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Landlords and Tenants Under Stress: Negotiated Resolutions May Offer Relief

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As we are all aware, the effects of the COVID-19 Virus have shuttered businesses resulting in widespread requests for rent relief from landlords that need an uninterrupted rent stream for debt service and property expenses, such as real estate taxes, insurance and maintenance and repairs. Given the likelihood that foreclosures and evictions will continue to be stayed by courts, legislatures and governors for the duration of this crisis, negotiated resolutions likely make more sense than litigation. The problem is, of course, most acute for businesses that rely on personal interaction, such as retail, restaurant and theaters, where closure eliminates all income. Where employees, such as accountants, lawyers and software engineers, can continue to work remotely, companies may continue to generate sufficient revenue to pay office rent.

A landlord's initial response to a request for temporary rent relief should be empathetic because good will now will engender tenant loyalty when we emerge from this crisis and courts will likely strive to protect tenants and look harshly on uncooperative landlords. That said, tenants must understand that landlords are constrained by their lenders and, generally, may not consent to rent abatement without lender consent. Where a lender is involved, any "deal" with the tenant will likely be contingent upon a corresponding forbearance from the lender. Initial reports indicate that the owners and servicers of Commercial Mortgage Backed Securities are exhibiting less flexibility than community bankers – at least as of today. If a lender simply ignores a landlord's request to accommodate a distressed tenant, review the loan documents. If the borrower (landlord) was well represented, the loan documents may provide that a lender's failure to respond, within a certain period of time, to a borrower's request to modify a lease is deemed to constitute the lender's approval of same.

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Of course, in fielding requests for rent abatement landlords must ascertain whether tenants are truly unable to pay rent and not taking advantage of this situation. Even if the lease does not require a tenant to provide its financials to its landlord, it's not unreasonable for a landlord to request a tenant's financials in considering a request for rent relief.

Our Firm is already extremely active in representing our landlords and tenants in negotiations. We expect that lessons learned from previous economic downturns will result in some form of forbearance by the landlord. For example, we recently took a very proactive approach on behalf of a movie theater chain which is now closed due to the coronavirus. We were able to negotiate and enter into Rent Forbearance Agreements, with several theater operators, which either abated base rent entirely, or partially, for a period of three months. The tenants (individual theater operators) are required to repay the deferred base rent over a period of four consecutive months commencing later this year or early next year. Under fully net leases, the cinema operators are required to maintain and repair the theater and continue paying all additional rent, such as real estate taxes and property and liability insurance during the base rent deferral period. In return, the rent forbearance periods are fixed at three months, and Percentage Rent is waived, even if the tenants are permitted to open to the general public before then, providing the theater operators with some degree of financial certainty for this period of time. The landlords were able to absorb this rent shortfall with temporary loans.

There are a number of options available to both the landlord and tenant in structuring forbearance agreements. They include the following:

- accrue interest on the deferred rent,
- reset the deferred rent at the escalated amount set forth in the lease for the period the deferred rent is to be repaid, or
- extend the lease term by an amount equal to the rent deferral period and reset the deferred rent to the amount payable at the end of the lease term, or the then-current fair market rent.

The retail world has generally accepted concepts which may be applicable in current circumstances. The typical shopping center or mall lease provides rent relief when an anchor tenant "goes dark" or when a co-tenancy clause is not satisfied because the center or mall does not have a critical mass of open stores. Recognizing the loss of business, and revenue, attendant to such situations, a retail lease might provide for reduced or abated base rent while retaining the right to collect Percentage Rent to the extent the tenant is able to open for business. Retail landlords and tenants should carefully review these provisions in their lease and consult with counsel to determine if they are applicable under current circumstances.

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In order to provide these types of rent concessions to tenants, landlords will, in turn, need to consult with their lenders and negotiate modifications to their existing loans. They might suggest that their lenders:

- defer all principal (but not interest) payments for the period of rent forbearance and extend the loan term by a period equal to the rent forbearance period, or temporarily reduce principal payments to an amount supported by rents after payment of essential expenses such as taxes, insurance, property management, maintenance and repairs. When the principal reduction period is over, deferred principal can be repaid over a period of time sustainable by rents.

Of course, the current pandemic is like nothing we have ever experienced, but the Real Estate attorneys of Pullman & Comley have many years' experience restructuring leases and financings to respond to economic downturns. The work-out lessons we learned in the banking crisis of the early '90s and the Great Recession of 2008 have applicability today and we are standing by to help you.

Pullman & Comley attorneys have been closely monitoring the many developing implications of the COVID-19 pandemic for businesses and for professionals, including law firms. We have been responding, and will continue to respond, to a wide range of risk management questions. The firm's FOCUS page for the latest COVID-19 advisories may be found here.

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