LEE & ASSOCIATES
COMMERCIAL REAL ESTATE SERVICES

COMMERCIAL LEASES AND SALES AGREEMENTS IN THE AGE OF COVID-19

Practical Guidance for Commercial Real Estate Brokers
In partnership with Ron Camhi, Partner at Michelman & Robinson, LLP

In the wake of the coronavirus pandemic, there is no doubt that most commercial real estate brokers and their clients have become at least somewhat familiar with force majeure and other related legal terms and defenses that have suddenly become top-of-mind. For those that have arranged for—or are currently parties to—commercial leases or real estate purchase agreements, COVID-19 has probably triggered a passing understanding of force majeure and the like, and has no doubt raised all kinds of questions in terms of existing commercial leases and pending and future sales transactions.

By way of this alert, Michelman & Robinson, LLP provides guidance to brokers regarding certain important issues (force majeure included) facing those in the commercial real estate space, and highlights areas where brokers will remain invaluable advisors to their clients during these challenging times.

More specifically, the narrative below serves as a follow up to the Lee & Associates panel discussion on the impact of COVID-19 on commercial real estate that took place on March 25, 2020, and furnishes information and discusses strategies to assist Lee's team of brokers.

COMMERCIAL LEASES

Many brokers are fielding calls from landlords and tenants seeking input about how they should approach existing commercial leases. This requires a look into force majeure and how it may impact lessors and lessees.

How does a force majeure provision impact the parties to a commercial lease agreement?
Force majeure language in any contract serves to suspend, postpone, and in some cases excuse performance obligations when certain circumstances outside the control of the parties occur. That being said, the force majeure "headlines" that brokers should keep in mind include:

- Force majeure clauses vary from contract-to-contract. Many agreements specifically list events that will trigger application of the provision, such as war, terrorism, an earthquake, a flood, government-mandated restrictions, or other "acts of God."

- Where a commercial lease includes a force majeure provision, its language controls the parties' obligations, though the law requires strict interpretation of the provision against the party asserting it (e.g., either the landlord or tenant).

- Commercial tenants are typically on the hook to pay rent to their landlords, notwithstanding the inclusion of a force majeure provision in their leases. Many, if not most, of these commercial leases contain language stating that force majeure may not be raised as a defense for a tenant's non-performance of any obligations with regard to the payment of rent (typically defined as all monetary obligations, including "pass-through" net charges, association fees, etc.). These carve-outs are extremely advantageous for landlords and—absent other possible defenses (see below)—effectively mean tenants will not be able to circumvent rent altogether—or pay lesser amounts—if something out of their control occurs that results in their landlords being unable to perform their duties under any given commercial lease. Of note, the carve-outs also act to insulate landlords from tenants that refuse to pay rent because of a force majeure that prohibits those tenants from entering or continuing their business operations on leased premises.

- Rent aside, force majeure usually excuses landlords and tenants from other performance under their commercial leases, but only for a period equal to the prevention, delay, stoppage or inability to perform. And of course, if a commercial lease does not include the carve-out language referenced above, even a tenant's rent may be subject to a force majeure clause.

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What are some of the issues regarding specific types of commercial leases that brokers should be considering?
OFFICE LEASES: Virtually all office leases require tenants to pay rent even in the event of a force majeure. Likewise, this category of commercial lease also requires landlords to provide services and access, but arguably, a force majeure would protect the landlord from doing so, sometimes for several months. It is important to mention that rent is sometimes abated during periods of disruption due to a force majeure. In addition, many institutional landlords are currently keeping their buildings open (as they do on weekends or holidays) and not restricting tenant access.

RETAIL LEASES: The retail sector had already experienced a downturn and has been hit hard by the pandemic. To the extent retailers can establish a causal connection between the COVID-19 crisis and their inability to perform under their leases, they could possibly leverage force majeure clauses in their retail leases to alleviate non-monetary obligations (e.g., continuous operations and similar provisions). We are seeing some landlords amenable to working with tenants and offering coronavirus-related rental abatements.

INDUSTRIAL LEASES: A common industry form (the AIR form of commercial leases) does not contain a force majeure clause. One reason for this is because the document as pre-written requires tenants to carry business interruption coverage (discussed below). As noted below, however, the absence of a force majeure provision does not necessarily mean landlords and tenants are without protection from or remedies for injuries due to COVID-19.

What can parties to a commercial lease do if no force majeure provision exists in their agreement?
The answer to this question depends upon what law governs the contract. In California, for example, Civil Code §1511 excuses performance when a party's performance under an agreement is prevented or delayed "by operation of law" or by an "irresistible, superhuman cause." This can certainly be read to include the onset of COVID-19 and resulting stay-at-home order in the state. Bottom line: at least in California, a statute-based force majeure right exists that may be relied upon in commercial leases that do not include such an express provision. There is a caveat to this—the burden is on the party relying on the statutory language.

Beyond force majeure, are there any other legal defenses to performance under a commercial lease that brokers should be aware of?
Yes, the stay-at-home orders that have been issued in multiple jurisdictions nationwide in the wake of the pandemic give rise to potential legal defenses like frustration of purpose (i.e., the stated purpose of the contract is frustrated by governmental prohibitions in response to the virus) and impossibility of performance (i.e., a narrowly-construed defense based upon performance being objectively impossible).

*What specific **strategies** should brokers keep in mind these days when representing landlords and tenants?*
Brokers might advise landlord clients to:

- Work with tenants and remember, given the uncertainty of the current real estate climate, being proactive is crucial
- Decipher "opportunistic" situations (they are not going to be looked upon favorably when landlords enforce their rights and the courts open up)
- If a tenant has advised that it is an "essential business" pursuant to a relevant stay-at-home order, consider seeking confirmation (many such business have been issued letters from state or local government officials)
- If contemplating a lease modification, make sure their agreements contain:
    - Representations and warranties addressing the actual need for a modification (so as to avoid opportunistic situations)
    - Releases of all claims (which should pertain to landlords, property managers and brokers, etc.)
    - A confidentiality provision
    - A limited term for modification, so matters can be assessed when the crisis ends
    - An added "inducement recapture," so that in the event of a future breach, all abated or forgiven rent is immediately reinstated and due (to ensure future performance)

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Brokers should urge their tenant clients to:

- Read the lease in question and be sure to follow any and all notice requirements, especially when relying on a force majeure provision
- Document escalating circumstances carefully and note their effects on the tenant's ability to fulfill contractual obligations (do not rely on the fact that people and industries around the world are being harmed or inconvenienced
- Consider offering to pay all or a portion of "pass-through" net charges/operating expenses; doing so will assist landlords with their lenders and other obligations

PURCHASE AGREEMENTS

In terms of pending and future sales transactions, brokers should consider offering buyers and sellers specific guidance given the impact of the coronavirus on real estate deals.

FOR BUYERS:

- Request updated Estoppel Certificates to ensure tenants are not in default (ask for a landlord/seller estoppel too concerning any recent notices from a tenant)
- Think about updating financial due diligence
- Work with lenders early
- Consult tax or financial professionals given the stimulus and relief packages now available to borrowers

FOR SELLERS:

- Inquire about the buyer's ability to perform (e.g., confirmation of down payment)
- Seek lender confirmation (e.g., loan term sheets often contain "MAC" provisions ensuring that there is no "material adverse change" or "material adverse effect" before a lender will make the loan)

FOR BUYERS AND SELLERS:

- Document extensions through formal written agreements
- Consider whether the coronavirus crisis constitutes a "MAC" in the purchase agreement (this may impact where deposits are paid in purchase and sale agreements that are past the due diligence period and have liquidated damage clauses tied to the deposit)
- Be sure all agreements are equipped for DocuSign PDF signatures, and check with title companies about lead time or "work-arounds" for documents that need to be notarized for recording

What should a broker's client know about insurance coverage in the face of COVID-19 challenges?
There are several different insurance products that may protect your clients in times like these. Of course, it would be best for them to consult their insurance advisors to best understand the scope of their particular insurance portfolios. In the meantime, your clients should be aware of business interruption and lack of access coverage.

Business interruption is first-party coverage typically triggered by physical damage to property owned by an insured (think natural disasters like hurricanes). What is important to understand is that coverage for business interruption is dependent upon policy language, and business interruption provisions tend to differ from policy to policy and endorsement to endorsement. That being said, if business interruption coverage is included in your client's insurance policy, and, as written, it requires "direct physical loss" to property to trigger its terms, insurance companies may rely on this requirement to avoid coverage. Note that this is a "hot topic" in insurance, legislative and legal circles and it is an evolving issue.

There is more. Many policies that include business interruption coverage have "virus" exclusions. Of note, oftentimes these exclusions indicate something else; for instance, that losses resulting from "microbes" are excluded. Some might read that as not having any relevance to COVID-19, but in the policy's fine print, the definition of "microbes" (or whatever other similar term may be used) could potentially include "viruses."

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On the bright side, some policies that include business interruption coverage do not require "direct physical loss" and do not impose "virus" exclusions. In fact, some insurance contracts offering business interruption protection specify that "loss of use" constitutes property damage. If this is true in your client's case, coverage for coronavirus-related losses may well be available.

In addition, it should be mentioned that some policies that include a business interruption provision provide coverage for "Governmental Denial of Access." Given the several stay-at-home orders in place nationwide requiring certain businesses to close or otherwise limiting access to them, your client may be covered for resulting revenue loss if his/her/its policy includes such language (but only if the policy does not require property damage or include a "virus" exclusion).

THE TAKEAWAY

Remember, commercial real estate transactions are generally not adversarial in nature, and brokers are an invaluable resource to their clients when it comes to market climate, structuring modifications, and providing valuation analysis, among many other things. Of course, brokers should not render legal advice, though it is critical that they and their clients be proactive in this current environment.

FOR MORE INFORMATION, PLEASE CONTACT:

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