

Commercial Landlords Face Difficult Decisions as Closures Spur Tenants to Seek Rent Relief

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As Maryland, the District of Columbia, and Virginia approach the two-month mark of mandatory business closures, the shockwaves from the COVID-19 pandemic are being felt by the entire economy. Although the plight of tenants has captured the headlines, commercial landlords also find themselves facing difficult decisions—often squeezed between tenants whose operations are shuttered and their own obligations to mortgage lenders. Evictions have been precluded by government orders (residential-only, in Maryland), and local courts are not open to hear cases or issuing judgments for failure to pay rent. However, there is nothing to suggest that a failure to pay rent now cannot be a proper basis for an eviction later on. Some public interest groups are actually pushing for legislation that would relieve rent obligations altogether, but as it stands there is no legislation that would suspend a tenant's monetary obligations under a lease.

D.C. Mandatory Payment Plans

On May 13, 2020, D.C. enacted novel legislation (Section 8 of the Coronavirus Omnibus Response Amendment Act, B23-0750) requiring that residential and commercial landlords offer “payment plans” to qualifying non-franchise tenants for rent that comes during the present public health emergency declared by the Mayor, and for *one year afterwards*. The bill lacks details about the specifics of permissible payment plans, but it does prohibit the landlord from imposing late fees or penalty interest as part of the payment plan and from frontloading the payment plan with a larger lump sum payment. Landlords are required to: notify tenants that payment plans are available with proposed terms, and describe how applications should be submitted (including “online and by phone”), among other things. Landlords may ask that tenants also provide supporting documentation. If the application shows “financial hardship resulting directly or indirectly from the public health emergency,” the landlord must approve the payment plan.

The D.C. bill leaves landlords to largely decide for themselves what type of plans to offer and approve. In assessing whether a hardship exists, and whether it is a result of COVID-19, landlords might have the discretion to explore the finances of guarantors or other payment resources, such as insurance.

Maryland & Virginia

Neither Maryland nor Virginia have adopted legislation or issued orders affecting commercial landlords' obligations on how to deal with COVID-distressed tenants.

Issues for Landlords to Consider

These present circumstances provide landlords a great amount of latitude, if also discomfort. When a tenant is unable to pay rent, the landlord could simply invoke the lease's default provisions until payment is made or until eviction can be carried out after courts re-open. Of course, that might only kick the can down the road and force the landlord to find a new tenant in a down economy. Landlords might also try to negotiate a rent abatement or forbearance agreement—or any other bargain that is reachable—in hopes of keeping the tenant's business alive and using the space.

In order to make the best legal and business decision, a landlord should first figure out its rights that are available under their respective lease when a tenant fails to pay rent. This way, even if the landlord decides to seek a workout arrangement, it can assert maximum leverage and protect itself in the event the arrangement fails. After all, the landlord's leverage comes from its ability to declare default and, eventually, evict the tenant. In contrast, most tenants have little in the way of leverage because the premises is their single most important business asset (potentially second only to human capital).

Before deciding on the best course of action, a landlord would be wise to consult the Default provision of its lease in order to confirm whether written notice is needed before a non-payment ripens into a default; where that notice needs to be sent; and other technicalities.

Next, the landlord should inspect their lease for any language providing tenants an obvious "out" or excuse not to pay rent. Such language might be found in a "force majeure" clause—which is enforced based on its own specific language.

A lease is a contract, which means that tenants might assert common law contractual defenses to rent obligations, including impossibility, or frustration or purpose, regardless of what their lease says. The applicability of those defenses might depend on the specific nature of the tenant's business, the ability to operate at some lessened capacity, or other circumstances. In general, these "excuse" defenses require a complete impossibility to occupy the premises at all or the occurrence of something that would make it futile for tenant to carry on its business—which means the average tenant will have an uphill battle. However, attorneys and advocates are waiting eagerly to see how Courts will decide these issues, given the unprecedented nature of this crisis.

Potential Deal Points

Once the Landlord understands how it can place the tenant in default and pursue remedies other than eviction, it can approach negotiations from a position of strength. Many tenants will simply ask for the rent to be forgiven until the government allows them to re-open, or longer. However, there is no need for the landlord to concede that the rent will simply be abated. Instead, a landlord can negotiate for deferrals, or other terms that improve their long-term position, such as a lease extension, new or additional guarantors, additional security, or increased late fees or interest on payments due after the closures are over (subject to prohibitions, such as those enacted in D.C.). In exchange for bending the lease terms as necessary to save tenant's business, the landlord should appreciate the opportunity to tweak the lease in its own favor. Another possibility is simply offering the tenant to get out of the Lease—if it would benefit the landlord—either with or without a termination fee. It should not be overlooked in these negotiations that most leases provide for reimbursement of the landlord's attorneys' fees upon a default—whether the Landlord wishes to ask for that payment as part of the abatement agreement, or to use that as leverage to dissuade the tenant from dragging out the negotiations or asserting frivolous positions.

Another useful mechanism is the provision in many leases that allow the landlord to inspect the tenant's books and records. Even if that right is not spelled out, a landlord might reasonably request financial statements from the tenant, and their guarantors, to ensure that the requested abatement or forbearance is actually necessary, and the tenant is truly unable to pay. Certainly the tenant should be reminded that the landlord itself faces financial obligations, such as its mortgage.

Drafting New Leases

Finally, the lessons learned during these periods should be remembered as landlords and their agents draft and negotiate future leases. Many landlords and attorneys are now reviewing language they never thought would apply (and hoped would never apply) in their lifetime. Given the new reality and new possibilities, old lease forms should be scrutinized when used for new demises, and new leases should be designed to prevent the type of confusion now being encountered.

The attorneys in Paley Rothman's Real Estate Group represent commercial landlords, large and small, in transactions and litigation. We would be happy to discuss any similar situations that you might encounter amid these unusual and uncertain times.