

COVID-19 – LEASE RE-GEARING: ISSUES TO CONSIDER

IT IS LIKELY THAT THE GLOBAL PANDEMIC WILL RESULT IN MAJOR CHANGES TO THE LANDLORD AND TENANT RELATIONSHIP AS TENANTS LOOK TO NEGOTIATE LEASE TERMS THAT OFFER BUSINESSES GREATER PROTECTION.

Landlords need rental income to service lending commitments and to maintain investment yields with a successfully re-gear lease proving to be very effective in supporting this objective. We set out below some of the Covid-19-related issues that may influence these negotiations and the re-gearing decision.

Insurance: Typically, a lease would allow rent payments to be suspended where the premises have been physically damaged. Although in the absence of 'damage' it seems unlikely that a tenant could rely on these provisions in light of Covid-19, we anticipate that tenants will want new leases to trigger rent suspension where a tenant is unable to occupy or trade from the premises. It remains to be seen whether this type of risk will be insurable. Alternatively, a landlord may agree instead to include provisions that allow rent payments to be deferred. This would assist a tenant's cashflow whilst protecting the landlord's investment yield.

Variation to rent payment terms: Most commercial leases do not give a tenant the right to suspend or defer payment of rent nor vary how and when it is paid. Tenants may look to include such rights, for example, to allow them to switch from quarterly to monthly payments or to reduce payments unilaterally in specific pandemic-type circumstances. Alternatively, a landlord may be willing to share the risk by including provisions allowing for temporary rent reductions where trade is prohibited or substantially reduced due to social distancing measures.

Term length: It seems likely that tenants will require even greater flexibility, perhaps by committing to shorter leases or by including rolling 'pandemic' break provisions. An all-inclusive rent would support the shorter-term lease model as well as easing the asset management burden associated with administering a service charge across a constantly changing tenant base.

Service charge: A number of our clients have experienced difficulties in recovering service charge, with tenants giving their inability to occupy premises as the reason for non-payment. Service charge provisions may be modified to ensure that expenditure incurred in delivering basic building services can be recovered even where a scheme cannot be occupied. Landlords may look to include separate schedules of services and for there to be a distinction between those services that a landlord must provide and those that are discretionary.

Turnover rent office leases: Although turnover rents are normally included in leases across the retail and hospitality sectors, it is possible that a turnover-based rent could become more prevalent across other sectors, especially if loss of rent insurance is not available for pandemics and tenants refuse to commit to leases which do not make provision for rent suspension in these circumstances.

Force majeure: Unlike development agreements or construction contracts, leases generally do not contain 'force majeure' clauses allowing the parties to end the lease where certain specified events occur (e.g. an "act of God" or other catastrophic event outside of the parties' control). Tenants may look to include provisions that allow termination in these circumstances, perhaps with this right being exercisable where a tenant has been prohibited from trading for a specified period.

Landlords will need to carefully review current lease terms to formulate its re-gearing strategy. A starting point may be to enter into dialogue with tenants to develop a better understanding of the challenges facing their businesses and to explore re-gearing proposals for the parties' mutual benefit.

FOR FURTHER INFORMATION



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