

# RETAIL PROPERTIES

## Quarterly

### Leasing

## How the COVID-19 era will change retail leases

Retail leases are not pandemic-proof. When COVID-19 first began to have a major impact in the United States, landlords and tenants flipped through their leases, only to find incomplete or unsatisfactory answers regarding government-ordered shutdowns, eviction moratoriums and other unprecedented COVID-19-related occurrences. As a result, new retail leases are being drafted and negotiated with a sharper eye on the potential effects of the current pandemic and similar future events.

**■ Redrafting force majeure clauses.** Before COVID-19, many landlords and tenants paid little attention to the boilerplate force majeure provision in their leases. It became a major flashpoint only after the governmental shutdown orders took effect and parties discussed whether any lease obligations would be excused. Force majeure is a contractual (rather than a statutory or common law) right that is governed by the specific language in the lease. Therefore, very few tenants were excused from payment of rent based solely on the force majeure clause. Many force majeure clauses provide for delayed performance (for example, construction obligations), but not complete nonperformance. A tenant's lack of funds, regardless of the cause, generally is not considered a force majeure event. However, an Illinois bankruptcy judge ruled in June that a restaurant operator was only lia-



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ble for 25% of its rent obligations, which percentage is attributable to food delivery and pick-up permitted under the Illinois stay-at-home order. The specific language in the lease provided that the tenant shall be "excused from performing its obligations or undertakings provided in the Lease, in the event, but only so long as performance of any of its obligations are prevented or delayed, retarded or hindered by ... orders of government." Therefore, the tenant largely benefitted from the broad force majeure language included in its lease.

Both parties will take a longer look at the force majeure clause going forward. Events of force majeure may specifically include epidemics, pandemics, public health emergencies and other outbreaks of disease or illness. However, landlords will want to make it abundantly clear that tenants will not be excused from payment of rent, whereas tenants will want to be relieved of payment obligations if a force majeure event prohibits them from operating their business. Since force majeure provisions typically are tucked away in the miscellaneous provisions at the end of the lease, any specifically negotiated tenant protections should be clearly

highlighted or moved to a separate provision in the lease.

**■ Restructuring lease concessions.** When negotiating new retail leases, both landlords and tenants will want to fully contemplate and reasonably allocate potential pandemic-related risks. A landlord may agree to rent abatement or deferment if the tenant is prohibited from operating its business for a certain period of time, and possibly a termination right if such prohibition continues for an extended period of time. The parties may consider more creative solutions, such as converting base rent to percentage rent, providing flexibility for the permitted use, broadening the tenant's assignment or subletting rights, or offering additional unused space for an outdoor expansion area, a pickup location, or a shipping and delivery area. In exchange for additional concessions, tenants may agree to provide additional security (such as personal guarantees or letters of credit) or pursue governmental aid and additional business interruption insurance, as available. These additional provisions in the lease may provide sufficient safeguards to absorb any future risks.

**■ Reconfiguring physical spaces.** The COVID-19 pandemic has shifted the focus from desirable amenities to essential safeguards to protect for the health and safety of occupants in retail spaces. The U.S. Green Building Council recently released new LEED credits for clean-

ing, workplace re-occupancy, water quality and air quality as a direct response to the COVID-19 pandemic. Tenants likely will demand more detailed requirements in their leases pertaining to heating, ventilation and air-conditioning systems, plumbing systems, janitorial services and other sanitation standards. The idea of shared gathering spaces, such as gyms, kitchens and lounges, already has lost its luster. Instead, prospective tenants likely will focus on retail spaces that allow for safe social distancing and seamless integration of online and in-person operations. In order to address these new concerns, landlords may reconfigure available retail space and common areas to meet evolving demands. Whether these new ways to use space will affect rental rates is yet to be seen.

**■ Conclusion.** As a consequence of the COVID-19 pandemic, landlords and tenants will need to re-examine their priorities as they negotiate new retail leases. Tenants may wield additional negotiating power but bear the burden of increased uncertainty and financial risk. Landlords may agree to additional concessions or elect to convert the use of space to more pandemic-friendly uses. In any case, both parties will need to address the new health and safety concerns for indoor retail spaces. With recent experiences, landlords and tenants can better address the COVID-19-related impacts in their retail leases. ▲