

Strategies for Landlords in Dealing with Tenants in Light of COVID-19

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Tenant economic issues due to COVID-19 have been well publicized and programs have been put in place to help tenants. Landlords, on the other hand, feel much of the same pain but that pain has not been well publicized, nor has it been addressed by federal or state programs. While landlords appear to have fewer options than tenants at this time, there are a number of strategies that landlords can employ to (1) address tenant concerns in a way that is mutually beneficial to landlord and tenant, (2) help landlords prepare for potential future litigation with tenants, and (3) restructure or expand operations to take advantage of current and near-term market conditions.

Addressing Tenant Concerns in a Mutually Beneficial Manner

If landlords have not done so already, they should reach out to their tenants to see how business is being impacted by the COVID-19 virus and the responses to it. Many retail tenants were deemed to be non-essential or were deemed to be essential but only able to operate in a limited manner. These tenants will obviously experience cash flow issues and rent will be harder to pay. Landlords that can afford a total or partial deferral of rent may want to consider offering such deferral in exchange for modifications to the existing lease. Some modifications may include:

- Term extensions;
- Removal of purchase options, termination rights, or other similar provisions that make the property less marketable
- Changes to permitted sales and use clauses;
- Adjustment of tenant security deposits or letters of credit;
- Amortization of deferred rent over a longer period of time, until government relief arrives, or business interruption pays out;
- Addition of "percentage rent" or other terms to enable landlord rent recovery;
- The addition of personal or corporate guaranties;
- Re-definition of property, premises, or common areas; and
- Reallocation of any remaining tenant improvement allowances.

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Many tenants will see the modifications to be acceptable in exchange for rent deferral, abatement or reductions. If the tenant is willing to make the modification, the landlord then needs to confirm that any lenders or other third parties with an interest are willing to consent. Cooperation with the lender may open the door to additional options. Many landlords have lenders that hold escrow funds to pay for leasing commissions, tenant improvements, replacement reserves, and other similar reserves. Depending on how the modifications are structured, modifying the lease may give landlords an opportunity to access these reserves, providing additional cash flow to the landlords to pay for a variety of items including mortgage payments or payments to investors. In addition, landlords should be careful to review any co-tenancy or existing percentage rent provisions. Generally, landlords should ask for updated financials and cash flow projections to help understand which tenants are in the worst positions. Landlords will also want to include “no waiver” provisions to protect themselves from waiver arguments as well as general releases to prevent tenant suits on unrelated issues. All of this can be wrapped in a non-disclosure agreement as well.

Preparing for Potential Future Litigation

In addition to proactively addressing tenants’ concerns through lease modifications, it is becoming ever more clear that some tenants will refuse, or be unable, to pay rent and other obligations under their leases. Unfortunately, in Wisconsin like many other states, the state government has issued a moratorium on any foreclosure and eviction activities. Further, many state court systems are shut down so even if foreclosure and eviction remedies were available, there would be no court to issue and enforce a judgment.

While the courts are effectively shuttered, it is important for landlords to keep in mind that they **still have all of their rights under their leases**. No programs have absolved tenants from performing under the lease, rather they have **temporarily** delayed landlords’ enforcements of their rights under the lease. A default under a lease is still a default and while a landlord may not be able to evict the tenant, the damages continue to accrue (likely with interest).

Since landlords’ rights are deferred, but not taken away, what should a landlord do with a defaulting tenant? Landlords should continue to perform under the lease. Document in writing all interactions with tenants and any attempt to work with tenants to remedy defaults. Courts have equitable powers that they can use at their discretion. Often, a landlord that is seen as attempting to make reasonable accommodations for a tenant and the tenant not being willing to make any concessions to the landlord will result in the landlord getting everything they are seeking in a future legal action.

Landlords should provide any correspondence received from tenants regarding the refusal to pay rent to their attorneys as soon as possible. Depending on the content of the communications, tenants may be seeking to establish grounds for

novel defenses such as impossibility of performance, force majeure, inverse condemnation or casualty under the lease. Any of these defenses, if successful, may result in the landlord being unable to collect all amounts owed to it under the lease.

Restructuring or Expanding Operations

Finally, there is widespread recognition of the unprecedented economic effects of the COVID-19 virus. This may be an opportunity for landlords to acquire more properties and negotiate better lease terms with potential tenants. Landlords that are acquiring new properties should consider adding lease amendment contingencies in their purchase agreements allowing landlords to get better leases in place before closing on the new properties. Landlords can underwrite any tenant concessions into the purchase price or otherwise try to finance such concessions hopefully resulting in a stronger asset after the economic impacts of COVID-19 have subsided.

CONCLUSION

COVID-19 has upended the “status quo” for the United States and real estate is no exception. Landlords have an opportunity, if they act proactively, to turn the current crisis into an opportunity that is mutually beneficial to the landlord, its employees, investors, tenants, and community.

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