



COVID-19 UPDATE

Rent Deferral Requests: Primary Considerations for Landlords

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In an effort to reduce the anticipated spread of the COVID-19 virus, on March 23, 2020, the Governor of the State of Hawaii issued a proclamation that requires all persons in the State to remain at home or at their place of residence starting on March 25 and continuing until April 30, 2020. Earlier proclamations by the Mayors of various counties, including Mayor Kirk Caldwell of the City and County of Honolulu, issued similar work-from-home mandates and closed restaurants, bars, and many other places of business. The resulting shut-down and closure of all but those companies conducting what is defined as Essential Business, is expected to create significant financial hardship for many (if not all) businesses in Hawaii, from retail to manufacturing, restaurants to processing, and industrial to professional services.

This financial strain has already manifested itself in the form of requests by commercial lessees to a deferral of rent payments under their commercial leases. Landlords and property managers are facing the prospect of a large number of commercial tenants who have lost the income stream necessary to timely meet their rental obligations and are therefore seeking relief from their immediate lease rent payments. In light of this situation, landlords and property managers will likely have to cooperate and work with their tenants to get through this COVID-19 crisis, but there are a number of important issues they should consider in connection with a deferral request by a commercial tenant. Here is a list of ten items to consider:

1. Tenant Viability. Is the tenant in a business that is going to be able to come back from a shutdown and return to paying rent soon after the mandated shutdown orders end? Is the tenant already in default and struggling to pay rent? Landlords should consider, as difficult as it may be, whether this is an appropriate time for both parties to cut-their-losses and agree to end the lease.
2. Rent Deferral or Rent Forgiveness. Is the tenant requesting that the landlord agree to defer rent payments, or to agree that there will be no rent (or reduced rent) required under the lease for a certain period. Obviously, a deferral of rent payments is preferable to the landlord, but both parties need to consider whether and how the tenant can reasonably catch up on deferred rent payments later (see Item #8). In some

cases, a combination of a deferral and forgiven or reduced rent might be appropriate for an important or long-term tenant.

3. Rent Amounts Deferred. Often the tenant is just requesting a deferral of rent without any further explanation. Landlords should consider this as a request to defer Base Rent, but generally not a deferral of the tenant's obligation to pay CAM and other "Additional Rent" under the lease. As CAM represents costs of operation to a landlord, deferring or reducing those obligations could create serious problems for the property and should therefore be avoided. Tenants with percentage rent provisions may need a deferral or forgiveness/reduction of any minimum rent requirement under the percentage rent provisions of their leases.
4. Deferral Period. The Governor's order runs through the month of April, but could be extended. Likewise, the hardship and potential inability to pay rent for many tenants will likely extend beyond the period of the mandatory closure. Setting a deferral period until April 30, 2020 may just result in facing the same issue in a month. At the same time, landlords need to get tenants back to a standard rent payment routine as soon as possible. Landlords may wish to tie the deferral period to the timing of the legal ability of the tenant to resume business, which will provide some flexibility and allow regular rent payments to resume, for example, on the month following the date the tenant can legally open for business.
5. Other Lease Obligations. Landlords should use this opportunity to confirm that the tenant is otherwise complying with all other lease obligations. Any rent deferral agreement should have the tenant specifically confirm that it is complying and will continue to comply with all other terms, conditions, and obligations of the lease. Obligations like maintaining insurance and paying other costs and expenses can be the first to go when money gets tight for a tenant.
6. Fix Tenant Defaults. If a tenant is already in default, this is an opportunity to address the other defaults and, assuming the landlord feels the tenant is viable (see Item #1), agree to terms and conditions that address the existing default as a part of an agreement for rent deferral.
7. Lease Extension. Depending on the remaining term of a tenant's lease, this may provide an opportunity to extend the term of the lease or renegotiate an option in the lease. A landlord who is agreeing to defer or reduce a tenant's rent obligations due to the COVID-19 pandemic may wish to extend the expiration of the lease for a period sufficient to ensure repayment (see Item #8) and that may be appreciated by the tenant. A landlord could also look to convert an option available to the tenant to extend the lease into an agreed lease extension at the option terms or something else.
8. Repayment. Landlords and tenants need to clearly address the issue of how and when deferred rent will be repaid. Generally speaking, most commercial tenants will find it difficult or impossible to pay the full amount of the deferred rent immediately upon the deferral period ending. Will the deferred rent be apportioned over a period of the

lease and if so, how long and will there be interest assessed on the deferred rent? The repayment obligation needs to be clearly set forth and included in the rent deferral agreement so that later non-payment will not result in collection problems.

9. Lender Approval. Landlords who have financed their ownership of the commercial property should check their loan documents carefully as amendments to their tenant leases (particularly those considered to be major leases) likely require lender approval. Tenants are not the only parties to the lease that will feel the squeeze of this COVID-19 pandemic.

10. Written Deferral Agreement. The agreement with a tenant to defer rent payments is a change in the tenant's obligations under the lease and most commercial leases specifically require that any amendments or changes be made in writing and signed by both parties. However the issues above are addressed, those terms need to be included in a written agreement that constitutes an amendment to the lease agreement. That deferral agreement is also an opportunity to include confirmation that all other provisions of the lease continue unchanged, and to have the tenant (or both the tenant and the landlord) confirm standard tenant estoppel items (e.g. the tenant is not in default and is not aware of any landlord default under the lease, the tenant has no claims against landlord, etc.).

The specific terms and conditions of each commercial lease are different, as are the financial situation, payment history and affected businesses of each tenant. Advice and assistance from an experienced real estate attorney who understands commercial leasing and the specific issues involved in lease deferral arrangements is recommended as these are just some of the issues that may be important in your particular situation.

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Bays Lung Rose Holma is a civil litigation and commercial transactions law firm located in Honolulu, Hawaii and specializing in real estate, construction, business law, commercial financing, and employment law. As an identified Essential Business, BLRH

attorneys are available to advise and assist clients, including property owners and their property managers, at any time during and throughout the COVID-19 crisis. BLRH can be reached at (808) 523-9000 with calls directed to someone who can assist you, or via e-mail at mail@legalthawaii.com. In addition, a listing of our attorneys along with their telephone numbers and email addresses is available at www.legalthawaii.com.