



REAL ESTATE DISPUTES BULLETIN


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MY TENANT IS IN FINANCIAL DIFFICULTY - NOW WHAT?! KEEPING HOLD OF YOUR STRUGGLING TENANT'S RENT DEPOSIT

In these challenging economic times, more and more tenants are struggling to cover their rent, or being forced into insolvency. Some landlords will have insisted upon rent deposits being taken from the tenants at the start of leases in order to have sought to 'ring-fence' the deposit and so enable deductions to be made by the landlord in times of trouble.

When the worst happens and a struggling tenant defaults on its obligations, landlords often believe that short term losses can be easily covered by dipping into the rent deposit. Whilst this is often the case, it is not always quite that easy and will depend on a variety of factors including who the rent deposit is held by, and whether the lease or rent deposit deed allows for such deductions to be made.

The landlord also needs to ensure that any deductions from the rent deposit are made properly. Failure to do so may enable an insolvent tenant's administrator, liquidator or trustee in bankruptcy to recover any sums deducted, leaving the landlord in the same position as any other unsecured creditor, i.e. unlikely to recover anything for a considerable time and then usually only a sum significantly lower than would have been due under the terms of the lease (if anything can be recovered at all).

Often a landlord's ability to make deductions from a rent deposit will depend on the nature of the deposit arrangement and how the sum is held. Broadly speaking, deposits can be held in various ways, for instance:-

||| By a third party, acting as stakeholder

A third party will usually hold the deposit on trust for both parties. However, their respective interests in the money will depend upon whether there has been a breach of the lease. Where the deposit has been properly set up, the landlord should be able to require the third party to release the deposit to him in the event of a tenant's default or insolvency, thereby keeping it separate from the claims of any other creditors.

||| By the landlord (or his agent)

Under this arrangement a landlord may be able to argue that the deposit already belongs solely to him (subject to an obligation to repay any sums owing to the tenant at the conclusion of the lease) and that he is entitled to make deductions in the event of a tenant's default. In many cases, though, strictly the deposit is actually held as security for the tenant's performance of its

obligations. A landlord therefore needs to take steps to safeguard his ability to draw down on the deposit, for instance, where the tenant is a company, by registering a charge over it at Companies House. It may now be possible to enforce a cash rent deposit even if it is not registered at Companies House in certain circumstances (for instance if it amounts to a financial collateral agreement between companies). However, to be safe, registration is still recommended in all cases.



||| **By the tenant (or more likely his agent)**

When the tenant retains the deposit, a landlord could try to argue that it is held on trust on his behalf and does not form part of the tenant's assets - but the landlord will have to convince the Court of this! A more likely situation is that the deposit moneys are not sufficiently 'ring-fenced' and that the landlord may in fact simply be an unsecured creditor.

In most cases, the circumstances in which a landlord will be entitled to draw down on the deposit will be documented in the lease or in a separate rent deposit deed, which sets out a number of steps the landlord will have to take before drawing on the deposit (for instance giving notice of his intention to

draw down on the deposit and setting a time limit for a tenant to respond to the notice).

If the landlord has secured a charge over the rent deposit at Companies House and the tenant goes into administration, the landlord will need the permission of the court or the consent of the tenant's administrator before taking any action to make a deduction from the rent deposit. Failure to obtain this would mean that the administrator (or other creditors) would be able to challenge the deductions made.

So while a tenant in financial difficulty is seldom good news (particularly in the present economic climate), in many cases losses can be minimised by drawing on a rent deposit. If a landlord finds himself in this

position, it is usually a good idea to take stock of the situation as quickly as possible and where necessary, to take advice on how best to take advantage of any rent deposit and keep any deductions safe from the hands of the tenant's administrator, liquidator, or trustee in bankruptcy.

This bulletin summarises complicated issues and should not be relied upon in relation to specific matters. You are advised to take legal advice on particular problems and we will be happy to assist.

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