Hicks Baker
Commercial Property Consultants

MAY 2021

Impact and Options

How The Pandemic Is Affecting Commercial Tenants

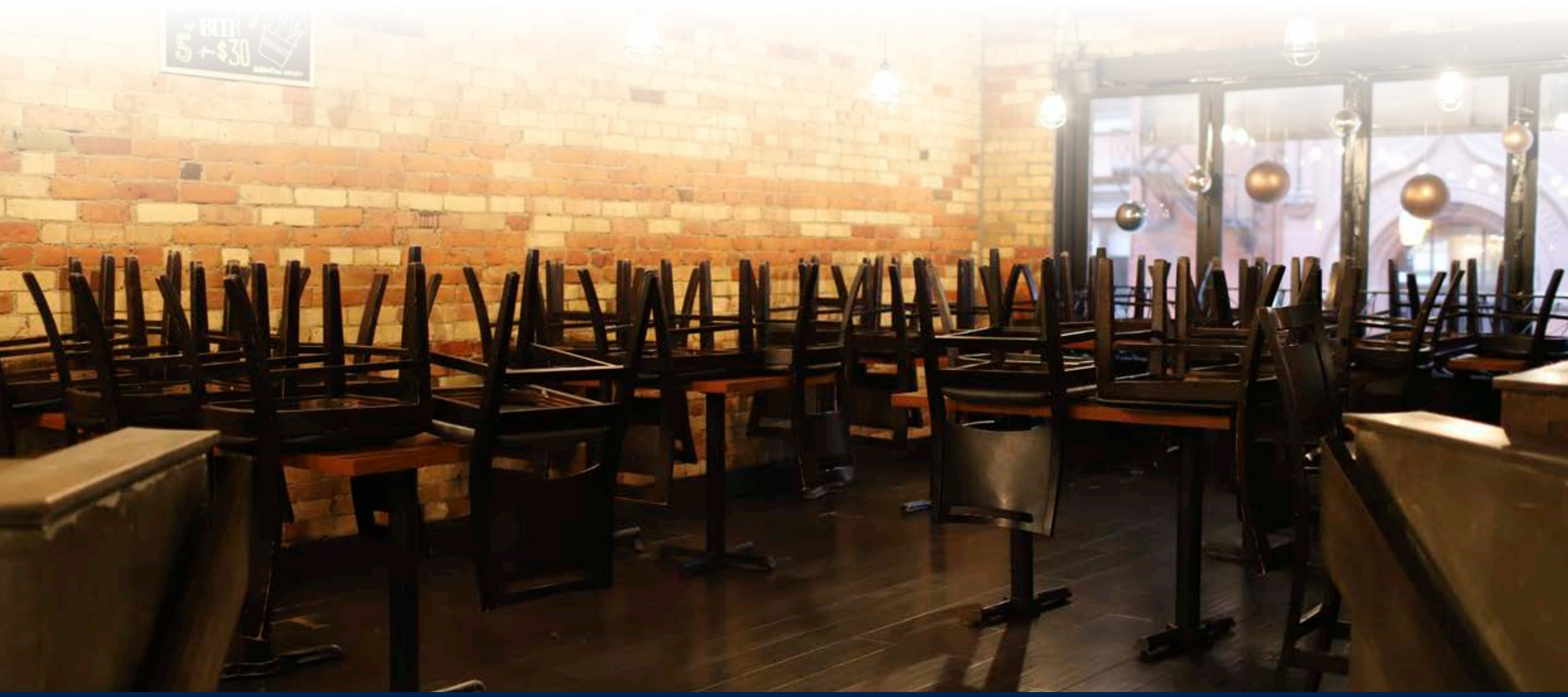
The pandemic and resulting lockdowns have significantly impacted many businesses. Some retail and leisure businesses have been unable to trade at all for long periods, while many others experienced restrictions in how they operate. This has inevitably affected revenues, profitability and, in some cases, ability to pay rent on commercial premises.

In other sectors such as office accommodation, the pandemic ushered in new working arrangements that are affecting the market in fundamental but unpredictable ways. Many businesses are reviewing the size, nature and location of the office spaces they need.

The retail and leisure sectors have inevitably felt the biggest impact. Many are actively reviewing their options as they seek to emerge from the pandemic with viable business models.

The light industrial market has been much less affected by the pandemic but there are potentially implications following the exit from the EU that need to be monitored in the coming months.

This paper focuses on the sectors most affected by the pandemic and lockdowns: retail, leisure and office space. It summarises the main issues for tenants and the options they can explore.



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Eviction Bans

As part of its package of support for business the Government implemented a ban on evicting commercial tenants for non-payment of rent. This came into effect in March 2020 with the Coronavirus Act. As it stands, this period ends at the end of June 2021. This represents a potential cliff edge for any business that has had difficulty keeping up with rent payments and has been unwise enough not to engage their landlord in discussion and negotiations.

It should be noted that evictions for other major breaches of covenant can still be pursued using a Section 146 notice. Where there has been no engagement from tenants over rent arrears, landlords will inevitably be exploring other forfeiture avenues.

Remember too - lockdown is not a rent-free period and the pandemic does not constitute a frustration of the lease. Even if your landlord has been unable to evict you for non-payment of rent you will still be carrying the financial liability, with the potential for bankruptcy proceedings or seizure of assets. For rental payments (rather than service charge or insurance), landlords will be able in due course to use CRAR procedures to seize goods to the value of the debt owed.

If Covid-19 hasn't worsened your financial situation, you should have been paying your rent as normal. Landlords are still able to initiate winding up proceedings where tenants' business have been unaffected by the pandemic or where the tenant was already not in a position to pay their debts before the pandemic.

In normal times, courts expect to see that both parties in a dispute have behaved reasonably and communicated openly. Failing to engage with your landlord or to follow the Government Code of Practice may damage your case.

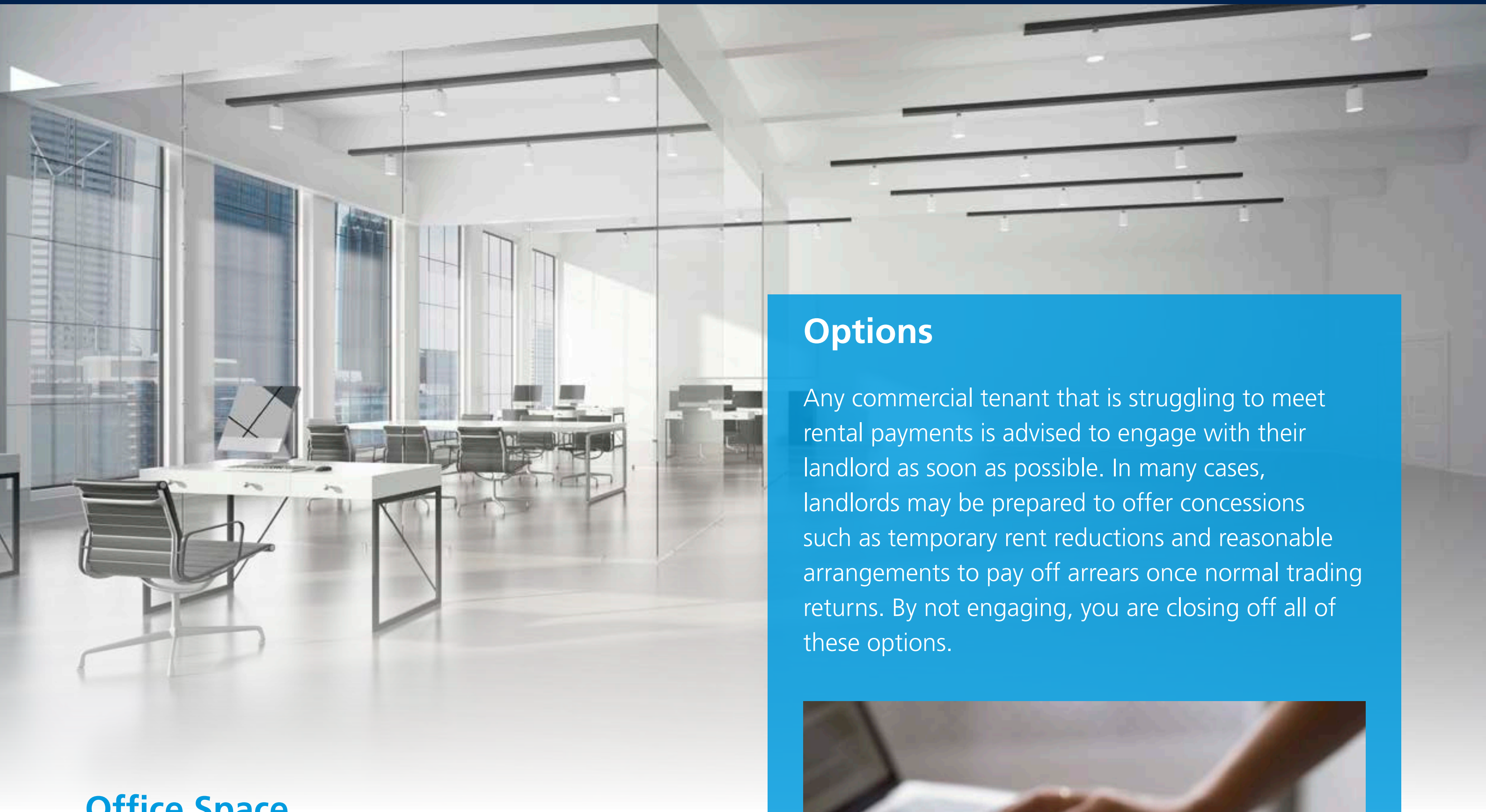
The lack of clear guidance on how tenants will be expected to clear rent arrears is unhelpful, as is the fact that landlords, unlike other businesses, have had limited access to Government support. Tenants should be aware that their landlord's room for manoeuvre may be limited. They may themselves be coming under pressure from their lenders where reduced property values put them at risk of breaching loan to value covenants.

Retail and Leisure

The biggest impact has been felt by large leisure and 'non-essential' retail chains. While smaller businesses have had access to proportionate Government support, large retailers with significant rent liabilities were limited during the first lockdown by EU state aid restrictions. The combination of large rent charges and significantly reduced income is likely to result in a spate of CVAs.

The business landscape for large retail and leisure spaces is highly uncertain with Debenhams disappearing from many high streets and retail centres. UK high streets saw a net loss of 9877 chain stores during 2020.

Retail and leisure businesses - particularly those with several outlets and extensive rent liabilities - should have a recovery plan in place so that they are in a position to carry on trading when the eviction ban ends. This should include a schedule for clearing any arrears that you have agreed with your landlords and, potentially, renegotiated rents for the future.



Options

Any commercial tenant that is struggling to meet rental payments is advised to engage with their landlord as soon as possible. In many cases, landlords may be prepared to offer concessions such as temporary rent reductions and reasonable arrangements to pay off arrears once normal trading returns. By not engaging, you are closing off all of these options.

Office Space

There is huge uncertainty in the market as businesses of all sizes are evaluating their working practices. Common themes seem to be greater adoption of 'blended' working where employees split their time between home and the office. This will affect the size and nature of the office space that businesses need.

The ideal office layout is likely to be different because the focus of office-based activities will be on collaboration and building team cohesion and less about 'getting the work done.' This means less formal desking and more breakout areas. Your existing office space might not make this easy to achieve.

Several large businesses are exploring regional models with satellite offices closer to where people live and a scaled-down city-centre presence. This is already having an effect on demand for space in the Thames Valley.

The popularity of short leases with breaks at the third year offers a welcome level of flexibility for many tenants. Flexibility, however, will be dependent on whether tenants have kept up with rent payments or negotiated suitable arrangements with their landlord if trading was affected by the pandemic.

Break Clauses

If, for whatever reason, your premises no longer meet your needs you need to check the terms of your lease agreement. If there is a break period falling due, this may give you the flexibility you need. However, it is essential to follow the exact prescribed process for serving notice that you intend to exercise your rights. You must also ensure that there are no serious breaches of any covenants that could disqualify you from exercising a break.

Assignment

Again, if your lease terms allow it, it may be possible to assign your lease to a third party or to sublet all or some of the premises. It might be worth exploring with your landlord whether they would be prepared to vary the lease terms to allow this in return for more secure occupancy.

Surrender

If there are no other options you may be able to negotiate an early surrender of the lease. Your landlord is under no obligation to agree to this but could be prepared to consider it as an alternative to forfeiture and the possibility of legal proceedings.

What To Do Next

What you certainly shouldn't do is ignore the issue and put off dealing with it - this will just narrow your options. Take advice from a commercial property specialist who will give you an honest appraisal of your situation and cast an expert eye over your lease agreement.

A commercial property specialist such as Hicks Baker will also be able to enter into negotiations with your landlord on your behalf. You will then be represented by somebody with an in-depth understanding of commercial property law and the realities of the local market.

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