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Retail insolvency and property assets

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The very public collapse of House of Fraser and Homebase highlights, once again, the need for retailers, shareholders and landlords to be realistic about the potential pitfalls and solutions created by property assets in an insolvency or distressed sale situation.

Mike Ashley offered £50m for HoF before administration, but once creditors rejected a Company Voluntary Arrangement (CVA) and it filed for administration, an insolvent HoF was worth £40m more to him and Ashley upped his bid to £90m. Why?

Insolvency versus CVA

The benefits to a purchaser of buying an insolvent company is the ability to jettison existing creditors, to negotiate with landlords to novate leases, renegotiate terms with suppliers, vacate properties and to avoid the costs of dilapidation charges to exit stores and of writing down stock. To Mike Ashley, £40m was the opportunity cost of obtaining all the same restructuring choices retailers are increasingly looking to achieve through a CVA - but with a completely free hand.

In contrast, and possibly even because of what unfolded at HoF, nearly 96% of Homebase's creditors approved a CVA. These creditors will incur the costs of supporting the proposal but the potential upside to the company and ultimately to them, is a return to profitability and of course continued occupation of their asset.

Monthly rental payments, downsize options, rent concession periods and business rate reductions are all tools the Homebase CVA is seeking to implement. Currently 42 of its 241 stores will shut and head office jobs will go. The business plan to improve financial performance over the next three years across a significantly rationalised store portfolio will be the test of a successful CVA process and will be watched closely by the market.

Step change

CVAs, just like Administrations, are governed by the Insolvency Act 1986 but are more restrictive. Whilst there is a growing trend for retailers to seek the CVA route and categorise landlords into different pots as a means of restructuring, it is nothing new.

A decade ago, retailer The Works was under administration. The purchaser didn't want all the stores so ahead of the sale, and to facilitate the deal being done, some stores were closed and some taken on a 'licence to occupy' for between a month and up to a year, allowing the purchaser to renegotiate lease terms, assess trading levels or trade out stock.

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So, whilst not a new phenomenon, the pace and frequency of the CVA process is undoubtedly increasing.

Will retailers use insolvency/CVAs to ditch unprofitable stores?

A perfect storm is brewing; declining sales, increasing costs, rising business rates, Brexit-related currency fluctuations, the introduction of the national living wage and apprenticeship levy, and the rapid growth of online retailing. The result is many retail and restaurant businesses toying with CVA or even administration, as a 'simple' way to shed unprofitable stores.

Thankfully, there is nothing to suggest, yet, that operators are jumping the gun and using this tool to get their businesses into better shape. This may be because there is still a stigma that comes with pursuing this route and the increased corporate governance scrutiny means directors risk prosecution if their actions are seen to defraud creditors.

CVAs often allow a company to keep trading, which may prove a better outcome for creditors, long-term, than going into administration. For purchasers, buying out of administration allows an element of wiping the slate clean, enabling fresh negotiations on every element of the business, including property assets. As pressure on the high street continues to mount, it's clear that flexibility and imagination are needed from both retailers and landlords to use property assets more creatively to prevent sizeable losses on both sides.

To learn more or discuss how Rapleys can assist contact **Alfred Bartlett,** Head of the Retail & Leisure Group at Rapleys or **Russell Smith,** Partner in Retail & Leisure Group.