Commercial Rents (Coronavirus) Bill

Lead department	Department for Business, Energy and Industrial Strategy
Summary of proposal	Landlords and commercial tenants would be required to negotiate on payment of rent arrears based on legislated principles with a binding arbitration backstop. The policy would apply to commercial tenants that were mandated to close by the Government in response to the Covid-19 pandemic.
Submission type	Impact assessment (IA) – 27 September 2021
Legislation type	Primary legislation
Implementation date	March 2022
Policy stage	Final
RPC reference	RPC-BEIS-5106(1)
Opinion type	Formal
Date of issue	13 October 2021

RPC opinion

Rating[1]	**RPC opinion**
Fit for purpose	The IA provides a satisfactory assessment of business impacts, making good use of a range of data collected. The IA includes a good monitoring and evaluation plan. There are some areas for improvement, such as use of sensitivity analysis and assessment of wider impacts.

Business impact target assessment

	Department assessment	**RPC validated**
Classification	Qualifying regulation provision	Non-qualifying regulation provision (*de minimis*)
Equivalent annual net direct cost to business (EANDCB)	£1.6 million	*de minimis* *(2019 prices, 2020 pv)*
Business impact target (BIT) score	N/A	N/A
Business net present value	-£1.6 million	
Overall net present value	£6.8 million	

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[1] The RPC opinion rating is based only on the robustness of the EANDCB and quality of the SaMBA, as set out in the Better Regulation Framework. RPC ratings are fit for purpose or not fit for purpose.

RPC summary

Category	Quality	RPC comments
EANDCB	**Green**	The calculations for business impacts are based upon a range of data collected and a clear methodology. However, the IA would, referring to RPC guidance, benefit from explaining its classification of business impacts as direct or indirect, particularly benefits.
Small and micro business assessment (SaMBA)	**Green**	Although a SaMBA is not required for this *de minimis* measure, the IA does include one. It notes that small and micro businesses (SMBs) are expected to benefit disproportionately from the proposal, due to the relatively high value of their rent debt and the high proportion they make up of the affected industrial sectors.
Rationale and options	**Satisfactory**	The IA sets out a clear rationale for intervention, drawing upon market failure arguments. It considers a number of options and discusses alternative options to regulation.
Cost-benefit analysis	**Satisfactory**	The IA appears to use a good range of data sources, including information obtained from stakeholders during a call for evidence. It would benefit from further consideration of risk and uncertainty, in particular the use of sensitivity analysis to test the impact of varying key assumptions.
Wider impacts	**Satisfactory**	The IA considers wider impacts throughout but would benefit from an assessment of competition impacts and proportionate consideration of any impacts on innovation.
Monitoring and evaluation plan	**Good**	We commend the Department on the IA's thorough and detailed post-implementation review (PIR) plan, which sets out the evaluation approach, research questions and data that will be collected.

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Summary of proposal

The Government introduced a range of measures from March 2020 to protect commercial tenants who would otherwise have struggled to pay their rent due to Covid-19 disruptions. These measures included legislation to prevent landlords of commercial properties from being able to evict tenants for not paying rent. In June 2020 these measures were extended to March 2022. Following on from this, the Government propose to introduce primary legislation to establish a set of principles that landlords and commercial tenants should use to negotiate on Covid-19-related rent arrears. Where commercial negotiations between tenants and landlords are not successful, they will be required to enter binding arbitration. Arbitrators could defer, or potentially waive, a portion of rent debt based on the ability of a viable tenant to pay their rent arrears. The preferred option (option 3a) is for the policy to apply only to commercial tenants which were mandated to close, in part or in full, due to Covid-19.

The IA estimates that around 50,000 businesses mandated to close have rent arrears. Based upon the call for evidence, the proposal is expected to lead to 15,500 additional negotiations, of which 7,500 are anticipated to go to arbitration. Under the central case, it is expected to take seven months to resolve all arbitration cases. Therefore, the Department expects all of the direct impacts to occur within the first year of the policy. The IA estimates a direct cost to business of £28.7 million, consisting of costs of arbitration (£24.4m), negotiation (£2.2m) and familiarisation (£2.2 million). The IA estimates a direct benefit to business of £27.1 million. This consists of averted court (£25.8m), insolvency (£0.9m) and redundancy (£0.4m) costs. The EANDCB is estimated at £1.6 million (2019 prices; 2020 present value base year).

The IA also identifies a £4.5m indirect benefit to other business creditors due to more businesses being able to avert insolvency and maintain their loan repayments; and a £3.9m benefit to workers from averting redundancies. This result in the proposal having a positive societal NPV of £6.8 million.

EANDCB

Counterfactual/baseline

The IA uses an appropriate baseline of the existing measures expiring in March 2022. It provides a detailed assessment of expected impacts under the counterfactual, such as the number of court cases, insolvencies and redundancies that might be expected if no action is taken. These impacts form the basis for the estimated benefits of the policy options.

Direct and indirect impact(s)

The IA classifies all of the costs to business as direct impacts of the proposal. It classifies averted court, insolvency and redundancy costs as direct benefits to business. The benefit of averted court case costs accounts for the large majority of direct benefits and appears to be the most immediate of the business benefits. The averted insolvency and redundancy costs appear to be less direct, as they seem to arise either from binding arbitration encouraging parties to come to an agreement or the outcome of the arbitration itself.

Benefits to business creditors in respect of forms of debt other than rent arrears are treated as indirect, although this is not explained in the IA. However, even if the benefits arising from fewer insolvencies were treated as direct benefits, the measure's EANDCB would still fall within the *de minimis* threshold. Nevertheless, the IA would benefit significantly from discussing how it arrived at its classification of business impacts as direct or indirect, particularly benefits, drawing upon RPC guidance.[2]

SaMBA

As a *de minimis* measure, a SaMBA is not required. However, we commend the Department for including one (paragraphs 199-213, pages 40-41), given the significance of this measure. The SaMBA notes that SMBs are expected to benefit disproportionately from the proposal, due to the relatively high value of their rent debt and the high proportion they make up of the affected industrial sectors. However, the SaMBA does note that the measure could have a proportionately higher impact on SMBs, due to the requirement to provide evidence of business viability and the possibility of Covid-19-mandated business closures having an impact on rent arrears during negotiations and the arbitration process. The SaMBA would benefit from explaining how this latter impact might be mitigated, for example through government guidance and communication.

The IA indicates that most of the market share for commercial property and accrued debt is held by a small number of large landlords. It would benefit from exploring further the proportion of the commercial property market that might be accounted for by SMB landlords and potential impacts on them.

Rationale and options

The IA provides a satisfactory assessment of the rationale for the proposal and options. It sets out a clear rationale for intervention, which draws upon market failure arguments (information asymmetry and market inflexibility). Responses to the call for evidence provide support for government intervention after March 2022 and for arbitration to be binding.

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[2] https://www.gov.uk/government/publications/rpc-case-histories-direct-and-indirect-impacts-march-2019

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The IA considers four policy options: (1) do nothing (allowing the existing measures to expire in March 2022 with no following policy intervention); (2) introducing non-binding arbitration; (3a) binding arbitration applying narrowly (to businesses mandated to close due to Covid-19) and (3b) binding arbitration applying more widely (with the scope extended to include businesses that closed voluntarily). It also discusses satisfactorily, alternative options to regulation. It provides a thorough explanation of why the Department believes that the existing voluntary code of practice, supplementary guidance, and communications have not produced the desired outcomes; and includes detailed consideration of non-binding arbitration.

The IA notes that option 3b has a higher NPV than the preferred option. However, it explains that option 3a is preferred because it provides significantly more certainty around a timely delivery of the policy benefits given limited arbitration capacity. The IA would benefit from addressing specifically whether or not it would be feasible to increase arbitration capacity in the short-term to reduce the risks associated with choosing the highest NPV option.

Cost-benefit analysis

Evidence and data

The IA appears to use a good range of data. The Government used a call for evidence to gather data on the state of negotiations between landlords and tenants regarding rent arrears and ongoing lease terms. The call for evidence received 508 responses. The IA reports that data has been collected, and used, from a range of sources, including published sources such as ONS, and information from a range of stakeholders (including tenants from a range of sectors, direct investors, landlords, commercial property owners, lawyers, industry bodies). It also looked at international comparators, in particular, data based on experience of arbitration in New South Wales and Queensland, Australia.

Methodology

The IA sets out clearly its modelling approach and the steps involved in calculating the estimates of the impacts. It uses HM Treasury (HMT) modelling to estimate the number of insolvencies and redundancies that are likely to be averted. This model has an underlying data sample representing 100,000 firms. Details of the HMT modelling are provided at Annex B to the IA.

The IA would benefit from discussing whether it is appropriate to apply to option 3b, the scope of which includes businesses that shut down voluntarily, the methodology used for the preferred option. Such businesses may already have factored rent negotiations into the decision to close voluntarily, along with their assessment of the likelihood of survival through the pandemic period. The IA would benefit from addressing how those factors might affect the analysis of Option 3b.

Assumptions, sensitivity analysis and risks/uncertainties

The IA includes a short 'risks and assumptions' section (paragraphs 217-218), which acknowledges that the analysis is dependent on key assumptions and explains that uncertainty is addressed through low, medium and high estimates. For example, it estimates lost working time as part of arbitration in three different scenarios to reflect the uncertainty in how much time business would spend on it. It would benefit significantly from using sensitivity analysis to test key assumptions (e.g. testing the risk of having insufficient arbitration capacity to complete all cases within the assumed timeframe). It could also usefully explain why it applies a uniform 10 per cent adjustment for "…*any uncertainty and optimism bias in the benefits calculation*" (paragraph 173).

The IA's approach could result in under or overestimates of impact in some areas, due to likelihood that businesses with deferred rent may be in relatively worse financial positions and that the industries most likely to be affected have shorter average job tenures. The IA presents data in these areas but would benefit from explaining why it would not be appropriate to adjust the estimates to take account of these factors.

The IA refers to the possibility of future legislative provisions intended to include any additional periods of restrictions, including further mandated closure periods (paragraph 41, page 11). It would benefit from discussing how any such further closures could affect its analysis and estimates.

The IA reports that intelligence from the hospitality industry suggests that the 'threat of arbitration' has started to open discussions and negotiation between landlords and tenants (paragraph 64, page 15). It would benefit from discussing how this factor affects the relative assessment of the counterfactual and the impact of the proposal.

Wider impacts

The IA includes a useful discussion of wider impacts for each option (paragraphs 56, 94 and 143-7) and an overall assessment, covering areas such as equalities, regions and trade (paragraphs 219-233). It would benefit from an assessment of competition impacts, further assessment of public sector impacts and briefly commenting on any impacts on innovation.

Monitoring and evaluation plan

The IA includes a thorough and detailed PIR plan (pages 46-49), setting out the evaluation approach, research questions and details of data collection. We particularly welcome the Department's consideration of lessons learnt from previous evaluations and setting out of responsibilities and timelines.

Regulatory Policy Committee

For further information, please contact regulatoryenquiries@rpc.gov.uk. Follow us on Twitter @RPC_Gov_UK, LinkedIn or consult our website www.gov.uk/rpc.

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