduced in this session to ringfence outstanding unpaid rent that has built up when a business has had to remain closed during the pandemic.”

UK Government Press Release
16 June 2021

Implications for tenants

It is possible that the new legislation will not ring-fence a significant proportion of the rent arrears accrued over the last 16 months.

Many essential and non-essential tenants have chosen not to open some or all sites once allowed under Government guidelines. If they have opened, they have done so with social distancing measures in place and therefore have not been able to operate at full capacity.

That said, on the basis that “COVID debts” relate only to a period of government enforced closure, it could be that rent due from 12 April 2021 (when retail and casual dining could open) is not subject to arbitration and will need to be paid in full (despite various restrictions being in place when it was accrued), unless an alternative agreement is made with the landlord.

Implications for landlords

Depending on the definition of a “COVID debt” in the new legislation, landlords may have potentially more remedies available than initially thought.

This may, for example, include the ability to pursue unpaid rent, for periods prior to the expiry of the moratorium (i.e. “non-COVID debts”).

Landlords may well consider the implications of the use of remedies available to them. Given the lack of demand for space in the market, it is unlikely that landlords will wish to take back vacant space unless it can be relet or redeveloped.

When will the legislation be passed?

Present situation

- Forfeiture moratorium in place
- Winding up moratorium in place
- Restrictions allow retail and hospitality operators to be open and trade, albeit with social distancing and other restrictions prior to 19 July 2021
- Government advice is that tenants should pay if restrictions allow them to be open, but landlords have limited legal remedy for non-payment whilst moratoriums are in place

1 October 2021

- Forfeiture moratorium in place
- Winding up moratorium due to end

Option A

If the winding up moratorium ends and the new legislation is passed:

- Tenants will be required to pay rent in full going forward (from 1 October 2021)
- Arbitration process in place for “COVID debts” up to 1 October 2021
- Funding requirement for “non-COVID debts” accrued e.g. June quarter rent for non-essential retail

Option B

If the winding up moratorium is extended and new legislation is not passed:

- No immediate legal remedies to wind up a company for landlords, in event rent is not paid from 1 October 2021
- “COVID debts” and “non-COVID debts” remain stayed whilst arbitration process is enacted via new legislation

25 March 2022

- Backstop for legislation to be passed
- Forfeiture moratorium ends
- Winding up moratorium ends
- Tenants pay rent in full from 26 March 2022
- Requirement to pay “non-COVID debts” in full, which are now capable of being pursued by landlords
- Arbitration for “COVID debts” up to 25 March 2022

The above timeline is anchored around the current dates presented by the Government. If legislation is passed between 1 October 2021 and 25 March 2022, then the implications at 25 March 2022 set out above would be brought forward.

The Arbitration Process

Below we consider the two key drivers to the outcome of any arbitration process:



Sharing of “pain”

We view that there are four ways that the Government could look to enforce tenants and landlords to share the “pain” of the accrued rent liability if they can’t come to a consensual agreement:

1. Majority weighting to the tenant; or
2. Majority weighting to the landlord; or
3. 50/50 split; or
4. Capped sharing mechanism, as seen in Australia.

The issue with any method is that it has to apply to all and given the disparity of health on the high street, this will create problems.

Affordability

The Government has always been clear that those operators which can afford to pay their rent should do so. A 50/50 solution would provide no incentive for a healthy operator to agree anything more than 50/50.

A landlord will have their own financing and banking covenants to consider and, in some cases, won’t be able to offer reductions unless forced.

In addition, the knowledge of a 50/50 forced agreement may mean landlords are not incentivised to accept anything less, unless it can be evidenced as unaffordable.

Ultimately, if a landlord accepts a 50/50 split is unaffordable, whether they accept such a proposal will come down to their view on:

- a. their ability to relet the property in the near term; and
- b. the long term viability of that tenant and security of future rent.

Can’t pay? What next

We expect that any tenant who puts forward a proposal for less than the amount per the arbitration process will need to evidence the following:

- Why the amount is not affordable – this could mean allowing landlords to diligence their business plans and cash flow forecasts, just as we would expect a lender to, if a similar waiver or funding request was made; and
- The alternative outcome for the landlord i.e. an insolvency is a worse outcome than the offer put forward by the tenant.



There are remedies available to landlords to ensure that, should a tenant return to health, they are able to benefit in the upside and potentially receive the unpaid arrears. These include:

- A payment plan over the course of the lease for the difference between what is affordable and the back stopped amount;
- Payment in Kind, in respect of the remaining arrears at the conclusion of the lease;
- Taking equity stakes in/acquiring tenants; and
- Turnover or profit share arrangements.

If a tenant is unable achieve a consensual solution via the arbitration route, as the payment of the arrears amount under the process would render it insolvent, or future rent is unaffordable, there are formal restructuring processes available, including (but not limited to):

- CVA;
- Restructuring Plan; and
- Administration.

Additionally, tenants may consider new ways to maximise their working capital and minimise costs to help them manage any funding requirement resulting from payment of “COVID debts” and other arrears which have accrued.





The Government announcement is not the saviour it is being viewed as by some tenants and neither is it the devil being portrayed by landlords. At this stage too much is uncertain.

A cliff edge could still be created come October (or at a later date when the winding up moratorium ends) depending on what is classed as a "COVID debt" - as this will ultimately dictate the quantum of unpaid rent which is not subject to any arbitration process.

If legislation is delayed and the moratorium against winding up petitions is also extended, landlords will remain in a position whereby they are unable to pursue either arrears built up during COVID or any go forward rent from October.

Any pain sharing mechanism enforced by the Government, whilst on the face of it would be welcome, could see profitable and successful high street chains and brands unduly benefitting and those who are struggling being forced to consider alternatives.

Tenants should consider the impact of repayment of arrears (either in full or in part by way of arbitration or commercial settlement). This will require assessment of liquidity in the business alongside consideration of the wider business needs, to support negotiations with landlords.

We expect landlords may want to diligence such proposals and any proposal for less than the arbitration amount will be considered on the basis of alternative occupier demand and security of future rent.

If landlords are not amenable to proposals for payments less than the arbitration amount, then we anticipate tenants will look to use the multiple restructuring options available to them to enforce an alternative solution.

Therefore, an open mind and transparent approach from both parties, to the financial difficulty both sides are facing, and the possibility of any future upside sharing mechanisms, are key to coming to a consensual solution.

How Teneo can help

Teneo has a team of experts who can support all stakeholders with the implications of the extension of the moratorium. We have a wealth of experience supporting all stakeholders in delivering consensual and non-consensual restructurings, as well as a suite of other services including performance improvement and management consulting, to support operators navigate their way through to recovery and growth.



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