

The rapidly developing coronavirus disease 2019 (COVID-19) pandemic, commonly known as the “coronavirus,” is having widespread impact on UK businesses and the real estate sector.

This article draws together a number of key issues affecting owners and occupiers of commercial properties in England and Wales to consider as part of their contingency planning.

Rent Suspension or Amendment

Most tenants are required to pay rent in full in advance on a quarterly basis. With the next usual quarter day fast approaching on 25 March 2020, the financial pressure on tenants is focusing minds on potential options to delay, amend or reduce rental commitments.

The vast majority of commercial leases do not provide a general right for tenants to suspend or defer payment of rent. Nor do leases commonly include rights to vary how and when rent is paid, e.g. switching from quarterly to monthly payment, or reducing payment unilaterally.

Failure to pay rent on time and in full can expose a tenant to enforcement action by its landlord, including potential lease termination (e.g. forfeiture), court proceedings to recover the debt owed, Commercial Rent Arrears Recovery (CRAR) or insolvency proceedings.

Careful review of the specific lease terms is necessary, as there may be limited provision for rent payments to be deferred in certain circumstances, e.g. if premises are rendered inaccessible, e.g. for the purposes of undertaking deep cleaning to combat the COVID-19 pandemic.

Some leases may also provide for rent suspension where premises are damaged or destroyed by an uninsured risk; however, even if COVID-19 were to classify as an uninsured risk, the right to withhold rent may only to apply if physical damage is caused, which seems unlikely.

In summary, whether a tenant may withhold rent as a result of COVID-19 will depend entirely on the scope of the rights granted under the specific lease.

However, regardless many occupiers are moving quickly to engage with landlords to seek to agree short-term changes to rental arrangements to manage the impact of COVID-19 on their businesses, including seeking agreement to pay rents monthly, reduce the amount of rent paid or defer rents. For landlords, weighing up the short-term cost of agreeing, such measures against the risk of avoiding defaulting tenants and potential longer-term rental voids altogether is important.

Business Insurance

Many businesses have business interruption insurance; however, under most standard policies, cover is only triggered where physical damage to property has occurred. It is also common that such policies exclude pandemics, such as COVID-19, from the range of insured events.

Even where insurance policies do expressly provide cover for pandemics or government-ordered closures, in some instances, there has been uncertainty over whether the COVID-19 pandemic will be covered as a result of the government to date, stopping short of ordering mandatory closure of premises.

The government has moved to quell such concerns in its guidance issued on 18 March 2020, stating that:

“Businesses that have cover for both pandemics and government-ordered closure should be covered, as the government and insurance industry confirmed on 17 March 2020 that advice to avoid pubs, theatres etc is sufficient to make a claim.”

The reality is that businesses may not have business insurance at all, and many that do may find that their cover is limited, excluding pandemics and extending only to where physical damage is caused. Businesses should carefully check the terms and conditions of specific insurance policies to determine whether they are covered for interruption caused by COVID-19.

For landlords, it is worthwhile checking whether any additional costs of providing services to combat the COVID-19 outbreak, such as additional cleaning costs, are recoverable under any insurance policy. Further, under some insurance policies, landlords may also benefit from limited insurance cover for rental voids, e.g. in the event of tenant insolvency.

Terminating or Avoiding Leases

An important consideration for both landlords and tenants is whether COVID-19 may constitute an event entitling a landlord or tenant to terminate a lease, delay performance (e.g. payment of rent, provision of services) or to decline to enter into a lease under a pre-existing agreement for lease.

Is There a Break Clause?

The specific lease terms should be checked to determine whether there is a contractual break clause, providing the right to terminate the lease for landlord, tenant or both parties, e.g. if premises are forced to be closed for an extended period of time.

Force Majeure?

Does the lease or agreement for lease include a *force majeure* clause? It is uncommon for commercial leases, or agreements for lease, to include force majeure clauses that may entitle a party to terminate, or delay performance, of a contract where certain specified events occur (e.g. an “act of God” or other catastrophic event outside of the parties’ control). Even where a *force majeure* clause is included in a lease, there is some doubt (but it cannot be ruled out) that the evolving nature of the COVID-19 pandemic would constitute such a single event that may be relied on to terminate.

Frustration?

Finally, can it be argued that the lease has been frustrated, preventing performance of its terms and warranting set aside of the lease? This is considered unlikely, even where the government orders closure of premises as a result of COVID-19. Although the impact of closure may be severe in many cases, preventing enjoyment of premises in accordance with the lease, ultimately the interference although prolonged is likely to be temporary. The courts in England and Wales have been reluctant to order that leases are set aside, even where enjoyment of the premises has been rendered impossible for an extended period of time.

Interference With Use of Premises – Is There a Breach?

Where a landlord is acting in accordance with government advice (e.g. in respect of retail, leisure and hospitality businesses), or mandatory order, to close premises, it is unlikely that a tenant would succeed in establishing a claim for breach of the lease.

If, however, a landlord elects to close premises voluntarily, tenants may be entitled to bring a claim for derogation from grant and/or for breach of the quiet enjoyment covenant in the lease.

The usual remedy would be claim for loss of income; however, depending on the nature of the business (e.g. fashion retailers, gyms, shopping centres), where a general downturn in trade is being experienced as a result of COVID-19, evidencing that all such losses have resulted from the closure itself and are recoverable may prove difficult.

It is unlikely that the tenant would be entitled to withhold rent or set off rent from any losses suffered, unless specific lease provisions permit.

Service Charges

Landlords will need to consider carefully their lease obligations to implement measures required to combat the COVID-19 pandemic.

Typical service charge provisions will include an obligation for landlords to provide services to comply with applicable laws and statutory requirements, and recover the costs from tenants. In relation to COVID-19, this may include the additional requirement to provide extra cleaning services.

Landlords should check that the costs of any such additional services are recoverable from tenants through the service charge mechanism and whether there is any financial cap that may apply. Equally, landlords will be concerned in the event that they are unable to provide services required whether this may give rise to a claim for breach of covenant by tenants.

Keep Open Obligations

In certain sectors (e.g. retail), commercial leases may include “keep open” clauses requiring the tenant to remain open and trade at certain times and days. It is possible that tenants will find themselves in difficulty in relation to such clauses, due to government guidance, staff absence through self-isolation.

The courts are often reluctant to enforce keep open clauses; however, tenants need to be mindful and look at the provisions of the clause to identify exceptions that would support a decision to close, to guard against potential landlord action.

Access

Under most commercial leases, landlords will have rights to access premises on giving prior notice to tenants, e.g. to undertake inspections. Given the health and safety measures being taken to limit the spread of COVID-19, tenant occupiers are likely to be concerned to avoid unnecessary visits, and with increasing home working arrangements put in place, may struggle to facilitate landlord access on request. Tenants will need to weigh up the practicalities (e.g. can hygiene protocols be put in place to reduce risk) and whether reasonable refusal to allow access, at least for a temporary period, would be in breach and the risk enforcement by the landlord.

Business Rates

The pressure of business rates liabilities is likely to be more acutely felt by business in these challenging economic times. In response, the government has announced a limited number of changes to business rates affecting retail, hospitality and leisure businesses and other small businesses, including:

- A business rates retail holiday for retail, hospitality and leisure businesses in England for the 2020 to 2021 tax year
- £25,000 grants for retail, hospitality and leisure businesses operating from smaller premises, with a rateable value between £15,000 and £51,000
- Support for businesses that pay little or no business rates, through one-off grants of £10,000 to businesses currently eligible for SBRR or rural rate relief

Whilst those eligible will undoubtedly welcome such measures, inevitably there are growing calls from other sectors severely impacted to extend the assistance further, including medical services practices (e.g. vets, dentists, physiotherapists, chiropractors). The government has promised further financial measures to assist individuals and businesses as part of Phase 3 of its planned measures; however, it remains to be seen whether extension of business rates assistance will be included.

Looking Ahead

The adverse impact of COVID-19 on many businesses presents both immediate and long-term challenges for the UK real estate sector as a whole.

The primary focus for owners and occupiers alike is likely to be on mitigating the widespread negative financial impact of the pandemic, with examples already of landlords and tenants seeking to engage in discussions over potential rent suspension/deferment to provide short-term business continuity.

It is critical that businesses move quickly to implement effective contingency planning, including ensuring a clear understanding of rights and obligations under key contracts (e.g. leases and insurance policies) and give focus to the full range of options available for managing their property interests.

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