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Corporate Recovery

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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Summer Edition

Welcome to the latest edition of Property Views, in which we go back to basics and remind ourselves of some of the fundamental issues and pitfalls when restructuring and recovering property backed security.

Since our last edition was published the political and economic landscape within the United Kingdom and Europe have both changed notably.

During the most eagerly anticipated general election for a generation the major parties put forward a number of manifesto proposals with potential implications for the corporate and residential real estate sectors, including, most notably, the Labour Party's Mansion tax, a number of pledges for new house building and a raft of taxation proposals, including changes to non-domiciliary tax status and inheritance tax regime.

The results of the election may have been unexpected but appear to have been broadly welcomed by the business community, including property owners and stakeholders; so too was the first full budget proposed by a majority government since the depths of the credit crunch. Conversely, within the Euro-zone, a standoff between the Greek government and its creditors recently presented the Euro with the most significant challenge in its history, resulting in a funding deal for Greece which many commentators believe to be nothing more than an unrealistic sticking plaster on a wound that requires major surgery. For the weaker European economies the prospects of a return to underlying growth and renewed economic stability remain weak and, before the end of the year, another sovereign debt crisis seems likely.

At a domestic economic level the United Kingdom also remains a country divided as levels of growth, activity and investment show marked differences across the regions. However, to help address this, George Osborne has launched the government's "Fixing the Foundations" package, which contains a raft of proposals to stimulate house building, including the prospect of automatic planning permission for many brown field sites and for the simplification of the conversion of industrial space into residential space. The Chancellor is also championing the development of "northern power houses" served by improved infrastructure, transport links, training, education and investment.

At the same time the composition and nature of the holders of senior CRE backed security have changed dramatically over the past few years following the packaging and disposal of large debt portfolios to investment funds. As a consequence we are pleased to have enjoyed working with a range of new clients on a wide variety of interesting and challenging CRE projects where our team of dedicated property and insolvency experts has preserved and added value in difficult circumstances.

At present we are responsible for property assets to the value of c.£230 million location throughout the United Kingdom, spanning all real estate sub sectors. We continue to pride ourselves on delivering unrivalled levels of service using fee structures which align our success with that of our clients and look forward to continuing to working with you and your clients over the coming year.

Author: Paul Zalkin, Director
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Back to Basics Part 1:
Legal and Structural considerations when planning an enforcement strategy

Putting aside considerations such as adverse publicity or complications arising as a consequence of interest rate hedges, the overriding objective of a lender with security over a distressed property asset will be to cost effectively maximise recoveries within an acceptable timeframe. The means by which that objective is met, and the degree to which the outcome is successful, will depend upon a range of factors and a series of strategic decisions taken at the outset.

Depending upon the nature of a lender's security in a recovery scenario, one of the first questions will be whether to appoint an Administrator over the whole company, its assets and undertakings or to appoint a Receiver over a specific asset? In a small number of cases the appointment of an Administrative Receiver may be an option if the lenders security was granted prior to 15 September 2003.

In the article that follows we go back to basics and summarise some of the fundamental issues and structural factors to consider when planning the enforcement of security via a formal insolvency process.

Fixed and floating charges

Fixed charges attach to specific assets or classes of assets whose value does not vary in the ordinary course of business and where control cannot be exercised by the borrower without the consent of the fixed charge holder. For example, real estate cannot be sold without the lender releasing its security so property is, by definition, a fixed charge asset class.

Floating charges do not attach to specific assets but to classes of asset that change in the ordinary course of business. Stock, book debts or cash are obvious examples but less obvious examples include actions against third parties, certain insurance claims and tax rebates, none of which require lender consent for the borrower to deal with them. In general the right to collect rent is a floating charge asset.

Procedural options for corporate borrowers: Administrators or Receivers

The options for a lender with fixed charge security only are limited to the appointment of a Receiver to recover specific assets or, like any creditor (with or without security), they can also apply to court for the appointment of a Compulsory Liquidator or an Administrator, once certain conditions have been met.

Lenders holding a debenture secured by a "qualifying" floating charge (a floating charge created on or after 15 September 2003 attaching to the whole or substantially the whole of the company's assets) are entitled to appoint an Administrator via the simple "out of court" route. This involves forms being filed in court when a demand remains unsatisfied and the company is technically insolvent. If the lender's floating charge was created before 15 September 2003 they may appoint an Administrative Receiver instead of an Administrator, although in practice it is increasingly uncommon to see this older form of security.

Solvency, creditor pressure and the Administration moratorium

In some instances a lender will be able to gain control of an asset subject to its fixed charge and dispose of it regardless of the borrower's circumstances and solvency. Creditor pressure being suffered by a corporate entity may be irrelevant to the repossession of a machine or piece of equipment when that asset is not critical to the ongoing business. In such instances a simple Receivership appointment may be most appropriate.

However, in many circumstances – and especially when a lender's security is underpinned by income generating property assets - continuity of the business may be critical to an enhanced outcome for the lender. The broader questions of the entity's solvency, the impact of creditor pressure and the availability of working capital are therefore key considerations when deciding whether to appoint an Administrator or a Receiver.

Herein lies a crucial difference between Administration and the various forms of Receivership: only a company in Administration enjoys the protection of a statutory moratorium which deprives creditors of the ability to issue legal proceedings against the company, or to recover assets that may be subject to retention of title.

Companies in Administration are therefore afforded breathing space which provides an opportunity for the Administrator to implement a strategy that will protect as much value as possible for the benefit of the company's creditors as a whole, ideally involving the survival of the trade and assets, if not the company itself.

At the same time, the Administration moratorium cannot be used as a mechanism to deprive a fixed charge holder of rights held under its security and, unless the disposal of the charged asset will materially harm the interest of creditors as a whole, an Administrator appointed by one secured lender (or the directors of a company) would be obliged to consent to the simultaneous appointment of a Receiver to take possession and dispose of assets charged to another lender. More commonly though the Administrator would, in fact, deal with the borrower's fixed charge assets for all secured lenders to the company in Administration, although in certain circumstances it can be advantageous for Receivership and Administration appointments to run concurrently (further details of which are discussed in the following article).

The officer holders purpose and scope

A Receiver is appointed to manage and dispose of a specific asset or class assets and has limited powers, duties and obligations. On the other hand, an Administrator enjoys a much wider range of powers and duties, codified in law to assist them in achieving a statutory purpose, defined hierarchically as:

- to rescue the company as a going concern; or
- to achieve a better result for the company's creditors as a whole than would be likely if the company were wound up without first being in administration; or
- realising the company's property in order to make a distribution to one or more secured or preferential creditors.

Duty of care

Although appointed by a fixed charge holder, a Receiver will act as agent of the borrower (unless that agency status is lost following the appointment of a Liquidator) but with a primary duty of care to the appointing lender. This means that the assets over which the Receiver is appointed can be disposed of with relatively little regard to the interests of other economic stakeholders.

For instance, even if the potential exists for a surplus to be available following a sale and the redemption of the secured creditor's debt, the Receiver's obligations to consider the borrower's outcome are limited to ensuring that they do not act in bad faith.

As long as a Receiver can demonstrate that they have marketed the asset over a reasonable timeframe they need not delay a sale and can choose to sell whenever they believe repayment of the secured debt will follow. Crucially, the Receiver is not obliged to postpone a sale in the hope of achieving a better price for the borrower's benefit.

An Administrator, on the other hand, acts as an agent of the company and owes a duty of care to the creditors as a whole. This means that whilst an Administrator will routinely dispose of property subject to fixed charges in favour of a lender, in doing so they must ensure they do not to prejudice the position of unsecured and preferential creditors of the company.

Powers

The Receiver's powers will be limited to those set out in Law of Property Act and the security document, but will typically include the power to take possession of and sell the asset over which they are appointed, the power to collect rent, the power to enter into contracts and the power to trade or manage the asset under their control. They have no statutory power to compel the borrower to cooperate or to deliver up records and no locus over the corporate entity's affairs (assuming the borrower is a company), including its employees and officers.

On the other hand, as an officer of the Court, an Administrator has an additional range of powers and duties, including - crucially - powers designed to secure cooperation from officers and employees of the company as well as third parties, the ability to deal with floating charge assets and the ability to investigate and pursue additional recoveries in connection with past transactions that do not stand up to scrutiny and have been detrimental to the company and its creditors.

The Administrator acts as an agent of the Company and, in effect, replaces the executive authority of the directors who are stripped of their powers, except to the extent they are delegated back to them by the Administrator. A Company in Administration can, therefore, continue to trade, enter into contracts, take credit, borrow money, employ staff, litigate, manage its tax affairs, recover VAT and dispose of assets. In many respects it is business as usual, whereas none of these powers and rights are available to a Receiver.

Commercial considerations

The factors considered so far are framed by structural and legal considerations and do not tell the whole story. Of equal importance when planning enforcement strategy are a range of commercial considerations. These are discussed in our next article.

Author: Paul Zalkin, Director
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Back to Basics Part 2:
commercial considerations when planning an enforcement strategy

Having already discussed some of the structural issues to consider when planning the enforcement of a lender's security, we now go on to look at some of the key commercial factors that influence strategy.

How big is the potential loss?

Even in a property lending scenarios, when the value of the security is primarily represented by the borrower's real estate assets, it may be necessary for the lender to look to the borrower's floating charge assets to recover the debt in full. In most situations this would involve the appointment of an Administrator who would not only deal with the fixed charge property assets but also make floating charge recoveries which, subject to certain deductions, would be available for distribution to the lender. Moreover if the value of the real estate assets is underpinned by the trade (for instance, a care home or hotel), the Administrator's ability to continue that trade may be fundamental to the recovery strategy and a key reason to choose Administration over Receivership.

Cost

Conventional wisdom suggests that Administration is relatively costly due to the more significant burden of statutory compliance. However, whilst that statement may be broadly correct in isolation, the impact and benefit of the Administrator's much broader range of powers and duties cannot be ignored. Considered holistically, the appointment of an Administrator is often a more robust and productive recovery tool than Receivership. In any event, the actual cost differential is often marginal relative to the value of assets and debt under consideration and administration can therefore be the right solution.

Complexity

Complexity is a largely subjective term. At one end of the scale the sale of freehold residential property owned by an individual, with clean title, no environmental issues and vacant possession could not reasonably be described as "complex".

If that freehold was owned by a company and the property had a sitting tenant, the situation would immediately become more complicated, especially if the director was not prepared to deliver up a copy of the tenancy.

Add in a myriad of additional layers– corporate structures and debt, personal and cross collaterised guarantees, restrictive covenants, the existence of leases, taxation, VAT, capital allowances, plant and machinery requiring statutory inspections, environmental issues, the ongoing cooperation of employees of the asset owning company, statutory licences, and non-cooperative shareholders and directors - and the situation is more complex.

All of the issues listed above may compromise the effective management and sale of real estate assets so, when they become a consideration – and when the lender has a qualifying floating charge – the recommendation may be to appoint an Administrator as a more robust recovery tool. It may mean bearing some additional compliance cost but, in the alternative, twelve months down the line, when a sale by a Receiver is being frustrated by a truculent director withholding records, it would seem a small price to pay.

Rent

A critical point which has come to the fore for many lenders when enforcing property backed security is the degree to which rental receipts can be controlled and captured under their fixed charge. Here a potential anomaly arises between treatment of the rent in Receivership and Administration.

A Receiver appointed over an income generating property under a lender's fixed should be able to collect rent and distribute those funds to the appointing bank without deduction, beyond the normal costs of collection. Yet unless that rent was subject to a valid deed of assignment, or paid into an blocked accounted mandated to the lender, an Administrator appointed over the same property would collect it as a floating charge company realisation, subject to dilution by way of general expenses of administration, unrelieved capital gains and corporation tax liabilities, preferential claims and the prescribed part (broadly speaking a 20% deduction against net receipt put aside for the benefit of unsecured

To get around this potential problem whilst still securing the wide ranging benefits of Administration, we increasingly recommend a two pronged approach involving, in the first instance, the appointment of a Receiver to collect rent followed by the appointment of the Administrator. The critical point is to ensure the Receiver is in office before the Administrator.

Rates

The costs of rates can be a significant expense in an enforcement scenario and it is therefore important to ensure that the correct procedural strategy is adopted to minimise unnecessary liabilities.

A Company in Administration is liable for business rates when it continues to enjoy actual or beneficial rateable occupation of a business premises. Vacating a property but failing to offer a surrender of the lease to the landlord whilst seeking to dispose of the lease would still constitute beneficial occupation. As a matter of routine an Administrator should therefore appoint a specialist to undertake a review to ensure the rateable value is not overstated.

If the property is empty and the Company is not in actual or beneficial occupation, the Administrator will seek to avoid paying business rates, although some authorities are becoming increasingly aggressive in their approach and, after applying discretionary empty property relief for a transitional period, will seek to charge business rates unless the property is completely empty of all furniture, fixtures and fittings, thus rendering the property incapable of rateable occupation.

A Receiver is highly unlikely to be liable for rates. As with various tax liabilities, it is the borower who, as principal, remains responsible for liabilities that continue to accrue.

This in itself may not allow the Receiver to avoid the requirement to fund the costs of the rates because, if the corporate borrower fails to do so, they may become subject to liquidation proceedings that would remove the Receivers status as an agent and cause other issues. In such instances, the Receiver may have no choice but to fund the rates.

VAT

The treatment and recoverability of input VAT suffered on costs and expenses in Receivership and Administration is another important commercial topic influencing lenders in their decision making processes.

The technical complexities of this debate are an article in themselves but, the key point is that a Receiver can offset input VAT suffered against output VAT collected but cannot reclaim a net refund of VAT. At best they will have no VAT to pay over to HMRC. An Administrator, on the other hand, is in control of a company's VAT return and can recover net VAT refunds for the benefit of the estate.

Again, where input VAT is likely to be material (for instance, when incurring significant costs in completing a building development) and a lender has a qualifying floating charge, a simple solution might be the two pronged approached described above, although on this occasion the Receiver might carry out the substantive property recovery work whilst a "light touch" administrator would be put in place simply to recover the VAT suffered by the Receiver as agent of the borrowing company.

Project management

Unlike an Administrator a Receiver need not be a licensed insolvency practitioner and, in some instances, property agents act as Receivers. Whether that is the right approach depends on a number of factors. Much of the value added by an insolvency practitioner when acting as Receiver or Administrator is derived from their ability to take on the role of project manager, acting as "ring master" overseeing the development, agreement and implementation of strategy whilst impartially selecting and scrutinising the best team of agents to deliver the different work streams.

Furthermore, given the typical accountancy backgrounds of insolvency practitioners, there may be certain issues – particularly around taxation, VAT and capital allowances - which they are better placed to identify and deal with.

Closing comments

In the context of our opening statement about a lender's overriding objectives, there are a number of questions that should be asked at the outset when exercising security over distressed property assets.

How simple is the situation and would the more restricted powers of a Receiver be sufficient to deal with the legal and practical considerations at play? Could a Receiver's liability status adversely affect the outcome by limiting the scope of their work? Is there potential for leakage of the lender's recoveries in relation to rent and VAT? Will the borrower cooperate? Is there working capital pressure and a requirement to maintain the borrower's trade? The list goes on.

Ultimately each situation will be different and, whilst there may be no simple answer to the question of whether to appoint a Receiver or Administrator the best outcomes are those where careful planning, technical scrutiny, a collaborative approach and team work drive the agenda.

Author: Paul Zalkin, Director
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When is a fixture not a fixture?

When is a fixture not a fixture? When it's a chattel of course. But do you really know how assets are categorised and why subtle distinctions may have consequences for the value of security?

Fixtures, fittings and registered security

In the normal course of business companies in occupation of leasehold premises routinely undertake property maintenance and building works that might involve the installation of expensive machinery and equipment.

The items in question may be financed and subject to chattel mortgages, or be capitalised on the company's balance sheet thus forming part of its inventory subject to a lender's equitable fixed charges or its floating charge. To further complicate matters, the assets may be subject to retention of title clauses in favour of the original supplier.

Insolvency

When the company fails, owing arrears of rent to its landlord, a debt to its secured creditor and a debt to the supplier, disputes will inevitably arise as to who is entitled to the equity or benefit of the items in question.

In the landlord's corner are precedents supporting the argument that equipment incorporated into the fabric of a building becomes part of a landlord's fixture and fittings, potentially depriving the secured creditor of assets it may have expected to realise under its security and defeating a retention of title claim.

In the opposing corner are precedents supporting an argument that if items can be dismantled and removed without causing irreparable damage to the building, they do not belong to the landlord. Indeed, the law seems reasonably clear on what constitutes a landlord's fixture, a tenant' fixture and a chattel. The problem is, not all assets fit into neat legal boxes.

The basic legal position

As general rule of thumb whatever is attached to the land becomes part of it. For example when a building is erected, the fabric of the building and any objects permanently attached to/within it become fixtures and, as such, are owned by the freeholder of the land.

In cases when a tenant has subsequently added integral fixtures, fixtures or equipment (air conditioning or alarm systems, generators, fuel tanks, data-cabling systems, suspended ceilings, partition walls, flooring, production lines) title to that equipment may pass to the landlord.

Plant and equipment

An example of a dispute involved the supplier of a substantial collection of exotic trees and shrubs planted in the grounds of an estate leased to a company that had gone into administration (little wonder given the money they had wasted on plants.....).

The supplier had not been paid in full and sought to recover their goods under a retention of title clause, whilst the freeholder argued that the trees belonged to them having been planted and thus becoming, quite literally, attached to the soil.

To the consternation of both parties, as administrators we viewed the trees and shrubs as floating charge assets with a resale value: it was perfectly possible to dig them up and back-fill the holes, thus defeating the landlord's argument, and conceptually impossible to apply retention of title principles when the "assets" were organic and had grown over the months since they were supplied ("of course you can have the original plants back but we're keeping the new branches and leaves....."). So we engaged a horticultural specialist to remove them and, in so doing, realised tens of thousands of pounds from their sale.

Not all situations have fallen in our favour though. As liquidator of a corporate tenant our attempt to remove an air conditioning system for onward sale was defeated by a claim that the equipment had become part of the landlord's fixtures, despite the system having been installed in such a way as to make it relatively easily to decommission and remove. In that instances, the landlord refused to agree to an assignment of the lease unless the air conditioning remained in situ.

Practical tests

Where a dispute arises, the basic tests developed through the case law are:

- an object resting under its own weight or temporarily attached to the ground is unlikely to be a landlord fixture;
- an object more permanently installed whose removal would cause significant damage to the land or building is likely to be a landlord fixture;
- the purpose and function of the object - as opposed to the intention of the party who installed the object - is relevant. A free standing object which formed part of the overall purpose of the land – perhaps a notable statue in an ornamental garden - might be construed to be a fixture of the land.

As ever, disputes in more obscure situations are best dealt without recourse to the courts, through commercial negotiation and the application of a healthy dose of common sense.

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Property Posession, Pitfalls and squatters

Enforcement of a lender's security via the appointment of a Receiver or Administrator can signal the beginning of a difficult and drawn out process to realise value, especially when uncooperative or duplicitous stakeholders attempt to frustrate the process.

The existence of personal guarantees helps focus minds on the benefits of cooperating with the office holder. However, without them, some stakeholders may see little reason to assist in an orderly realisation of the assets, especially if they have lost their investment. A relatively toothless directors' disqualification regime, combined with significant hurdles frustrating legal actions against errant directors, does little to help.

Opco/Propco structure

The "opco/propco" structure can be a particular scourge for Receiver or Administrator. An insolvency appointment may be complicated if the trading premises is owned by another company controlled by a common shareholder whose business is about to be put into Administration on a hostile basis by a lender.

This is usually dealt with by a concurrent appointment over the property company - assuming the lender's charges secure the assets of both entities, which, of course, is not always the case. Worse still, it is not unknown to encounter situations where an opco/propco structure has been put in place after the security was taken, thereby putting an extra layer of complexity between the lender's security and the most valuable asset.

Similarly enforcement over a commercial property can be compromised when a common shareholder controls a separate trading business operating from the property and that trading entity is not subject to the lender's security. All too often a "tenant friendly" lease is produced, purporting to provide the tenant with the right to occupy the property for an unusually modest rent over an extended period of time with no break clauses or provisions for rent reviews. This diminishes the investment value of the building and compromises the office holder's ability to gain vacant possession.

Vacant Possession

Obtaining vacant possession can be difficult at the best of times, even in relatively common circumstance such as non-payment of rent. Legal processes can be prolonged and expensive, taking many months to complete, during which time rent is invariably not being paid. Even once vacant possession is obtained, properties are often left in a state of disrepair that has to be remedied in order to allow marketing to commence. In extreme cases, like the one described below, the time taken to obtain vacant possession can be measured in years, not months.

Case Study: Project Queen

Receivership of a commercial company with a defaulting tenant

Project Queen involved the Receivership of a commercial property occupied by a company connected to the borrower in default. The tenant had not paid rent for over 9 months, despite signing a new lease with the Receivers to formalise their tenure prior to completion of a contract for them to acquire the property.

After many months and various hearings - a number of which were adjourned after the court took pity on the apparently hapless tenant, represented by its sole director as a litigant in person (albeit one who knew exactly how to play the system) - the Receivers obtained a possession order.

However, when an officer attended the premises to enforce the order the director claimed to be living in part of the property with the rights and security of tenure that attach to residential occupation. Moreover, he had also installed a number of other "residential occupants" into illegally converted office space, all of whom claimed to have valid assured short hold tenancies.

Whilst it was possible to secure the majority of the commercial elements of the site, none of the "residential" tenants could be removed without another round of notices being served and court hearings being attended. In the meantime, manned security and legal costs were mounting.

One by one each residential occupier was removed by order of the court until only the warehouse occupant remained, although at this stage the director had substituted himself for one of his young employees. We later proved the individual was being paid by the director to live and sleep in the property.

Enforcement Difficulties

As a first step in removing the occupant it was necessary to demonstrate that he did not have a formal tenancy and was therefore squatting. Fortunately he made the mistake of confirming this on camera, at which point the Receivers were entitled to repossess and change the locks - providing the occupant was not physically present and there was "reasonable cause to believe" he had left. Leaving clothes, bedding and personal effects lying around was arguably enough to frustrate the process. Legal advice suggested that cutting off power and water was not a viable strategy. The situation was at deadlock and, to all intents and purposes, the Receivers were taking part in a siege whilst legal enforcement action ground its way through the courts.

Having spent nearly £100,000 on security and legal costs, the deadlock was eventually broken but not by a legal remedy but by the squatter deciding, one day, to simply pack up and leave. He was bored.

Events like those described above can be difficult to avoid but there are some basic steps that lenders should take to protect their position. The first principle has to be the perfection of security, especially when lending to a trading business with an opco/propco structure in place.

Summary

Personal guarantees – ideally secured against a director's personal property – are an effective tool providing an insolvency practitioner with leverage to prevent a property being held to ransom.

Negative pledges to prevent the creation of security over property without the lender's agreement and tightly drafted insolvency provisions in loan documentation are also important. Finally, lenders should undertake periodic reviews of a borrower's operations to ensure they have a full understanding of the potential risks in the event of default.

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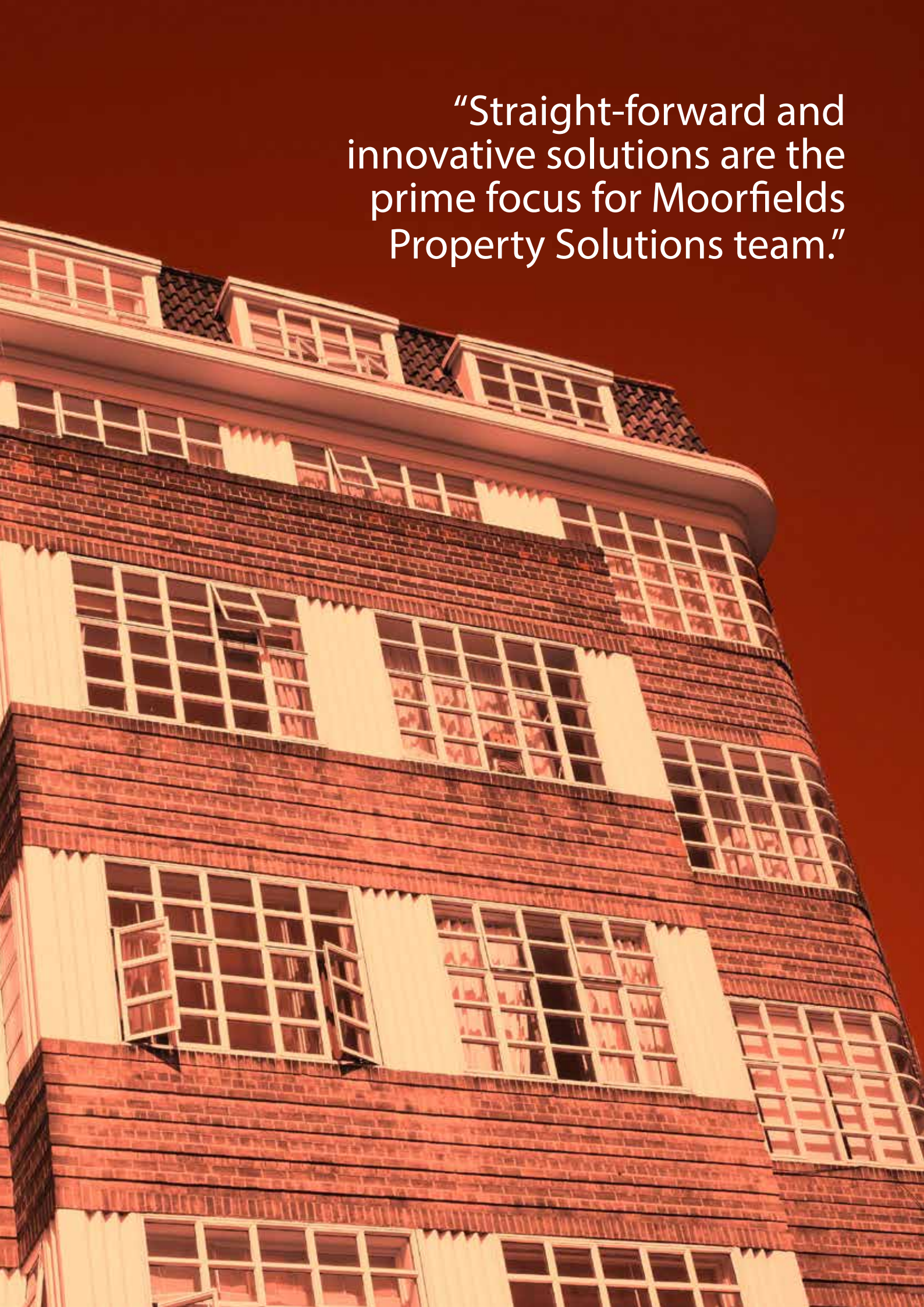

"Straight-forward and innovative solutions are the prime focus for Moorfields Property Solutions team."

Luxury Apartments prove to be very uncomfortable

Any prudent bank or other institution that lends money will only do so if, after completing its relevant due diligence, it considers that the prospective borrower is likely to be able to appropriately service the loan so as to lead to a full repayment with interest.

However, it is of course trite to state that no lending is risk free. Therefore in order to protect its investment a lender will very often wish to take security for their loan, so that if difficulties then arise it has protection to the extent of the value of the asset over which security has been taken.

Despite the potential comfort that taking security affords to a lender, realising the value of the relevant asset (or enforcing the security) can often be a difficult, expensive and time-consuming process.

A secured loan made to a high-end residential property developer, which lawyers at our firm were instructed to enforce, provides one such example of this.

Funding a development in the heart of London

The scheme involved the construction of a super-prime residential scheme: luxury apartments in one of the most sought after locations in Central London. The landlord/freeholder was one of London's "Great Estates".

The developer took a long lease over the site (which included building obligations and a strict timetable for completion of the scheme) and a loan to fund construction of the apartments. Its corporate structure was relatively complex – the development company was based in the Isle of Man, its holding company was in the British Virgin Islands (BVI), and the ultimate beneficial owner was incorporated in the Seychelles.

When the developer approached the bank, asking for a development loan, the bank had to think carefully about the security that it would need to take in order to protect its position. Ultimately the bank took out three sets of security, vertically across the structure: (i) over the shares in the BVI holding company; (ii) over the shares in the Isle of Man developer; and (iii) over the Isle of Man's Great Estate site leasehold interest.

A fraud is revealed

However, the bank unfortunately found itself in an extreme situation. The developer had not managed to meet the necessary sales milestones yet had instead produced false documentation with a view to persuading the bank that the project was on track.

In due course the bank discovered that the developer was lying. In addition to this, the development was running behind schedule and extensions of time were going to be required from the freeholder.

Unsurprisingly these failings and misrepresentations constituted an Event of Default under the loan agreement, as well as a complete break-down of trust. As you would expect, upon the occurrence of an Event of Default the bank was contractually entitled to enforce its security.

Enforcing security is seen as the last resort for the secured lender who will normally first investigate and exhaust other avenues when dealing with a borrower. This is because once security is enforced it can have far-reaching effects for the borrower in question, including insolvency. However, in this instance the bank-developer relationship was beyond repair and so enforcement was inevitable.

Enforcement by the bank

At the time that the developer's deceit was uncovered, the development was only part-built and was running way behind schedule. Having considered all of the options available to it, the bank decided that the best way to protect its position would be to appoint English administrators over the Isle of Man development company, so that these administrators could then oversee the completion of the apartments' construction, thereby realising the bank's investment.

The bank's right to appoint administrators was derived from the qualifying floating charge that it had over the whole of the assets of the borrower (including the leasehold property interest on which the apartments were being built).

Bearing in mind the complicated corporate structure involved, putting the company into administration was easier said than done. One impediment to appointing English administrators was that the development company was incorporated in the Isle of Man. It is a requirement of insolvency law that in order for English administrators to be appointed, the company must have its Centre of Main Interests ("COMI") in England. In this regard the basic test is where the company has its central administration, often deemed to constitute the place of the company's head (as opposed to the registered) office. In this case, COMI was considered to be in the Isle of Man.

"Unsurprisingly these failings and misrepresentations constituted an Event of Default under the loan agreement, as well as a complete break-down of trust."

As the bank had taken security over the shares of both the Isle of Man company and the BVI holding company, by working through the corporate structure it was eventually able to replace the directors of the Isle of Man development company, a necessary act so as to then allow the bank to shift the developer's central administration, and therefore its COMI, to England. The process of shifting COMI involves steps such as moving management functions; informing all suppliers, creditors and counterparties of the company's new (English) address; holding board meetings in England; and establishing bank accounts in England. The Court has to be satisfied that "there has been a genuine movement in the COMI that is ascertainable by third parties".

Once the tortious process of shifting COMI had been completed, administrators could be appointed over the development company. But that was only stage one. The administrators then had to work out how to finish construction of the apartments.

Completing the development

Standing in the shoes of the development company, the administrators now had control over the long lease taken out over the site owned by the London Great Estate. The freeholder was threatening not to allow any extension of time for building the development, which was by this time late, and also to seek to forfeit the lease for breach of covenant.

The administrators were advised by our lawyers that a Court would not allow them to forfeit the lease in these circumstances provided they could demonstrate a sensible proposal to complete the scheme and essentially remedy the breach of covenant in the lease. So the administrators had to find a new development partner to oversee the remaining construction of the apartments to ensure that they could achieve this. A pitch process was run.

The Great Estate freeholder wanted to be the new developer. But another developer was the administrators' first choice. However, the freeholder said that they would not allow any extension of time and would take Court action. In practical terms and to get the development back on track, that meant that the administrators had little option but to partner up with the freeholder in order to finalise the development. As part of the deal the freeholder demanded a share of the profits obtained upon completion. Although an aggressive stance to take, the freeholder was not acting unlawfully. So a deal was done.

The final step was to negotiate and document additional finance from the bank.

Ultimately, the apartments were completed and have been sold. The bank achieved its return on its investment. So the process of enforcing the security was successful. But by no means straightforward.

Author:Julian Cahn, Partner and Paul Hayward-Surry,
Parter, Stephenson Harwood LLP

Maximising the value of a distressed portfolio through asset management

The term "added value" has become a business buzzword and should be applied equally to the work of insolvency practitioners appointed over distressed assets as it does to the work of any other professional. Moorfields took the decision to invest in a team of specialists dedicated to property insolvency because we understand that there is rarely a "one size fits all" solution and, in many situations, a proactive asset management strategy is required to enhance capital value and the prospects of disposal.

We adopt a three stage approach to all projects, large and small:

1. Review
- Site visit to assess physical condition, security issues and health and safety concerns
- Discussion of property and asset management issues with directors and key employees
- Desktop review of prior valuations
- Gathering of property information and documentation
- Title and registered security review
- Planning review
- Tax and VAT review
- Initial tenant and lease appraisal
- Initial market appraisal

2. Strategic analysis
- Analysis of agents reports and updated valuations
- Rent and service charge analysis
- Capital expenditure analysis
- Non-domestic rates and utility analysis
- Analysis of lease breaks, renewals, rent reviews and dilapidation settlements
- Analysis of opportunities to increase net income

3. Implementation
- Instruction of property managers and investment agents
- Negotiation with tenants to re-gear leases
- Settlement of rent reviews
- Tenant marketing initiatives (bespoke website, brochures, local advertising etc...) to fill voids
- Renegotiation of contracts or change of suppliers for M&E, utilities, security and property management
- Programme of capital works and maintenance if considered beneficial
- Regular site visits and reporting.

Although we recognise that secured lenders can be reluctant to commit further capital once they have enforced security over a distressed portfolio, we are always willing to make clear recommendations if we believe that the exit will be enhanced as a result. The partial refurbishment of older stock or simple initiatives such as basic landscaping and improvements to communal areas can have a disproportionate effect on the ability to attract new tenants and increase the value of the asset.

In some cases the enhancement of old stock can simply mean addressing health and safety issues that have compromised the ability to attract new tenants. Even looking at energy suppliers to reduce the running costs of the building can help make a property more attractive.

We have also undertaken projects over the past twelve months that have required fundamental alterations to planning restrictions and section 106 conditions, involving legal applications and many months of negotiation with planning authorities.

The case study below set next details how our asset management initiatives resulted in the exit value of a business park increasing from less than £4m three years ago to nearly £8m (contract exchanged).

In a competitive and challenging market, the right asset management initiatives can add significant value to a distressed property assets, whether the holding period is short or long term.

Author: Paul Zalkin, Director
Moorfields Corporate Recovery Ltd

Asset Management of a Milton Keynes Business Park

Driving Results for our Clients

In-

Site Background

Location: *Milton Keynes*
Size: *112,870 sq ft*
Rental Income: *£675k pa*
Service Charges: *£370k*

Combination of new and old stock with 644 car parking spaces

Old stock struggling to attract new tenants due to oversupply of this stock in the market

MILTON KEYNES BUSINESS PARK

9 acre industrial park and 5 acre business park with 9 commercial buildings

Moorfields Asset Management implemented a strategy which has resulted in:

- *Subject to contract exit price circa 90% higher than day 1 agent's valuation*
- *Increased lettings in the first year by 20% with new lettings totalling £300,000 after rent free and discounted rent periods - Lettings now total 80%*
- *Year 1 net profit £475k - 17% increase on initial forecast*
- *Dilapidated building mothballed to remove service charge, settlements in excess of expectations*
- *Improved communication with tenants with regular face to face meetings and updates*
- *Inital optimum asset management period suggested for 3-4 years but disposal plan is likely to be accelerated to Year 2*

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 1164.

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