

**From: Rebecca Spore – Director of Infrastructure**

**To: Mr. Peter Oakford – Deputy Leader and Cabinet Member for Finance, Corporate and Traded Services**

**Subject: COVID19 – Treatment of Rental Payments to the Corporate Landlord Estate and Property Investment Fund**

Key decision – This policy fully taken up could have a negative impact on the in-year deferred income of over £1 million.

Classification: **Unrestricted**

*The attached appendix however is exempt from publication under schedule 12a of the Local Government Act 1972 as it contains detailed consideration as to the treatment of rental payments which may prejudice Kent County Council's position as Landlord.*

**Past Pathway of Paper:** None

**Future Pathway of Paper:** None

**Electoral Division:** All

**Summary:**

The outbreak of the Novel Coronavirus (COVID-19), declared by the World Health Organization as a “Global Pandemic” on 11 March 2020, has impacted global financial markets. Restrictions have been implemented by many countries including the UK.

Following the necessary response to limiting the spread of Covid19 by the British Government, many businesses are unable to trade or are struggling to sustain their business; KCC’s tenants are already in contact, asking for assistance with rent.

Whilst a landlord and tenant relationship is a contractual one, a good landlord should recognise it as a partnership in that without tenants, a landlord would not be able to derive income from property assets.

Whilst it may wish to provide support, KCC must also be mindful of its wider statutory and fiduciary duties, particularly to the Kent taxpayer.

This report sets out a practical means to support KCC’s tenants during the COVID19 period and proposes a rent deferment policy for a six month period be adopted and backdated in addition to its usual protocols for dealing with matters of rental payment management.

**Recommendation(s):**

The Deputy Leader and Cabinet Member for Finance, Corporate and Traded Services is asked to agree:

1. Adopt the COVID19 Response to Rental Management Policy;
2. Delegate authority to the Director of Property and Infrastructure to take such actions as are necessary to implement this decision, including but not limited to finalising the terms of and entering into contracts or other legal agreements; and
3. Delegate authority to the Director of Property and Infrastructure, ongoing management and review of the Policy during the initial 6-month period.

**1. Introduction**

- 1.1 The outbreak of the Novel Coronavirus (COVID-19), declared by the World Health Organization as a “Global Pandemic” on 11 March 2020, has impacted global financial markets. Restrictions have been implemented by many countries including the UK.
- 1.2 Following the necessary response to limiting the spread of Covid19 by the British Government, many businesses are unable to trade or are struggling to sustain their business.
- 1.3 The Government has responded already and are offering a Business Support Package including grants and loans designed to mitigate the severe impacts the action necessary to defeat COVID19 is having; tenants are already contacting KCC and asking for assistance with rental payments however.
- 1.4 Inevitably businesses will be struggling during this time and in to the recovery period with the Chancellor reporting on 14th April that, whilst almost impossible to predict with any degree of certainty, there might be a 35% contraction in the economy, although it is also anticipated that this position would quickly bounce back.
- 1.5 Whatever KCC does as landlord, it must accept that some of its tenants’ businesses may not survive these times.

**2. KCC’s Tenants and the Role of the Landlord**

- 2.1 KCC’s has a diverse range of tenants who fall broadly into the following groups
  - “business” tenants – business and organisations who operate for profit and to a degree manage the risks of their business. In good economic times, these businesses often benefit from higher profits and a proportion of these set aside as reserves in a well-managed set up.

- smaller and new businesses. Although these do work to turn income, some of these may not have the same profit margins to enable them to make reserves provision.
- tenants that supply services in to the community (nurseries), who may also be in receipt of KCC grant funding or some other arrangement where they may have very limited or no profit and no reserves to support themselves where there is sudden change to their business climate. A good number of these trade as charities.

2.2 Whilst the relationship may be a contractual one, a good landlord should recognise a landlord and tenant relationship as a partnership in that without tenants, a landlord would not be able to derive income from property assets; this should be the starting point in considering whether an intervention is required from the landlord to support its tenants.

2.3 Whilst this is the case however, it must also be recognised that some of KCC's tenants are Public Sector Organisations, are subsidiaries of KCC or work under a contract with the Council to provide services. In these cases, whilst there may be no profit involved, they have an established budget available or a contractual position with the Council that would already mitigate any impact from.

### **3. KCC's Duties**

3.1 KCC has a statutory duty to ensure it receives best consideration from its assets under s123 Local Government Act 1972. This is the starting point for determining what rent should be derived from its assets, but in addition to this Councils can undertake lettings at less than market value for terms less than 7 years. This statutory duty is acknowledged but has little effect in these circumstances as the Council's policy position would only apply to existing tenants where this has already been considered.

3.2 Councils should not advantage companies and organisations by providing "state aid". In this instance however KCC in its capacity as a landlord is responding to a tenant's request for assistance to ensure its business can continue. This response would be no different from a normal landlord faced with a tenant who is temporarily struggling and there are numerous examples of this in the property investment business.

3.3 In taking such decisions, a reasonable landlord would take into account factors such as the market, the costs involved in the alternative such as having to deal with unplanned arrears, pursuing bad debt, terminating the tenancy and then having to find a new tenant, the amount of time the temporary situation is likely to last etc. (mitigation of landlord's risk) KCC may also want to take account of the fact that it does not wish to lose community service provision (mitigation from loss of services provision).

3.4 As a public sector authority, KCC is required to be even-handed and transparent in whatever approach it takes.

- 3.5 The situation the whole country finds itself is extra-ordinary and temporary and therefore establishing a policy position now on how it deals with its tenants regarding rent is advised as being a reasonable response under the circumstances. This would be of course in addition to the protocols it has in place already regarding dealing with struggling tenants, rent arrears etc.
- 3.6 Lastly, however, it must also be mindful of its fiduciary duty to the Kent taxpayer where the response should not over-reach on the need it is addressing or where other government subsidies are available.

#### **4. The Current Approach to Rent Payment Management**

- 4.1 KCC already recognises where tenants are struggling with their business and as any good landlord, it will weigh up the situation to determine how temporary the situation might be, the risks associated with having a void premise, the market, economy and so forth.
- 4.2 The approach is considered on a case by case basis and on average these arrangements would be in place with a handful of tenants, where a struggling tenant contacts KCC or has been identified to be in arrears. In these circumstances KCC has several mitigating options which include rescheduling payments, renegotiating “stepped rents” or other such adjustments, including rent free periods. These can be agreed with the tenant, notarized and then enacted.
- 4.3 These approaches are only agreed to following a process of due diligence to determine the tenant’s ability to pay, proof of their claimed status etc. and are one offs. Regardless or not of a temporary policy position, these remedies remain available.

#### **5. Policy Requirement Specification**

- 5.1 The specification for a policy should be considered as follows:
  - a. The policy should set out KCC’s position as a landlord.
  - b. Ensure the position is as simple and effective as possible with easy roll-out.
  - c. KCC should be even-handed and transparent about its position.
  - d. Provide landlord support for tenants additional to the Government’s Business Support Package.
  - e. Protect the landlord from not having to expend resources pursuing arrears and bad debt and/or incurring other extra-ordinary property management costs as a result of the Covid19 impact on businesses.
  - f. Not put its tenants in a better position than they would have been in otherwise at the expense of the taxpayer.
  - g. Observe the Council’s fiduciary duty by not being over-reaching in its offer to tenants.
  - h. Run for a period of up to 6 months which should include not only the national response impact, but recovery time for businesses to restart.

- i. Keep policy under review and consider readjustment as circumstances evolve.

## 6. Terms of the Policy Offer

Term	Rationale	Considerations
1.To access this policy initiative tenants must make a request to KCC by 24th June 2020.	By request – available only to tenants who require this support Date limited – in order that KCC’s position is clear by 24 <sup>th</sup> June quarter day. Backdated – Tenant will have already considered 1 <sup>st</sup> quarter’s impact and can adjust request with a degree of certainty	A blanket provision could have been made, but some tenants may not require it and KCC may therefore be “over-reaching”.
2. Rent deferment will be for a maximum period of up to 6 months from 25 <sup>th</sup> March 2020.	Rent Deferment – This is considered a reasonable landlord position. Tenants will still be liable for rent. Landlord merely lending “cashflow” up to 6 months – Should cover disruption and recovery period and gives scope to cover the full period of likely disruption	Cancellation of rent may be considered a “grant” or “aid” and a longer deferment period unnecessary at this stage.  A shorter or longer period of deferment may be considered, but 6 months should provide a MAXIMUM range of discretion.
3. The amount of rent that can be deferred can be up to 100% of the tenant’s periodic rental payments (although a tenant can request less).	Tenant knows their own requirements having reviewed their business.	KCC make a “take it or leave it” offer of deferment which may not help the tenant or may not want to take up offer.
4. The rent deferred will accrue without interest and be repaid by the tenant, according to an agreed repayment schedule between KCC and the tenant.	Mutual agreement so that both parties can take a reasonable view and repayment is not protracted. No Interest – KCC recognising the cashflow difficulty is not of the tenant’s making.	No schedule agreed at outset – Agreement will be more difficult after the event. Interest – Unfair given the circumstances
5.Repayments will commence from 25th December 2020 for a maximum period ceasing by 25th March 2022.	18 Months is a reasonable period to expect repayment. Bear in mind that the tenant will also have its normal rental payments to pay on top. The tenant will effectively paying 1/3 of a month’s rent additional to every month over 18 months in the repayment period.	Shorter period – May put pressure on the business increasing the risk that the business will struggle and go.  Longer Period – This could be considered under exceptional circumstances in the same way some bad debt cases are dealt.

6. Service charge payments are excluded from this policy and must be paid in full as usual where applicable.	Service charges are for building expenses incurred by landlord on behalf of tenant therefore KCC should not be out of pocket	Applying deferment to service charge against fiduciary duty.
7. The tenant must confirm that this arrangement will not place them into a more advantageous position to that which may have existed if these extra-ordinary circumstances did not exist.	Arrangement is offered to lessen the impact of present services and not a benefit. Confirmation taken on trust as a “means test” too complicated and resource intensive, but discretion still used in making the deferment “offer”.	Full means test – Not practical. However note that the application form “screens” tenants to ensure that they are making an application genuinely.
8. The tenant must also confirm that it will be accessing all government business support that it can and provide evidence	Encourages tenants to access Government support first and lessen burden of number of rent deferments	Do not include – Tenants may not be do, damaging their business opportunity and increasing risk of debt etc.
9. The following tenants will be excluded from this policy – and considered on a case by case basis Government departments, Public Sector, tenants that hold a tenancy in conjunction with a KCC service contract.	These groups are unlikely to have business impact in the same way as ordinary business or will have other means to mitigate. It is advised that Service Contract tenants must discuss any hardship mitigation through its main service contract.	Provide the opportunity across the board – This is unnecessary and does not protect fiduciary position
10. The policy should be kept under review during the period of the National Covid19 response and after as the country returns to normality.	Evolving and uncertain circumstances	Rigid one off approach may become quickly out of date.

## 7. Financial and Other Impacts

- 7.1 The impact to KCC is primarily cashflow and theoretically up to c.£710,500 (corporate landlord) and £833,250 (Property Investment Fund) could be deferred though unlikely all tenants will require the facility. KCC will still collect the rent by way of an agreed repayment schedule. An *illustration* of the impact is considered in Appendix 1.
- 7.2 The request period follows at least a 6-week period where tenants would have been able to consider realistically their business impact, and this may mean that only those who really require support will do so (i.e. limit requests to those genuinely in need)
- 7.3 An alternative approach such as offering up to a 6-month rent free period to certain groups (for example charities, Community and Social/Policy return tenants) would result in c.£388,700 of foregone income if applied to these groups. At this stage KCC would not be offering this as part of a policy

package but could be something that would be considered in line with its rent payment management protocols where a tenant could demonstrate extreme hardship.

- 7.4 To date only a handful of tenants have applied. These are attached at Appendix 2.
- 7.5 A policy is likely to have a positive impact on KCC's risk of bad debt, since it will have repayments pre-agreed and in place. The alternative would be to ignore the issue Covid19 is raising and remove the opportunity KCC has where at least it can exercise a degree of control.
- 7.6 It is also likely that a proportion of tenants will discontinue after the Covid19 crisis. Section 8 below considers "bad debt" more comprehensively, although this would not be as a result of the policy implementation, but the wider impact of the Covid 19 crisis.
- 7.7 The impact on capital value is unlikely to be material to this policy impact, although inevitably following most crisis, a risk of recession could lower the value of the investment estate until recovery.
- 7.8 This policy will be welcomed by tenants who require support during this time.

## **8. Bad Debt and Voids Impact**

- 8.1 The current response to COVID-19 means that we are faced with an unprecedented set of circumstances on which to base a judgement on the likely impact to KCC's portfolio. However, the policy is unlikely itself to prevent rent due from being paid.
- 8.2 With deferment there is a risk that if a business struggles and is unable to recover, the landlord may lose rent it has deferred. It may also be argued that these businesses would already be in trouble and would most likely default on rental payments in any event and therefore the bad debt provision with or without the policy would remain the same but gives business a greater chance of surviving in the current climate.
- 8.3 Other factors like economic recovery, the employment market and other such factors are likely to have a greater impact overall than the policy itself.
- 8.4 The 60-day bad debt on rents in KCC stands at £59,000 (representing approx. 2% of the annual income, adjusted to remove rent which is in dispute) and has been improving.
- 8.5 If Covid19 impacts the economy similarly to that experienced around 2008, a number of businesses would likely fail (KCC tenants are mainly at the more vulnerable end), cash flow would tighten and it may have to accept up to an estimated increase on its bad debt level at 60 days (i.e. £180,000). The policy may mask the impact and the real effect may not really be seen until the March 2021 Quarter reporting cycle.

- 8.6 Voids may also increase. Not only will this result in less income, but vacant holding cost and risk are likely to increase and longer remarketing periods with falling rents a possibility.
- 8.7 It is very difficult at this stage to predict this risk, but Kent County Council should be considering forecasting a 2.5% reduction in income every quarter until September 2021 and a 2.5% of estimated rent needed to be recycled for holding costs at every quarter. Over the period for illustration a 20% reduction has been applied.
- 8.8 There are risks particularly with Tenancies at Will, held over leases and expiries that are due. The income which fall into these higher risk categories is £393,000
- 8.9 An illustration in appendix 3 shows the impact over 18 months of this type of forecast.

## **9. Roll Out**

- 9.1 The policy approach will be outlined via Kent.gov.uk.
- 9.2 Application forms received will be reviewed along with supporting information and a letter sent outlining the terms which should be agreed and signed by the applicant.
- 9.3 The deferments will be entered onto a tracking sheet and rent demanded as usual but entered on the system as a repayment schedule in place. The Covid19 deferments will be reported separately and not as rent arrears or bad debt.
- 9.4 Tenants may make multiple applications or discuss the position if circumstances have altered their ability to make repayments as agreed.
- 9.5 The application will be screened by KCC to ensure that:
- The applicant is a qualifying tenant
  - The applicant is taking steps to access government support and mitigate their position overall before applying for the deferment
  - The applicant is applying for an appropriate level up to the maximum deferment terms offered based on what they believe to result in them being in a position of no better than neutrality (i.e. that they were trading as usual).
- 9.6 Where the applicants are not prepared to provide assurances (to the best of their assessment of their businesses' position) or confirm that they are seeking Government support or that the information given does not align with the deferment policy, KCC would reserve the right to decline applications, require further supporting information or amend the terms of the offer for deferment



## **10. EQIA Screening**

- 10.1 There should be no negative Equalities Impacts in respect of this policy. Where this policy may ease impacts of Policy Return tenants (e.g. nurseries) there may be some positive impacts in supporting services to groups identified in the Equalities Assessment criteria.

## **11. Review Date**

- 11.1 The status of the present and future position is materially uncertain. Consequently, with less certainty, we attach a higher degree of caution to the assumptions we have made in evolving this policy. Given the unknown future impact that COVID-19 might have on the economy, it is recommended that the policy is kept under frequent review.

## **12. Conclusions**

- 12.1 The outbreak of the Novel Coronavirus (COVID-19) has impacted global financial markets.
- 12.2 Following the necessary response by the British Government, many businesses are unable to trade or are struggling and KCC's tenants are already asking for assistance with rent.
- 12.3 Whilst it may wish to provide support, KCC must also be mindful of its wider statutory and fiduciary duties, particularly to the Kent taxpayer.
- 12.4 In addition to its normal rental payment protocols and remedies, it is proposed that KCC implement a temporary "COVID19 Response to Rental Management Policy" as follows:
- 12.5 To agree any rent deferment requests on the following basis:
1. To access this policy initiative tenants must make a request to KCC by 24th June 2020.
  2. Rent deferment will be for a maximum period of up 6 months from 25th March 2020 (i.e. until 29th September 2020). The request can be backdated.
  3. The amount of rent that can be deferred can be up to 100% of the tenant's periodic rental payments (although a tenant can request less).
  4. The rent deferred will accrue without interest and be repaid by the tenant later, according to an agreed repayment schedule between KCC and the tenant.
  5. Repayments will commence from 25th December 2020 for a maximum period ceasing by 25th March 2022.
  6. Service charge payments are excluded from this policy and must be paid in full as usual where applicable.
  7. The tenant must confirm that this arrangement will not place them into a more advantageous position to that which may have existed if these extra-ordinary circumstances did not exist.

8. The tenant must also confirm that it will be accessing all government business support that it can.
9. The following tenants will be excluded from this policy – Government departments, Public Sector, tenants that hold a tenancy in conjunction with a KCC service contract who will be dealt with on a case by case basis.
10. The policy should be kept under review during the period of the National Covid19 response and after as the country returns to normality
11. KCC can refuse to grant deferment support.
12. Where KCC is temporarily closing a multi-occupancy building and tenants will have no access, no rent will be charged during the period of closure.

**13. Recommendation(s):**

13.1 The Deputy Leader and Cabinet Member for Finance, Corporate and Traded Services is asked to agree:

1. Adopt the COVID19 Response to Rental Management Policy;
2. Delegate authority to the Director of Property and Infrastructure to take such actions as are necessary to implement this decision, including but not limited to finalising the terms of and entering into contracts or other legal agreements; and
3. Delegate authority to the Director of Property and Infrastructure, ongoing management and review of the Policy during the initial 6-month period.

**Background Papers**

None

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