

MEMORANDUM

DATE: May 15, 2020

RE: Commercial Lease Rent Abatement or Reduction During COVID 19 Emergency –
Landlord and Tenant Perspectives

Greetings:

This article addresses some issues that should be considered by landlords and tenants pertaining to requests for rent abatements, rent reductions and other modifications to the tenant’s obligations under commercial (i.e., non-residential) leases as a consequence of the COVID 19 emergency.

Statewide Limitations on Non-Residential Evictions.

As many commercial landlords and tenants already know, by an April 2, 2020 Executive Order (Executive Order 20-13), Oregon Governor Kate Brown imposed a 90-day moratorium on non-residential evictions (subject to certain qualifications and exceptions), which moratorium is also subject to an extension by a further order. Additional information about the Governor’s moratorium is provided in an April 6, 2020 Memorandum available on our website titled “Update for Residential and Commercial Landlords Regarding Coronavirus.”

The Governor’s Executive Order, however, while temporarily barring landlords from pursuing commercial evictions based on nonpayment as defined in the order (including taking steps as a precursor to an eviction, such as delivery of a default notice); also makes clear that except for late fees and penalties that accrue during the moratorium, tenants are *not* relieved of the responsibility to pay rent. In other words, while landlord *remedies* for nonpayment may be *temporarily* curtailed; when the moratorium is lifted, there may be a “day of reckoning” for commercial lease tenants who, without obtaining some further relief from the landlord, will then be obligated under the threat of lease termination and possible eviction to pay in full all past due rent.

In view of that reality, some tenants have now been approaching their commercial landlords (and in some cases, commercial landlords have been approaching their tenants) with proposed terms for temporary abatement (suspension) of the obligation to pay rent, proposed terms for repayment over time of past-due rent that will accrue during the moratorium, and similar modifications of the lease obligations that may call for an amendment to the parties’ lease.

Landlords and tenants will undoubtedly have differing perspectives on such matters, and this article discusses some of those perspectives.

Rent Abatement and/or Reduction from the Landlord's Perspective

As mentioned above, tenants are notifying landlords that they will not be paying rent and/or are requesting rent reductions, rent forgiveness, application of security deposits and/or “last month’s rent” to current rent obligations, and other financial relief. In evaluating such requests, each tenant’s individual situation will be different and any such request should be based on the impacts that the COVID-19 pandemic and governmental response to the pandemic (such as ordering “nonessential” businesses to be closed) has *on the tenant’s particular business*.

Other relevant considerations include whether there are personal guarantees of the lease in place, the tenant’s and any guarantors’ assets as disclosed by the most recent financial statements provided to the landlord, the desirability of the premises for leasing to a replacement tenant, potential costs of reletting the premises (including brokerage commissions) if the lease is terminated on default, the tenant’s payment history and adherence to all other terms of the lease (i.e., is the tenant a “good” tenant or historically a “problem” tenant?), and a myriad of other relevant considerations.

In addition to the above summarized general considerations, the following issues, strategies and perspectives should be considered by the landlord.

- Is the leased property subject to a mortgage? If so, before agreeing to modify any of the lease terms, the landlord should complete a careful review of the loan documents to determine if lender consent to a lease modification is required. In that regard, one should also consider that virtually all commercial mortgages include a security assignment to the lender of any and all leases on the mortgaged property, which security assignment includes an assignment of rent. If lender consent is required and not obtained, that will be a default under the loan documents in which case, the default may not be a curable default and could place the landlord in a particularly precarious position *vis-à-vis* the landlord’s lender. Moreover, in light of the current pandemic emergency, landlords may hope to obtain some mortgage relief from their mortgage lenders, including a restructured payment schedule, waiver of late fees and default interest, and/or a temporary or permanent interest rate reduction. Successfully obtaining any such loan modifications will be made more difficult if the borrower/landlord is already in default for failure to involve the lender in the lease modification approval process and for failure to obtain the lender’s consent to a negotiated lease modification.
- Even an exchange of emails related to a requested rent abatement, rent forgiveness, or other waiver of certain tenant lease obligations may be sufficient to constitute a binding amendment of the lease. Accordingly, responses to tenants should be couched in terms of statements such as: “Yes, we will in good faith consider your request for rent abatement and a deferred repayment schedule; but any agreement is subject to review of our legal counsel and no modification agreement will be binding on us until reduced to a formal lease amendment that is fully executed by both parties (and by any mortgage lender, lease guarantors, franchisors, or other third parties whose consent to a lease modification may be required).

- Encourage each tenant who has given notice that rent will not be paid, who has stopped paying rent, and/or who is otherwise requesting financial relief under the lease, to explore all state and federal assistance options, including the SBA's Paycheck Protection Program and additional funding available under that program if and when approved by Congress.
- Encourage tenants to review their business interruption insurance policies and discuss possible coverage and claims with their legal counsel and insurance broker.
- Remind tenants that even though there is currently a moratorium on evictions, the Governor's order does not waive a tenant's obligation to pay rent and accordingly, the tenant should make its best efforts to pay as much of the rent owing as is possible, with a particular emphasis on keeping utilities current, maintaining the property, and reimbursing the landlord for common area maintenance charges and taxes. Payments made now will soften the blow when the moratorium is lifted and the emergency fades.
- Consider deferring requests for rent abatements and other financial assistance at this time with a response that an abatement will be considered as the current crises begins to subside, the business environment improves, and/or the tenant is allowed to reopen its business at the premises. Explain that the landlord's decision will be based in part on full financial disclosure by the tenant and the tenant's adherence to a repayment plan if partial rent forgiveness is to be granted. It should also be made clear, however, that any future rent abatement and/or forgiveness will be in the landlord's sole and absolute discretion and, if applicable, conditioned on lender consent.
- Any agreement in modification of the lease terms should be in writing and preferably included in a formal lease amendment or addendum to lease.

Rent Abatement and/or Reduction from the Tenant's Perspective

Tenants, of course, should take into consideration the landlord's perspectives as outlined above. Supplementing those considerations, some additional considerations from the Tenant's perspective may include the following:

- Communicate promptly difficulties paying the rent and propose in good faith a reasonable proposal for addressing partial or no base rent payments now with deferred repayment later and, depending on the particular circumstances, some form of rent forgiveness.
- Endeavor to provide a full and complete disclosure to the landlord (similar to what might be provided to a commercial lender) in support of any requested rent abatement, temporary rent reduction, rent forgiveness, and/or other lease modifications for the benefit of the tenant. With regard to such disclosures, keep in mind that under the Governor's Executive Order, within 30 calendar days of unpaid rent being due, the tenant is obligated to provide documents or other evidence showing that nonpayment is caused, at least in part, by the COVID-19 pandemic. Exactly what evidence must be provided is very far from clear; yet if the tenant hopes to obtain some financial relief under the lease beyond a temporary

moratorium on being evicted; providing something more than the bare minimum that may be required under the Governor's temporary order is likely called for.

- In some cases, a tenant's need for rent abatement may be obvious. For example, if the tenant's business at the premises is operation of a sports bar that has been forced to close as a nonessential business (and is not reasonably adaptable for takeout or delivery orders), it should be relatively obvious that the pandemic has contributed to the tenant's inability to pay the full rent due under the lease. At the same time, the landlord will want to be assured that the tenant is not otherwise able to pay the rent as a consequence of the availability of (i) exiting reserve accounts, (ii) draws on a line of credit, or (iii) cash infusions by financially capable guarantors of the lease. And where the need for a rent abatement or reduction is less obvious, such as where the tenant's business may still be operating but at reduced capacity; further financial disclosures may be required to induce a landlord to favorably consider modifying the tenant's lease obligations.
- Consider proposing some ongoing payments under the lease while the emergency continues, with some proposed rent forgiveness if the tenant fully performs its modified obligations. As just one of many potential "workout" scenarios, a tenant might propose that until the business reopens, rent will be deferred but that the tenant will continue to maintain the premises, promptly pay all real property taxes, utilities and insurance premiums, and will provide added security services at the premises while the premises remains unoccupied. After the business is finally allowed to reopen, the proposal may provide for a "ramping up—return to normalcy" rent schedule and a past-due rent repayment schedule (with the past-due rent amortized over the remaining months of the lease term or some other manageable term of months). Finally, the proposal might include some past-due rent forgiveness towards the end of the workout period provided that the tenant has otherwise adhered to the lease terms.
- Recognize that depending on the circumstances, both the landlord and the tenant may come out ahead by negotiating reasonable lease modifications that will allow the tenant to continue to successfully operate at the premises. The alternative if it leads to the eviction of the tenant will likely mean an extended period where no rent is received while a replacement tenant is secured, and with the landlord incurring substantial expenses in the form of brokers' commissions, costs of refurbishing the premises, payment of tenant improvement allowances, and costs of negotiating a new lease. And while the landlord may under the terms of the lease be entitled to recover all of those costs from the defaulting tenant; if the tenant goes out of business or otherwise receives a bankruptcy discharge, the landlord may only receive pennies on the dollar.

For more information, please contact Paul Vaughan or Pablo Valentine, who are two of the lawyers in our Business Transactions Practice Group.

This summary provides general information and should not be construed as legal advice or a legal opinion on any specific facts or circumstances. If you have specific legal questions, you are urged to consult with your attorney concerning your own situation.