

Dealing with personal insolvency

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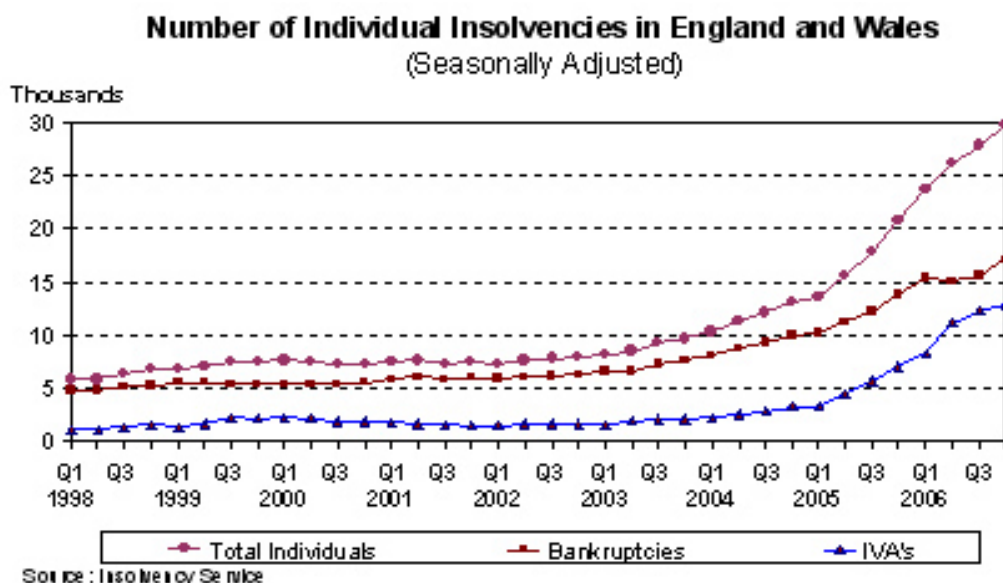
Dealing with personal insolvency

Key points

- There have been huge increases in recent years in numbers of bankruptcies and individual voluntary arrangements (IVAs) caused by personal debt problems
- If a tenant goes into bankruptcy, arrears of rent should be claimed from the Trustee in Bankruptcy. The landlord can still evict the tenant under breach of tenancy agreement
- If the tenant stays in occupation, the tenant is liable to pay current rent as normal
- Pre-bankruptcy benefits overpayments cannot be recovered out of post-bankruptcy benefit payments. However, post-bankruptcy overpayments can be recovered out of these post-bankruptcy payments
- The effective date for bankruptcy claims is the date of the Bankruptcy Order (not the petition date or the discharge date)
- The rules for IVAs are the same as for bankruptcy as regards claims for arrears of rent, future rent payments, and benefit overpayments. The effective date for an IVA is the date on which the IVA proposals are approved by creditors at a meeting called for that purpose
- The rules in Scotland are different from England and Wales and are not addressed in this briefing.

Introduction

There is an increasing personal debt problem in the UK. In 2006 more than 105,000 individuals in England and Wales were declared bankrupt or entered into an IVA with their creditors. The number of voluntary arrangements has doubled between 2005 and 2006.



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Number of Insolvencies in England and Wales (seasonally adjusted)								
							Percentage change	
		2005	2006	2006	2006	2006	Q4 2006 on:	
		Q4	Q1r	Q2r	Q3r	Q4p	Q3 2006	Q4 2005
Individuals		20,679	23,531	26,125	27,828	29,804	7.1	44.1
of which:	Bankruptcies	13,675	15,321	15,002	15,569	17,063	9.6	24.8
	IVAs	7,004	8,209	11,122	12,259	12,741	3.9	81.9

p = provisional, r = revised

Tenants of housing associations and councils will be just as much at risk as others and in the course of rent collection, issues will arise as a result of tenants entering into bankruptcy or an IVA with their creditors. (ALMOs act as agent for the council and therefore have the power to act as landlord which is delegated to them.)

What is bankruptcy?

An individual who is unable to pay his debts as they fall due is insolvent and it is possible for a creditor who is owed more than £750 to petition for bankruptcy. As a prelude to this procedure it is usual for the debtor to be served with a statutory demand from the creditor. The debtor has 21 days in which to object or settle the debt, after which the creditor can proceed to petition for bankruptcy at the court. It is also possible for the individual to petition for his own bankruptcy. In both cases the effect of bankruptcy is to freeze all claims against the individual and the trustee takes charge of the bankrupt's assets.

Whilst bankrupt, the debtor cannot buy on credit or borrow money, and he cannot be a company director or hold certain offices. Where a housing association or ALMO is a limited company, a director who becomes bankrupt must resign immediately. If he does not resign, the board of directors should have him removed on the grounds that he is committing a criminal act by remaining a director whilst bankrupt. As Industrial and Provident Societies (IPSs) are not registered under the Companies Act 1985, the same restrictions do not apply to their officers. However, to continue to be an officer of an IPS would be inappropriate following bankruptcy in view of the fiduciary responsibilities attached to acting as an officer of an IPS.

The bankruptcy order normally lasts for one year (the minimum period used to be three years but this was relaxed in the Enterprise Act 2002). Bankruptcy Restriction Orders can be made to extend the bankruptcy for longer than one year, and if the debtor does not co-

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operate with the trustee his discharge can be opposed at the end of the normal bankruptcy period.

During the course of the bankruptcy it is possible for the trustee to seek an Income Payments Order whereby any excess earnings over the bankrupt's basic cost of living are to be paid over to the trustee. This forms a fund out of which a dividend can be paid to the creditors at the end of the bankruptcy. The balance on debts in the bankruptcy is written off.

The debtor who is bankrupt will remain on the bankruptcy register for six years and this will affect his credit rating in the future.

What is an IVA?

As an alternative to bankruptcy a debtor can make a proposal to his creditors, usually to make a payment out of his future income to his supervisor on a monthly basis for up to five years. In return for agreeing to this arrangement, the creditors agree to take no action in respect of outstanding debts during the period. This has a similar affect to bankruptcy in that all the debts are frozen, but to approve the proposals, the creditors are invited to a meeting at which the details of the proposals are discussed.

It is the usual practice that a minimum dividend of 25 pence in the pound needs to be offered to creditors after costs have been met and the main credit card companies are not prepared to consider IVAs unless the total debts exceed £15,000.

The proposals need to be approved by 75% of the creditors in value and the supervisor then oversees the receipt of monthly payments from the debtor. If the debtor fails to make payments as promised in the proposals or fails to co-operate with the supervisor, the voluntary arrangement can be failed and the supervisor is often required to petition for bankruptcy in those situations. On completion of the voluntary arrangement, creditors will be paid a dividend and the balance on the debts in the voluntary arrangement has to be written off. As with bankruptcy, the credit rating of individuals who go into a voluntary arrangement can be affected in the future.

What should landlords do?

If a tenant tells you that he is bankrupt or is in an IVA he is still liable for future rent and should pay it in the normal way as an 'essential payment'. Although the trustee can apply to the court for an Income Payments Order, in agreeing any figure to be paid over, the trustee must make an allowance for essential living costs, which includes rent. If the tenant is continuing in paid employment there should be no excuse for not paying rent. Similarly in an IVA the tenant is permitted to pay reasonable rent and living costs before he has to pay the supervisor a contribution out of surplus income.

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Bankruptcy and IVA status is no reason for the debtor to withhold payment of future rent, but arrears of rent should be claimed in the bankruptcy or IVA as an unsecured debt. Unpaid service charge is treated in the same way as for rent. It ranks as a debt in the bankruptcy.

It can be argued that landlords are in a stronger position to collect rent from employed tenants simply because there are fewer demands on their income. Before bankruptcy or an IVA was put in place, the credit card companies would be pursuing the tenant for payments. Once those claims have been frozen by bankruptcy or an IVA, the tenant can make sure that the rent is paid promptly.

If a tenant has little or no income because he is out of work, that is a different matter. Most local authorities have a discretionary housing payment (DHP) fund, which could be used to top up the HB payments if there is a shortfall. It may be in the council's interest to provide this support to avoid having to face dealing with an eviction which itself will create an urgent housing problem. The DHP would often be a cheaper option than having to re-house the individuals. However when an application for a DHP is made, the HB department will generally only consider the income and expenditure of the claimant, when deciding whether to award a DHP.

At the time of bankruptcy or entering an IVA the debtor is required to provide a full list of his creditors to the trustee or supervisor.

In bankruptcy, a circular letter will be issued to all known creditors with the notice of appointment, a proof of debt form, a proxy form and a copy of the statement of affairs of the debtor. In respect of the rent arrears landlords should complete the proof of debt form which sets out the details of the debt, the period that it covers and the amount together with a proxy form that provides the opportunity to vote for the resolutions which may be put to a meeting of creditors. Normally these matters are routine and include the authorisation of the trustee to be paid on a particular basis, usually on time costs. These resolutions are in a standard format and as long as the trustee carries out his duties efficiently and professionally, creditors usually accept this basis.

Depending on the complexity of the debtor's finances, the trustee may ask the creditors to attend a creditors' meeting where a creditors' committee can be appointed. There is no obligation on creditors to attend the meeting and often a short report is circulated in advance with the notice of the meeting. Creditors do not often attend the meetings though on particularly large cases the banks and lending institutions will send representatives to ask appropriate questions. A committee of creditors can be formed to assist the trustee in carrying out his duties. It is very rare for committees to be formed unless there are particularly complex or large figures involved.

In IVAs, as well as the proxy form and proof of debt, creditors will be issued with a set of proposals, setting out the rules for the conduct of the IVA. These normally consist of a monthly payment being made by the debtor out of which the costs of the IVA will be met and a dividend paid to creditors. The proxy form gives the creditors the opportunity to vote on the proposals, without the need to attend the meeting.

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Dividend prospects

On small bankruptcies with nil assets the prospect of any dividend payment to creditors is extremely small. However, in the case of IVAs, there is a greater prospect of a dividend as approval is only given where there are genuine reasons to believe that the debtor can make future payments out of surplus income.

Benefits and overpayment recovery

The fundamental principle of being entitled to benefits is unaffected by the bankruptcy or voluntary arrangement status of an individual.

At the time when a bankruptcy order is made, any overpayment of benefits will rank as a debt in the bankruptcy estate. Subsequently, after the bankruptcy date, new benefits will become payable to the debtor. As these post-bankruptcy benefit payments were not due at the time of the bankruptcy, in law there is no mutual set-off between overpayments recoverable by the benefits office and future benefits payable.

For this reason, overpayments due to be recovered should not be deducted from benefits payable after bankruptcy. Overpayments remain a claim in the bankruptcy.

At the end of the bankruptcy period (usually one year) the debtor can apply for discharge. As any overpayment made before the start of the bankruptcy was taken into account in the bankruptcy procedure, it is not a debt which can be collected after bankruptcy. The Insolvency Act states that the bankrupt is released from all bankruptcy debts on his discharge with the exception of fraud, fines, confiscation orders, and family proceedings. There is no provision for collection of overpayments after discharge unless arising through fraud. A recent High Court case (*Balding versus DWP*) has confirmed this point. At the appeal handed down on 3 April 2007, the decision was upheld. As a result of this decision, overpayments arising before bankruptcy should be claimed from the trustee and any balance of the recoverable overpayment remaining after dividends must be written off.

Any overpayments arising after the bankruptcy has commenced can, of course, be recovered in the normal way.

In the case of IVAs, the rules are the same as for bankruptcies except that the effective date is the date on which the IVA proposals are approved by creditors at a meeting called for that purpose.

Leaseholder debts

Unpaid costs of major repairs which are due under the terms of a lease are again treated as part of the total debt claimable in bankruptcy. There may be forfeiture provisions in the lease which come into play in these circumstances. You need to examine the terms of the lease carefully and take legal advice before action.

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Conclusion

Personal insolvency of tenants need not be a hindrance to rent collection where the tenant has ongoing income. Equally where a tenant is on benefits, the right to receive benefits is unaffected by bankruptcy or IVA. The landlord is entitled to receive rent for current occupation out of current income/benefits and the prospect of the landlord being paid is actually improved as a result of bankruptcy or an IVA. That is simply because there are fewer demands on the debtor's income as all claims in bankruptcy and IVA are frozen. It is important that the landlord makes a claim in the bankruptcy or IVA for any arrears of rent to ensure that if there are any dividend prospects to creditors, payment will be received in time.

Note the rules in Scotland are different from in England and Wales and are not covered in this briefing.