

A Commercial Landlord's Guide to Surviving a Pandemic

Let's be honest: no one prepared you for how to respond to this. That said, you survived the financial crisis of 2008/09. While the world is not suffering from a subprime mortgage crisis, we can apply some of the lessons learned during the Great Recession to the pandemic. During the dark days of 2009, we all learned that a little empathy coupled with a collaborative approach allows all of the parties involved to overcome difficult circumstances.

The barrage of deferment requests are coming. If they haven't reached you yet, they are on their way. Landlords have difficult decisions to make, and landlords must be thoughtful in their approach. Landlords will need to sort the pretenders from those tenants that truly need assistance during this difficult time. Grocery tenants will continue to pay rent, but other tenants will suffer due to the various shelter in place orders and general drop in economic activity. While the decision is ultimately a business one, it is important to take a look at all of the relevant variables before making a decision.

1. The Lease.

It may sound simple, but landlords need to read their leases. There are several provisions that landlords must review to see the whole picture.

A. Force Majeure.

The force majeure provision in the lease typically excuses a party from performing its obligations under the lease so long as the force majeure event prevents the party from performing. The force majeure clause typically includes events such as strikes, riots, labor and material shortages, war, terrorist acts, governmental laws, acts of God, and other causes of any kind beyond the control of such party. While pandemics are not expressly mentioned, the concept will likely fall within the force majeure clause. Generally, the force majeure provision will carve out the payment of monetary obligations (including rent), meaning that, even in the event of a force majeure event, the lease obligates the tenant to continue to pay rent; however, the force majeure clause may apply other obligations of the tenant, such as a continuous operation clause.

While landlords may initially look to the force majeure provision to understand its impact on tenants, landlords must remember that the provision will affect them as well. If a landlord is unable to perform its maintenance and repair obligations due to the pandemic, the landlord needs to document the obligation it cannot perform, the reason why it cannot perform the obligation, and the amount of time that it is prevented from performing the obligation. In addition, landlords need to be mindful of any notices required by the lease in order for the landlord to claim a delay due to an event of force majeure.

B. Default.

If the tenant does not pay rent when due, a default will occur. Each lease will handle the occurrence of the default differently. For example, some leases will require the landlord to send a written notice of the default to the tenant prior to an event of default occurring; other leases will treat a missed payment as an immediate event of default. Following the expiration of any applicable notice and cure period, the landlord will have a decision to make. The landlord will have to weigh the ramifications of putting a tenant in default for failure to pay rent. While the landlord may have the legal right to do so, it may not make business or economic sense to actually declare the default. If the tenant is a tenant that is truly affected by the pandemic, it may be in the landlord's best interest to come to some other agreement with the tenant rather than defaulting the tenant, terminating the lease or possession of the premises, and forcing the tenant to close. If the landlord believes that the tenant will survive and continue to pay rent once life returns to "normal," it may make more sense to negotiate a deferment and payback of rent or other agreement than to terminate the lease.

Landlords will also need to keep in mind the potential ramifications of a default under its loan documents. If a landlord's loan agreement mandates an occupancy rate, a debt service coverage ratio, or notice to the lender of any default, the landlord will need to think through the potential default under its loan documents prior to making a decision on whether or not to terminate a lease.

C. Financial Statements.

Some leases require the tenant to provide the landlord financial statements following the landlord's request. In order for the landlord to get a clear picture of the financial health of the tenant, it may make sense for the landlord to use the lease obligations to make the request. Several financial statement provisions contain limitations related to when and how many times the landlord may request financial statements. The landlord must review the lease to ensure that the request complies with the lease and factor in how long the lease permits the tenant to respond. Tenants may have up to 2 weeks or more to provide the financial information, so it is imperative for landlords to make the request sooner rather than later. If the lease does not require the tenant to provide financial statements, a request for a deferment of rent may provide the landlord the opportunity to ask to see financial statements.

D. Insurance.

Every lease requires tenants to maintain certain levels of insurance, and many leases require tenants to maintain business interruption insurance. While there is debate as to whether or not business interruption insurance will cover a loss related to COVID-19, it is imperative that the landlord speak to the tenant about the possibility of filing a claim under the tenant's business interruption insurance in an effort to provide the tenant with as many resources as possible to enable the tenant to continue to pay rent under its lease.

E. Commencement Dates and Work Letters.

If a landlord recently signed a lease or lease amendment, the landlord will need to review the commencement date and substantial completion language in the relevant document. Between government orders and supply chain interruptions, hitting the anticipated completion date may not happen. The landlord should check to see what, if any, penalties may occur if the landlord is unable to complete the work by a certain date. A well-written abatement provision will include force majeure as a circumstance granting landlord more time to complete the work, but, if the lease does not contain the language, the landlord will need to have a conversation with the tenant about a realistic timeline of completion. If the work letter has a date by which the tenant must spend its tenant improvement dollars, the landlord may want to consider providing the tenant with additional time to use the funds for the same reasons the landlord may need more time to complete the work.

F. Operating Costs.

If a lease contains a base year provision or a cap on operating expenses, the landlord may need to think through how the calculations of those provisions may change. If landlord or landlord's contractors do not provide certain services during any shelter in place order or any other governmental mandate, the landlord may not incur those costs, which could artificially reduce the operating expenses for a calendar year. If that is the case, a base year or cap year may not produce the intended results. While it is still early to make the determination, the longer any restriction or mandate lasts, the more likely the actual expenses will change.

G. Use Provisions.

While it is not common to see continuous operation clauses in office and industrial leases, some leases contain them. While it may be tempting to find ways to place a less desirable tenant in default for non-monetary reasons, a force majeure clause applying to both the landlord's and tenant's obligations will preclude a landlord from defaulting a tenant under such a provision. It is also important to keep in mind that many jurisdictions have a moratorium on evictions, so, even if the landlord defaults the tenant and terminates the lease, the courts may not enforce the action.

H. Holding Over.

Several leases will expire during this time. While a tenant remaining in possession of its premises beyond the end of the term would normally entitle the landlord to holdover rent, most tenants will not have the ability to vacate their premises in a timely manner due to logistical reasons, as well as the potential that the tenant's new space is not complete as a result of the pandemic. Tenants may have standing to claim their vacating their premises is subject to force majeure delays. Landlords should be cognizant of the issues surrounding any potential holdover prior to attempting to charge holdover rent.

I. Options.

Many renewals, rights of first refusal, rights of first notice, and other options contain very specific time periods within which the parties must respond. For instance, most renewal options require the tenant to notify the landlord of the tenant's election to exercise the option within a specified time period prior to the expiration of the lease. Given the delays and inability to operate resulting from the pandemic, there is a high likelihood that notifying the landlord (or the landlord responding to such notification) in a timely manner may not be possible. The affected tenant may have a claim that the timelines for the tenant to respond should be extended as a result of force majeure depending on how the lease requires the tenant to deliver notice. The landlord will need to determine how much additional time, if any, the landlord is willing to provide a tenant to time exercise or respond to any options.

2. The Request.

Now that the landlord reviewed the lease, it is time to review the request for a rent deferment. The landlord will need to determine what, if any relief, they are willing to provide their tenants. Prior to providing any relief, the landlord may want to consider the following:

A. Loan Documents.

Before agreeing to any modification of the lease terms, the landlord will need to review its loan documents to see what the landlord may do, such as determining which leases do or do not require lender consent to modify and what modifications to a lease, if any, may be made without the lender's consent. It is important to be in communication with the lender in order to keep the lender apprised of what the landlord intends to do with regard to the leases, especially if the landlord's loan contains a guaranty, occupancy requirements, or debt service coverage ratio requirements. No landlord wants to inadvertently trigger a default under the loan documents or a guaranty provision. Each loan is different, so it is imperative that the landlord understands its obligations under the loan documents prior to negotiating with the tenant.

B. Financial Statements.

As noted above, the landlord should use this opportunity to request and review the financial statements of the tenant. The financial statements will indicate whether or not the tenant was in good financial health prior to the pandemic. If the tenant's financial health declined prior to the pandemic, the landlord may not want to modify the lease knowing that the tenant was likely to default even if the pandemic did not occur.

C. Entity Standing.

The tenant's request for deferment would be a good time for the landlord to request certificates of good standing from the tenant's state of formation and the state in which the property is located. The landlord will want to ensure that the tenant entity exists and that the tenant paid all taxes and other fees prior to providing any rent relief.

D. Additional Information.

The landlord may want to request additional information on the tenant making the request, such as requiring the tenant to identify any current defaults under any financial obligations beyond the lease, as well provide financial information related to any guarantors under the lease. [Click here](#) to view a form of checklist.

3. The Documentation.

If the landlord elects to provide the tenant with relief, the parties should enter into a written agreement to memorialize the deferment and repayment conditions. The landlord should include some of the following concepts in the agreements:

A. Force Majeure.

If the lease is not clear about how force majeure affects rent or other provisions of the lease, the amendment provides an opportunity to clarify the provision. If the original force majeure provision applied to the tenant but did not specifically carve out the payment of rent, the landlord should remedy such oversight.

B. Business Interruption.

If the lease does not obligate the tenant to provide business interruption insurance or is not clear that the landlord is not liable for any business interruption or loss of use of the Premises, the landlord could include such provisions in the amendment so that the lease is ready in the event of a future catastrophe.

C. Governmental Aid.

Some landlords may desire that the tenant making the request also apply for a loan under the Paycheck Protection Loan Program created under the CARES Act, as well as any other federal, state, or local programs designed to help businesses during the pandemic. Rent relief is only part of the equation, and it may make sense for the landlord to require that the tenant improve its cash flow as much as possible so that when rent comes due again and the repayment of the deferred rent commences, the tenant will have the cash flow to meet its obligations under the lease.

4. Survival.

Ultimately, the landlord and the tenant must work together to come through this crisis. By reviewing the lease, gathering all relevant information, and documenting the deal points, both the landlord and the tenant will reach an agreement that will enable both of them to make it through the pandemic together.

Munsch Hardt Kopf & Harr is continually monitoring leasing and landlord developments related to COVID-19 and will send out additional information as pertinent updates occur. In the interim, please contact Kitty Henry or Ian Fairchild if you have any questions or need any additional information.



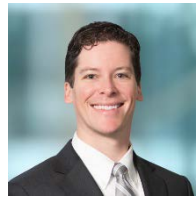
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