Duncan Grubb

Duncan Grubb is chair of the British Property Federation Insolvency Committee and head of credit control at Hammerson. In his role with the BPF, Duncan heads a group of insolvency experts – from major landlords, leading law firms to insolvency practitioners – responding directly to government consultation papers on insolvency issues and meeting with The Insolvency Service. He has overall responsibility for the credit control teams at Hammerson, operating on the company's portfolio of shopping centres and retail parks. He is responsible for all aspects of credit strategy, including covenant approval for much of Hammerson's business and has been directly involved in many of the high profile retail insolvencies including CVAs, where he has promoted landlords' interests and in some cases helped shape the proposals in direct consultation with the CVA supervisors.

Interview with...

Duncan Grubb

Sandra Kessell talks to **Duncan Grubb**, chair of the British Property Federation's Insolvency Committee.

Why is the current perception of IPs negative?

An IP's involvement represents an interruption to an established business model. Our business is to cater for our investors; most of the big landlord companies are investment companies that deal in property and most of the investors are global pension funds. Any interruption to that investment flow is seen as negative. It also impacts other areas, such as valuation. If you have a unit that stops trading due to an insolvency regime, or is traded as a concession in order to keep the lights on, that can affect the valuation. The valuation is paramount because independent valuers assess a centre – which is the reported asset of the company or the value of the company's assets – and that directly affects the share price. Obviously, a reduction in a significant number of the assets due to a spate of insolvencies negatively affects the share price. It's probably more critical for smaller landlords – for those who have two or three shops in a local high street. Not only could an administration result in a unit closing and the landlord not receiving rent or service charge, but if it goes into liquidation he may get a disclaimer and no rates protection either. So the secondary and tertiary landlords are suffering far more than the prime at the moment. We may be talking about a recovery, but it's only at the top of the scale.

Has that perception changed in recent years?

Over the last four or five years, largely down to R3, it has changed. The BPF was invited to contribute to an R3 conference years ago, and Brian Green from KPMG and I gave a joint presentation because at that point there had been some very prejudicial CVAs that had been voted down by the landlord community due to the potential to negatively affect the business plan in an unacceptable way. I presented a case for the landlord community during which I outlined their dilemmas and where the touch-points and no-go areas were for us. We felt the level of understanding among IPs at that conference was shockingly low, yet the level of willingness to engage was terrific.

Since then, there has been a coming together of the two sides. IPs realise we are a major creditor group and that we can only help them in certain areas for reasons that aren't under our control; investor protection and asset protection, and the level of engagement is very good. I'll discuss CVAs in particular in the later question. I see the potential for improvement to continue because it makes all our lives easier. The lines of communication are better and the old confrontational idea of the IP, as a court-appointed officer who can do what he likes while the landlord has no say in the matter, is long gone, thankfully.

Would you like to see young and trainee IPs having more information about what you do at an early stage so that their level of understanding starts early?

Yes – the same way as I would like to see more business studies courses include modules on credit management and insolvency. They are taught to micro-manage every other aspect of running a business but these two areas are often skipped over. It may also be useful to offer trainee IPs an internship with a landlord for a couple of weeks.

How engaged are landlords in the insolvency process?

It does vary. The big majors have more attachment to proper credit management and don't confuse credit management with debt recovery. But risk protection, proper evaluation of tenants, making sure you're adequately protected if something goes wrong despite everybody's best intentions, that's given a lot more credence than in the past. The bigger landlords employ full-time credit managers and relationships have improved as a result, because we tend to keep an eye on everything and deal with the IPs on a regular basis – an important point in the engagement process. We're going to deal with them again, unfortunately.

> "All these things sound very nice, but you're trying to get investors to put money into these businesses."

Smaller landlords with a smaller portfolios deal with insolvencies rarely – perhaps once in their lifetime – and come to the BPF only when needed. There are links on the BPF website, there's a PwC link and a LinkedIn discussion group specifically aimed at small landlords who don't have the expertise or money to pay for insolvency lawyers when they do come up against an insolvency problem. They don't get a great deal of use, unfortunately.

What are the BPF's views on the recent pre-pack report?

The report was very well prepared. Teresa Graham took on board everything that we had said and included a landlord section. The intent was good but we are concerned that the proposal for the pre-pack pool is voluntary and the amount of take-up on it will be anybody's guess. There's a lot of work to be done setting it up and meetings are ongoing. It may work as it is, but there is primary legislation in the background if it doesn't.

Tell me about the work the BPF is doing around CVAs.

To go back to our points on engagement; the landlord community started discussions during the Powerhouse case, back in 2007, which we felt was a prejudicial CVA because it permitted parental guarantees to be stripped out in an insolvency regime. It had a negative effect on valuations; many leases are guaranteed by a parent company and it would have permitted unscrupulous companies to strategically strip out guarantees and get rid of leases that weren't performing very well. Landlords won that one. The Stylo CVA followed; again, considered prejudicial, because it commuted all the revenue on all the Stylo units across the country to three per cent turnover. That would have meant a massive income hit to the landlord community. Either of these would have established a dangerous precedent.

CVAs are only as good as the last one because people tend to build on what's been established. If the Stylo one had got through and had been approved by the creditor groups, various other retailers or companies would have used that same model. If you have six distressed companies and three per cent turnover on all their units within major landlord centres, that's a huge hit on income and valuation and investors would not be happy. Pension funds would evaluate whether their money was in the right place.

KPMG came up with a model, the first JJB Sports CVA, after engaging with landlords and developing more interaction and understanding. After that was voted through, various other CVAs followed using the same model: Focus, the Speciality Retail Group and Blacks. The second JJB CVA introduced some compensation clauses for the compromise leases when it came along, because the cuts hadn't been deep enough first time around. Unfortunately it didn't work.

We've done five now and insolvency firms are coming to the BPF with unpublished CVA models, usually under a non-disclosure agreement (NDA) – a confidentiality agreement. They ask us, as a major creditor group, if it includes anything that would cause landlords to vote against it. We've done Bowlplex, Fitness First, LA Fitness and Café Rouge. In each case we've gone back and said, for example, that we would like to see more rates mitigation if you're closing a unit and rates protection for a year at least. Giving a voice to our dilemmas and problems, and highlighting things that IPs may not have thought of is a major development – it helps IPs as well. However, the BPF can't endorse any of these models. What we can say is that there's nothing contentious or prejudicial, but we have to be very careful with cartel arrangements. All landlords have to vote individually based on their own portfolios and their own investors' models.

Is there a feeling that landlords can take a hit in a worst case scenario because they gain from both the increase in property or site values and the income from rents as well?

The idea that the landlord just builds property, a centre, a retail park or an office building, then sits back and collects the rent, is not accurate. Most big landlords spend a lot of time and money micro-managing their assets to drive value for their tenants. Business models are established, the lease lengths have come down to ten years – they used to be 15. There's also a myth about over-renting. An IP may say, these rents are above market value because they're a desirable unit, you had various tenants bidding for it and got the best deal. That may have happened, but usually the reason for above-market value is because the tenant has received a long rent-free period, or a big capital contribution such as landlords' works or an escalator, for example. There's a large amount of capital to pay back and the landlord's business model will work out what rental level is required to pay this money back and give the desired level of additional income – profit – over that period of time or up to the first break notice, when the tenant can legitimately leave. Assuming that bringing a lease down to market rent won't affect the landlord ignores that investment. If the tenant goes bust after two years, that's a major impact on the landlord because they're not going to get their money back on their investment.

> "Most big landlords spend a lot of time and money micro-managing their assets to drive value for their tenants."

Would you like more tenants to come to you when there's an initial problem rather than waiting until there's a critical problem?

We want to encourage dialogue when a problem is genuine and discourage it when it's strategic. Landlords are not a bank – the first point of free loans – and borrowing landlords' rent to pay other suppliers rather than going to the tenants' own bank is not the way. We can generally reconfigure something if there's a major problem and they provide financials, so we can make a forensic decision. We might give them a concession in exchange for a landlord break, for example.

How can the industry develop constructive agreements that are seen to be fair? The recent Mamas & Papas proposal is being held up as an example.

The Mamas & Papas CVA was a typical KPMG model, with a few extra bits in it. The landlord community is used to seeing this type of CVA model. There is only so much money – the level of investment, the number of units and the manageability of that portfolio are all going to be different. However, certain terms of these CVAs seem to be common ground now and it would seem a good idea if R3 could say, 'This is a standard form, we recommend…' – almost like a standard CVA. Anything that differs from that could be highlighted very quickly and evidence to justify it could be sought.

What more can IPs do to improve confidence in the insolvency regime for landlords?

Scrutiny. If you go back ten years or so, when a company went into administration, you would have a meeting with the IP and the new buyer of the business. Nowadays you see the buyer of the business and their highly incentivised letting agent. You don't see the IP anymore and we are pressing for the IP to retain a seat at the table to stress-check the rental proposals and the new proposals to ensure they are watertight and not prejudicial – to ensure this is a genuine attempt to rescue an existing business and save what they can, rather than strategically increasing profits downstream for a new investor or a new owner.

> "CVAs are only as good as the last one because people tend to build on what's been established."

It applies to administrations and CVAs as well. We would like to see the IP at the table right up to the point where leases are assigned to the Newco. Thinking about CVAs – as an example the JJB CVA – Dick's Sporting Goods put £20m into JJB, just as a toe in the water in the UK, and it wouldn't have hurt them to pay KPMG to have someone sitting at the table at JJB to make sure that CVA was working properly. We would like IPs to have that level of scrutiny, to have more power. We would like them to have more authority over the Newco and what the Newco is doing. Because they are, in a way, protected by the moratorium, against any legal action or the recovery action, and yet there's very little that the landlord can do to ensure fairness and make sure the rental levels being proposed aren't ridiculously low. The IP's presence would instil a lot more confidence in the system as it stands.

If landlords were to see three changes to the insolvency regime, what would they like them to be?

Coming on from the last point, certain parts of the sale and purchase agreement between the IP and the Newco should be published and seen by the landlords. Any that are sensitive can be done through a non-disclosure agreement or you could just publish the categorisation of the leases. But more publication, more visibility, that's one.

Two: perhaps limiting the moratorium, after the Newco has bought the assets of the business, so they can negotiate on an open market basis, rather than being protected and saying, we will walk away from that lease unless you give us a deal on it. That would make things better. As soon as the sale has been completed to the Newco, the moratorium is lifted because then we're dealing on an open market basis. They can say, we will take the lease or we won't take the lease and we can say, we will give it to you, or we won't give it to you. It becomes a straight property deal then rather than all the cards being stacked in favour of the Newco.

Number three is something that I've spoken to Giles Frampton about before – notices of intention. These are not public notice documents at the moment and they should be. We've suggested that they are either published on The Insolvency Service website when they're filed or, more preferably, they should be gazetted. We want to see the same level of disclosure as for a winding-up petition or a meeting of creditors. If necessary, let's get the primary legislation because at the moment these things are invisible and can be used strategically – often the landlord doesn't know they've been filed. We have had situations where up to four have been filed, one after another. What happens is: notice of intention goes in; after ten working days, another one goes in; after ten working days, the excuse is the deal wasn't done in time. Some are put in place strategically. The administrator is appointed after that and he will only take on the responsibility from that point onwards. So while these repeated notices are being filed, more of the landlord's rent is becoming unsecured. He can therefore end up with a month's worth of income disappearing under notices of intention because he can only claim for it once the administrator is installed. Insurances might deter investment. All these things sound very nice, but you're trying to get investors to put money into these businesses. We've already seen HMRC asking for VAT deposits on failed and phoenix companies, where there's a history of insolvency. Who would pay for the insurance and would the Newco pay for what is effectively an insurance bond? Who would insure them? It would fall down on the 'real world' test; a landlord isn't going to pay for the insurance; the premiums are prohibitive, it's cheaper to take the hit, actually.

Why should IPs build a relationship with the BPF? What do they get from understanding your viewpoint and what's in it for them?

Fewer challenges for a start, and a much easier life. Better cooperation from the landlord community. I was talking to an IP recently about a small matter, not a national issue, and we sent him a lot of information he didn't otherwise have. Whenever there is a big insolvency now, the first thing I do is send a schedule off to the lead IP explaining our portfolio, rental levels and service charges to show what they are dealing with. They can come back and we can make rational decisions about it. It's very much a collaborative approach and I'm sure it's just as helpful to them as it is for us. KPMG is on the front foot with this. The others are catching up and there's a lot of goodwill there.

> "Let's get the primary legislation because at the moment these things are invisible and can be used strategically."

Is there anything you want to add?

At the time of the interview, we're still waiting for the decision of the Supreme Court on the Game trial. Even though it's only an outside possibility that the Court of Appeal decision will be overturned, all IPs have to act as if it could happen. So we're still working as if it's the bad old days. With the Mamas & Papas situation, for example, all those units would have closed in administration just before the next quarter day if that CVA hadn't gone through because IPs don't want to pay three months' rent. If the Supreme Court decision and the Appeal Court decision had been overturned, even if the IPs had only traded for two days, they would have had to find three months' money.

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