



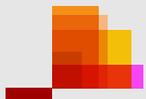
UK Commercial Real Estate Guide

Staying ahead of COVID-19

25 March 2020

26 March 2020 Update:

Please see our supplementary comments added in red at “Which tenants are covered by the rent suspension period?” covering further updates received from the government on interpretation and guidance on the provisions of the draft Coronavirus Bill (Coronavirus Act 2020, once in force).



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Introduction

The recent global outbreak of COVID-19, which was declared a pandemic by The World Health Organisation on 11 March 2020, has not only impacted small businesses and markets across the world, but significantly impacted the UK real estate industry.

Sellers and buyers remain cautious, resulting in a slowdown of big-ticket transactions, while commercial landlords and tenants are looking for solutions to slow down any further disruption to their businesses.

We have set out below some legal guidelines, solutions and steps that commercial property owners and occupiers can take to mitigate any associated risks as far as possible, while the real estate industry grapples with the uncertainties of COVID-19.

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Can commercial tenants suspend rent due to COVID-19?

Rent suspension will most likely not be an available remedy under commercial leases if tenants need to close their premises due to COVID-19. These provisions are usually only operational following extensive damage to properties, rendering it (or access to it) unusable, until such damage is rectified.

Despite this strict interpretation of rent suspension under commercial leases, the government has announced temporary relief measures from forfeiture due to non-payment, as a result of the COVID-19 outbreak. These measures will be passed through Parliament as an emergency bill (the “Coronavirus Bill”), which will essentially restrict landlords from evicting commercial tenants for non-payment of rent during the suspension period.

Does the forfeiture suspension period qualify as a rent free period for commercial tenants?

The short answer is no. The government stated that this is **not** a rental holiday and that landlords are still owed the rent. Once the suspension period has ended, landlords will be able to claim forfeiture for any rent that was originally due and covering the suspension period.

Care should therefore be taken and landlords and tenants are encouraged to continue having proactive conversations to reach alternative voluntary arrangements, as the new measures simply delay the right for landlords to forfeit leases for non-payment of rent to a later date once the suspension period has ended.

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When does the suspension period start?

The measures will come into force as soon as the Coronavirus Bill receives Royal Assent and will last until 30 June 2020. The draft bill does however provide options for the government to extend the suspension period beyond 30 June 2020, should this be needed.

Which tenants are covered by the rent suspension period?

All commercial tenancies which qualifies as a business tenancy, as defined under the Landlord and Tenant Act 1954 (the “**1954 Act**”) will have the benefit of the rent suspension period. This however only appears to extend to commercial tenants which **occupy** premises for the purposes of carrying on a business.

The rent suspension measures do not therefore appear to currently apply to tenants under superior leases for instance, as they would most likely fall foul of the “occupation” requirement.

Types of ‘businesses’ that will be covered are defined as those that are a trade, profession or employment and includes any activity carried on by a body of persons, whether corporate or unincorporated.

The Coronavirus Bill also goes further to extend protection to “relevant occupiers”, being anyone who occupies commercial premises lawfully (other than the tenant) to which the 1954 Act would have applied if the relevant occupier were the tenant (e.g. potentially covering occupiers without leases, such as tenancies under licences to occupy or where group sharing arrangement are in place for instance). It will therefore be interesting to see what further guidance and clarity is made available by the government on these points and the exact extent of tenants covered once the bill has passed.

Update (26 March 2020):

The government released supplementary explanatory notes which give further clarity on points of uncertainty, including which tenancies

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qualify as a “business tenancy”. The legislation provides that “relevant occupiers” which the 1954 Act would have applied to (if they were tenants) will also be covered. The example given in the explanatory notes is “...where the original tenant has sublet premises and is no longer in occupation”. It therefore appears that tenants under superior leases will also be covered.

No further clarification has however been given to date whether the definition of “relevant occupiers” will also extend to tenants who are occupying under licences to occupy or sharing as part of a group.

What protective measures will commercial landlords receive?

The government stated it will continue to actively monitor and keep dialogue open with commercial landlords to assess the impact this will have on their own cash flow. The government has also made it clear that non-collection of rent during the forfeiture moratorium period will not be treated as a waiver by landlords to pursue rent that was due during the forfeiture suspension period and that other forfeiture breaches remain unaffected during the suspension period (e.g. if a tenant wilfully damages the property).

Whether any additional reciprocal measures will be available for commercial landlords are yet to be seen. It is however worth mentioning that the government has planned other additional support to all businesses, including £330bn government backed loans and guarantee, which landlords’ businesses will benefit from too.

Which rent payments are covered by the forfeiture suspension period?

The Coronavirus Bill defines “rent” as **any sum** a tenant is liable to pay under a relevant business tenancy. This will most likely therefore extend to other payments due under commercial leases (other than principal rent).

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As some leases reserve the right of forfeiture only if principal rent is unpaid (and others extend forfeiture right to other payments due under the lease, such as insurance rent), it would be useful to see what further guidance and clarity is given by the government once the bill is passed.

Will retail stores be required to comply with ‘keep open clauses’?

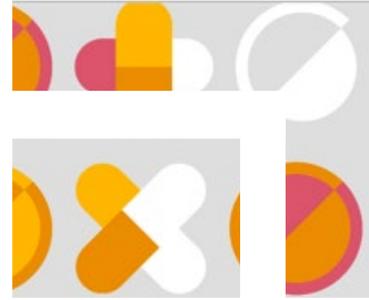
Retail leases will typically contain a ‘keep open clause’. These clauses create a positive obligation on retail tenants to remain open for trading. Landlords usually have rights to recover damages for a tenant’s breach of these provisions. Most commercial leases will however also contain an obligation to comply with all notices, orders, statutes and laws. As a result, a retail tenant’s decision to remain open following mandatory closure orders due to COVID-19 by the government, would be a breach under the latter obligation.

It is also worth mentioning that courts have traditionally been reluctant to order specific performance and landlords will also have a difficult time to prove its losses, especially if closures were in line with the government’s advice and guidance in helping the country to contain the spread of COVID-19.



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Can commercial leases be terminated due to COVID-19?

The short answer is probably not, unless landlords and tenants commercially agree to surrender a lease (possibly at a premium) or if a break date is due soon in the lease.

Two potential options that commercial tenants could pursue to try and terminate under a COVID-19 outbreak, would be under the contract law doctrine of 'frustration' or pursuant to a 'force majeure' clause, if one is included.

Frustration

To satisfy the conditions for frustration, the tenant would need to prove that COVID-19 is a supervening event which 1) renders the lease impossible to perform; or 2) fundamentally changed the nature of the performance. This would be hard to prove if the government only gives an advisory notice, as opposed to a mandatory order to close premises. Even if an absolute ban is put in place by the government, it will most likely be a temporary emergency measure, as opposed to a permanent fundamental change. It is also worth mentioning that similar frustration grounds pursued for termination of leases due to Brexit also failed, which in itself, one could have argued constituted a more permanent change.

Force Majeure

Albeit commonly used in agreements for sale and most other commercial contracts agreed between parties, leases will typically not include a force majeure clause, unless specifically drafted for.

If it does, the clause will need to be reviewed carefully to consider whether it extend to COVID-19.



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Force majeure clauses will ultimately be dependant on what parties' advisors agreed, but typically list out the specific events that will constitute a termination event for the underlying agreement, lease or deed. Some robust force majeure clauses may even contain a 'catch-all' definition extending to all other events beyond the reasonable control of the parties. Consideration will also need to be given to the definitions used - e.g. whether a 'notifiable disease' (the latest classification of COVID-19 by the government) will be covered.

Would business interruption insurance be available for closures due to COVID-19?

Depending on the terms of the policy, commercial tenants may be able to get some relief from their business interruption insurance to cover losses suffered during the period of closures due to COVID-19.

These policies usually only cover for business interruption where such suspension is due to property damage caused as a result of certain events, such as fire, floods or natural disasters. Some policies do however extend their business interruption coverage to include diseases and pandemics.



Policy wording and definitions should therefore be checked carefully, especially in line with the government's decision on 5 March to designate COVID-19 as a 'notifiable disease'. Consideration will also need to be given whether the policy covers advisory recommendations by the government or only mandatory closure orders.

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Long Term Planning

With the uncertainty of how long the COVID-19 pandemic will last, commercial tenants could also look at a variety of other long term planning solutions to start mitigate any future liability.

There are a variety of steps that commercial occupiers can take, but all of which will ultimately depend on the underlying terms of their commercial lease. We set out some of these considerations below.

Lease assignments

A long term solution could be to dispose of the leased premises and downscale to temporary or more affordable accommodation during the downturn period.

Most leases will include rights for tenants to dispose of their lease by assignment, usually with landlord's consent, not to be unreasonably withheld or delayed. Your lease may also stipulate certain conditions that need to be met, such as rent that needs to be paid up to date or financial viability and covenant strength of the new incoming tenant. You may also be required to provide a guarantee that the incoming tenant will perform all the tenant covenants under the lease, including paying rent (usually, up until the lease expires, or until it is subsequently assigned a second time round).

Whether this option is viable will of course depend on the appetite in the current market and the length of the remaining term on the lease. Some tenants might be looking for a temporary place, and see the short term left as an incentive, some will be looking for a slightly longer term.



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Underletting part or whole of your premises

Some leases will allow tenants to underlet whole, or a distinct part (e.g. if a tenant leases a whole building, it might be allowed to underlet a separate floor, which could save on overheads if done on a temporary basis).

Most leases include a right to underlet, subject to the landlord's consent, not to be unreasonably withheld or delayed.

Again, this will depend on the demand for space in the market; but may be easier than assignment as the size of the space can be adjusted, as can the underlet length of term.



Group sharing as an alternative

If you have various leasehold premises, held by different group companies, you could always look to assign or underlet one premises to a third party and move staff to share with another arm of the business on a temporarily or longer period to save on overheads. You might also have a lease coming to an end, and instead of taking on a new lease liability, decide sharing is a better temporary solution in the current economic climate.

Careful review of your lease terms will however need to be made to ensure the two companies sharing the same premises can do so. Most commercial leases offer a group sharing option, without landlord's consent, provided no landlord and tenant relationship is created and that both companies are within the same group (which will be defined). Some leases will, however, require the landlord to be notified of any such sharing arrangements.

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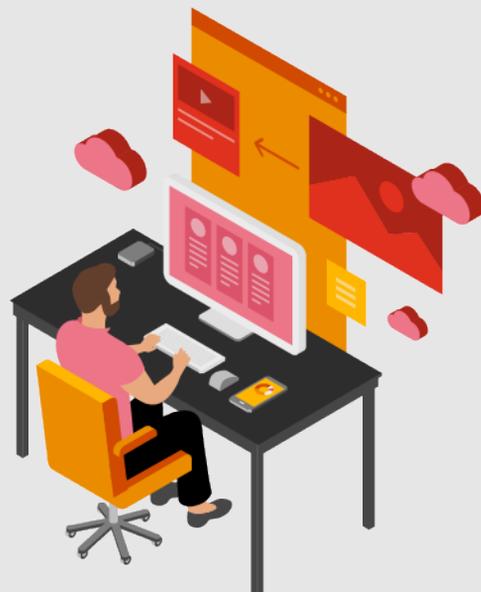
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Confidential variation of your lease terms

During times of uncertainty, tenants and landlords can commercially agree an alternative rent payment plan. As a temporary measure, this could mitigate any immediate cash flow risks. Options such as alternative rent payment dates or re-distributing a higher level of rent to a later period, in return for a lower rent period, could make all the difference to a landlord wanting to keep a reputable corporate tenant, without losing out on the full rent across the overall term.

Landlords would typically not agree to incorporate such amendments directly into the existing lease. The main reason being, such amendments would need to be publicly registered at the Land Registry if the underlying lease is registered. Landlords might not feel it is appropriate to give the same incentives to all its corporate tenants and therefore want to keep such arrangements private and confidential. The solution would therefore be to record such concessions in a confidential side letter. Such side letters would not need to be publicly registered and it could also be made personal to the specific tenant.

With the unprecedented impact of COVID-19 this could be a temporary measure that would most likely be a welcoming solution to landlords, who would not necessarily want to lose reputable corporate tenants, merely because they could not find a confidential temporary solution.



Whether you are looking to draft or negotiate an existing agreement or lease, we can assist you with tailored legal advice on the best available solutions to mitigate your risks during the COVID-19 outbreak.

Equally, if you are an existing commercial property owner, landlord or tenant, we are happy to advise you on legal solutions or other options available to you during the periods of uncertainty due to COVID-19.

Should you need any further advice, please reach out to one of our real estate legal specialists.

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