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Commercial Real Estate Leasing and Financing Considerations
During the COVID-19 Pandemic

The outbreak of the novel coronavirus, COVID-19, across the world and the US has resulted in countless deaths and wreaked havoc on the global economy, shuttering businesses and forcing people into quarantine all over the world. The pandemic is impacting commercial real estate transactions and relationships. Some of the most common issues and concerns for commercial landlords, tenants, lenders, and borrowers are highlighted below, although this list is by no means exhaustive, and may change as the commercial real estate industry grapples with the rapidly evolving layers of federal, state, and local governmental guidelines and regulations being passed in response to the pandemic.

The widespread voluntary and government-mandated closures of businesses, especially retail businesses, raises numerous leasing issues:

Force Majeure.

- Most leases contain a force majeure clause, which delays the performance of obligations by either or both of landlord and tenant in certain unavoidable circumstances. Neither landlord, nor tenant should assume the current pandemic automatically qualifies as a force majeure event because such clauses remain open to interpretation and few are written to expressly cover a pandemic such as this one. However, depending on the specific wording, force majeure may be applicable (i) if landlord is unable to timely deliver the premises due to government restrictions on construction, labor or material shortages, or permitting delays, (ii) if landlord closes the building and cuts off tenant's access to the premises, (iii) if tenant ceases business operations, and (iv) in some limited circumstances, if tenant ceases paying revenue-based rent, such as percentage rent.
- It is important to note that a force majeure clause generally only delays performance; it does not excuse performance entirely. The exact words of the force majeure clause will govern how and when it will apply and the exact language is typically the result of negotiation, so it varies from lease to lease.
- A typical force majeure clause will list specific events that will be a covered event of force majeure, such as fire, flood, storm, "act of God", governmental regulation. A pandemic would delay performance if it is expressly listed, but few clauses are written to expressly cover a pandemic. It is not clear that a pandemic would be considered an "act of God" and some courts have limited the meaning of "act of God" to natural phenomenon without human cause, such as weather-related disasters. In jurisdictions where the local or state government has already taken action to

close businesses as part of its response to the COVID-19 crisis, language relating to governmental regulation may be relied upon in invoking a force majeure clause.

- Most force majeure clauses also contain a catch all provision for unforeseeable events "beyond the reasonable control" of the party whose performance is delayed, but again, the exact wording of the provision will govern. Some provisions may limit the catch all provision only to "other similar events", in which case a pandemic may not be covered if no other event similar to a pandemic is listed.
- Note also that, in most force majeure clauses, the payment of money (such as rent) is expressly carved out and is not excused by a force majeure event, even if a pandemic would otherwise be a covered event of force majeure. One exception may be revenue-based rental, such as percentage rent; however, it is important to also review continuous operation requirements in this regard as discussed below.
- Many force majeure clauses also contain notice requirements so they can only be invoked if the affected party timely gives notice to the other party. A related issue, then, is establishing exactly when the event of force majeure began so that notice can timely be given. It is not necessarily easy to determine at what point COVID-19 became a pandemic that would be considered an event of force majeure for the purposes of a specific lease, especially in light of the lack of uniformity of regulation and timing of local, state and federal action in response to the crisis.
- Given the unprecedented nature of the current pandemic, however, it is likely that public policy may play a role in how force majeure clauses are interpreted.

Insurance Coverage.

- Landlord and tenant may attempt to look to insurance for coverage for losses in revenue, rent and the like, but should review their respective policies and consult with insurance providers to determine coverage. Timely giving insurance providers notice of the claim is also vital to preserving any potential claim.
- It is not clear at this time if commercial general liability policies would provide coverage for COVID-19 related claims because such policies typically cover bodily injury, sickness or disease or loss or damage to property occurring on the property.
- It is also not clear that business interruption coverage, for tenants (and its corollary, rental interruption coverage, for landlords), would cover COVID-19 related claims. Typically, as a condition precedent to making a claim for business interruption or rental interruption, the tenant or landlord, as applicable, needs to suffer a loss for which it could make a claim under its casualty insurance policy (such as in the event of damage by fire or flood). Generally, there must be a cause and effect relationship between the actual physical loss or damage and the loss of income. The current COVID-19 related business interruptions are largely due to factors other than physical damage to the property. Even if creative arguments could be made to prove physical damage, there are further obstacles in proving the time period and cost required to cure the physical damage and it's not clear that extended business closures would be covered. Moreover, even if a landlord or tenant were able to actually prove physical damage, many all-risk policies expressly exclude loss due to communicable diseases, viruses, bacterium, and micro-organisms. This does not mean that parties should refrain from making claims under these coverages, just that they should do so knowing the potential limitations to those claims.
- It is possible however, given the volume of these claims, that the government may step in to backstop insurance companies and reimburse some of these claims through further aid packages.

Continuous Operations.

- Many leases contain a continuous operation clause that requires the tenant to continuously operate for business in the premises, except for certain permitted closures, and provides that failure to operate is a default under the lease. Events of force majeure, as discussed above, may be one such permitted closure that excuses continuous operation in the premises; thereby allowing tenant to avoid being in default under the lease. A tenant claiming the benefit of such a permitted closure provision should, however, be careful to comply with the notice provisions of the lease in notifying landlord.
- Other leases may expressly allow tenant to "go dark" without be in default, as long as tenant is still paying rent and otherwise complying with the lease. In such an instance, while tenant is permitted to stop operating, landlord may have certain rights to recapture the premises if tenant does not resume operations within a certain time period, so once again, tenant must be careful to comply with the notice provisions of the lease in notifying landlord.
- In some parts of the country where the state or local government has stepped in and mandated closures of certain non-essential business, tenant is more likely to succeed in arguing that its duty to comply with law supersedes any continuous operation provision and that such governmental action is an event of force majeure that delays the application of any continuous operation provision. The foregoing would not, however, allow the tenant to stop paying rent (except possibly revenue-based rent, such as percentage rent) and otherwise violate the lease, including maintenance obligations of tenant under the lease.
- In jurisdictions where government-mandated closures have not yet been imposed, landlords and tenants must look to the exact terms of the continuous operation requirements in the applicable lease to determine its remedies.

Premises Liability/Access to the Premises.

- In the event of a confirmed diagnosis of COVID-19 in tenant's premises or in the common areas, both landlord and tenant should take steps to notify other tenants and protect the health and safety of other occupants, while also complying with applicable privacy laws.
- Landlord may also consider taking voluntary health and safety measure to minimize its premises liability as the owner of the property. This may include increased sanitation and disinfection measures, but may even require more stringent controls, such as restricting access to the building or screening those that enter the building. Such actions may or may not be mandated by applicable law, depending on whether the jurisdiction in question has adopted mandatory "shelter in place" orders or not. Whether or not the additional costs and expenses incurred in taking such action can be passed through to tenants will also depend on the exact provisions of the applicable lease.
- Various lease provisions will govern landlord's right to restrict access to the building or the premises and security measures, which may be necessary at landlord's election or due to governmental regulations. Tenant's remedies, including possible rent abatement, will also be controlled by such lease provisions.

Constructive Eviction / Quiet Enjoyment.

- In jurisdictions without mandatory governmental orders in place, landlord should also consider whether or not restricting access to the building or screening those that enter the building could

result in potential claims by tenant that landlord has interfered with tenant's quiet enjoyment of the premises or effectuated a constructive eviction of tenant. In jurisdictions with mandatory governmental orders in place, landlord's obligation to comply with applicable law would likely supersede such arguments.

Casualty/Condemnation.

- The law is currently evolving on whether the current pandemic could be considered an event of casualty under applicable lease provisions, which vary widely in terms of what classifies as a casualty and the remedies available to landlord and tenant in the event of a casualty. In some leases, but not others, an event of casualty may allow a tenant to abate rent for the duration of repair of the casualty loss and even terminate the lease in some circumstances. In the current COVID-19 crisis, it is unclear how such duration of repair or rent abatement would be determined. It is also unclear how successful a casualty claim would be, given the difficulty of determining actual physical damage to the property caused by COVID-19.
- Another evolving argument is whether business interruption due to a government mandated closure could be considered a temporary taking, in which case, if suit is filed against the applicable governmental authority, the condemnation provisions of the lease could be invoked. Most leases discuss partial and total taking, but most leases are silent on the issue of temporary taking. A key consideration here will be how a potential condemnation award is divided between landlord and tenant. A temporary taking claim also raises some of the same open questions as casualty claims with respect to the rent abatement and termination remedies that apply and how to calculate the amount of the taking and the time period that it continues.

Evictions.

- Some jurisdictions have instituted moratoriums on commercial evictions for defaults under leases, which would include defaults in the payment of rent. As of this writing, no statewide moratorium is in effect for commercial evictions (but is for residential evictions). Local law will govern in this regard and whether or not a tenant can be evicted will depend on the jurisdiction in question.

Workouts and Negotiated Solutions.

- In light of the unique and unprecedented nature of the current crisis, there is no panacea to be found in existing lease provisions or in insurance solutions. Each may provide some guidance, but a clear and concrete solution to lease-related issues arising from this pandemic is not readily apparent.
- Landlord and tenant must each appreciate that they are in a long-term relationship, with obligations on both sides. Both sides must be mindful of the crisis that has changed the world since those commitments were made, but, in most cases, one thing that has not changed is the landlord's obligation to meet its debt service obligations.
- Early and frequent communication between landlord and tenant is key to maintaining their relationship and negotiating a solution that works for all; however, a tenant should also review its lease to confirm that admitting an inability to pay rent is not an express default under the lease.
- Some landlords may be willing to negotiate partial rent abatements, if tenants can produce proof of loss. A landlord's willingness to negotiate such a solution will depend on the overall

creditworthiness of tenant and its ability to bounce back after the pandemic and whether landlord's lender will grant similar mortgage payment deferments. In exchange for doing so, landlord may ask to be partially or proportionately subrogated to tenant's business interruption coverage and/or other reimbursement programs by the federal/state/local government. Landlord may also seek to extend the term of the lease to recover the rent abatement on the tail end of the lease. Landlords may also use the opportunity to renegotiate problematic lease-provisions and to seek improved business terms through changes in term, timing on increases, percentage rent, and a host of other potential avenues.

- Landlords should be very mindful that such negotiations are kept confidential by tenant. Landlord should require the tenant to enter into a non-disclosure agreement and pre-negotiation agreement, confirming that such negotiations are confidential, non-binding, and do not constitute a waiver of any claims by landlord under the lease.

Lender Concerns.

- A landlord's first step before engaging in a substantive workout with a tenant needs to be a conversation with its lender. In addition to pursing the opportunity for a potential modification of the loan itself (which is a topic for another discussion), many, if not most, loan documents reserve some level of lender control regarding leasing matters and changes or amendments to leases. Amending or abating a lease without lender's consent may be a default under most loans; also, borrowers/landlords generally have an obligation to let lenders know when a tenant is in default.
- When discussing a property with a lender, landlords should take care to avoid making express statements in writing, including via email, that they are unable to pay upcoming loan payments. Under many loans, admitting a general inability to pay debt in writing can be considered a default, and, under nonrecourse loans, this can lead to carveout liability for loan guarantors.
- CMBS landlords/borrowers are in a tougher position, as the master servicer has limited authority to offer payment relief (some have decided that they can defer reserve payments and waive late fees), so those landlords should weigh the pros and cons of being transferred to the special servicer.
- In addition to needing lender consent for most workout actions, non-recourse borrowers/landlords should take special care to avoid inadvertently tripping certain non-recourse carveouts that could lead to damages for the loan guarantors or even result in the loan becoming a full recourse loan. A few (not exhaustive) examples of carveouts that could lead to liability are below:

  1. Lease Amendments – Some lease amendments and deferrals that are entered into without lender consent and without compliance with the loan documents could trip up the "anti-transfer" provisions of non-recourse guaranties and result in a loan becoming full recourse.

  2. Waste – The standard nonrecourse carveout for waste to the property could be invoked for buildings that are closed. Borrowers/landlords should document their ongoing maintenance, janitorial, and other activities so that it can be demonstrated to lender that the landlord took specific steps to avoid waste.

3. Inability to Pay Debts - As noted above, the admission in writing the of a borrower's inability to pay debts as they become due may result in non-recourse carveout liability. Accordingly, borrowers should take care when communicating with lenders, even via email.

4. Capitalization – If the current business interruption lasts for several months, borrowers should also be mindful of any non-recourse carve-out that requires the borrower to maintain adequate capital in light of its contemplated business operations and carefully consider its capitalization position and needs.

Please note that no attorney-client relationship is created by virtue of this report, the content of this report does not constitute legal advice, and this report does not attempt to cover all legal issues raised by recent developments or address how such legal issues apply to a specific transaction or in a specific jurisdiction. You should consult an attorney regarding your individual transaction and should not rely on the information contained in this report without seeking legal counsel.

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