Be careful when walking the tightrope of property disposal

By Dave Boland

Whichever way one looks in the recession, it is almost impossible to avoid the issue of property. Thus, a key decision that many businesses will have to take is whether not to dispose of a property, even if that property had been acquired as premises rather than simply being an investment. According to John Duggan of Callan Tansey, a solicitors' firm based in Sligo and Boyle, in either case, the decision will more than likely be prompted by the increasing difficulty, in the face of declining revenues, of servicing the debt incurred in acquiring the property.

"This asset may have been acquired at the height of the market when prospects for the business were bright, and not much thought was given to the long-term needs of the business or the long-term investment value," he said.

"Likewise, not much thought may have been given to the manner in which the property was acquired. Therefore, it has probably ended up being owned by the trading company itself, rather than being held separately outside of the business. So any action by the bank in trying to recover its debt will have an impact on the business."

John Duggan of Callan Tansey

Typically, a bank will have a first legal charge, meaning that it will hold the primary security over the property for its loan and will be entitled to be paid first out of a sale; and the amount outstanding to the bank will be probably well in excess of the price likely to be realised.

However, there may be other creditors who also hold security over the property, such as trade creditors who have obtained judgements and registered judgement mortgages. State agencies who have given financial assistance will usually also rank behind the bank. But, all in all, it can pose a real headache for the company looking to dispose of the property.

"While none of these will be entitled to anything out of a sale, and even the bank will come out at a loss, all have an effective veto on whether the property is sold," explained Duggan.

"None of them can be compelled to remove their security from the property without being paid off. Even where the bank is willing to take a loss on its loan or transfer the debt to other security, the company will have negotiate with those other creditors before it can sell. One stubborn judgement mortgage holder is all that is required for deadlock."

The bank's options will be either to appoint a receiver, or to take possession of the property and sell it. If the bank's security is a debenture, there will a fixed and floating charge and all of the assets of the company will form part of the security. In this case, appointment of a receiver will mean that the receiver will take control of the company from the directors. This will be the end for the business, as the receiver will probably want to sell the entire business as a going concern, and not just the property, to maximise return for the bank.

Where the bank has only a fixed charge, the security will be confined to the property itself, and the receiver will take possession of the property only. If this the main premises out of which the business operates, the company will have to negotiate for its continued use of the premises and ultimately leave.

"However, even a receiver will have to get the agreement of the other secured creditors before the he or she can sell the property," said Duggan. "If this agreement is not forthcoming the only course open to the bank is to take possession of and sell the property; to sell as "mortgagee in possession". This may require getting a court order giving possession of the property to the bank, but this will not be necessary where the company gives up possession voluntarily."

The effect of a sale by a "mortgagee in possession" is that the security of the other secured creditors will be automatically removed from the property as a result of the sale. If there is anything left after the bank's loan has been paid off, the bank is merely obliged to account to the other secured creditors for this, and the first in line will get paid first and so on. Therefore, in negotiating with these other creditors, the possibility of this outcome should impressed upon them.

Of course, institutional creditors will usually already be aware of this, and may not cause too much difficulty. But it is clear that, when deciding what to do with a property which has become a threat to the viability of its business, a company has to walk a tightrope between the threats of the bank and the demands of the creditors.

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