

Effect of COVID-19 related shutdowns & delays under commercial office leases*

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1. Introduction

COVID-19 and the massive efforts being made to prevent or delay its spread can potentially affect tenants and their landlords in many ways, including full or partial building shutdowns or vacation, interruption of access or building services, suspension or delay of construction (in general or certain trades), etc. These can be government mandated or recommended or privately elected or can arise out of materials shortages or labor unavailability. Delays in one building can affect another, e.g., a tenant delayed in moving into building A holding over in building B.

While leases almost always include a force majeure clause, most often those clauses are written so that they only benefit the landlord. However, sometimes they are written to give the landlord less benefit than one might initially think. For example, a force majeure clause might excuse a landlord default (and thus avoid the general remedies for default which the law would otherwise give the tenant), but might neither delay the onset of a specific tenant remedy expressly provided for in the lease, nor shift related costs from the landlord to the tenant.

In each COVID-19 related situation, a review of the individual facts, a careful reading of the lease and, often, knowledge of the applicable law (both leasing law and COVID-19 related law) is required. This paper is not a substitute for that, nor for consultation with counsel. Its purpose is to provide a framework and describe how some commonly arising issues are commonly addressed in modern commercial office leases.

The discussion below is divided into three major sections: Tenants not yet in occupancy; Tenants in occupancy; and Tenants nearing the end of their term.

2. Tenants Not Yet in Occupancy

2.1 Preliminary Items

- **Distinguish between:**
 - *Landlord's Base Building Work, e.g., structure & shell, central components of building systems, core facilities, corridors and demising.*
 - *Fit-Out Work (a/k/a build-out, leasehold improvements, tenant work) which can be performed by the landlord or the tenant.*
- **Think separately about:**
 - *Who will bear the increased costs of construction.*
 - *Who will bear the costs of delay in substantial completion. This is frequently more important than the increased cost of construction. There are two different types of costs.*
 - » Cost of rent commencing before the premises are available for occupancy (or earlier than anticipated).
 - » Cost of holding over at the existing premises.
- Keep in mind that leases use different terminology for the date when rent commences. Some refer to that date as the Rent Commencement Date; others refer to that date as the Term Commencement Date or simply Commencement Date.

2.2 Landlord's Base Building Work Not Completed

- Under almost any lease, the landlord will bear any increased cost of completing Landlord's Base Building Work.

- Most leases provide, explicitly or by operation of defined terms, that a delay in landlord's completing or substantially completing Landlord's Base Building Work pushes back the date on which the term commences and/or the date on which rent commences. Depending upon how the force majeure clause is written, this can be so even if the delay in landlord's completing Landlord's Base Building Work results from force majeure. However, if the lease provides for a push back in commencement longer than the delay in completion (e.g., so-called two for one) or for a tenant cancellation right if the delay extends beyond a specified date, it would be common for the penalty component not to apply in case of force majeure and for the specified date to be extended by reason of force majeure. Sometimes the landlord's force majeure right is capped, i.e., force majeure delay in excess of the cap is treated as ordinary delay.
- Some leases provide for a fixed term commencement or rent commencement regardless of whether the landlord has completed Landlord's Base Building Work. The law may provide the tenant with some relief in such a case, but because the landlord is not responsible for the underlying cause (COVID-19), such relief is not certain.

2.3 Tenant Performing Fit-Out Work

- In large and medium leases, it is common for the tenant to perform its own Fit-Out Work, i.e., to engage a project manager, an architect/engineer and a general contractor or construction manager.
- In most cases, if the tenant is performing its own Fit-Out Work then it will bear any increases in cost, and the rent will commence on a schedule determined without reference to whether the Fit-Out Work is completed. As a general rule, the tenant pays for the greater control that this structure provides by assuming these risks.
- In most cases, for the tenant to perform its own Fit-Out Work, the landlord will need to provide access (outside hoisting

or building freight elevators), temporary electric, temporary heating or cooling, etc.

- If the tenant's completion of its Fit-Out Work is delayed by COVID-19 related unavailability of labor or materials and especially if the landlord doesn't provide access or required services, the lease or the law may provide the tenant with some relief (such as delay in rent commencement), but again because the landlord is not responsible for the underlying cause (COVID-19), such relief is not certain.

2.4 Landlord Performing Fit-Out Work

- In small and medium leases, it is common for the landlord to perform the Fit-Out Work.
- These landlord-to-build arrangements can be structured such that the landlord bears either the entire cost [i.e., the marginal dollar is borne by the landlord] or the cost up to a stated maximum [i.e., the marginal dollar is borne by the tenant]. One common hybrid is to provide that, initially, the landlord's contribution is fixed [i.e., the marginal dollar is borne by the tenant] but once the plans are approved and bid out a firm price is established, and the tenant's responsibility is fixed on that basis [i.e., the marginal dollar thereafter arising is borne by the landlord].
- Under most landlord-to-build arrangements, regardless of who is bearing the marginal dollar, the landlord takes the risk of delay, i.e., rent commencement is postponed. The discussion above regarding remedies for delay in Landlord's Base Building Work is also applicable to the Fit-Out Work in this circumstance.
- Regardless of who is bearing the marginal dollar, and even if the landlord is bearing the risk of delay in substantial completion, if there is Tenant Delay the risk shifts back to the tenant. COVID-19 could give rise to Tenant Delay if, for example, the tenant does not give timely approvals or if an architect engaged by the tenant does not timely provide plans.

3. Tenants in Occupancy

In general, a tenant is not released from its obligation to pay rent by reason of the tenant ceasing to use the premises.

- Under most space leases, damage to the premises by fire or other casualty (the term used in a typical lease) is an exception to this rule. If a particular premises were actually contaminated by the COVID-19 virus, that might be a casualty, depending upon the language of the lease. Some leases define casualty by reference to what is insurable and, if so, insurance practices would need to be consulted. Once the contamination is remedied the abatement would cease. If the premises are not contaminated and are vacated solely as a precaution, even a legally-mandated precaution, that would not be a casualty.
- Another exception to this rule is that, in some cases, if the tenant's ceasing to occupy is caused by a failure of the landlord to provide access or services rent is abated. However, under the language of most leases, this exception only applies if the failure to provide access or services is the fault of the landlord and not force majeure, and even then the lease usually specifies a waiting period.

4. Tenants Nearing the End of Their Term

Even when the lease includes a force majeure clause in favor of the tenant, it is common to exclude from that clause the tenant's obligation to vacate. Therefore, in all but rare instances, the fact that the tenant's vacation of premises is delayed by force majeure does not give the tenant a legal right to holdover. As a practical

matter, however, it will almost certainly slow down an eviction proceeding, assuming that the tenant can show that it is making serious efforts to overcome the delay. Also, in some leases, the holdover clause provides for a lower rent if the holdover is due to force majeure.

5. Other Issues

The above is not exhaustive. COVID-19 will certainly have other effects on commercial tenants and commercial leases, including effects on building operating expenses (particularly important for tenants with a 2020 base year), new or additional systems or capital expenditures to resist future viruses, new legal requirements, potential governmentally-mandated rent relief especially for small or retail tenants, landlord insolvency, increased prevalence of work-from-home.

Tenants should also review their business interruption insurance, or consult their insurance advisors; questions to consider include whether COVID-19 virus contamination of premises triggers coverage or whether coverage is triggered by an interruption even in the absence of such contamination.

Savills is available to help its clients think through and work through the effects of COVID-19 on their occupancies, leases, premises and construction projects. This white paper deals with only a few aspects of that topic. In most cases, equally or more important will be all parties working together in a positive and cooperative way to deal with this unprecedented situation.

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*This white paper does not constitute, and neither Savills nor the author is providing, legal advice. No attorney-client relationship is or will be established. Tenants and other transaction parties are encouraged to consult with their legal counsel.

**For more than 30 years before joining Savills in 2008, the author practiced law, specializing in representing commercial office tenants in New York and throughout the country.