BLANKROME

Real Estate

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Coronavirus Guidance for the Real Estate Industry

This client alert is intended to highlight some issues facing landlords, tenants, lenders, borrowers, sellers, and buyers arising out of the coronavirus, known also as "COVID-19." The legal landscape will likely change as courts and governments create new "law" in response to the unprecedented consequences of COVID-19, and "pandemic" clauses are incorporated into contracts. For up-to-date advice on real estate issues regarding COVID-19, or how these issues would be resolved under the laws of a particular state, please ***contact us****.*

FORCE MAJEURE/COMMERCIAL FRUSTRATION/ IMPOSSIBILITY OR IMPRACTICABILITY OF PERFORMANCE

In General

In the current COVID-19 environment, a *force majeure* clause that expressly addresses circumstances, such as an "epidemic," "pandemic," "contagious disease," or other similar public health-related occurrence would likely provide the greatest protection for the contracting parties. The protections afforded by other circumstances frequently used in *force majeure* clauses, such as "Act of God," "disaster," or "emergency," are less clear as it relates to the effects of COVID-19.

Furthermore, some *force majeure* provisions may contain open-ended language, such as "including, but without limitation," "similar or dissimilar events," or "acts beyond their reasonable control"—language designed to capture the overall purpose of a force majeure clause, or stated differently, to protect an impacted party if an unforeseen harm outside of the party's control frustrates the party's performance. However, unless the parties make it clear that such phrases are intended to expand the possible circumstances justifying a force majeure event, courts may be required to construe such phrases narrowly, consistent with the otherwise enumerated events.

Common law doctrines, such as "commercial frustration" and "impossibility/impracticability," may also provide potential defenses to claims of nonperformance resulting from coronavirus-related disruptions. Commercial frustration provides that when the occurrence of an event substantially frustrates a contracting party's principal purpose, the party's remaining contractual duties are discharged, so long as (i) the non-performing party is not at fault; (ii) the non-occurrence of the event was a basic assumption on which

the contract was made; and (iii) the language of the contract or surrounding circumstances do not provide to the contrary. Importantly, frustration of purpose is a future-facing defense; it can only be used to excuse future performance.

Similarly, the defense of impracticability/impossibility requires a party to demonstrate (i) the occurrence of an event, the nonoccurrence of which was a basic assumption of the contract; (ii) that continued performance is not commercially practicable; and (iii) that the party invoking the defense did not expressly or impliedly agree to perform notwithstanding the impracticability. Applied here, if a party is prevented from providing contractually required services or goods due to a supply chain disruption or because a quarantine blocks access to a particular source of materials, "commercial frustration" and/or "impossibility/impracticability" could be viable defenses to a claim of breach for nonperformance.

Leases

Most leases contain a fairly typical *force majeure* provision. To the extent the parties are delayed in performing obligations under the lease due to COVID-19 (*e.g.*, obtain permits, complete construction, commence business operations, provide building services, continuously operate, etc.), the *force majeure* clause may excuse these delays to the extent they are legitimately related to the pandemic (particularly during governmental states of emergency). However, most *force majeure* clauses expressly exclude relief for payment obligations. Moreover, some clauses cap the length of time for which a party may claim a delay, or condition the time extension on the other party's receipt of timely notice of the *force majeure* event. In all instances, it is essential to review the specific language in the lease to determine whether, and to what extent, performance is excused as a result of COVID-19 issues.

Purchase and Sale Agreements

While most purchase and sale agreements do not contain general *force majeur*e provisions (and instead rely on casualty and condemnation provisions), it would be advisable to incorporate "pandemic" *force majeure* provisions benefitting sellers and purchasers, carefully drafted so that time extensions are only granted for those obligations directly impacted by the pandemic. For example, a *force majeure* provision may benefit a seller who is otherwise unable (or determines it is imprudent) to continue the property's normal business operations, or a purchaser by extending the due diligence period if they or their lender are unable to access the property within the prescribed timeframe. Also, the *force majeure* provision can allow an extension of the closing date due to a seller's or purchaser's inability to obtain and deliver original notarized signatures or record deeds or mortgages as a result of closures of clerks' offices.

Construction Contracts

As with all agreements, the question as to whether COVID-19 would constitute a *force majeure* event depends upon the specific language employed. However, even where COVID-19 is determined to be a *force majeure* event, if there is an attenuated connection between COVID-19 and the claimed delay, the contractor may not be entitled to a time extension. For example, while construction delays caused by governmental orders related to COVID-19 or supply chain problems attributable to COVID-19 would likely entitle the contractor to a time extension, it is not certain that the contractor would be so entitled if a construction delay occurred by reason of: (i) a subcontractor advising laborers to stay home; (ii) a labor shortage resulting from a large number of laborers contracting the virus; or (iii) laborers refusing to work until prophylactic measures are implemented by the contractor or subcontractors in order to mitigate the risk of contracting the virus.

As discussed above, in the *In General* paragraph, if the COVID-19 pandemic made performance of the contractor's obligations illegal, impossible or radically different, then the contractor may be entitled to relief under the common law doctrines of "commercial frustration" or "impossibility/impracticability" (for example, the government imposes a quarantine on the area where the project site is located, prohibiting or materially impeding the movement of people or construction materials in or out of the area for an extended period of time).

Loan Agreements

Most *force majeure* provisions used in loan documents will not excuse borrowers from payment obligations, but they may allow for a time extension for certain of the borrower's performance obligations. They are particularly important in construction loans, especially with respect to completion milestones and other performance covenants. Most *force majeure* provisions in loan documents do not include "pandemics," "epidemics," or "diseases." However, they

often include such clauses as "acts of God" or "government restrictions," which may or may not be broad enough to cover pandemics such as COVID-19.

LEASES

Except as may otherwise be indicated, the below discussion pertains to commercial leases.

Access

Whether a landlord can limit a tenant's access to the building, or otherwise condition access on some form of screening test for the virus, will most likely be determined by the building rules and regulations. A comprehensive and well-crafted set of rules and regulations will generally permit the landlord to do so, particularly in light of the recent governmental emergency declarations. However, a tenant may seek redress in court under common law principles (see the discussion below, under *Rent Payment Obligations*).

Rent Payment Obligations

As discussed above, under the Leases paragraph in the section captioned, *Force Majeure/Commercial Frustration/Impossibility or Impracticability of Performance,* even if COVID-19 is considered to be a *force majeure* event, most *force majeure* clauses expressly exclude relief from rent payment obligations. Furthermore, this exclusion applies even if the tenant is forced by the government to close their business. Nonetheless, such tenants may cease paying rent, relying upon the "commercial frustration" doctrine (see the discussion above, under the section captioned, *Force Majeure/Commercial Frustration/Impossibility or Impracticability of Performance*). This is a very aggressive stance, but in light of the exigencies surrounding COVID-19, it is conceivable that a court may exercise its equitable powers to grant this extraordinary relief.

If there is no government mandate, but the tenant elects to close its business due to the consequences of COVID-19, they will likely try to claim "commercial frustration" as the reason for withholding rent; however, they will be less likely to succeed than if there had been a government mandate.

In some leases being negotiated now, landlords are acceding to requests by tenants for rent relief if the tenant is unable to perform construction work or open for business due to circumstances related to COVID-19.

Reporting COVID-19 Cases

Pursuant to the typical building rules and regulations, a landlord would be permitted to require that tenants self-report known cases of COVID-19, and bar entry to a tenant's employee who is symptomatic.

Whether the landlord is obligated to report known cases may depend on applicable governmental requirements or guidelines. Yet even if not legally mandated, it may be prudent business practice for the landlord to report cases to other building tenants, especially those occupying premises on the same floor or using the same elevator bank (without identifying the person).

Force Majeure

Please see the discussion above, under the Leases paragraph in the section captioned, *Force Majeure/Commercial Frustration/Impossibility or Impracticability of Performance.*

FINANCING

Material Adverse Effect

A loan agreement may permit the lender to default the borrower, or not disburse funds or release escrowed monies, if a "material adverse effect" (or "material adverse change") occurs. The term "material adverse effect" (or "material adverse change") generally means a material adverse effect on (or change upon) (i) the condition, operations, business, assets or prospects of a borrower or guarantor, (ii) the ability of the borrower to perform their obligations under the loan documents, (iii) the rights or remedies of lender, or (iv) the ability to operate the real property securing the loan.

To preempt the lender from enforcing its rights to default the borrower or withhold funds based on the general economic impact of pandemics, a borrower should attempt to exclude such an impact, and its effect on the borrower, from the definition of "material adverse effect." Even without such an exclusion, the lender may be reluctant to rely solely on these rights because they will need to overcome a high burden of proof and may subject themselves to a lender liability claim. Though the economic impact of COVID-19 is in its nascent stages, the severity and duration of this may strengthen a lender's ability to invoke these rights. However, lenders need to consider the potential reputational risk in the marketplace, and the corresponding impact when the economic environment resulting from COVID-19 improves.

Anti-hoarding
Anti-hoarding provisions in loan agreements limit how much cash a borrower can hold or receive as an advance, and require loan paydowns if cash held by the borrower exceeds a certain amount over a designated period. Borrowers facing a liquidity shortage may pull down more cash than presently needed in order to satisfy future obligations, and anti-hoarding provisions are designed to curtail that behavior. These provisions have not often been used, but based on the current actions of borrowers, who are withdrawing cash in reaction to the COVID-19 crisis, lenders will likely start incorporating them in their loan agreements or amendments thereto.

Title Insurance
Lenders and borrowers should consult with their title companies on potential delays in conducting title searches, UCC searches, and the like, and regarding local rules governing electronic signatures, electronic filing, electronic notarizing and insuring over the gap period between closing and recording, especially when a recording office is not currently operating.

Force Majeure
Please see the discussion above, under the Loan Agreements paragraph in the section captioned, *Force Majeure/Commercial Frustration/Impossibility or Impracticability of Performance*.

PURCHASE AND SALE AGREEMENTS

Risk of Loss Doctrine
The risk of loss doctrine governs whether the seller or the purchaser assumes the risk of the property being damaged or destroyed between contract execution and closing. Most state statutes place the risk of destruction or material damage squarely on the seller, except in instances where the purchaser acquires possession of the property prior to the closing or is otherwise at fault. In addition, the parties can agree in the contract to a different allocation of the risk, but most purchase and sale agreements conform generally to the statutory allocation scheme. With COVID-19, since there has been no destruction of any part of the building, the risk of loss provision does not entitle the purchaser to terminate their contract. In anticipation of future pandemics (or even potential additional effects of COVID-19), purchasers may request that sellers expand these provisions to include specified material adverse impacts of a pandemic.

Access for Due Diligence
A purchaser's due diligence involves inspecting properties and meeting with tenants. The due diligence access provisions in purchase and sale agreement typically allow the purchaser "reasonable" access to the property, subject to the rights of tenants. In the post-COVID-19 world, sellers should include in these provisions sole discretion approval rights over whether, and to what extent, the purchaser can gain access to the property, especially tenant-occupied areas. Sellers should also consider imposing new access protocols to protect against COVID-19 transmission, and requiring appropriate insurance coverage to the extent available. Access rights are a particular issue with multi-family properties because sellers are now less inclined to allow purchasers access to inspect individual units. From the purchaser's perspective, they will be reluctant to have their employees travel to the properties or meet with tenants in person. In an effort to address the current access challenges, some sellers are providing representations not ordinarily given regarding the physical state of the property.

Operating in the Ordinary Course
Many purchase and sale agreements include covenants requiring the seller to operate the property in accordance with a particular standard. The standard can vary, but generally most sellers will agree to operate in the ordinary course, consistent with past practices, subject to casualties and ordinary wear and tear. Even this low standard, however, can be difficult to meet at this time, with on-site leasing offices closing and routine building services being delayed or curtailed due to government mandate or otherwise at the discretion of the seller or service provider. Sellers will likely want to modify this standard to address these issues; purchasers, on the other hand, may want to incorporate requirements intended to mitigate potential contamination from a pandemic.

Financing Contingencies
Purchasers may be concerned about obtaining financing during this time, with lenders becoming more conservative given market uncertainties. Despite financing contingencies

generally being disfavored by sellers, they may not resist as strenuously given the current extraordinary circumstances. Yet purchasers, depending on the asset class, purchase price, and available cash, may want to consider whether it is appropriate to request a financing contingency, or even a funding contingency.

Title Insurance

Purchasers and sellers should consult with their title companies on potential delays in conducting title searches, UCC searches, and the like, and regarding local rules governing electronic signatures, electronic filing, electronic notarizing and insuring over the gap period between closing and recording, especially when a recording office is not currently operating.

Force Majeure

Please see the discussion above, under the Purchase and Sale Agreements paragraph in the section captioned, *Force Majeure/Commercial Frustration/Impossibility or Impracticability of Performance.*

Blank Rome's COVID-19 Task Force is continuing to monitor the COVID-19 crisis and will provide further updates for the real estate industry as they become available.

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