

## How will leases change as a result of Covid-19?

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*Covid-19 is already impacting on legal documents. Tenants are requesting the suspension of rent clause to be extended to include not just physical damage to buildings but also when premises cannot lawfully be accessed or used, or the tenant chooses not to access or use them, because of a pandemic.*

Where should the rent risk lie?

It's a similar discussion to terrorism or uninsured risks. Why should the tenant pay for space it cannot, or should not for health and safety reasons, occupy? Why should the landlord take the hit when it has a pension fund to protect or the bank to pay?

Insurers need to be part of the discussion. Is the risk more appropriately covered under a tenant's or landlord's business interruption policy?

Landlords may want tenants to keep paying rent and to cover it with a pandemic extension to the tenants' business interruption insurance. But will tenants, particularly smaller ones, be sufficiently sophisticated to do that? It may be safer for landlords to insure and to re-charge the tenants.

Will insurance be available at all? The potential cost of a pandemic event is huge. This points towards a Pool Re type solution where insurers pay capped amounts with the remainder paid by the Government (and repaid by insurers over time).

The insurance issues are complicated. If an office or retail tenant is still able to access premises and is not prohibited from trading, but business is 70% down "because of the pandemic" what level of proof will insurers require?

Rent suspension clauses may get more sophisticated – there may be room for reductions in rent (i.e. risk sharing) where there is a Government prohibition on trading or where social distancing measures cause a substantial drop in trade.

If no satisfactory risk allocation/insurance solution is found then leases may become shorter; trading and traditional fit-out/reinstatement structures may change; and user provisions (and perhaps as a consequence alienation provisions also) may broaden.

Landlords and tenants may prefer to have a 3-year lease rather than a 10-year lease if there is uncertainty around payment or receipt of rent and ability to use, and then tenants won't want the costs of fitting-out and reinstatement, so landlords may provide fitted out space and charge accordingly.

This may lead to a bigger serviced office style market, although Covid-19 has not done the WeWork style market any favours. Serviced office providers in particular are going to have to up their game on air quality, cleaning, distancing etc measures and these may become a requirement of insurers and also banks across the board.

Could a market for turnover rent office leases develop? If there is no landlord's loss of rent insurance available for pandemics, and tenants won't accept the risk of paying rent for premises they can't occupy, shorter turnover based leases would help.

Break clauses in the event of a pandemic could appear if an insurance solution is not found, but the break conditions could be tricky.

There are valuation implications in all these scenarios.

Service charge provisions are likely to be modified. Landlords will want to make it clear that in pandemic circumstances certain services still need to be supplied to an office block or shopping centre or retail park and tenants need to pay for those. Business insurance policies will need to deal with service charge more specifically.

The circumstances in which landlords can voluntarily close premises like shopping centres for health and safety reasons in the event of a pandemic, and to avoid claims from employees/others required to work on site, will need to be thought through. At present, voluntary closure would possibly expose a landlord to tenant claims for breach of the landlord's quiet enjoyment covenant. Keep open clauses will be modified.

The concept of "force majeure" maybe introduced into leases to deal with events (war/pandemic) which aren't currently dealt with specifically, possibly with ultimate reference to a third-party arbitrator to decide on appropriate levels of rent and service charge adjustments.

The industry representative bodies will need to get talking and try and give guidance, following consultation with landlords and tenants, as to the best way forward, with updates to the leasing and service charge codes.

Don't forget the banks. If there is less certainty around income and lease term, then banks will be less willing to lend and bank terms will change. Banks will also be concerned with implementation of building safety measures.

There's a lot to think about and some changes ahead. Insurance will hopefully play a big part.

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