

NAVIGATING COMMERCIAL LEASE CHALLENGES DURING THE COVID-19 PANDEMIC

The COVID-19 pandemic continues to wreak havoc and uncertainty on every aspect of the commercial real estate sector. Federal, state and local government orders have caused commercial tenants to go out of business, temporarily close, curtail operations, lay off employees and suffer sharply declining revenues affecting their ability to pay rent, while landlords are obligated to continue paying maintenance costs, real estate taxes and debt service on their properties. This article provides key considerations to commercial landlords and tenants as they navigate lease challenges generated by the COVID-19 pandemic.

It is important for landlords and tenants to combine an understanding of their legal rights and remedies under their leases with practical knowledge and reasonable business sense. Typically, leases provide the landlord with the right to terminate the lease or terminate the tenant's right to possess the premises in the event of a monetary default. However, landlords should consider that many courts have closed, limited operations and/or suspended evictions and foreclosures until further notice. Please [**click here**](#) for our practical guide to landlord-tenant evictions during the COVID-19 pandemic. Landlords should also assess their ability to find a suitable replacement tenant and perform necessary repairs for reletting all while state and local governments are imposing restrictions on construction activities.

When requesting a rent concession, tenants should be prepared to demonstrate and/or evidence item numbers 1 through 5 in the enumerated list below. If tenants have not already done so, landlords should encourage tenants to apply for the various disaster relief programs, as eligible, and to pursue insurance claims, where applicable.

In determining how to respond to a rent concession request, landlords should analyze each tenant independently and consider the following factors:

1. Long-term viability of the tenant;
2. Tenant credit, current financials and prior years' financials demonstrating an impact due to COVID-19;
3. Tenant applications for the various disaster relief programs, if any;
4. Tenant's insurance policy endorsement for business interruption insurance coverage and any insurance claim, where applicable;
5. Whether a personal guaranty might bolster the tenant's credit worthiness;
6. Tenant payment history;
7. Remaining term on the lease;
8. Existing lease terms that could be modified in exchange for a rent concession, such as the addition of a relocation clause or elimination of a right of first refusal, right of first offer, expense caps or other similar negotiable provisions; and
9. Landlord cash flow needs and overall property cash flow.

Additionally, landlords should review their own insurance policies as well as existing contractual obligations to lenders and to other tenants. Many insurance policies will contain exclusions for viruses or pandemics, but it is worth reviewing the policy to determine if coverage

is available. For a further discussion of business interruption insurance coverage in the context of the COVID-19 pandemic, please [click here](#). Many loan covenants require minimum levels of rent or occupancy and of cash reserve and cash flow. Some leases have co-tenancy requirements or require specific anchor tenants.

Landlords may respond to lease concession requests by:

- Immediately starting lease enforcement actions against tenants, guarantors and any collateral provided as security (after the expiration of any grace or default notice and cure periods);
- Holding off on taking any action or declaring tenants in default and reserving landlord's rights and remedies; and/or
- Engaging in workout discussions with tenants before or after taking the above actions.

If lease obligations other than the payment of rent are at issue, the force majeure provision of the lease may be implicated. Force majeure provisions rarely excuse a tenant from making rent payments but may excuse a tenant from maintaining continuous operations or other active lease obligations. However, the level of protection provided to the parties will vary depending upon the specific language in the lease. Landlords and tenants alike should involve counsel in evaluating whether and how the force majeure provision in their lease is implicated by the COVID-19 pandemic.

Notwithstanding the foregoing, where is the relief for landlords? Landlords typically cannot avail themselves of the relief options the federal and state governments have enacted due to a myriad of disqualifiers, including but not limited to the lack of employees, the classification of real estate investment as a passive business activity and mortgage obligations that do not qualify for Federal Housing Finance Agency forbearance. While the relief options for landlords has been minimal to non-existent, landlords may accelerate cash flow through changes in the tax law. Please refer to our discussion of the increased net operating loss carryback and the qualified improvement property correction [here](#). In addition, landlords should consult with their tax preparers to adjust the amount of estimated taxes to be paid this year if income has been reduced due to rent concessions or otherwise.

Strategizing how to combat lease challenges generated by the COVID-19 pandemic requires a delicate balance of legal rights and obligations, practicalities and business sense. Winne Banta has assisted its clients in achieving such a balance for almost a century. If you have any questions about managing the landlord and tenant relationship or the impact of COVID-19 on your business, please contact Winne Banta's COVID-19 Recovery Team at 201.562.1002.