



PANDEMIC-RELATED ISSUES IN COMMERCIAL LEASES

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In the year or so since COVID-19 has disrupted every industry, there have been several recurring issues in commercial real estate leases worthy of discussion. In this brief alert we delve into a few of them in the hopes of better educating and arming our clients against certain common issues.

Rent Deferrals

As the operations of retail businesses have been significantly curtailed, the number of rent deferral and forgiveness requests have increased drastically. While the ability to pay rent has been less impacted in the traditional office context due to remote working capabilities, retail properties that generated their income from in-person sales and foot traffic have experienced steep declines in revenue. These include properties such as car dealerships, restaurants, and gyms. While landlords have generally been understanding of the circumstances, most requests from tenants for rent forgiveness have resulted in negotiated rent deferrals, whereby landlords have agreed to defer rent payments for a certain number of months until a later date.

We have yet to see whether tenants are able to make the deferred rent payments, but with the easing of COVID-19 restrictions the hope is that tenants will be able to perform under the rent deferral agreements. If not, then both parties will need to re-visit the negotiating table and decide whether further rent deferrals and/or forgiveness is merited.

Amenities

To meet tenant demand and compete in the office leasing market, many office buildings and complexes now offer increased tenant amenities, such as an on-site fitness center, cafeteria, or conference center. Leases at these properties typically require that landlords maintain these amenities throughout the term of the lease. The amenities generally must be open during regular business hours and available for the tenants' use. The COVID-19 pandemic has forced the closure of many of these amenities, raising the issue of whether a landlord has breached its lease obligations or if a tenant can claim a reduced rent.

The defense most often cited by landlords in this context is excusal of performance due to force majeure. Most sophisticated commercial leases contain a force majeure provision that effectively excuses the landlord (and sometimes the tenant) from its performance obligations due to events beyond the landlord's control. The list of force majeure events varies on a lease-by-lease basis, but generally they are drafted as broadly as possible to capture unanticipated or unforeseen circumstances. While the force majeure provision usually does not excuse any monetary obligations (i.e. rent payments), it provides a strong defense to landlords unable to operate the amenities.

Prior to the COVID-19 pandemic these provisions rarely were the subject of extensive negotiations, but both landlords and tenants should be diligent moving forward and pay close attention to how force majeure may affect each party's obligations. In particular, landlords should consider including express force majeure references in any provision obligating them to provide amenities.

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Construction Delays

As many landlords and tenants have unfortunately experienced, COVID-19 has not only forced the closure of retail spaces and amenities, but also caused delays in building out tenants' spaces. Even as restrictions on physical construction activities have been eliminated or reduced, local authorities may still be facing backlogs of permit requests, thereby further slowing down the process.

For leases where tenants are performing the initial build-out work, the risk of any construction delays generally falls on the tenant. The date on which a tenant must begin paying rent usually takes into account an estimated timeframe for the tenant to finish the space and start operating. As the pandemic restricted construction activities, those estimated timeframes could no longer be met and a tenant's rent obligation would begin without the space being ready. To protect themselves moving forward, tenants can negotiate extensions of the rent obligation due to COVID-19 delays. Landlords may be willing to agree to this concept, but often will seek to clarify that the entire term will be delayed (rather than shortened). Landlords might also include an outside date for the rent obligation to commence, regardless of any COVID-19 delays.

For leases where landlords are required to prepare the premises for a tenant's occupancy, the risk of construction delays would more often be a negotiated point. For example, tenants might be able to negotiate rent penalties or even termination rights if the landlord fails to complete the work by a particular date, or commencement could be based entirely on when the landlord finishes the work. Further, any target or outside completion dates could be subject to extensions for any tenant-caused delays or force majeure events. With pandemic delays being more prevalent, landlords have become more sensitive to delay provisions and should make clear that COVID-19 delays excuse any late delivery. As a compromise, many landlords and tenants agree to include COVID-19 delays as excuses for late delivery, but provide that the entire lease term be pushed back as well.

Regardless of the issues that a landlord or tenant may be facing in the context of a commercial lease, maintaining an open line of communication is an effective and important tool in addressing and resolving any issues as they arise.

The future is far from certain, but Cummings & Lockwood is committed to helping our clients weather these challenges as we move forward together.

About the Author

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