



## Real Estate Leases: The Impact of COVID-19

### *An In-Depth Look at Landlord/Tenant Options for New and Existing Leases*

Since the onset of the COVID-19 pandemic in early 2020 and its impact on real estate leases across the country, many tenants have been unable to occupy (or fully occupy) their leased premises due to government-imposed shutdowns and occupancy restrictions. As customers have stayed away and many employees have begun working from home, many businesses have struggled to meet required rent payments.

Neither the law nor the overwhelming majority of leases have excused tenants from their rent obligations, and therefore any relief in the form of abatements or deferrals has been decided by negotiations between the parties based on the individual facts and circumstances. Landlords and tenants have often worked together during the pandemic to enter into mutually acceptable amendments. New leases have also been struck with a renewed focus on certain lease provisions that, prior to 2020, many thought were not worth negotiating because the odds of an epidemic, pandemic, insurrection, or riot impacting businesses seemed too unlikely to even consider.

Below is a broad range of options for addressing this new reality. These options have been actively negotiated during the pandemic and are generally listed in order from most favorable to least favorable financially from the Tenant's perspective.

#### **EXAMPLES OF BASE RENT ABATEMENTS IN EXISTING LEASES**

- 100% for 6 months, 75% for 4 months and 50% for 4 months
- 100% for 5 months and 50% for 4 months
- 100% for 4 months and 50% for 5 months
- 100% for 4 months

#### **EXAMPLES OF BASE RENT ABATEMENTS IN NEW LEASES**

- Base Rent will be based on percentage of typical rent corresponding to percent of normal occupancy allowed by the State of New Jersey (e.g. 25%, 50%, 75%, 100%)
  - Base Rent will be based on percentage of typical rent corresponding to percent of normal occupancy allowed by the State of New Jersey (e.g. 25%, 50%, 75%, 100%) but the Lease Term is extended whenever Base Rent is reduced
  - 100% Base Rent abatement after 10 days, but only if Tenant is prevented from conducting any operations in the Premises
  - 100% Base Rent Abatement of all Base Rent and Additional Rent if Tenant is unable to operate for more than 30 days due to a recommended or mandatory shutdown
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## EXAMPLES OF BASE RENT AND ADDITIONAL RENT DEFERRALS IN EXISTING LEASES

- 100% for 4 months, to be repaid in 4 equal installments
- 100% for 1 month, to be repaid in 3 equal installments
- 50% for 4 months, to be repaid in 4 equal installments

## ADDITIONAL CONSIDERATIONS AND QUESTIONS TO ASK

- Landlords must keep in mind that their lenders will often need to approve any lease amendment or concession.
- Can security deposits be increased or should existing deposits be applied against arrears?
- Can additional guarantees be obtained as consideration for a rent abatement request?
- Timing issues throughout the lease should be carefully evaluated for potential force majeure delays (i.e. timing for both parties to obtain permits and approvals and deliver possession, complete repairs or exercise self-help remedies and timeframes to rebuild following a casualty).
- Co-tenancy rights and remedies may be triggered by pandemic-related closures, so the applicable lease provisions should be carefully evaluated and negotiated.
- Essential businesses have been open and operating throughout the pandemic, and therefore were generally less impacted and considered less risky tenants.
- Landlords have weighed the risks of pushing tenants too hard for payment against, especially particularly hard-hit tenants such as restaurants, gyms, other fitness uses, spas, and salons.
- Businesses facing great economic uncertainty have also been wary of entering into long-term commitments and permanent adjustments to their existing leases, in many cases slowing negotiations for months as the parties hope for light at the end of the tunnel.

## AT THE HEART OF THE MATTER

Many landlords and tenants have responded to the challenges of the pandemic to successfully negotiate new leases as well as lease amendments offering rent abatements, rent deferrals, and other concessions, if and when merited by the individual facts and circumstances. To determine the merit of such requests, some landlords have analyzed their tenants' financial statements to understand losses in business and profitability. Landlords may also request consideration in return for any concession granted, such as a lease term extension, additional security deposits and guarantees, or early termination options in the landlord's favor. Many landlords also required that their tenants apply for PPP and EIDL loans and use the funds to pay their rent.

In cases where businesses show little or no chance of survival, some landlords have even been willing to terminate leases (with or without a termination payment) simply to gain back control of the space, rather than relying on the court system (which is currently tremendously backlogged due to its own pandemic-related challenges and cannot offer a timely remedy).

The events of the past year have proven the importance of boring but crucial fundamentals. Entering into a lease transaction from a landlord's perspective is primarily a credit decision. What are the odds that the negotiated rent will be paid? The answer depends on the fundamentals of the particular tenant and a myriad of other risk factors, including the possibility of an epidemic, pandemic, insurrection, riots and other force

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majeure issues that few viewed as being even remotely possible a year ago. Landlords should also focus on the character of prospective tenants prior to entering into a long term leasing transaction.

Landlords should require security deposits, carefully check a potential tenant's credit and financial statements, and consider the tenant business's financial susceptibility to COVID-related shutdowns. If and when the unexpected occurs, landlords will be in a much stronger negotiating position and at less risk if personal, entity, or franchisor guarantees are in place. Landlords will also have considerably more flexibility in addressing these challenging times if they are not too highly leveraged and their mortgage loan payments allow for a downturn in rents collected.

## CONCLUSION

The bottom line is that risk management is crucially important; the rent specified in a lease is of no value if it is not actually collected. Landlords should not simply enter into a leasing transaction with whoever is willing to offer the highest rent. The pandemic has also demonstrated the importance of relationships between landlords and tenants and landlords and their lenders, as well as carefully negotiating lease provisions to allocate risks that were previously considered unlikely. Today, in 2021, the mindset of many landlords and tenants has shifted from "if" to "when" the unlikely and improbable will occur.

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Morgan Law LLC is a boutique law firm located in Marlton, New Jersey with a concentration in the areas of transactional real estate and business counseling. A graduate of the University of Pennsylvania (B.A. 1989), Drexel University (M.B.A. 1994), and Rutgers University School of Law-Camden (J.D., with honors, 2002), Kenneth Morgan has held previous positions as Partner at a local mid-sized law firm, an Associate at an AmLaw 100 law firm and Vice President and commercial lender with a financial institution. Born and raised in South Jersey, he is an active member of the professional community and strongly committed to supporting local and statewide charitable organizations.

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