

# Property Views

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**Moorfields Corporate Recovery**

# In this edition

We are delighted to welcome you to the October issue of our Property Views Newsletter for professionals in the real estate sector.

The property sector has been one of the worst hit sectors in this double dip recession, but with the spotlight now firmly on London and the UK due to the legacy left by the summer games it now slowly seems to be making a recovery.

In the last 6 months we have acted on behalf of a number of lenders in the property sector, collectively owed some £800m, across a variety of properties including residential, commercial, licensed trade and development sites.

In this issue we have an article from Savills UK Plc exploring the performance of prime regional property since the market downturn.

We also have an article on the licencing of HMO properties, often found in large portfolios. We look at what happens if these properties are subject to enforcement and the additional concerns for appointees.

DLA Piper discuss administration expenses and the need for careful consideration when timing enforcement action.

In addition, we also have an article on evicting bad tenants. Despite landlords' best efforts to vet new tenants, unfortunately, many find themselves in a situation where they need to evict.

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 get in contact with us on 0207 186 1144 or call your usual Moorfields contact.





# A market of contrasts

With relatively low levels of wealth flowing out of London, the UK's prime regional markets have witnessed a markedly differing set of results

Words by Sophie Chick, Savills Residential Research

TABLE 3.1  
Five year growth in Estate Assets

	% growth from H1 07 to H1 12
Main House	-12.2%
Cottages	-10.6%
Farmland & Farm Buildings	66.6%
Woodland, Sporting and Misc Land	36.0%
Commercial & Development	-14.5%
Marriage Value	-50.6%
Total Growth	-1.6%

Table source: Savills Research

In contrast to the markets of London, the performance of prime regional property has been patchy since the market downturn.

In the last 12 months, prices in this market have fallen by 3%, constrained by caution among predominantly domestic buyers, in much the same way as the mainstream markets.

Behind this general trend, different property types and locations have reacted differently to changing market conditions.

Within the core, prime regional markets townhouses have held up well across all regions, but particularly the South East. These markets tend to benefit from an element of stock scarcity, particularly for traditional family houses, which has helped to temper major price fluctuations in locations such as Tunbridge Wells and Cambridge and districts such as Clifton in Bristol and Mount in York.

## Differing fortunes

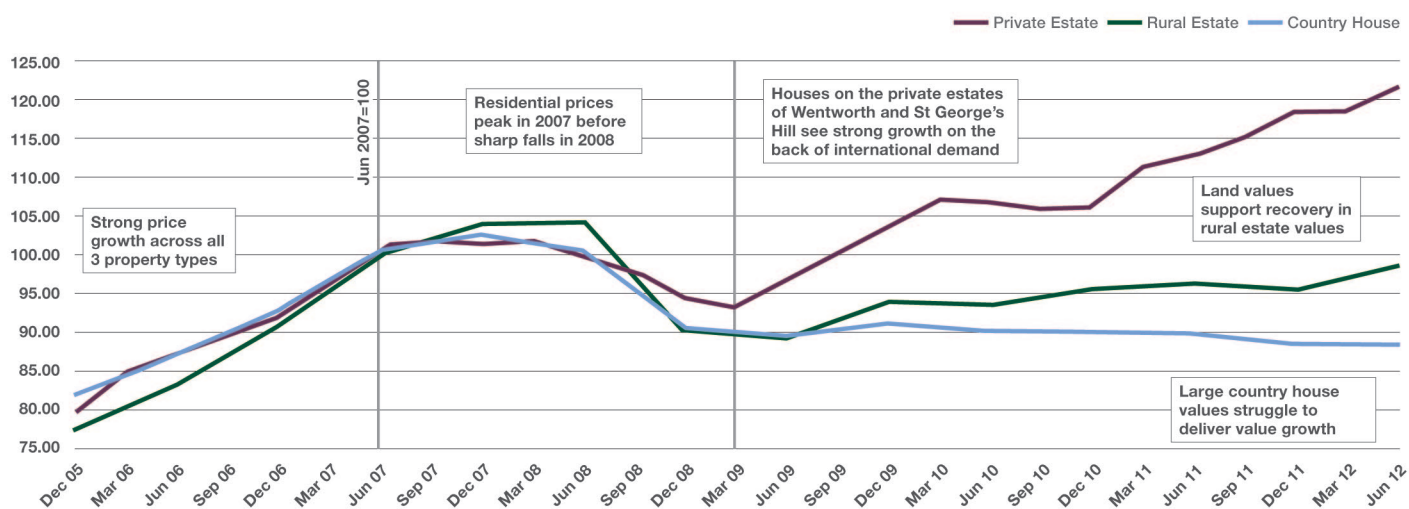
The variation in performance is also evident within the top end of the prime regional market. This is demonstrated by the very different fortunes (see opposite) of four properties that were all worth £3 million pounds in June 2005.

This shows big variation in the performance of, say, mansions in the most exclusive private estates of the suburban South East, where buyer profiles are similar to those of central London, and prime coastal property in Cornwall, where prices were inflated by bonus money in the boom years of the market.

Both provide evidence of how prices with sub-markets can be re-pegged, either upwards or downwards, because of a change in the buyer profile.

In St George's Hill, the arrival of international wealth, particularly from the CIS, has reignited the market with 18 sales in the first six months of 2012 generating aggregate sale proceeds of just under £90 million, a figure only previously exceeded in the second half of 2005.

GRAPH 3.1  
Private Estate v Rural Estate, Price Index from December 2005 – Jun 2012



Graph source: Savills Research

By contrast, in Cornwall, the absence of 30 and 40 something buyers, has caused prices to become re-pegged to the purchasing power of the grey pound. That has played an important part in freeing up the market but has suppressed prices.

Though these examples highlight the extremes, they have some relevance for the wider market.

### Shaping the top end

The internationalisation of the country house market in the South East is still in its infancy, but is likely to be a factor that shapes the top end of the market over the next decade.

In the shorter term, the rest of the prime regional market is likely to see only relatively low levels of wealth flowing out of London. This will not change significantly until economic growth gives potential buyers the confidence to cut ties with the capital and exploit the wide price differential that has built up over the past seven years between London and the country.

The uber towns of the South East will give the earliest indication of the speed and strength of this change. ■

### Estate Assets

Across the private estates of Wentworth and St George's Hill average values are now 19.3% above their previous peak in 2007. By contrast, across the wider country house market where values across England and Wales values are 9.6% below their peak, and much further adrift in Scotland.

However, the dramatic rise in agricultural and woodland values mean that for the rural equivalent of the suburban private estate house, namely the mixed rural Estate values (see table 3.1), prices are broadly in line with five years ago. Over this period the agricultural component of the estate has risen from £4,100 to £7,300 per acre.

Similarly the increase in woodland and amenity land has offset the fall in marriage value between the assets (see table 3.1)

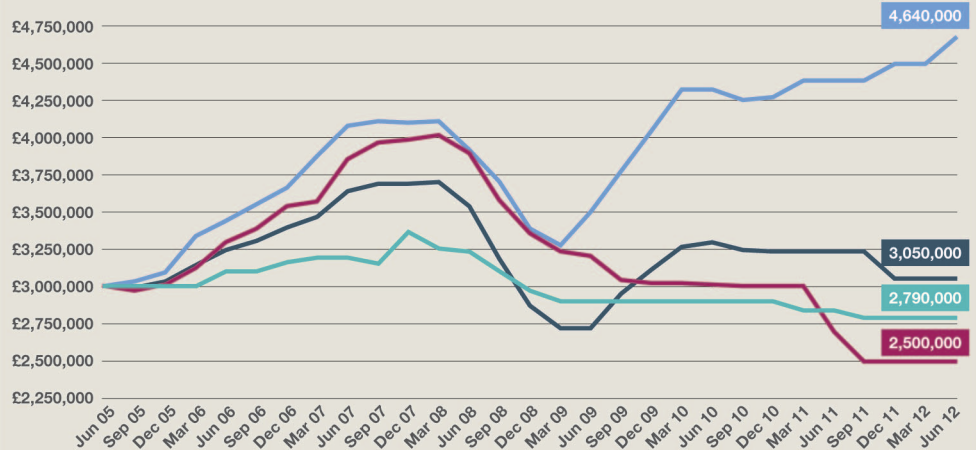
## A TALE OF FOUR PROPERTIES

Valued £3 million in 2005, what is their value today?

Over the period since the middle of 2005, prices within the country house market have varied significantly according to market conditions. Figures from Savills Research department track values for four different country houses in four different locations whose fortunes have varied.

**KEY**  
 Property 1: Cotswolds  
 Property 2: North Yorkshire  
 Property 3: Coastal Cornwall  
 Property 4: Wentworth Estate

GRAPH 3.2



Graph source: Savills Research

**1** 7,000 sq ft, 7 bed country house, set in 50 acres, near Painswick in the Cotswolds.

Price growth of 12% since the bottom of the market reflects the enduring appeal of the area. Whilst prices are marginally above levels seen at the beginning of the period, the slow return of London money means the current value remains 17% below peak



**2** 9 bedroom Edwardian property set in 20 acres on the southern fringes in North Yorks National Park.

Slow to catch the ripple of positive sentiment from London and the South East, price growth was limited in 2006 and 2007. Broadly static prices since 2009 means the current value is 7% below its June 2005 level.



**3** 6,500 sq ft, 6 bed Georgian rectory, near the River Fowey in Cornwall.

Strong price growth in 2006 and 2007 was fuelled by city bonuses and other London wealth as Cornwall joined the 'it' crowd. Post-recession prices fell significantly until reaching a point where they can be supported by different types of buyers with lower budgets.



**4** 8,000 sq ft, 5 bed modern mansion on the Wentworth Estate.

Strong international demand means that price movements show parallels with Prime Central London. Despite price falls of 20% during the downturn, strong price growth prior to the credit crunch subsequent the recovery mean prices are over 50% above those in June 2005.



In Scotland the top end (£2m+) country house market saw values double at the peak, but they have now fallen back to 2005 levels. See forthcoming Spotlight: Scotland's Prime Residential Property Market for detailed analysis.

# Watch out for HMO!

The area of Houses of Multiple Occupation “HMOs” has often proved to be lucrative for many landlords particularly in locations with large student populations where yields can be two to three times that of the average rental income. Despite this, research has proven that HMOs provide some of the poorest housing conditions, often prone to overcrowding and inadequate health and safety. So what is required to ensure houses meet HMO standards and how does this affect insolvency strategies/practitioners?

## So what does House in Multiple Occupation “HMO” mean?

The definition of House in Multiple Occupation ‘HMO’ under the 1985 Housing Act is “a house which is occupied by persons who do not form a single household”.

## Properties Classified as “HMO”?

The definition of HMO is defined as owning or letting a property which falls into any of the following categories:

A property let to three or more tenants; Rooms and bedsits which are let singly, where tenants share facilities such as the kitchen and bathroom. A building entirely converted to flats which doesn't meet the current building regulations (the 1991 Building Regulations) and where a third of the flats are let on short-term tenancies.

In addition to the above, the Local Authority (“LA”) also has the right to introduce HMO licensing for other properties within their area. Fundamentally this means that the properties subject to HMO fall into a wide scope and can often include Bedsits; Shared houses; Households with a lodger; Purpose-built HMOs; Hostels; Guesthouses - if rented out of season; Bed and breakfast establishments providing accommodation for homeless people and some types of self-contained flats converted from houses.

## The Licence Requirements

If a property is classified as a HMO it is mandatory for the landlord to hold a licence from the LA. Licences are specific to the property and applicant applying, and are valid for 5 years but the cost and procedure of a licence varies between each LA.

The purpose of the licence is to ensure that properties meet minimum standards including Health and Safety; Gas Safety; Adequate water supply; Drainage; Electrical Goods Safety; suitable management; good repair of property and suitable rubbish disposal.

## Licence Refusal

Letting a licensable HMO without a licence is a criminal offence and can result in a fine of up to £20,000, together with personal liability and associated compliance issues. Properties which have been refused a licence are subject to an interim order. Enforceable by the LA, an interim management order enables the authority to take over the management of the property for a 12 month period.

## Effects on Insolvency Proceedings

In the case of many property insolvency proceedings, expediting a quick sale is essential in maximising the recovery for lenders. As a result, any issues with HMO licensing could potentially delay this process and result in difficulties with the proposed strategy.

HMO Licenses which have been obtained are specific to the property and individual and cannot be transferred to a third party, so on appointment insolvency practitioners must obtain a new licence, particularly when there are tenants in situ.





Think now .....

In summary, any property falling under the HMO classification will need to hold a valid HMO licence. If works are required to get the property to meet the minimum standard it will result in additional expense and a delayed sale until a new licence can be obtained.

If you have properties within your portfolio which you think are subject to HMO please give us a call so we can advise you and ensure we act promptly and maximise recoveries.

If the proposed strategy is to continue to manage the property and collect rent from tenants, then it is essential that the HMO licensing issues are dealt with promptly. Failure to adhere to the licensing requirements can result in the insolvency practitioner facing criminal proceedings, a fine of up to £20,000 and an order to repay any rents collected. In addition, whilst the property is without a licence, the insolvency practitioner loses all powers to pursue tenants for unpaid rent.

When the appointment is over a vacant property, the insolvency practitioner does have the option to market the property without a licence, although HMOs let after 6 April 2010 are required to have Class C4 planning permission. This can often mean selling the property at auction, resulting in a reduced price. However, this may still yield a better return to the lender compared to the cost of making the property HMO compliant or converting back to a single dwelling.

The Local Authority (“LA”) has the right to introduce HMO licensing to other properties within their area



# Administration Expenses

## To pay or not to pay rent

The “new” administration regime, effective from 15 September 2003, introduced, for the first time, the notion of administration expenses. Administration expenses are (unless the statutory order is interfered with) payable out of floating charge assets in priority to a number of other matters including payments to a secured creditor and the administrator’s own costs. Since inception, what items exactly qualify as administration expenses have been the matter of continued debate and judicial decision.

### Does rent qualify as an administration expenses and if so what does it actually mean?

For example, there may be arrears of rent when the administrator takes office, future rent that may become payable whilst an administrator is in situ or a situation where an administrator only requires use of the premises for part of the term of the lease. Are these all payable as an expense or none at all?

In the spirit of *Re Atlantic Computers Systems plc*, most administrators who needed to trade from premises for any period of time, tended to conduct a balancing exercise, weighing the proprietary interests of landlords against the general body of creditors, commonly reaching agreement with landlords to pay for such of the demised premises as they were using for as long as they were using them - on a day to day or weekly pro-rata basis.

In 2009, judicial guidance was provided in the case of *Goldacre (Offices) Limited v Nortel Networks UK Limited* (“Goldacre”). This case decided that where an administrator was appointed after a quarter day, all rent (and it seems by implication, potentially other sums) falling due under the lease for the whole premises demised by the lease on each quarter day that the company in administration is in occupation (or otherwise benefitting from the property) would be payable as an administration expense, regardless, in the case of the final quarter, whether the company occupies the premises for the entire quarter or not.

Goldacre did not, however, address the question of what happens if rent falling due on the quarter day before the administrators are appointed, has not been paid. This question was addressed in *Leisure Norwich (II) Ltd & Others v Luminar Lava Ignite Ltd* (in administration) & Others (“Luminar”). Within his judgment, Pelling J provided a summary of his understanding of how rent should be treated in a number of different scenarios; namely:

1. where rent is payable in advance and falls due for payment prior to the appointment of administrators (as was the case there), it is provable but not payable as an administration expense, even if the administrator retains the property for the benefit of the administration for the whole or part of the period for which the rent in advance was payable; and,
2. where rent is a payable in advance and falls due for payment after the appointment of administrators and the administrators are retaining the property for the benefit of the administration (as was the case in Goldacre), the whole sum is payable as an administration expense, even if the administrator gives permission to forfeit or vacates before the expiry of the period for which rent has been paid.



Does this mean therefore, as it stands, that in those circumstances, the company in administration could now occupy rent free? A cautious approach to this would be wise as the consequences of it being a provable debt were not examined in Luminar. For example, if a landlord's right to payment of rent is replaced by a right to prove for that rent, does that preclude the landlord from exercising his right to forfeit for non-payment of that rent?

This question has not yet been the subject of a publicly available judgment but press reports of the decision regarding Game's Oxford Street premises indicate that, where, following three alleged breaches of the lease, including non-payment of rent, the court was prepared to allow the landlord to forfeit.

The question of whether or not the court has any discretion to order that rent be paid as an administration expense has also been the subject of some apparent divergence of approach. The judgments in Goldacre and Luminar appeared to proceed on the basis that there is little scope for court discretion to be applied such that only part of the rent for the premises must be paid for. However, most recently in MK Airlines Property Ltd, the court appeared to consider that it was acting within its discretion to make an order that the first quarters rent, falling due before the administrators had a realistic opportunity to decide what to do with the property, should be payable as an administration expense.

Where then does that leave an administrator? Perhaps practically, an administrator will engage with the landlord and try to agree the best and fairest deal as between landlord and creditors. But there are risks in that approach as well, particularly if there are guarantors to consider. So, we have some clarification of what is and is not an administration expense but there is plenty of opportunity for more debate, as the see-saw of landlords rights versus creditors' rights continues.

As a result of this, the timing of any enforcement action needs to include careful consideration of the date that rent falls due in order to enable the administrator to minimise any rental costs incurred in the administration.

**In summary, it is important that careful consideration is given to the timing of enforcement action to enable the administrator to minimise any rental costs incurred in the administration.**

What items exactly qualify as administration expenses has been the matter of continued debate and judicial decision.



# Evicting a “bad tenant”

Unfortunately, it is a reflection of rising unemployment that tenants, who a few years ago were considered good tenants, are now providing little security or stability for landlords. It is now more important than ever for landlords to understand the options available to allow them to ensure they protect themselves against loss of rental income.

Letting a property may be profitable for many landlords, but in some cases it can become costly.

Despite the best efforts by the landlord to ensure the financial and social suitability of the tenants, they may be left in a position when eviction is the only remedy, this could be due to rent arrears, breaching tenancy agreement terms or property violations. Possibly posing the biggest problem is rent arrears, the National Landlords Association survey conducted earlier this year highlighted that a staggering 49% of landlords had suffered rental arrears in the past 12 months. Whilst an average portfolio of 12 lettings had 4 tenants in arrears.

Unfortunately whatever the situation, residential tenant evictions can prove to be particularly complex, time consuming and often have serious financial implications for the landlord. This is especially true when there are rent arrears or damage to the property leaving the landlord to foot the bill.

**So what processes must be taken to evict bad tenants and can an insolvency practitioner appointed as LPA Receiver or Administrator take the same steps?**

## Assured Shorthold Tenancy (AST)

If tenants are still within the fixed term of their Assured Shorthold Tenancy (AST) then a landlord must have reasonable grounds to evict the tenant. This can include rent arrears, property damage or other issues.

In this situation, landlords have two options under the Housing Act 1988 depending on the circumstances.

- To serve a section 21 notice used to legally terminate an AST at the expiry of the fixed term; or
- To serve a section 8 notice – used to terminate an AST during the fixed term when terms of the tenancy have been breached.

### Section 8 Notice

A section 8 notice can be served on a tenant at anytime providing there are reasonable grounds to do so. Depending upon the grounds used to serve the tenants, a notice period must be served before proceeding with a court possession this can be between 2 weeks and 2 months. If successful then a possession order can be gained, plus a money order to recover any unpaid rents.



If insolvency practitioners have been appointed over the property they take on the powers of the landlord and can evict tenants in the same way.

#### Section 21 Notice

A section 21 notice can be served on a tenant at anytime, but does not take effect until the fixed term agreement has come to end and two months notice has been given. In most cases a section 8 notice offers a greater flexibility for problematic tenants in the early stages of tenancy.

If insolvency practitioners have been appointed over the property they take on the powers of the landlord and can act evict tenants in the same way.

#### Court Possession

Once a valid section 8 or section 21 notice has been served and the relevant notice period has elapsed. Landlords can apply to the courts to start proceedings. If the court rules in favour of the landlord a court order will be granted requiring the tenant to vacate the property.

#### Eviction

If tenants fail to vacate following appropriate notice of the possession order, the Landlords can rely on bailiffs to enforce the order.

#### Think now.....

Evicting tenants can be problematic, costly and time consuming, especially when managing with a large portfolio.

If the impact of loss of rent and resulting legal costs is affecting performance of your client's investment property loans and you would like further advice please give us a call.



MOORFIELDS CORPORATE  
RECOVERY

Moorfields is a leading provider of Corporate Advisory, Restructuring and Insolvency Services.

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.

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