

Property Views

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A NEWSLETTER FOR LENDERS AND PROFESSIONALS
EXPLORING THE CHALLENGES AND OPPORTUNITIES FACING
THE DISTRESSED REAL ESTATE SECTOR

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We are delighted to welcome you to the 2013 Spring edition of Property Views

Despite recent budget announcements 2013 will remain a challenge. A lack of confidence still looms over the sector and at most we are expecting the market to remain stable before picking up in early 2014. Whilst the chancellor's announcements to inflate the residential sector provide some optimism they only look to provide a real boost to the lower end of the market and do little to help the commercial or licensed market. Still the initiatives are a step in the right direction and will provide some welcome news in the residential market.

In 2012 Moorfields saw a 25% increase in the number of property companies entering administration/LPA receivership and a 100% increase compared to this point in 2008, a sharp reflection of the state of the sector. Many of these cases were in the licensed sector.

We are continuing to work with a number of lenders who are dealing with their underperforming property loans and our focus remains on maximising the returns through innovative and proven strategies.

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Matthew Barrow covers should fixed charge receivers trade and what to do with unsecured operating companies.

We hope you find this issue interesting and informative. If you wish to discuss any of the issues in this newsletter please do not hesitate to contact us 0207 186 1143 or call your usual Moorfields contact.



Maximising the potential of distressed property

Despite early indications that 2013 should see the real estate market stabilise, property loan defaults will continue to remain a reality in the recovery of today's economy. Maximising value and accelerated turnaround times are key for financiers, but whilst many financiers traditionally opt for quick fire sales, could exploring some short term strategies maximise their potential?

Nobody can be certain what 2013 will hold for real estate but many lenders have and will continue to be faced with the burden of non-performing property loans, weighing heavily on their balance sheets. The Bank of England's Financial Policy Committee estimates that UK Banks may still have more than £30bn unprovided losses on property loans. Unfortunately as a result of the double dip recession many of these properties would have significantly reduced in value due to high rates on vacant properties and insufficient capital to re-invest. We are also seeing more distressed debt property portfolios being sold as finally banks and investors value expectations have started to meet.

On the appointment of a receiver or an administrator lenders will generally be keen to make a quick disposal whilst receiving the maximum value for the asset. For many properties their value is based heavily on their physical characteristics such as style of building and location rather than their classified usage or lease terms. As a result many lenders feel that the value of the property is determined by these factors. Although in today's challenging economy taking some more in-

novative short-term strategies could produce better returns.

One such route is to consider changing the usage of a property or reviewing planning permissions a topic which is particularly relevant based on the governments recent initiative.

The initiative brought in at the end of January this year allows commercial property to be converted to residential use without the need of planning permission. Whilst local authorities can choose to opt out, with areas such as the City of London, Chelsea and Kensington already rumoured to have opted out, this initiative will mark a significant break-through for many other areas. Additionally for properties in receivership or administration the initiative could benefit in enhancing the appeal of a property, which would have previously struggled when marketed on the basis of its existing use.

An example of this could include converting a vacant office building on the outskirts of town to residential usage allowing a developer to convert to flats, therefore enhancing its appeal and potential market value. Whilst this can take up to 13 weeks if planning permission is necessary the risk of the property continuing to sit on the market with little interest can prove detrimental. Although in many cases this process can be run in tandem with the marketing of the site.

Moorfields recently adopted a slightly similar strategy for a site in Essex. On appointment the half acre plot had some challenging restrictive covenants restricting future developments. These included any proposals to develop the site for residential use were required to additionally development a doctors surgery and public house.

“In today's challenging economy taking some more innovative short-term strategies could produce substantial returns.”

Agents found the site unmarketable, with its current planning permissions, based on plot size and location making it virtually impossible to include a public house. As a result Moorfields applied to Uttlesford District Council to change current planning applications to provide for community facilities and residential units as opposed to a public house.

After careful consideration the council agreed that previous plans were unsuitable and an independent feasibility study supported that there was not enough local footfall to sustain a local pub. As a result the new planning application was granted.

Consequently Moorfields have now sold the plot subject to completion and achieved nearly £500,000 for a plot that was previously regarded as unmarketable.

THINK NOW

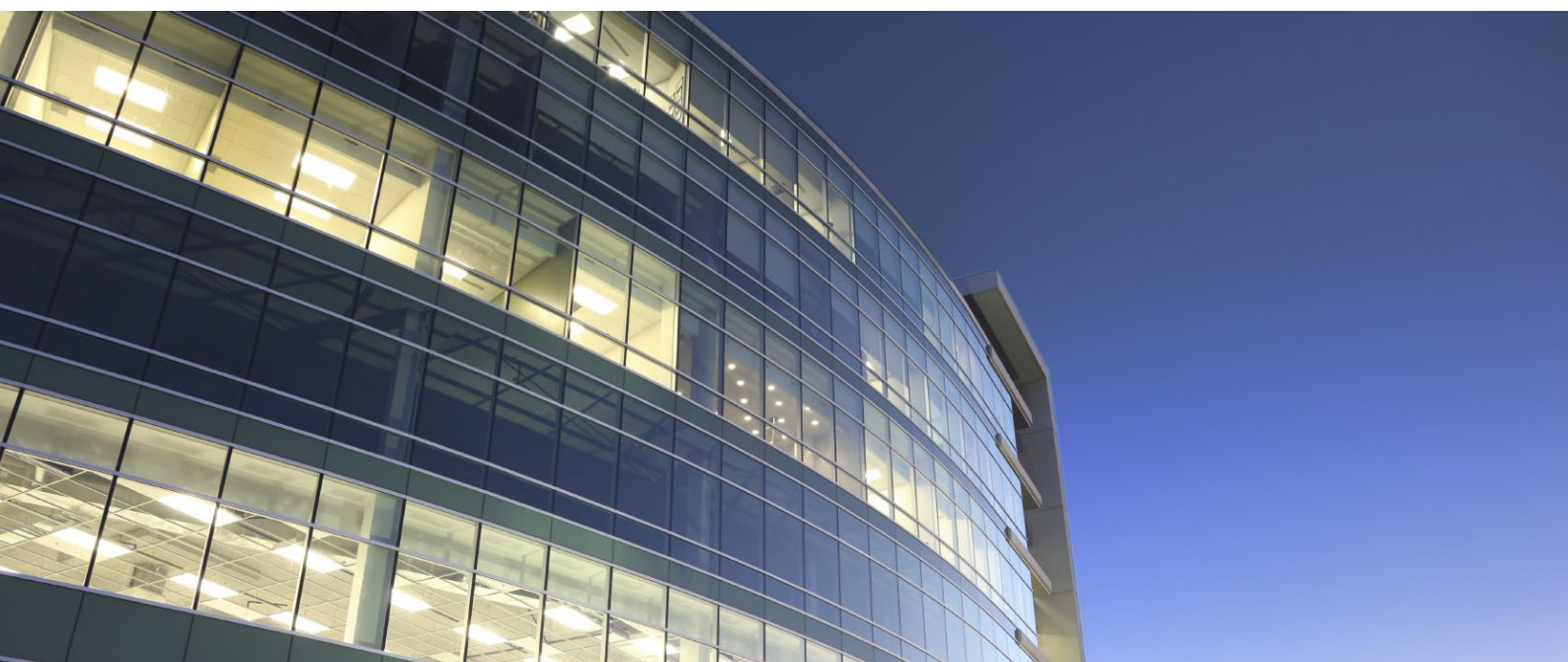
Disposing of distressed properties can be complex and time consuming especially when dealing with large portfolios.

Innovative disposal strategies are particularly important in the current market. If you would like to further advice regarding properties within your portfolio please call us.

Author:

Simon Thomas

Partner, Moorfields Corporate Recovery LLP





Retail

The inconvenient truth

A lot has been written about the beleaguered retail sector over the past 3 months with further high profile casualties hitting the headlines pre-Christmas with no respite post the New Year.

JJB Sports, Comet and Jessops ended a very challenging 2012 for retailers. HMV, and more recently Blockbusters and Republic have seen 2013 start with no more optimism for the high street.

Whilst the casualties are from different sectors within the consumer products spectrum, ranging from consumer electronics to apparel, there are a few consistent themes that can be traced back to the pre-financial crisis era:

- Balance sheet issues with over leverage featuring significantly;
- No investment and liquidity to effect change
- Over rented estates
- Increasing on-line competition
- Management ill-equipped to deal with today's retail challenges

Add to these core problems the issues like supplier nervousness, no marked improvement in consumer confidence and lower individual disposable income and you have a basket of problems with no easy fix. These are once in a generation issues that require structural changes to be made before we hit calmer waters.

All doom and gloom you might imagine, but with these issues come opportunities for retail stakeholders to “right-size” the structural and balance sheet issues in order to position for success. Landlords, owners and investors, lenders and suppliers have to pick the winners to support, where the basic retail proposition has a continuing reason to exist, and back these businesses to succeed with a program of transformational change.

The retail sector is no different to any other in that obsolescence is a fact of life and needs to be dealt with and not swept under the carpet. Eventually the “ostrich” effect typically produces a worse outcome for all concerned. The retail casualty list proves that previous light touch pruning, often championed by use of the CVA's (Company Voluntary Arrangements), has not produced many happy outcomes, and sometimes preferred one creditor class over another, causing its own issues when more deserving cases have come to the front of the queue.

“Obsolescence is a fact of life and needs to be dealt with and not swept under the carpet”

The inconvenient truth is that not all retail businesses deserve to survive. Many do not have a reason to exist amongst their peer group. Many chains were established during the boom times on the back of high leverage, low investment and questionable business models, with little modern day relevance to the consumer and their needs.

Insolvent restructuring using Administration as the tool of choice is relevant for particular cases.

If, and only if used correctly, to renegotiate affordable rents and replace over leverage with new liquidity. Practitioners and investors have to weed out the deserving cases whose business model has a chance of success. The test is an easy one – can the business produce enough 4 wall contribution to make a positive profit and return for its investor or owner, whilst paying current market rents and its bills on sensible credit terms? Does the business have a credible digital offering to complement its stores? And is the central function fit for purpose or bloated and dysfunctional?

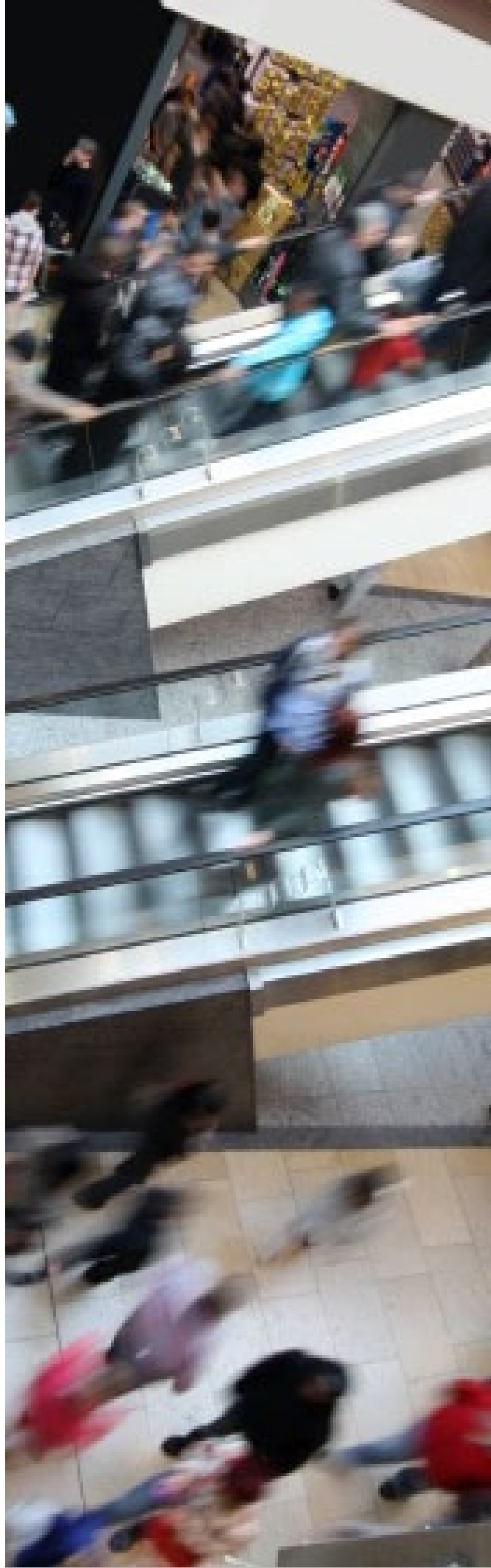
If rescues could be done out of court, so much the better, but realistically these situations just have too many moving parts and time pressures making this route fraught with danger and uncertainty. When this happens value is destroyed.

The message is simple – apply the test and then apply the solution. Is the concept obsolete or does it have legs? If it's the latter, stakeholders need to give it the chance it deserves, because second chances are now in very short supply.

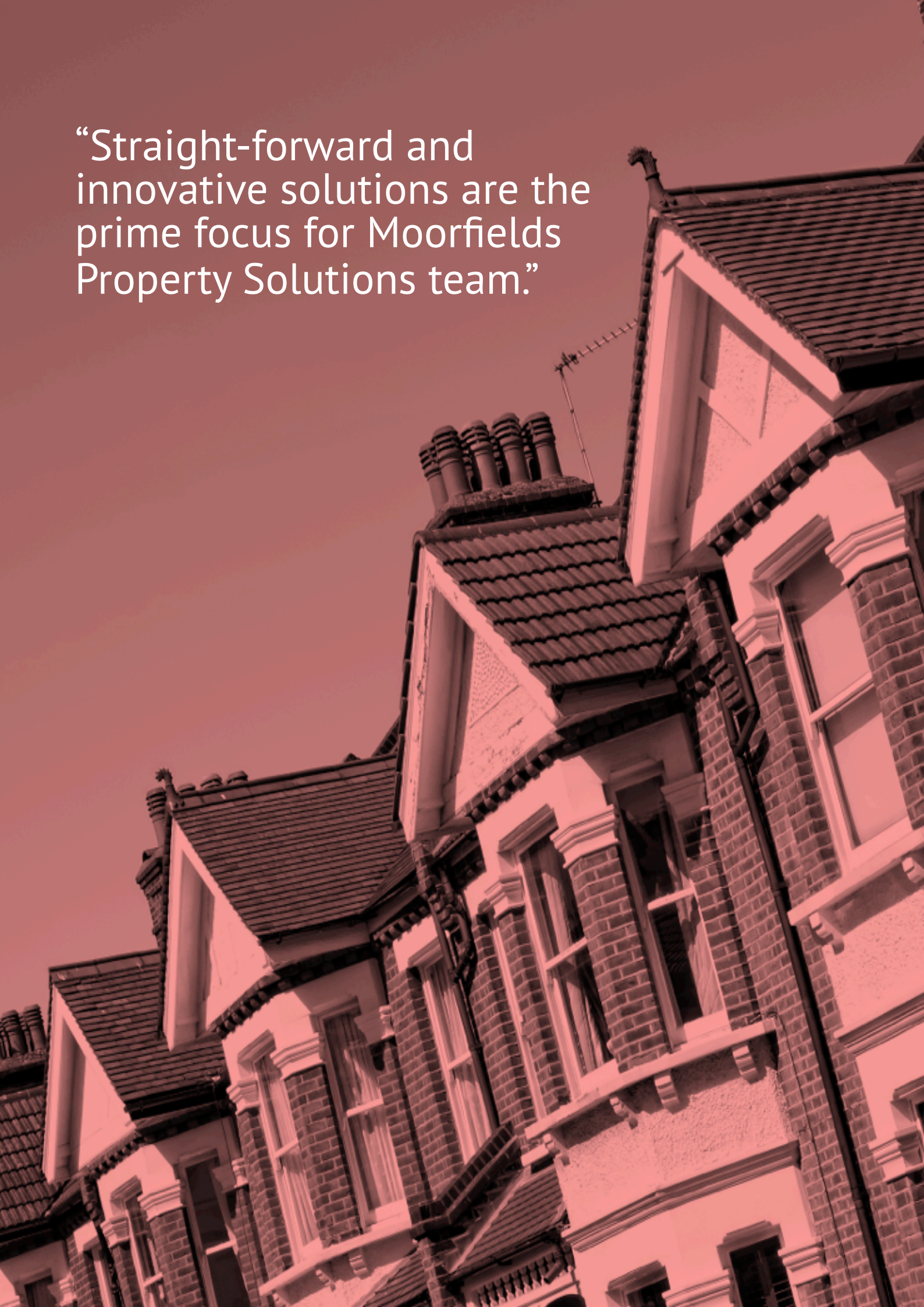
Author:

Fraser Pearce

Investment Director, Gordon Brothers Europe



“Straight-forward and innovative solutions are the prime focus for Moorfields Property Solutions team.”



Maintaining Goodwill

With consumer spending likely to remain weak in 2013 it will be difficult for the licensed sector to remain optimistic about the year ahead. Unfortunately the summer games did little to give the sector the boost it required in 2012. For vendors and lenders looking to shed assets in 2013 realistic prices will be key, but in a competitive market how can insolvency practitioners help maximise the value of a distressed pub?

Whilst the budget looked to try and reinforce confidence in the licensed sector many will argue its too little too late and despite positive news in the form of corporation tax, national insurance and fuel, factors such as VAT, business rates and duty on spirits and wines remained untouched and are likely to present further challenges for the sector.

Owners and operators are working hard to continue trading and those which have adapted to cultural changes such as gastro pubs or unique branding concepts seem most likely to survive and even prosper in this market. Tenanted premises are having to deal with unrealistic leases and challenging landlords.

As a result we expect to see a number of lenders and operators to continue disposing of pubs in 2013 and in particular wet-let pubs. CAMRA (The Campaign for Real Ale) supported this when their recent statistics revealed that London lost 2 pubs a week in 2012.

So how can lenders receive maximum value for their licensed assets in a competitive market when sold through receivership and administration?

Whilst 2013 expects to see a number of interested purchasers on the market the task of acquiring a good investment will still present a significant challenge even for experienced pub operators.

With the average pub values for both freehold and tenanted properties having fallen in 2012 it is still possible for successful operators to turnaround units which have previously been mismanaged or suffered from a lack of investment.

Successful disposal will in most cases mean maintaining the goodwill, securing the asset and safeguarding the short-term security of income to allow marketing as a going concern.





The success of this strategy allows

- *The protection of income, which can often result in an increase of profits as cost cutting procedures are introduced.*
- *Ensures the premises remains compliant with all statutory laws and regulations.*
- *Management of any existing bookings to minimise any negative impact.*
- *Continuation of premises licence.*
- *Provides prospective purchasers with a realistic vision of the pubs market and current operations making the purchase seem more achievable.*
- *Investment opportunities to be reviewed to see if a greater return can be achieved following investment.*
- *Eliminates close down insurance which due to drain down, security and boarding costs can be extremely high.*
- *Avoids risk of vacant dilapidations.*
- *In some cases we will issue tenancies at will which are tied to a beer supplier provided by the administrators. Enabling the tenant to trade at a profit and minimise the costs of keeping the unit open while it is marketed as a going concern.*

This strategy was recently adopted by Moorfields over a grade II listed pub in the countryside town of Derby. Despite heavy footfall the pub had experienced reduced trade for a number of months due to competition from larger hotels in the area and had failed to explore funding options to make valuable investment in the premises.

On appointment Moorfields worked with a number of agents to obtain market appraisals that focused on the pub's unique features. Whilst it was advised there would be a steady interest there were concerns that potential purchasers may be daunted by the level of investment needed.

Moorfields' strategy put to the lender advised contracting a specialist licensed management company to trade the pub during administration to illustrate the pub's potential to interested parties.

As a result of this strategy the pub achieved a sale within 3 months at a price agreed to be higher than estimated valuations.

If you have licensed properties within your portfolio it is important that careful consideration is given to enforcement action and strategies for disposal. Please give us a call to ensure you compile the best strategy to maximise recovery

Author:

Simon Thomas

Partner, Moorfields Corporate Recovery

“Profitable pubs will always be the most sought after, so obtaining an appetite for a distressed pub will require experience.”



Common Security Issues

Can fixed charge receivers trade and what to do with unsecured operating companies?

When considering a trading business with property as the core asset, such as a care home, hotel or pub, the preferred security from the lender's perspective will generally include a fixed charge over the property and a debenture in respect of the business. The lender can then control and sell the business and assets in the event of default.

There are two common situations where such ideal security is not in place. The first is where a lender has fixed charge security only because the borrower, who operates the business, is an individual. The second is where the lender has no security over a separate operating company, as distinct from the property owning borrower, which may be an individual or company. In either scenario, if the lender can only exercise a power of sale in relation to the property, the effect on value can be significant.

Dealing with the first example, one possible solution is to appoint fixed charge receivers to trade. Whilst relatively unusual and not always straightforward, this can often lead to an improved outcome for the lender. Its success will depend to a great extent on the terms of the fixed charge as the receivers' powers and ability to trade will derive from it. The key areas to consider here are how receivers can deal with the business, chattels, employees and contracts, in addition to the more usual property disposal.

Business and goodwill

Most fixed charges include the goodwill of any business operated from the property. This goodwill can be treated as being distinct from the business itself, which is incidental to the goodwill. Some charges will go beyond containing a charge over goodwill, and include an express power to manage the borrower's business from the property. Where this is the case,

receivers can collect and give receipts for income of the business, for example monies due under contracts with residents in a nursing home. The receivers can of course also sell the goodwill, which together with the property, should preserve the value of the lender's security.

Chattels and stock

Use by and powers of fixed charge receivers in relation to chattels and stock in trade are a grey area, and few fixed charges specifically cover the point. Some commentary suggests that the lender (as opposed to the receivers as agents for the borrower) needs to buy these from the borrower, which is not necessarily practical.

It is at least arguable, however, that if the charge contains a power to manage the business, this ability extends to use of the chattels (albeit not to their sale). When it comes to selling the chattel assets, if agreement cannot be reached with the borrower, there is generally a power to sell them subject to first giving notice to the borrower, although the net proceeds remain due to the borrower.

Employees

The Insolvency Act 1986 does not appear to deal with fixed charge receivers appointed over the business of an individual. Section 37, which governs liability under employment contracts, refers to "companies" and the relevant part of the Act refers to "Company Insolvency".

However, a fixed charge will often give the receiver the power as agent of the mortgagor, to deal with staff specifically, and failing that, a power to manage a business arguably extends to this.

Subject to anything contained in a particular charge, fixed charge receivers can employ staff as a mortgagor's agent and without personal liability.

This position will change on the borrower being made bankrupt. The bankruptcy does not affect the statutory powers of receivers, but from that point they are potentially personally liable.

Contracts

Before any bankruptcy, contracts with third parties, for example residents in a care home, would be carried on by the receivers on the mortgagor's behalf as their agent. After bankruptcy, the contracts could be terminated on application to the court by the other party to the contract, although this is rarely sought when it comes to the types of business we are considering here. Bankruptcy itself does not automatically terminate the contract (unless the contract expressly provides for termination on an insolvency event) however the trustee in bankruptcy may of course disclaim it. After bankruptcy, the receivers continue to have the power to perform the contracts but without the shield of acting as agent of the mortgagor.

Conclusion

Whilst not wholly straightforward or without risk, it is worth considering whether and how a fixed charge receiver could operate the business and achieve a better outcome than simply selling the bricks and mortar.

Unsecured operating companies

It is not unusual to have separate property owning and operating vehicles controlled by the same interests. However, these can evolve over time and lenders who believe they have all encompassing security can discover that the business and its assets are operated and owned by a separate company, from which they have no security.

The lender in such a position has no obvious rights or security in relation to the business or its assets, and remedies available do not provide an obvious solution. They may for example be able to take possession of the property against the operating company, particularly where it took possession without the lender's consent. Alternatively, if the lender took a floating charge over the business before the operating company took occupation, it may have crystallised.

In either case, the enforcement process would lose momentum and a lender may find that it is left with nothing more than bricks and mortar to sell by the time it has been able to see such action through.

The commercial reality may be that the property owning company is in financial default because the operating company is struggling. From a practical perspective, an appointment at that stage by the lender in respect of the property company can lead to matters unraveling and control being relinquished by the operating company.

Dealing with issues such as employees, chattels, stock and contracts in those circumstances will vary from case to case, but can be problematic, particularly where the operating company has granted security to another lender, typically a debenture to secure an overdraft facility.

Often, the gap in security becomes apparent some time before enforcement is being considered. A lender would be well advised at that point to take security over the operating company to ensure that if it does need to enforce, matters are more straightforward. Consideration for any security given by the operating company in these circumstances can usually be demonstrated, but is easy to overlook.

Author:

Matthew Barrow

Partner, Lester Aldridge Solicitors



Moorfields Property Solutions

Our specialist property team is dedicated to supporting secured lenders in handling some of the complex issues arising in property insolvency. Unlike many other firms our property team dedicate 100% of their time to property assignments so are constantly up to date with the latest developments and market related issues.

Our expert knowledge and understanding of different types of property mean we can readily identify the most appropriate strategy.

Our focus is to offer a dedicated service with straight forward options and realistic solutions to ensure we maximise the financial outcome for our clients and business stakeholders.

Want to find out more?

To find out more about Moorfields' restructuring and insolvency services contact: Simon Thomas on 0207 186 1143.

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