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Some Guidelines on Rent Relief and Lease Obligations

Landlords discussing rent relief with commercial tenants need to consider a number of caveats.

By Stephanie Friese, Christine Norstadt and Jennifer Garner | May 13, 2020

The jury is still out for May income as landlords and property managers are still assessing the impact from their tenants ' payments. Office, industrial, and multifamily landlords will likely receive most, albeit with some shortfall, of rents because tenants in these sectors have not been affected as much as in the retail

sector, where we are hearing reports that as many as 40-50 percent of retail tenants will not re-open.

Strategies to provide tenants with relief

Landlords must time the relief right. On the one hand, don't rush. Investors need to make sure any relief is not in conflict with loan documents or is pre-approved by their lender(s). Many also believe we don't yet know how long or short the recovery process will be and want to avoid the costs of multiple amendments. On the other hand, if recovery is going to be long, engaging with tenants early gives the landlord an opportunity to structure a relatively good deal with tenants, builds goodwill, and creates a basis to deny additional requests for relief from that same tenant if circumstances continue to worsen in the coming months.

Assess the specific tenant's needs and determine whether relief is needed, and if so, whether it will actually allow the tenant to succeed. Additional caution should be exercised when considering rent relief for a business that was already in decline pre-COVID-19. Use any available security deposits, letters of credit or unused rent concessions first. Offer to apply the security deposit and allow replenishment within 12 months, draw down on the letter of credit, or modify the lease to convert tenant improvement allowances to rent abatements.

Structure relief to increase the value of the asset. If rent relief is determined to be a good course of action, most landlords are negotiating for term extensions in exchange for abatement, elimination of pending termination options, or fairly expeditious repayment (e.g. by year-end or at least by the end of 2021) of any deferrals, perhaps amortized with a modest amount of interest. Landlords can also strongly consider subleases with direct payment to the landlord to avoid a situation in which the tenant is getting paid, but the landlord is not.

Force majeure clause does not excuse tenants from paying rent

The bottom line is that barring some extraordinary clause which can be imagined but which we haven't seen yet, tenants are not, by virtue of a governmental order, excused from paying rent under the force majeure clause or any other clause of the lease.

Force majeure clauses excuse non-performance of some lease obligations if an unforeseeable circumstance occurs and if that circumstance renders the party unable to perform, despite its best efforts. However, a force majeure clause does not excuse non-performance based on claims of economic hardship and changing economic conditions. As such, if the clause does not specifically contemplate worsening economic conditions as a "force majeure" event, a provision of this type will not typically relieve a party from a payment obligation.

In the commercial context, absent a bargained-for benefit in the lease, such as a termination clause or abatement right, there are few protections afforded to commercial tenants with respect to financial obligations under the lease. Most jurisdictions adhere to the common law doctrine of independent covenants, meaning the landlord's obligations under a lease and a tenant's obligation to pay rent are independent of one another, and therefore, even if the landlord fails to uphold some of its responsibilities under the lease, that failure does not excuse the tenant's obligation to pay rent. Instead of offsetting rent, a tenant must seek redress in a separate action.

Some tenants argue that they should not be obligated to pay rent because the events surrounding this pandemic have rendered it impossible or impracticable to perform, and that these events are not the tenant's fault. Known as the doctrine of impossibility, this argument has traditionally been applied to situations where there is death or incapacity of a person or destruction of something necessary for performance, or where performance is prohibited by law. Importantly, this doctrine does not typically extend to financial inability or market shifts that adversely affect the tenant's business.

Potential legal implications or negligence claims against co-working spaces

Space as a service agreement, or co-working agreements , are licenses, which are separate and distinct from leases. The biggest difference in these two types of agreements is a lease gives a tenant more control, such as exclusive possession of a space. But in co-working agreements, the licensor maintains control, and the "tenants" must share their workspace and all the amenities. By design, the co-working agreement provides the licensor with more flexibility (as compared to a commercial landlord under a lease), and legally they are more akin to a gym or club membership. Flexibility and the retention of control, however, may have the unintended consequence of heightening a licensor's responsibilities to its customers.

In a traditionally leased building, tenant spaces are not shared, and common areas are limited to parking decks, cafes, elevators, fitness centers, restrooms, lobbies and shared conference rooms. In a co-working environment, every area is a common area, and no tenant has exclusive control over any area. The licensor maintains control over the entire space.

Accordingly, co-working agreements do not grant the "tenant" the right to quiet enjoyment of the property, do not create a landlord/tenant relationship between the parties and therefore laws that govern landlord/tenant relationships may not apply in co-working environments. Similarly, a licensor under a co-working agreement cannot rely on laws that protect traditional landlords who have relinquished control of a leased premises to traditional tenants.

For example, a landlord is not required to ensure the safety of a tenant or invitee, because under a lease, a landlord relinquishes possession to the tenant, so the tenant is presumed to have the requisite control over the premises to keep itself safe. Co-working spaces (like WeWork), however, are especially known for their communal perks, which the licensor is responsible to provide. Accordingly, this model composed almost entirely of common spaces may carry more risk in a pandemic than a traditional office space. The licensor may have greater duties to warn

licensees of conditions and risks and to abate conditions that pose risk of harm, to be more diligent in determining whether there is potential for COVID-19 exposure in the workplace and to take extra precautions to implement and enforce rules (such as wearing masks), to notify customers of risk and to sanitize common areas to mitigate risk to which other co-workers are exposed.

Interestingly, WeWork recently announced guidelines for reopening, which incorporate new social distancing workspace designs and enhanced standards for cleaning workspaces.

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