

Lease Forbearance Agreements in the Age of COVID-19

As retail businesses around the country begin the process of slowly restarting after the COVID-19 shut down, many tenants still find it difficult, if not impossible, to meet their rent and other financial obligations. Some landlords are looking for ways to provide their tenants with temporary relief to help them through this challenging period. Some landlords are considering abating or deferring rent for some limited period of time to give the tenants a respite until their business operations improve. Below are a variety of issues and provisions landlords (and tenants) should consider when crafting a lease forbearance agreement during the COVID-19 crisis.

Amendment vs. Separate Agreement

Consider what form your agreement should take. Most forbearance arrangements will likely take the form of an amendment to the lease. However, this need not necessarily be the case. A separate forbearance agreement can also be used that may be styled in a manner that technically does not amend the lease. Consider whether there are circumstances that would militate in favor of one form or the other.

Abatement vs. Deferred Rent

From a landlord's perspective, it is better to defer rent than to abate it entirely. Rent payable during a given period of time may be deferred until later in the lease term, and amortized over a longer period of time, in order to allow the tenant an opportunity to get back on its feet before it is required to start repaying the deferred rent. By styling a document as an abatement of rent, the landlord risks giving up the rent entirely for that period of time. This places the landlord at a disadvantage if it becomes necessary in the future to seek damages from a defaulting tenant (as the abated rent may not be included in the damages calculation).

Forbearance Period

The parties will need to determine what length of deferral is appropriate. While this is certainly an inexact science, the parties will need to take into account not only the period during which the tenant is not permitted to operate, but also a potentially extended reopening period during which the tenant may need to slowly ramp up to normal business operations. We have seen landlords start off with an offer of a three-month rent deferral period, with the possibility of revisiting the issue once that period has expired.

Accrual of Interest

Consider whether the deferred rent should accrue interest and, if so, at what rate. Many leases contain a penalty interest rate that is applicable to amounts a tenant may owe while in default of the lease. This rate is typically at an above-market rate and may not be equitable in the current situation. If interest is to be charged, consider having the interest rate reflect (at a minimum) the landlord's cost of funds at a market interest rate and accrue from the date of deferral until repayment.

Repayment Period

The period during which the tenant is required to repay the deferred rent need not be the same period as the deferral itself. For example, three months of deferred rent might be repaid over a period of six, eight, or 12 months or more. This makes repayment more manageable for the tenant and takes into consideration the potentially long glide path the tenant may need to get back up to full operations and revenue stream.



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Cancellation upon Default

The forbearance agreement should provide that if the tenant defaults at any point after the agreement is in place all deferred rent is automatically accelerated and becomes immediately due and payable with interest (note that, in this instance, the default interest rate is appropriate). Among other things, this acceleration of deferred rent provides the landlord with the greatest potential claim for damages, particularly if the tenant files for bankruptcy. In such a case, a landlord may be limited to seeking damages based on the loss of rent for a given period of time. The acceleration provision at least gives the landlord the argument that the deferred rent should be included in this calculation (although there is no guaranty that a bankruptcy court would agree).

Payroll Protection Program Considerations

If a tenant is seeking a loan under the Payroll Protection Program of the CARES Act (a PPP loan), it may be advantageous for both parties to have the rent deferral begin after the PPP loan period has ended. In order to include rental payments as an expense in calculating the portion of a PPP loan to be forgiven, the portion of the loan used to pay rent needs to be applied for rent that is due and payable during the PPP loan period. Therefore, if the parties defer or abate rent during the PPP loan period, the rent will not be payable, and the tenant will not have the opportunity to include the abated or deferred rent when calculating the amount of forgiveness pursuant to its PPP loan. It may be better to have the deferral commence after the PPP loan period has expired, so that both landlord and tenant get the full benefit of that federal program.

Lender/JV Approval

A landlord must be careful to review its loan documents to determine whether a rent abatement or deferral (or a lease amendment in general) requires the approval of its lender or JV partners. In particular, the landlord must be careful not to inadvertently trigger any non-recourse carveout applicable to any personal guaranty of a loan. Furthermore, many lenders are currently being inundated with requests from borrowers for various kinds of approvals and loan modifications. Therefore, it may be challenging to get the attention of one's lender. A landlord should begin the process early and reach out to its lender as soon as possible. If circumstances require, it may be necessary for the landlord and the tenant to agree on the form of a document (and perhaps even execute the document), and condition its effectiveness on final approval by the landlord's lender and/or JV partners.

Landlord Remedies on Default

The forbearance agreement should not in any way abrogate the remedies available to the landlord under the lease, at law or in equity. In addition to the remedies that may already be provided under the lease, the landlord may seek to have the right to accelerate the deferred rent upon an Event of Default by the tenant (as described above) and terminate the lease if the tenant fails to timely repay the deferred rent. A landlord might also consider obtaining a lien on the tenant's personal property (which, under the UCC, may include accounts receivable, equipment, personal property, etc.). If the premises is in a state that does not provide for statutory landlord's lien on the tenant's personal property, it may be necessary to draft a UCC security interest provision into the forbearance agreement and file a UCC-1 financing statement with the appropriate secretary of state to perfect that security interest. Be aware, however, that even if the tenant willingly grants a security interest in its personal property, such a grant might be void as a preference or fraudulent conveyance in bankruptcy. Even so, the landlord will likely be in a better position with the security interest than without it. The tenant should also be careful not to run afoul of its financing by issuing a security interest in favor of the landlord.

Confirmation of Guarantor

If the lease is guaranteed by a person or entity, the guarantor must join in the forbearance agreement to confirm that the guaranty remains in full force and effect, and to guaranty the obligations of the tenant under the forbearance agreement.
