

COMMERCIAL LEASE WORKOUTS DURING COVID-19 PANDEMIC

April 23, 2020

Posted: April 23 at 8:45 AM

In the wake of social distancing measures and “shelter-in-place” orders enacted to mitigate the impacts of the current COVID-19 pandemic, many businesses have been forced to close for an indeterminate period of time or change their business models in ways that have significantly impacted their revenue and ability to fully perform under their existing leases. This has left many commercial tenants and landlords, be they retail, office or warehouse, seeking guidance on how to best navigate these uncertain times and work together to determine practical short-term solutions, including negotiating amendments to existing leases or entering into other workout solutions. This article provides pragmatic guidance for commercial landlords and tenants negotiating and evaluating potential solutions.

1. Tenants should make clear and specific requests regarding what type of relief they need and the time period for such relief. For instance, is the tenant asking for rent reduction, abatement or deferral? Can the tenant pay for any portion of the rent, like utilities, taxes and operating expenses? How long does the tenant need the relief? Does this period of relief need to extend beyond the point at which “shelter-in-place” orders are lifted to allow the business to recover?

2. Landlords may be more willing to consider a deferral that delays, rather than waives or abates, landlord’s rental income because the landlords will still have to pay the operating expenses, taxes, insurance and mortgage payments that the rental income covered. Alternatively, landlords may consider applying existing security deposits toward current rental obligations and setting a date for when the

security deposits will need to be replenished. Additionally, landlords may require lease extensions in exchange for providing near-term rent relief and establishing timelines or metrics for when tenants will be required to resume operations.

3. If landlords are able and willing to grant some near-term relief, they may want to provide some protections for any planned future payments. For example, landlords may want to provide that the relief granted to a tenant is contingent on the tenant otherwise remaining in compliance with the lease. Landlords may also consider asking for security enhancements, like guaranties or letters of credits, to ensure the tenant's future performance.

4. Landlords may require, and tenants should be prepared to periodically provide, detailed financial information and projections related to the tenant's business in order to support any request for rental relief and allow the landlord to assess the tenant's ability to comply with rent obligations and other lease covenants going forward. Landlords may also require detailed business plans from tenants showing what specific actions tenants intend to take to survive the pandemic and eventually resume operations, as well as projections showing expected cash flow under a variety of recovery scenarios.

5. Landlords may also want to require tenants to use best efforts to obtain eligible relief under the CARES Act and under economic stimulus programs that are or may become available (for instance, the Paycheck Protection Program or Economic Injury Disaster Loan Program may provide funds that tenants can use toward rental payments and operating expenses under existing leases for a period of time), which are discussed in more detail here ([link to Ira's articles](#)). Landlords should consider how such relief will impact any rental relief landlords have granted. For instance, if tenants are able to obtain such relief, will they be required to use some or all of it to pay rental obligations that landlords had otherwise agreed to reduce, abate or defer, and when will such payments need to be made?

6. Tenants with multiple locations should review their entire portfolio of leases and related documents (e.g., guarantees and letters of credit) in order to make strategic decisions on renegotiating and continuing to perform under certain leases (for instance, tenants may prioritize performance on leases that have guarantees that may burn off but for a failure to pay rent).

7. Other than rent relief, landlords and tenants may also need to acknowledge and renegotiate certain other lease provisions that have become impracticable or impossible to comply with during the pandemic (such as certain operating covenants, co-tenancy provisions and tenant improvement obligations and timelines). For example, existing leases may require tenants to remain open for business on a daily basis, with a full staff, or require landlords or tenants to complete certain improvements to leased premises by certain dates, all of which may have become difficult or impossible to comply with while "shelter-in-place" orders are in place.

8. Landlords and tenants should also carefully review their leases to determine whether they may be contractually entitled to any relief. Examples where such relief may be available include the following:

- a. Retail leases sometimes include co-tenancy provisions that allow tenants the right to terminate their leases or abate rent in the event that the retail centers in which they are located fail to maintain certain levels of occupancy or certain key stores within those retail centers fail to operate for a period of time.
- b. Condemnation and casualty provisions may provide tenants with certain rights to rent abatement or lease termination, although these provisions often require physical damage or takings. In the event that such provisions are broad enough to cover losses of use and access caused by governmental actions, landlords and tenants will need to consider whether such governmental actions involved mere recommendations or mandated orders and whether tenants stopped operating in their premises prior to or after such governmental actions.
- c. In Texas, the obligation to pay rent is typically independent of landlords' obligations under leases, and rent is normally required to be paid without any deduction, set-off or abatement, absent express provisions in leases to the contrary. Tenants have been quick to argue that *force majeure* or quiet enjoyment clauses forgive or delay the obligation to pay rent, and landlords have just as quickly countered that neither applies. However, the parties should carefully review their specific leases to determine what was previously negotiated in the lease. A *force majeure* clause in a lease may excuse a party's failure to perform under certain unexpected occurrences, such as riots, wars or extreme weather events. A party may attempt to invoke such clauses to excuse their inability to timely perform a certain obligation under the lease, for example, a needed repair. Whether a particular *force majeure* clause in a lease will permit a tenant not to pay rent due to government mandates or public health emergencies, has to be reviewed on a case-by-case basis. While most leases we've recently reviewed expressly require the tenant to pay rent even during an event of *force majeure*, we have seen a few leases that do not expressly require the payment of rent. Both landlords and tenants should expect attempts to enforce or evade *force majeure* clauses under commercial leases in the near future. Such clauses are discussed further here (<https://www.bellnunnally.com/force-majeure-the-biggest-buzz-term-of-litigation-in-a-covid19-world>; <https://www.bellnunnally.com/impacts-of-covid19-on-commercial-leasing>).
9. Landlords and tenants that have outstanding loan obligations should determine whether their lenders' consent or notice would be required for any workout solutions and lease amendments negotiated between landlords and tenants. If so, landlords and tenants will want to include the lenders early on in their lease renegotiations. Landlords and tenants should also consider how a loss of income will impact covenants under their loan documents and determine whether they will need to request short-term relief from their lenders, including deferrals for loan payments and temporary suspension of financial covenants. Loan workouts are discussed further [here](#).
10. Landlords and tenants should review their insurance policies to determine whether business income/business interruption insurance may provide coverage for income losses related to the pandemic, which is discussed in more detail [here](#).
11. Landlords should consider their ability to re-lease space to new tenants in the event negotiations with existing tenants fail, while complying with any applicable moratoriums on evictions, which require careful reviews in each jurisdiction and are discussed in more detail [here](#).

12. Landlords and tenants should review their notice provisions in their leases, loan documents and insurance policies and ensure they are providing any required notices in a timely manner in order to preserve certain rights they may have.

13. Tenants may need to consider whether bankruptcy options ought to be explored, which are discussed further [here](#).

As the COVID-19 pandemic continues, landlords and tenants should carefully review their existing leases and loan documents, be candid with each other about their current outlooks and work together to negotiate practical workout solutions. They should also consider involving counsel early on in their negotiations to avoid missing important details that may inform their negotiations and impact their workout solutions.

If you have questions or would like to discuss further, please contact [Jean Boyea](#), [Kassie McLaughlin](#), Natasha Gandhi and Murphy Sayre.

Related Practices

Commercial Finance
Real Estate Law

Practice Area Contact

Jean Pierre Boyea
Kassandra "Kassie" G. McLaughlin