



Tenancy Tribulations

Commercial and residential property rentals: Impact of COVID 19

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In an aim to curb the spread of the corona virus, governments in many countries have resorted to a lockdown period where all institutions that are not regarded as providing essential services are forced into a period of closure. This closure in South Africa, although instituted for a period just over a month at this point, has already started having a devastating impact on the economy. Let's look the following scenario.

The company that you are working for has just been notified that because it does not provide essential services, it will need to close its doors during the lockdown period. The company, a clothing company has been in existence for 3 years and has shown a positive percentage increase in turnover over the 3 years. Although the company receives raw materials from several countries around the globe, its biggest market is South Africa, where it employs 1000 people (with about 300 of these 1000 being temporary staff who receive wages). The company is totally reliant on consumers and clients for income generation. The company has been forced to lay-off all temporary staff with immediate effect. The company operates out of two large warehouses, one in Johannesburg and the other Durban and it has one outlet store in each of the 4 biggest provinces. The company head-office is in Cape town and lease agreements for the properties mentioned have been signed for an initial 5-year period with first option to extend. The start date being October 31, 2019. Yes, you guessed it, the company pays monthly bills to property group for commercial rental.

Now let's introduce one more variable. A friend of yours who also works for the company, is a mid-level manager. You introduced him to this company and until now he didn't have one bad thing to say. He moved from the Free- State to take this job at the Johannesburg office. He is a family man with 7 years of work experience. He makes monthly rental payments for boarding and lodging, car payments for a vehicle that is almost paid off, pays for school fees for 2 kids, medical aid, insurance and monthly groceries. His disposable income is small, but he was promised a big bonus if he stayed with the company for 4 years with the bonus to be paid out at the end of the fourth year. He is one of the lucky ones who hasn't been laid off but has to endure a 50 % pay cut of his monthly salary for the next 3 months.

Let's delve into the reality

Faced with the current situation, the company can manage salaries for the next 5 months at 50 % for all staff currently employed. It is also able to make payments to all creditors for materials purchased over the last 6 months. The finance manager, however, is busy reviewing its ability to make commercial rental payments for the foreseeable future.

Your friend is in a very tight spot as well. With teachers still able to teach online and every other monthly expense still a necessity he is unable to meet his monthly expenses with his current income. He cannot cancel his medical aid payments and insurance is a necessity. He has managed to pause his annuity payments and place a temporary hold on the education policies for his kids and a joint investment policy for him and his wife. Your friend has made application to postpone payment on his vehicle and is awaiting feedback from the bank. He expects that this might not be a problem

since he has never missed a payment and is in the last year of his 5-year term. He is worried about being able to manage his rental payments over the next few months

Avenues available to the commercial tenant

The most striking difference between a commercial lease and a residential one is that the commercial lease is generally drawn up for a **much longer** period. Common with commercial leases is that tenants make additional payments, including: property taxes, insurance and premiums related to maintenance of the common area.

Landlords include clauses that mandate operating hours and days for operation. In many cases, landlords incur upfront capital costs, in order to accommodate any changes to the property requested by the tenant. Broker fees are also paid upfront by the landlord in most cases. These costs are expected to be recouped towards the end of the lease period. Having said that, the contract is, however, like any other lease agreement in that its terms will guide in determining the responsibilities of each party.

With respect to this commercial lease, all points mentioned above apply. The added costs mean the commercial landlord is initially renting out at a loss for some time knowing that they start to generate positive revenue in the later years of the lease. Taking the current climate into consideration and with an aim to plan for the next steps, the company has two options. Terminate or seek to amend the commercial lease.

Termination of commercial lease depends on several factors. The lease may have specific provisions for the unilateral termination or cancellation of the lease, upon the occurrence of certain events or with certain notice. The inclusion of a *force majeure* clause, which typically excuses the performance of one or both parties, due to an unforeseen circumstance beyond the party's control, is also common. These clauses refer to an unforeseen event which may excuse a party due to *frustration, impossibility or impracticability*. Whether these can be used depends on the specifics of the lease and the *force majeure* clause itself.

Amendment is possible if the parties agree. Some avenues that parties are willing to look at may include, suspending payments partially or wholly for a pre-agreed amount of time, interest charges for unpaid rent, lumpsum payment to reduce the remainder of the lease, subletting or any other changes agreed upon by the parties.

It must again be emphasized that commercial leases are leases drawn up for much longer periods, for example five, ten or twenty years. There is a substantial investment by the landlord in the initial years with an inherent understanding that costs are still being recouped in the earlier years and profit will only be earned in the later years. As a result, landlords are generally more comfortable at suspending obligations for a period and looking at re-instating them as conditions improve rather than allowing tenants to renege on leases completely.

Avenues available to the residential tenant

The tenant, in respect of the residential lease agreement, is similarly subject to the terms of the agreement and should continue to pay rent and abide by all other tenancy rules to the best of their ability. The terms with respect to *force majeure*, can still apply, however those of *frustration, impossibility and impracticability* are less easy to prove and would largely depend on the value of the argument presented. The difference in this situation is that the tenant, in a residential property, is not prevented from occupying the leased premises during the lockdown period. Residential rental agreements are for much shorter periods, therefore, the landlord may be less comfortable at looking at suspending rental payments

If the tenant's ability to pay is affected, such as in this example, it is important to have an early conversation with the landlord. Rental payments, as agreed in your lease agreement, remain legally due. A conversation between the landlord and tenant can help both parties to agree a plan if tenant is struggling to pay their rent.

Alternatives can include accepting a lower level of rent, agreeing a plan to pay off arrears at later date, or some other avenue agreed by both parties. There is also the possibility for financial support from local authorities. At this stage, evictions are not permitted during the lockdown period and any court decision can generally only be imposed post lockdown

Our commitment

Parties to a contract cannot simply rely on a clause that is labelled as a '*force majeure*' or contains those words without listing specific details to them. *Force majeure* clauses should list the events that the parties agree will suspend their performance of the contract (such as an epidemic). In this regard, parties should be careful with reference to the exact

wording of contracts, such as 'act of God' or 'acts of authorities' which can then be relied upon to include events they may not reasonably have foreseen.

Courts interpret *force majeure* provisions narrowly and insist that the events giving rise to the suspension or termination of the agreement fall within one of the defined events. An alternate approach to this is that parties will not be excused from their contractual obligations due to the occurrence of an event which the parties had clearly contemplated. In addition, it could be argued that parties may be discharged from their obligations if the performance of a duty is made *impossible* by having to comply with a government regulation. Having mentioned the above and, in the absence of an air-tight *force majeure* clause in a contract, outcomes are based on the facts and varied circumstances of each individual case.

Although only one scenario has been provided here, we at TIM TU DOIT & CO INCORPORATED are very much aware of the various spin-offs, permutations and ripple effects of the national lockdown. If you are landlord, a commercial tenant or a residential tenant faced with the above dilemma in some way or form and regardless of the implementation of a lease agreement, we can:

1. Assist you with drafting a contract where none exists
2. Review your current contract suggest modifications and assist with the negotiations
3. Add a *force majeure* clause or amend the clauses in your existing agreements to satisfy all parties; and
4. Advise you on your rights in the event of possible litigation.

Sources referenced in this article

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