

CORONAVIRUS ACT: PROTECTING COMMERCIAL REAL ESTATE YIELDS

Commercial property partner Fionnuala Nolan and property litigation partner Michael Tatters consider the impact of the recently introduced Coronavirus Act on commercial property owners, their tenants, funders and investors.

The UK Government has enacted the Coronavirus Act with the purpose of defending its people and economy against the accelerating threat of COVID-19.

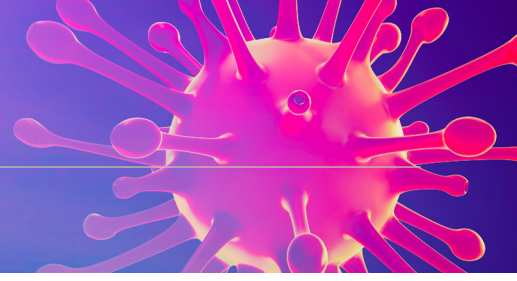
The speed of its passage through both Houses of Parliament - it was given Royal Assent on Wednesday 25 March 2020 - tells its own story. And within its provisions are changes that will redefine our lives over the coming months.

The thrust of the legislation from a purely property perspective is to protect the occupancy rights of tenants and occupiers whose economic situation may be adversely affected by COVID-19.

COMMERCIAL TENANTS

The Coronavirus Act adopts the definition of business tenancies laid down in Part 2 of the Landlord and Tenant Act 1954, or a tenancy to which that part of that act would apply if the relevant occupier were the tenant.

A tenant enjoys a right to occupy its leased premises to the exclusion of all others (including its landlord) subject to payment of its rent and compliance with its tenant obligations as agreed and provided by the lease.



WHAT IS FORFEITURE?

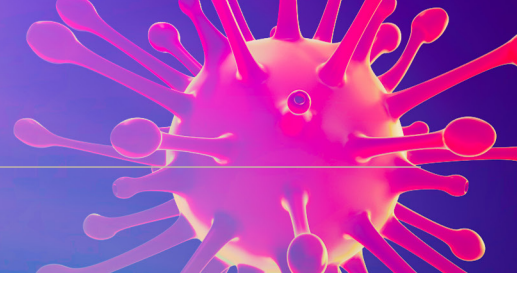
Forfeiture is a contractual remedy available to commercial landlords in most well-drafted leases. It allows a landlord to exercise a right to re-enter a leased property after a certain number of days to terminate the lease and take back possession of the property where a tenant has breached its obligations under the lease.

This right could arise, for example, if the tenant has failed to pay its rent, if it has become insolvent or for any other breach of a tenant obligation in the lease. In most cases a landlord would only exercise this right where a tenant had failed to pay rent or service charge and had a history of defaulting under the lease, or in the event of insolvency or substantial dilapidations.

In respect of non-payment of rent for commercial premises, with no residential element, this right may be exercised by what is called “peaceable re-entry”. This remedy involves the gaining of entry and the changing of the locks by the landlord, as a result of a rent payment breach, if certain criteria are met and the right to forfeit has not been waived. For all other breaches (and also for non-payment of rent if this method of enforcement is preferred) there is a regulated statutory notification by the service of a Section 146 Forfeiture Notice and if the breach is not remedied by the tenant in default, court proceedings to terminate the lease may then be followed. Under existing rules, there is also the possibility for a tenant to apply to a court for ‘relief from forfeiture’ and if successful a lease may then be reinstated in certain circumstances.

WHAT DOES THE CORONAVIRUS ACT SAY?

Section 82 (1) of the Coronavirus Act removes the landlord’s right to exercise forfeiture for what is termed “the relevant period”. This is defined to run from 25 March 2020 until and including 30 June 2020 “or such later date as may be specified by the relevant national authority in regulations made by statutory instrument (and that power may be exercised on more than one occasion so as to further extend the period)”. It states that a right of re-entry or forfeiture under a relevant business tenancy for non-payment of rent may not be enforced by action (court proceedings) or otherwise (peaceable re-entry) during the relevant period.



Section 82 (5) states that where any court order for possession is made during the relevant period, it cannot require possession of the property to be given to the landlord before expiry of the relevant period. If a court order giving the landlord a right of possession has already been granted (i.e. before 25 March 2020) and the tenant applies for it to be varied after that date, the same moratorium on enforcement during the relevant period will apply.

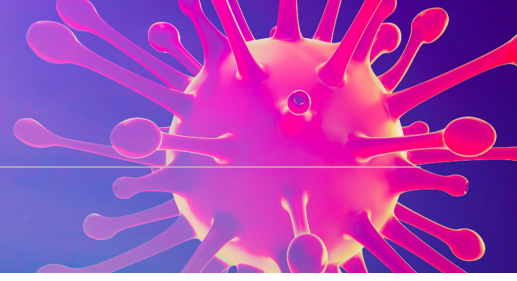
Section 82 (2) states that no action other than an express written letter assenting is to be regarded as waiving a landlord's right to re-enter for non-payment of rent.

Section 82 (11) removes the statutory ground of a commercial landlord to apply to court for possession in respect of a protected business lease where there is a persistent delay in paying rent where such non-payment arises during the relevant period.

COMMENT

For landlords, these emergency statutory provisions mean they have been compelled by statute to agree without notice to an unexpected rental deferral. This immediately impacts on direct income flow in already stretched commercial property portfolios. Commercial property valuation assumptions and (where applicable) security obligations in related funding documentation are also affected.

For tenants, the provisions do not absolve their financial obligations. They simply postpone the requirement to pay until such time as the relevant period expires. In real terms this is just postponing obligations for a tenant whose economic yield from the property has been substantially erased by lockdown measures. It is unlikely that on exiting the relevant period, a tenant's economic position will have recovered or indeed improved to the extent necessary to enable immediate payment of these sums. Under the act, the liability remains on the tenant's balance sheet. Meanwhile, the landlord's right of enforcement for these sums (including accrued interest under the lease) is simply postponed until the expiry of the relevant period unless it expressly elects to waive payment.



ACTION FOR TENANTS

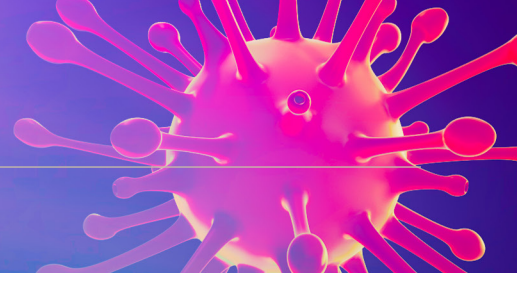
A tenant who is in difficulty may wish to:

- Review the statutory provisions above and consider taking advantage of them. If it does, it will need to ensure the liability remains factored into its financial projections, including accrued interest.
- Open negotiations with its landlord to agree a workable repayment mechanism once the moratorium period has expired. This could, for example, involve spreading the payment over a 12-month period together with ongoing rental obligations. The terms and thrust of negotiations will very much depend on the landlord/tenant relationship and the direct impact of COVID-19 on that commercial relationship.
- Seek legal advice in any dealings involving its property assets and changes in its relationship with its landlord.

ACTION FOR LANDLORDS

A landlord investor may wish to:

- Urgently consider banking covenants and, where appropriate, seek a waiver breach from funders where a freeze on rental income impacts on funds flow and loan-to-value assumptions, particularly across larger property portfolios.
- Agree suitable arrangements with tenants who are in difficulty and react quickly to these events to agree a suitable short-term moratorium position whilst protecting their rights under existing leases.
- Review and re-value commercial property holdings, including location use and contracted tenants. Can changes be made to facilitate and harvest a growth upsurge on exit from the moratorium period? What sectors might this affect and are there professional market predictions looking at demographic reaction and demand? Where can it strengthen its offerings in response and where are the fault lines?
- Seek legal and professional valuation advice in relation to its portfolio and any changes to its existing legal relationships with its tenants and funders that may be deemed appropriate.



CONCLUSION

It is clear that landlords, tenants, investors and funders and their professional advisors now have an urgent need to use this statutory moratorium effectively. As a result of economic pressure, parties will communicate and collaborate quickly in respect of the effects of this global lockdown. Stakeholders from these groups have a vested interest and the opportunity to agree a recalibration that not only weathers the financial challenges but also provides workable repayment and revaluation solution across the sector. The outcome of this collaboration may result in a re-engineered UK commercial real estate sector and hopefully one that facilitates future investment, growth and recovery when it comes.

Please note: Nothing in this article constitutes legal advice and we are not liable for any reliance on the information provided. This is a rapidly changing subject, and whilst correct at the time of writing, circumstances may have changed since publication. Please refer to **Gov.uk** for up-to-date advice on the Government's response to this issue.

To find out more about anything covered in this article, please contact Fionnuala Nolan, Michael Tatters or other members of Thrings' Commercial Property and Property Litigation teams.



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