Rent deferment agreements in light of COVID-19

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In a typical commercial lease the tenant is required to continue paying rent, “without abatement, set-off or deduction,” throughout the lease term, except in circumstances of material damage or destruction. That continuous rental obligation usually extends to circumstances where the leased premises, and/or the project of which it forms a part, is closed by governmental shutdowns. This has happened in several provinces in order to address the COVID-19 pandemic.

As discussed in BLG’s March 20 article “COVID-19 and the Landlord/Tenant Relationship”, the risks associated with a governmental shutdown and the obligation to continue paying rent generally (subject to the specific provisions of the lease) reside with the tenant, barring:

- A legislative response that impacts leases;
- A court evolving equitable doctrines to suit the circumstances at hand; or
- A possible argument for rent abatement arising from either the landlord not meeting its obligation to provide the tenant with quiet enjoyment of the premises or not providing the services required by the lease (unless closed by governmental shutdown).

The symbiotic relationship

There is a symbiotic relationship between landlords and tenants, of which most landlords are acutely aware. A multi-tenancy retail project will not thrive without a diverse collection of tenants attracting the public to their various operations. It is from the rent received from those tenants that the landlord pays their operating costs, property taxes and financing charges, as well as providing a return to its shareholders and investors. Likewise, unless a retail tenant is prepared to buy its own real estate and does not need to be part of a community of tenants to attract customers, they will seek a well-managed, operational project with an appropriate tenant mix from which to generate their businesses. Non-retail businesses are similarly motivated to lease their business premises, though less interested in the tenant mix of a particular project. Landlords need tenants and tenants need premises from which to operate their businesses.

For a particular project, if a significant portion (by size and/or number) of the tenants' businesses fail because of shutdowns caused by COVID-19, once that crisis has passed the landlord will be left with:

- Vacant premises;
- Outstanding lawsuits resulting from tenants' defaults;
- Bankruptcies or insolvencies;
- Lost rents;
- An inability to pay project-related expenses;
- Vulnerability to co-occupancy termination or rent reduction rights; and
- An impaired ability to attract new tenants from the remaining pool of businesses, then likely cautious to expand.

Even in a stable economy, landlords understand that it typically costs more to attract a new tenant than to retain an existing one.

With an eye to assisting their tenants with surviving the unprecedented challenges of the COVID-19 crisis with the full stable of their existing tenants, some landlords have started offering Rent Deferment Agreements to tenants, even though their governing leases make no provision for that type of assistance.

The rent deferment agreement

Although Rent Deferment Agreements vary in their preconditions, terms and operation, they generally allow the tenant to defer paying certain rent obligations under a lease for a specified period. The tenants are then required to pay the deferred rent to the landlord in staggered instalments once the deferment period is over.

They are usually structured as an agreement by the landlord to forebear exercising its default and termination rights, notwithstanding the temporary non-payment of specified rent payments. Unlike a Rent Abatement Agreement, these agreements do not forgive the rent otherwise payable by the tenant. Rather, they allow for that payment to be made at a later date. Some landlords, despite the agreed deferment, may elect to forgive a portion of the deferred rent once the tenant has established its commitment and ability to remain in the project after the period of interrupted or slowed business operation is over.

Which tenants to help?

Many factors influence a landlord's decision whether to offer a Rent Deferment Agreement to a particular tenant or group of tenants.

- What is the tenant's financial position? Do they have the ability to pay rent during a closure and still meet their other commitments to employees and suppliers?
- What is the impact of COVID-19 on the tenant's business? Some tenants, especially essential services, will still be able to operate, though possibly at a reduced capacity and with higher overhead and operating costs.
- Is government assistance available to backstop the rent the tenant is required to pay? If so, what is the timing of that assistance? There is often a material lag.

Rent Deferment Agreements are often conditioned on such assistance not being available or provide the deferment ends upon receiving government assistance.

- Does the landlord's mortgage, co-ownership agreement/partnership agreement or management agreement prevent or restrict the landlord from offering rental concessions without the consent of the landlord's mortgagee, co-owner/partner or registered/beneficial owner? It is not uncommon for non-disturbance agreements between tenants and the landlord's mortgagee to require the tenant to obtain the mortgagee's consent to any lease amendments, including rental concessions. Landlords should ensure they have the required consents for a deferment. A tenant could request the Rent Deferment Agreement include confirmation from the landlord that it has authority to grant the concessions provided in the agreement.
- Does the tenant have business interruption insurance that will cover the period of projected closure? If so, what is the timing of that assistance? There is often a material lag.
- How important is a particular tenant to the project, and how much time is left on their lease? If a particular tenant is a strong draw factor for the project and its departure could impact other leases, then a landlord may be more inclined to provide rent deferral assistance.
- Is their continued operation implicated in a co-tenancy clause of another tenant?
- How easy would it be to re-rent the premises if the tenant defaults and the landlord decides to terminate the lease?
- What is the history between the landlord and the tenant? Have they had a co-operative relationship, where the tenant regularly paid rent on time? Is the tenant located in multiple projects operated by the landlord?
- What financial flexibility does the landlord have to agree to defer rents for a period? What are the landlord's financial obligations for the project as a whole?

The relevant provisions

Rent Deferment Agreements should address the following issues:

Portion of rent to abate

More typically, only basic/minimum rent abates and not always 100 per cent of those payments. This way the landlord retains some income stream to meet operating costs and property taxes.

As governments offer assistance packages, such as removing school taxes on certain property classes and reducing electricity charges, landlords can in turn reduce the amount of the required monthly instalments for the corresponding portion of additional rent, to immediately pass those savings on to tenants.

Deferment period

It is difficult to comment on the length of the deferment (the "Deferment Period"). We have been experiencing an initial Deferment Period between one and six months, with that period terminating earlier if the tenant is able to reopen.

Landlords will want the right to terminate the Deferment Period if the tenant fails to pay a portion of the rent that has not been deferred, the tenant is otherwise in default under its lease, or the tenant discloses to any third party the existence of the Rent Deferment Agreement. Landlords should also require automatic termination of the agreement if the tenant becomes bankrupt or insolvent, or if the lease is terminated or transferred to a third party.

Payment period

After the Deferment Period is over, the period over which the deferred rent is to be paid (the "Payment Period") will vary depending on why and how the Deferment Period ended. If it expires in the ordinary course then the Payment Period is often longer than the Deferment Period, so as not to unreasonably burden the tenant. Twelve months is not uncommon, though the Payment Period should not extend passed when the lease term expires. The deferred rent is paid in equal monthly instalments over the Payment Period. At the same time, the tenant is paying regular monthly instalments of basic rent and additional rent, in what potentially will be a struggling economy. Careful thought is required to determine a realistic Payment Period.

If other circumstances cause early termination of the Deferment Period, then all deferred rent may be payable automatically or immediately.

Other provisions

Landlords may wish to charge interest on the deferred option of the rent until paid. Tenants may wish to specify that all interest on the deferred rent is not payable so long as the tenant is not in default of the Rent Deferment Agreement.

Landlords may require increased security from a tenant as a condition of granting the Rent Deferment Agreement, in the nature of an additional indemnifier or by granting a personal property security interest.

For a landlord reluctant to grant a Rent Deferment Agreement to a tenant with only a short lease term remaining, the tenant could offer to extend that term as part of the Rent Deferment Agreement.

Some tenants will request forgiveness for part of the deferred rent if they otherwise pay the balance of the rent that was deferred.

All existing indemnifiers to the lease should be a party to the Rent Deferment Agreement and ratify and confirm their obligations.

To address the difficulties in arranging for execution of documents at this time, the Rent Deferment Agreement should allow for execution by digital means.

As the above indicates, there are numerous issues for landlords to consider when contemplating entering into a Rent Deferment Agreement with a particular tenant or group of tenants, additionally there are several permutations to the clauses that should be included in a Rent Deferment Agreement.

Tenants have no right to require their landlords enter into these agreements; yet the importance of that symbiotic relationship should not be underestimated, especially in the current rapidly changing economic landscape.

For assistance in considering whether to grant Rent Deferment Agreements, how to construct the same, and how to negotiate them, please communicate with our team mentioned below, who are ready and available to assist. BLG has also created a COVID-19 Resource Centre to assist businesses on a variety of topics, including investment management, labour and employment, contractual risks, public disclosure requirements, education and criminal law.

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