

Insights

Commercial Landlord's Guide to Navigating Tenant Workouts in the Age of COVID-19

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As the COVID-19 or novel coronavirus pandemic continues, landlords have increasingly received communication from distressed tenants requesting rent relief and, in some circumstances, lease termination. With government restrictions on certain industries—such as restaurants and retail—throughout the United States, many tenants have temporarily shut down operations and will be seeking rent relief from their landlords.

While a lease workout may be beneficial for both landlords and tenants, landlords should carefully consider the terms and potential implications of agreeing to amend a lease, as well as the implications of engaging in lease workout negotiations with tenants. Landlords should make sure that any lease amendment is memorialized in writing and signed by both parties along with any guarantors, and landlords should be cautious not to agree to any terms informally through email correspondence. In certain circumstances, sophisticated parties will want to enter into a pre-workout agreement prior to engaging in any negotiations. We recommend involving your attorney as early as possible in the process to protect against unintended consequences.

One of the paramount concerns for a landlord both before and after engaging in lease workout negotiations is confidentiality. Any lease amendment should include provisions addressing confidentiality and restricting the tenant from disclosing the terms of the lease amendment or even the existence of an amendment. Landlords should also consider requiring tenants to agree to confidentiality prior to commencing negotiations, so as to protect landlords in the event that a workout is not reached.

Prior to engaging in lease workout negotiations with a tenant, landlords will also need to conduct a thorough review of the landlord's existing loan documents. Many loan documents require the lender's consent to amend existing leases and/or may contain other covenants that could be impacted by a tenant workout, like debt service coverage ratios, among other things. Landlords will be best served by involving their lender in the process as early as possible.

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Once a landlord is ready to engage in lease workout negotiations with a tenant, they should always start by requesting and reviewing all tenant and guarantor financial statements and any other documentation the tenant can provide to prove the need for rent relief actually exists and that the prospect for recovery is real. If your lender holds any consent rights, they will likely also want to review such tenant financial statements.

With regard to rent relief, alternative rent structures should be considered prior to agreeing to straight rent abatement. For instance, rent deferral or amortization over the remaining lease term may be a sustainable option, ensuring that the landlord is entitled to the full amount of rent over the term. In addition to rent, other provisions of the lease, like operating covenants, may need to be addressed or revised in certain circumstances. That said, any lease amendment providing rent relief needs to clearly address those monetary obligations of the tenant other than base rent, like operating expenses, taxes, insurance and other forms of "additional rent." A landlord will also want to ensure that the tenant is fully complying with all maintenance covenants before, during and after any period of rent relief.

In return for providing rent relief, landlords might want to seek concessions from tenants in other areas of the lease. For instance, an amendment could include:

- Increased tenant financial reporting obligations;
- Additional remedies upon tenant default;
- Additional security and/or guaranties;
- Additional bankruptcy protections; or
- Removing or revising any special tenant rights like expansion options, substitution rights, rights of first refusal or first offer, purchase options, early termination rights, permitted assignment/sublease rights, and self-insurance rights.

In addition to any concessions received, a prudent landlord should always seek certain protections from the tenant in any lease workout. For instance, an amendment should include:

- Estoppel language confirming that no landlord defaults exist as of the date of the amendment;
- Indemnification for any liability related to COVID-19 in connection with the premises or tenant's use thereof;
- A requirement that tenant comply with all Center for Disease Control guidelines and recommendations;
- Waiver of applicable common law defenses excusing non-performance, including the doctrine of impossibility and frustration of purpose;
- Revisions to, and/or waiver of, the force majeure clause of the underlying lease to remove any doubt as to the clause's non-applicability to COVID-19; and
- A requirement that the tenant pursue all legitimate insurance claims related to COVID-19 and fully cooperate with any claims pursued by the landlord.

If the landlord and the tenant enter into a forbearance agreement with regard to any prior tenant default, it should be clear that any forbearance is terminated upon further default by tenant, without notice from landlord. Should landlords elect not to engage in any such lease amendments or forbearance agreements and instead seek to enforce the lease for any tenant non-payment or other default, please be advised that in several jurisdictions, including the entire State of Florida, the eviction process has been temporarily suspended. Furthermore, attempting to evict a tenant while the COVID-19 pandemic continues also has the potential for reputational harm to the landlord from the public.

Finally, both landlords and tenants will want to consider the effect of any governmental assistance programs, like the recently enacted Federal CARES Act, to ensure that any rent relief does not diminish any potential recovery or loan forgiveness available to the Tenant.

Prior to engaging in lease workout negotiations, we recommend contacting your attorney to provide guidance and recommendations specific to your circumstances. The Lowndes Commercial Leasing Practice Group is here to assist.