

Considerations in relation to commercial landlords: a Jersey perspective

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The UK government attempted to ease the financial strain of the COVID-19 pandemic with, among other things, rent "holidays" for tenants and the opportunities for loans for certain businesses. While some businesses were able to avail themselves of such measures, not all were eligible or able to utilise such schemes. It seems that commercial landlords have been one of the sectors that have been hit hard, especially with some commercial tenants not surviving the downturn.

Jersey structures are often used to acquire and hold interests in UK real estate, including shopping centres. Often "part and parcel" of such acquisitions is third-party bank financing, with such loans requiring servicing and requisite financial covenants to be met.

Amid this backdrop, the Jersey solvency test is established by the "cash flow" test, being "the inability of a debtor to pay their debts as they fall due". Understandably, many facility agreements look to both cash flow and balance sheet solvency in relation to triggering a default. However, the cash flow test is paramount in relation to the potential trigger of any Jersey insolvency procedure.

Understandably, directors of Jersey companies have to continuously keep in mind the provisions of their company's finance documents, with loan to value covenants in particular causing concerns during the uncertainty of the pandemic. However, with income levels being at an all-time low due to rent payments being minimal and the company's debts still payable (including capital and/or interest payments due each quarter along with all other outgoings), if the outlook is that the company may not be able to pay its debts as they fall due, directors have more fundamental considerations than just the loan documents.

When the directors know or should know that the company is or is likely to become insolvent, the directors of a Jersey company have a duty to act in the best interests of the company's

creditors (rather than the shareholders). Prior to an insolvency event (being a declaration of *en désastre* or creditors' winding up in Jersey), if a director of a company knew that there was no reasonable prospect that the company would avoid an insolvency event or was reckless as to such avoidance and the directors of that company continue trading, there could be personal liability attached to such "wrongful trading". A director has a defence to such action if they take reasonable steps with a view to minimising the potential loss to the company's creditors. Unlike England and Wales, such wrongful trading measures have remained in place throughout the COVID-19 pandemic, as the Jersey defence is broader. (Jersey company directors are not required to take "**every step**" to minimise the loss to creditors). In practical terms, in such circumstances Jersey directors should be demonstrating prudent business management, including (without limitation), sensible cashflow models, being proactive and having open lines of communication with creditors, considerations as to how to improve cashflow, taking relevant professional advice (for instance, accountants, lawyers and/or other related advisors) and ensuring frequent meetings of the board of directors to monitor the situation. It goes without saying that all of such steps should be documented to ensure they can be evidenced.

To add some colour in relation to the solvency of Jersey property unit trusts (**JPUTs**) (being a prevalent holding vehicle for UK real estate), such entities are not subject to the same rules as companies in relation to insolvency (including wrongful trading). A Jersey trust is not a legal person but acts through its trustee(s), so a trust cannot **itself** as a matter of law be "insolvent", more that the trust will be considered to be "insolvent" if the trustee (as trustee of the trust) is unable to pay the debts of the trust as they fall due (hereon this will be referenced as a trust's insolvency).

Where a trust is **solvent**, a trustee owes its duties to, and must exercise its powers in the interests of, the beneficiaries of that trust (in the case of a JPUT, its unitholders). However, insolvency brings about a shift towards the interests of the creditors of the trust as a whole and the trustees of a trust that becomes insolvent should thereafter exercise their powers in the interests of the trust's creditors as a whole. What limited Jersey case law there is, suggests that when faced with an insolvent trust the Royal Court of Jersey would generally expect an interested party (including the creditor(s) and/or the trustee(s)) to seek directions as to how the assets of the trust should be distributed.

During the past two years, there has not been a significant increase in insolvencies or enforcements in Jersey, rather creditors appear to have been willing to take a flexible and pragmatic in relation to cash flow issues. What we have seen is a number of restructurings and facility amendment involving payment deferrals, loan term extension, grace period extension and waiving breaches of financial covenants. In terms of Jersey solvency, where payment deferrals (and breaches of covenants and waiving any relevant defaults) have been agreed, Jersey borrowers should be able to continue to meet the cash flow test, however these entities should still be mindful of the future and being able to pay their debts going forward.

With such a backdrop, it is not surprising that there has been little appetite from creditors to enforce security or instigate insolvency procedures, as this could be counter-productive; with valuations falling, a depreciating asset is not an attractive prospect for a lender to obtain full recovery of its loan.

With most of UK lockdown restrictions now lifted, valuations stabilising, footfall increasing and the UK moratorium on evictions and winding-up orders (albeit implemented with temporary amendments) being lifted, if the lenders continue to support their borrower customers, there is hope that the market can be cautiously optimistic that the commercial landlords may be able to get back onto an even keel. There are still some "wrinkles", as the ban on the use of rent arrear to place relevant tenants into insolvency proceedings does remain in place until at least next year, and the lower property valuations could pose continuing a problem into the future.

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