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The Potential Impact of COVID-19 on Real Estate Leasing

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Posted By: Benjamin S. Stern

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COVID-19 and the governmental regulations enacted to combat the spread of the virus have had substantial impact on the real estate community. The State of Wisconsin has prohibited eviction proceedings, foreclosures, and sheriff's sales, and many courts are currently closed for all but emergency action. Apartment leasing agents are unable to enter into apartments. There is an ongoing push to postpone the payment of property taxes, and many other issues arising out of the state and federal legislation arising from the pandemic are having drastic effects on the real estate industry. However, the most common questions that our real estate clients have been asking us concern the effect of COVID-19 related issues on lease obligations.

The rights and responsibilities of landlords and tenants are governed by the specific provisions of the lease agreement and any inquiry relating to the rights of either landlord or tenant must begin with a review of the lease agreement. Specific provisions of commercial leases that should be reviewed include: force majeure, insurance, quiet enjoyment, termination, operating covenants and co-tenancy provisions. Below are a few of the issues which we have been analyzing for our landlord, tenant and lender clients in light of COVID-19.

Does COVID-19 allow residential tenants to stop paying rent or to terminate a lease?
Typical residential leases do not contain provisions that would allow the tenant to stop paying rent due to COVID-19. The fact that a tenant has been fired or laid-off may be an excuse for being unable to pay rent but it is not a legal defense. Even if a tenant is not able to occupy the apartment due to an issue related to COVID-19, the tenant does not have the legal right to withhold rent or terminate the lease except in the unlikely event the tenant's lease allows non-payment. For example, a tenant that is a university student does not have the right to stop paying rent for his apartment even though the university has been closed. Similarly, a tenant that has been quarantined out of the area does not have the right to withhold rent for the period of the tenant's absence.

What is a force majeure clause and will it allow a commercial tenant to withhold rent?

Commercial leases typically contain a "force majeure clause" that are intended to relieve a party from performing an obligation under the lease if the performance is excused due to an event outside the party's reasonable control. Events commonly listed within force majeure clauses include strikes, war, bombing, insurrection, invasion, act of God, calamities, civil commotions, catastrophic weather conditions, or regulations of any governmental authority, state, law or ordinances, or other events outside a party's reasonable control which could be argued to include contagion and pandemic. If the force majeure clause in a lease relieves a party from performance of a lease obligation due to a governmental action, it is possible that both the landlord and tenant may benefit from the force majeure clause for COVID-19 closures. For example, the force majeure clause in some mall leases will relieve the landlord from the landlord's obligation to provide access to the leased premises if a governmental action has required the mall's temporary closure to reduce the spread of COVID-19. The force majeure clause may also be used as a defense to a tenant's claim that the landlord has breached the landlord's covenant of quiet enjoyment by requiring closure of the leased premises in compliance with governmental regulations. It is also possible that a tenant could argue that the closure of a mall by a governmental action is a force majeure event that should excuse the tenant's obligation to pay rent although many leases specifically provide force majeure events do not excuse the obligation to pay rent.

While many of the post-COVID-19 lease default cases will consider the applicability of the force majeure provision there may be other commercial lease provisions that allow a tenant to partially or totally abate the payment of rent. One such clause that may be contained in retail shopping center leases is a co-tenancy clause. Co-tenancy clauses may require that a designated anchor tenant or a percentage of other tenants in a project be open for business or the rent will be partially or totally abated. The closure of stores relating to COVID-19 may trigger the co-tenancy rent abatement provisions.

In addition to the above considerations, there may be other lease provisions which inure to your benefit. Whether you are a landlord, tenant, or a lender, the new COVID-19 regulations will likely impact your rights and remedies under the lease.

My tenant told me that they cannot pay rent. What should I do to protect my rights?

Governor Evers Emergency Order #15 signed on March 27, 2020, prohibits residential and commercial landlords from instituting eviction actions against tenants for non-payment of rent until May 25, 2020 at the earliest. The order does not give tenants the legal right to withhold rent. Subject to the provisions of their specific leases, landlords are able to impose late fees and other collection costs under the leases if tenants fail to pay rent. A landlord can send a notice of unpaid rent and late fees (if allowed by lease) but should not send a 5-day notice to quit or pay rent or a default notice to a commercial tenant threatening eviction as the Governor's order prohibits serving notices threatening eviction for failure to pay rent. Any notice of unpaid rent and late fees sent to a tenant should clearly indicate that the landlord is not waiving any of its rights under the lease, any amount of rents owed, nor is the landlord allowing rent abatement.

Should I wait until the 60 days' stay on evictions is over to address rent defaults or should I consider my tenant's request for a lease modification now?

It is difficult for landlords and tenants to confidently negotiate lease amendments modifying material lease terms without knowing when the COVID-19 crisis will end but that does not mean discussions regarding lease modifications should be delayed. It is important for landlords, tenants and lenders to obtain commitments as to when and how much rent is to be paid under the lease. Among the types of lease amendments likely to result from this crisis include:

- A tenant may request a partial or full abatement of base rent and/or operating expenses for a stated period. As an alternative, a landlord may offer deferral of rent payment but require payment of interest, require a balloon or full amortized repayments, increased rent for the remainder of the lease term and may require an extension of the lease. A payment of percentage rent may also be negotiated for a period until the tenant has resumed business operations.
- For tenants that have applied for relief under the CARES Act or other disaster related loan sources, the amendment may be tied to the date the tenant has received its relief/loan payments. Similarly, if either the tenant or landlord has carried business or rental interruption insurance which may cover the losses arising from the COVID-19 regulations, the lease amendment may be tied into the date of the party's receipt of insurance proceeds.
- Some businesses that were experiencing difficulties prior to COVID-19 will not survive the crisis and the landlord and tenant may use this period as an opportunity to negotiate a lease termination agreement to avoid future litigation. A tenant with a stronger financial condition may be able to negotiate a tenant's relocation to a more desirable space, a lease extension under favorable lease terms, or other landlord concessions.

Should I advise my lender that my tenants have told me they will not be able to pay rent?

Landlords whose real estate is secured by a mortgage should be aware that their loan documents may require the landlord obtain its lender's approval to lease modifications. Many lenders have advised their landlord customers of their willingness to work with them rather than declaring defaults even if the landlord is temporarily unable to make the mortgage payments and/or is in default for not meeting the financial covenants of the loan. Early indications from all parties have confirmed that tenants, lenders and landlords understand that it is in the respective interests of landlords, tenants and their lenders to continue to cooperate to reduce the long term damage done by COVID-19. Your lender may be willing to enter into a loan modification agreement with you in recognition of the effects of this crisis.

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