

COVID-19: IMPACT ON UK REAL ESTATE

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UK Real Estate Alert

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There isn't a vaccine to protect the commercial real estate industry from the impact of the increasing number of Covid-19 cases both in the UK and globally. Individual countries have reacted to the virus in different ways, but now, declared a pandemic, it presents a real challenge for the entire world. Many of the issues and questions the real estate industry are facing are the same, irrespective of jurisdiction. K&L Gates has established a global task force to guide our clients through a full spectrum of practical solutions to address their coronavirus concerns. In this article we will particularly focus on issues which are arising in the real estate sector.

REAL ESTATE INDUSTRY - IMPACT OVERVIEW

Real estate shares have seen a downturn, which is similar to many sectors of the market, and the virus does not discriminate across jurisdictions, demonstrated by headline news coverage on FTSE, S&P, and Dow Jones. Some of the leading hotel chains have seen significant falls in the value of their shares. The retail industry has also inevitably been hit badly, and in all real estate sectors there are questions and concerns about disruptions in the supply chain. These include issues with overseas suppliers but on a local level the issue of lack of availability of construction materials has led to questions surrounding contractual obligations. These can range from questions on cost overruns and delay, to specific questions on whether different laws apply to different points of the supply chain. As for the retail industry, it is expected that shopping centres, restaurants, cinemas, museums, gyms and theatres will be avoided whilst the outbreak is at its peak. Milan and now the rest of Italy, being "shut for business" is operating as a real life case study for other jurisdictions. For retail landlords and tenants the Covid-19 virus throws up another raft of issues such as "keep open clauses", particularly if the tenant has been asked to vacate in accordance with health and safety legislation. Sectors such as offices are likely more protected, at least in the shorter term as occupiers will still pay their landlords rent, despite members of the workforce being asked to work remotely. In times of crisis there are inevitably opportunities too, so for example in the flexible working space market, there may be opportunities as those working from home choose to use local facilities to speed up printing and working off line. The real estate sector is a people/sociable industry so working in isolation may not suit many and flexible providers can always capitalise on that, whilst still being mindful of health and safety considerations.

With the situation changing on a daily basis, and with the UK having now transitioned to the "delay" phase it is important to stay calm but also closely to monitor resources and information available. The real estate industry has always been an optimistic one with many predicting a relatively short term disruption and we hope this to be the case too. We have set out below some of the issues which our real estate clients are facing and some resources which will help.

LANDLORD AND TENANT QUERIES

I am a Landlord and need to close my premises temporarily, and my tenant is querying rent for the closure period

Landlords and tenants are already experiencing the premises which they own or occupy being closed either temporarily or for a longer period because of Covid-19. This throws up a range of issues with access of course being the most significant, but also for retail tenants particularly, the interplay with "keep open" clauses. Most commercial leases have "suspension or rent clauses" as standard, but it is very unlikely that the standard wording would cover cases like we are currently experiencing as most rent suspension is linked to physical damage by "insured risks". Withholding of rent wouldn't be allowed in most commercial leases. It might be that future contracts/leases anticipate wording which expressly refers to pandemic or virus situations, but the most practical option now would be for a tenant to check its level of insurance cover. We have specialists that can help review and negotiate robust insurance wording, as there is always an interplay between the different clauses. The issue with most commercial property contracts is that insurance is linked to the property being damaged, or some degree of physical loss and it would not likely have pandemic as a standard clause, and would not allow for the rent to be suspended.

As a Landlord how do I decide if I should be closing my premises?

Public Health England (PHE) and the Department of Health and Social Care are issuing guidance on what to do if members of a workforce either have Covid-19 or come in contact with a member of public with signs of contagion, and issue advice which includes whether to close buildings. The advice changes on a daily basis, but is not currently advising the closure of all workplaces. As we move to the delay phase this guidance is likely to change. Commercial leases oblige the tenants to comply with all statutes and notices and orders made by competent authorities. So a tenant sending its workforce home for example, would be doing so in compliance with government led edicts, despite a building potentially still being open. If, like Italy, workforces are obliged to close, a tenant would need to leave the premises in order to be lease compliant. A landlord would also need to close its property if government guidance requires it to do so. This does throw up a raft of issues, including any preventative costs incurred pre closure, and during closure, such as additional cleaning and security, and more on that below.

If there are extra costs to implement coronavirus measures who pays?

It is inevitable that there will be costs associated with stopping the spread of the virus. Commercial leases anticipate that the Landlord recovers costs from tenants via the service charge provisions. These include costs incurred through statutory measures as well as in the interests of running the property or estate effectively with good management. Who pays, is usually about the wording of the lease as service charge provisions do vary. So if tenants have negotiated a cap or exclusions then it would be important to review those carefully. Most leases do anticipate costs for cleaning and they would usually pass these costs to the tenant, via the service charge, but

these are unlikely to include enhanced levels and additional cleaning (well publicised school closures and deep cleans for example in large campus premises) and so this is another area where the lease wording would need to be reviewed carefully. In future we may see increased provision/drafting related to hygiene and enhanced cleaning services. Insurance policies in place, covering business interruption for example may also be a starting point for recovering costs.

What are my health and safety obligations as Landlord of a property?

Landlords are likely to have additional obligations including taking a proper risk assessment of property it owns/manages, covering putting in place adequate hygiene measures, and disposing of waste which could be hazardous. It will be important to comply with any additional regulations put in place, and by existing statute, as well as any new emergency measures. At the end of this article is a link to some useful resources.

Can I end the tenancy because of the coronavirus uncertainty causing issues in my supply chain for example?

A lease is type of contract, and UK law does provide circumstances on which all contracts can be terminated. Leases though are unlike many other "commercial type of contracts". UK leases, unlike JCT type construction contracts, are unlikely to have specific clauses on Force Majeure and this is an area which is covered in more detail on our COVID-19 resource center. It is more likely that either landlord or tenant would seek to rely on the common law doctrine of Frustration. Frustration is usually very difficult to invoke but in these unprecedented times where whole countries are closed for business, then we could see an increase in the likelihood of success.

I am a retail tenant with a "keep open clause" how do I reconcile this with a requirement to vacate?

It is likely that lease keep open clause clauses will be in conflict with government and PHE requirements to vacate, and requisite health and safety implication's necessary to delay the spread of Covid-19. A court in the UK can enforce a clause through a legal mechanism known as specific performance, but it rarely does so. A landlord would be very unlikely in this sort of circumstance to claim damages for breach of the keep open covenant. Although there are of course grey areas and each circumstance and lease would need to be looked at on its facts.

What resources are available and what practical steps are important?

Whilst we all appreciate the primary consideration is health and keeping the workforce safe, business owners and occupiers still need to operate (supermarkets for example) in order to contribute to the wider public health initiatives. There are no quick fix answers but we have set out below some practical steps and resources in connection with real estate issues.

K&L GATES HUB

- Talk to your counterparty early on – these are unprecedented times and keeping lines of communication is important.
- Review your leases, licences and agreements in terms of termination provisions, particularly if you are in construction industry and operate under JCT contracts.
- Look at which laws govern your agreements, particularly with supply chain questions.
- Review your insurance policies, and lease provisions regarding suspension of rent clauses.
- UK Government's Coronavirus Action Plan, an up to date resource
- World Health Organization
- K&L Gates COVID-19 Resource Center
- Centers for Disease Control and Prevention

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