

Covid-19 – Considerations for landlords



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COVID-19: RENT MITIGATION NEGOTIATIONS BETWEEN LANDLORDS AND TENANTS

1. Overview

Tenants are approaching their landlords to ask for assistance in mitigating their financial outgoings. They are requesting rent holidays, rent reductions, and monthly as opposed to quarterly rent payment schedules. Some tenants are also seeking longer term variations of their leases. Tenants might also decline to pay rent or certain items of a service charge, and in some cases may try to exit their lease altogether.

Some tenants will be close to insolvency if they cannot reduce their liabilities. For them in particular, it may be difficult to justify treating landlords preferentially, by paying rent quarterly in advance for premises that are shut or barely trading, when their other business payments may only be payable in arrears or on a monthly basis. In the event of insolvency, rent payments might be treated as preferences of one creditor over another and might therefore be liable to being set aside. The directors of such tenants will be concerned to ensure that they are not infringing insolvency legislation.

We have seen several different types of request from tenants in respect of payments under commercial leases, and provide comments on these below. We hope this may help you to reply to similar queries from tenants. Please be aware that every situation is different and this note assumes standard commercial lease terms. You must also consider the full terms of a tenant's lease and any other information you have, including the terms of any superior leases, to ensure that your decision accords with this general guidance. We are happy to discuss this with you and to assist you in reviewing specific leases.

The position is likely to change as a result of legislation introduced to deal with issues for landlords and tenants arising from Covid-19. We will update this note regularly to reflect any changes.

2. Tenant Requests

2.1 May we pay less rent?

We have seen requests from tenants to pay less rent for a fixed period of 3 or 4 months, for the period during which the Covid-19 virus affects trade and for the remainder of a lease. Sometimes these requests are coupled with a proposal to pay the arrears caused by the reduced rent at a later date.

Leases, except where rent is entirely calculated by turnover, do not contain provisions allowing reductions in rent. This may change in the future. In one recent Landlord and Tenant 1954 Act lease renewal claim, the court imposed an upward or downward rent review into a renewal lease. However, at present, rent can only be reduced or delayed by agreement between a landlord and a tenant.

If a landlord is prepared to negotiate a change to the tenant's rent payment obligations under the terms of its lease, this arrangement should be documented. If it is not, there is a risk that a tenant may subsequently claim that the landlord has lost its right to enforce the lease terms by way of waiver or estoppel.

The Government's Coronavirus Bill prevents landlords from seeking to forfeit leases falling within Part 2 of the Landlord and Tenant Act 1954 for arrears of rent until at least 30 June 2020. It records that a landlord does not waive its right to forfeit for these arrears except if it does so expressly in writing.

A change in rent payment terms can best be recorded in a side letter. This is preferable to a deed of variation of a lease, as a variation is more time consuming to negotiate and may bind successors in title. The side letter should contain:

- the new rental payment terms including the terms, if any, of repayment of the accrued arrears;
- the length of time for which these new arrangements will last and the situations when the landlord can revoke the concession;
- a statement that the other lease terms remain unaffected by the concession and that the letter will be disregarded on rent review;
- agreement as to what happens when either party assigns their interest;
- confidentiality provisions; and
- the agreement of any guarantor (including guarantors under AGAs) to the terms.

2.2 May we suspend rent payments for a period?

If a landlord is willing to suspend payment of rent for a limited period, the landlord should try to record this by confirming the terms on which it will accept this. The tenant will require this to be on the condition that the landlord does not take other action to recover rent for that period. Recording the terms in writing will make it more difficult for the tenant to argue later that there has been a waiver of the obligation to pay rent. The landlord should record that it is not waiving its entitlement to forfeit for non-payment of these rents. A landlord could confirm that it will permit suspended payment of rent on specific quarter days or other payment days for a limited period and will expect payment of the arrears at a later date. Non-payment at the later date could still trigger forfeiture. Again, a side letter is the best means to record this.

If a tenant pays a single month's rent rather than a quarter's and it has not agreed monthly rental payments, landlords will need to decide what action to take. Forfeiture will not be permitted for the next three months until 30 June 2020 and possibly longer.

A landlord can accept the payment offered by a tenant and write to the tenant confirming that this is without prejudice to any action they may take to recover the arrears. This may be done in conjunction with negotiations with the tenant on future payments.

2.3 We are not going to pay elements of the service charge that are Covid-19 related

If a landlord of multi-let premises has incurred costs in connection with its response to Covid-19 which are outside its usual service charge expenditure, its tenants may try to argue that such costs are for the landlord to pay, or should be recovered under its insurance policies, rather than being passed on to tenants via the service charge. Whether or not this is a good argument will depend on the drafting of the service charge provisions in a lease. Well drafted leases will include sufficient flexibility to allow recovery of costs incurred by a landlord in relation to compliance with statute, regulations, health and safety measures, safety and security and the well-being of tenants.

It is not yet clear whether the Government's restriction from eviction for non-payment of rent is limited to principal rent or whether it also relates to other amounts payable as rent.

2.4 Can we change the terms of the lease permanently because we expect difficult trading conditions?

A tenant is not entitled to be granted a permanent variation of a lease. If a tenant tried to argue that because of the change in conditions it should be entitled to change the lease terms, a court would be likely to say that changing conditions was a risk a tenant accepts when it takes a lease.

2.5 Can we terminate our lease?

If a landlord would like to recover premises, now is likely to be an opportunity to do so. It might be that the premises need refurbishment or development and this could be commenced as an alternative to agreeing to alter rent provisions. This is more likely to be attractive for a landlord if it has already developed plans for doing this. This may be the most effective time to persuade a tenant to give vacant possession without a premium or a dispute and also the time when the least rent is lost during development or refurbishment.

3. Arguments tenants may use to try to avoid rent payment or terminate a lease

A commercial tenant is unlikely to be able to argue successfully that its lease permits it unilaterally to withhold the rent. It may be able to counterclaim for an amount equivalent to the amounts paid under a lease if it is unable to use the premises. Most modern commercial leases only allow for a rent cesser on the occurrence of an insured risk. These are usually fairly narrowly drawn and usually cover damage to buildings and property rather than the adverse financial effect of an epidemic. Commercial leases often also contain provisions which explicitly prevent tenants from withholding or off-setting rent or other payments.

If a landlord will not agree suspension of rent then a tenant may argue that:

3.1 Breach of quiet enjoyment and derogation from grant

A tenant might claim that the landlord has breached the tenant's quiet enjoyment of the premises or derogated from grant (for instance if the landlord has shut the premises or closed common parts for deep cleaning) and that it is therefore entitled to compensation equivalent to all the rent and any other charges, plus other losses arising. Such an argument is likely to be based on the idea that the landlord's acts have made the premises unfit or unsuitable for the purpose for which they were let. If the premises are closed by the landlord without the agreement of a tenant or Government requirement, a tenant could succeed with this argument.

3.2 Forfeiture

If a landlord closes the premises without Government requirement and prevents a tenant having access, the tenant could assert that the landlord has illegally forfeited the lease. The tenant could choose to accept this. In this case it would be difficult for a landlord to maintain it had not forfeited if it wanted to enforce covenants in a lease.

If the tenant wanted their lease to continue and applied to court for a declaration that forfeiture had occurred illegally, it would be likely to succeed and to be able to recover costs and damages.

Provided that the landlord has notified the tenant of a proposed temporary closure and tried to discuss this with it, a claim by a tenant that the closure amounted to forfeiture is less likely to succeed.

3.3 Force majeure

The tenant might argue that Covid-19 is a force majeure that relieves a tenant of having to pay rent. This argument is unlikely to succeed unless a lease contains specific reference to force majeure which covers the present situation. Most leases do not.

3.4 Frustration

The tenant might claim that the lease has been frustrated because the tenant is not able to use the premises. This is unlikely to be a successful argument in court except if the remainder of the term is short and expires before the tenants are free to return to the premises. In most cases a temporary inability to use their premises will not amount to frustration of a lease.

4. What is a landlord entitled to do if it does not want to reduce or suspend rent payments?

A landlord is not obliged to accept a request for rent reduction or suspension. However, it may not be able to enforce the obligation to pay rent if it has closed premises or made them impossible to use without this being required by the Government. Here are some remedies that a landlord might be able to use:

4.1 Rent deposit

A landlord faced with unpaid rent may be able to avail itself of any rent deposit. It could attempt to require the tenant to top up the deposit. If the premises are closed or incapable of beneficial use save as a result of a Government requirement, a court may say that the deposit has been used as a result of the landlord's breach of the lease and refuse to enforce the terms of a rent deposit deed.

4.2 Guarantee

A guarantee, including any AGAs, will be enforceable to the extent that the tenant's breach of covenant is properly enforceable against the tenant. The guarantor usually has the same defences to a claim by a landlord as the tenant has. Subject to this and the validity of the guarantee, landlords can continue to recover under guarantees.

4.3 Court claims for payment of rent

If a landlord shuts premises without a tenant's agreement or Government requirement and then brings court proceedings to recover unpaid rent, the tenant would be likely to counterclaim for losses resulting from the closure and a court would almost certainly award the tenant damages amounting to the rent that they would have paid, other charges under the lease and losses arising from any loss of business. This would more than set off the amount owing for rent and other charges. With the suspension of forfeiture for unpaid rent resulting from Coronavirus, the Government may provide recommendations or requirements for how arrears of rent occurring now are to be recovered. Courts may not want to process debt claims for rent quickly.

4.4 Forfeiture

Arrears of rent is the ground for forfeiture that entitles a landlord to change locks without notice. Once the Coronavirus Bill is passed, it will be illegal to forfeit leases to which Part 2 of the Landlord and Tenant Act 1954 applies for arrears of rent until 30 June 2020 and possibly longer. Rent is defined in the bill as any sum a tenant is liable to pay under a relevant business tenancy. This would mean that this relates to *any* sum and not just any sum that is reserved as rent under the lease. It cannot be intended to include some amounts due, for example, the reasonable costs of an application for consent to alter or alienate. The bill includes existing arrears within this protection and so it would seem that the arrears do not have to be arrears that accrue in the March 2020 quarter alone. This is likely to give tenants a stronger negotiating position when seeking to agree rent suspensions.

These protections do not prevent a landlord from taking steps to forfeit for other breaches of lease. Most leases will contain forfeiture rights on the happening of various insolvency events. If this includes balance sheet insolvency, many tenants are likely to face being in this situation as their cash reserves are used during the current period of no trading.

Currently, the proposed legislation also does not affect a landlord's right to take other steps to recover unpaid rent, such as those remedies referred to above, and it does not change the position in respect of existing enforcement action. Whilst tenants that go into arrears on their rent will be protected from eviction in the short term, they will need to repay the arrears in full plus accrued interest once the

protection is lifted (be that 30 June 2020 or later if the UK Government extend the arrangements) to avoid facing forfeiture proceedings at that point.

4.5 Keep open clauses

Leases which contain rents calculated on the basis of turnover, particularly in the retail sector, often oblige tenants to stay open for business during normal opening hours. Where footfall and has dropped significantly for tenants, they will be considering closing premises.

Courts can require tenants to keep premises open. This is usually only the case where a tenant is an anchor store or has some other special significance to a landlord. A court has discretion whether to award specific performance or damages for loss of profit as a remedy for a tenant's failure to keep premises open. In the present circumstances with little footfall and poor trade, the balance of convenience between the landlord and the tenant is likely to persuade a court to refuse a claim by a landlord for specific performance. Instead the court is more likely to award damages for loss. This is particularly the case if the nature of the premises means that the tenant is required to close. The Government's instruction of 20 March to cafes, pubs, restaurants and other leisure venues to close will mean that a court will not require these to remain open in contravention of the law.

4.6 Recovering rent directly from sub-tenants

When a tenant is in arrears of rent, a landlord is permitted by section 81 of the Tribunals, Courts and Enforcement Act 2007, to serve a notice on any sub-tenant of the premises requiring it to pay rent directly to the landlord until the arrears have been cleared. While in principle this offers an alternative way of getting rent paid, we expect that landlords will not be permitted to forfeit the intermediate lease if the sub-tenant does not pay. As a result this may not offer an effective way in which to get full rent paid.

5. Does a landlord need to get consent from any third parties?

A landlord will need to consider whether its interest in the premises is leasehold, and if so, whether the terms of its own lease require it to approach a superior landlord to obtain consent for any rental or other lease concessions granted to its tenants. If it proceeds without obtaining consent, then it risks triggering its own landlord's right to forfeit or make claims in damages against it.

In addition, if the landlord has charged its interest in the premises, whether that is freehold or leasehold, then it will also need to check the terms of its financing documents carefully to ensure that it will not breach these by agreeing any concessions or variations, or by commencing any claims against a tenant. Again, failure to do so could trigger adverse consequences under the finance documents such as repayment obligations or enforcement of security.

6. Conclusion

Although there are actions and remedies that landlords can pursue to enforce the rent payment terms of leases, if landlords wish to keep premises tenanted, it makes sense to reach agreement with tenants who seek concessions. Any agreements should be recorded in side letters to avoid later claims by tenants that the lease terms have been varied permanently.

The above is subject to the specific terms of leases, and any legislation that the Government may introduce.

FOR FURTHER INFORMATION, PLEASE CONTACT



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