



# COVID-19: Real Estate

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A short update from our experts in key locations across Europe comparing government responses and assessing if and to what extent the obligation of tenants to pay rent is affected.

The Covid-19 pandemic has created challenges for the commercial real estate sector – whether caused by lockdown strategies, cash flow interruptions or general economic uncertainty and disruption.

Some governments have quickly enacted specific laws to respond to some of the immediate challenges, others have left the market to rely on pre-existing laws and regulations. In this note, to assist companies with occupational and/ or investment interests in key locations across western Europe, we offer a high level comparison of the position for landlords and tenants of commercial premises in **Germany, France, Italy, Spain and England & Wales** (looking specifically at real estate issues and not wider business support).



## Germany

On 25 March 2020 the German Federal Parliament (*Bundestag*) unanimously passed a draft bill aimed at mitigating the consequences of the Covid-19 pandemic in civil, insolvency and criminal proceedings (*Gesetz zur Abmilderung der Folgen der Covid-19-Pandemie im Zivil-, Insolvenz- und Strafverfahrensrecht*) (COVID-19 Act). Such provisions of the draft bill stipulating changes to German lease law came into effect on 01 April 2020.

According to the COVID-19 Act, landlords may not terminate lease agreements solely on the grounds that a tenant failed to pay the rent during the period from 1 April 2020 to 30 June 2020 (the period may be prolonged until 30 September 2020 by way of an ordinance (*Rechtsverordnung*), provided that such rent arrears are based on the effects of the COVID-19 pandemic, where the burden of proof is on the tenant. This suspension of the termination right applies to both residential and commercial leases and applies until 30 June 2022, ie the landlord will only be entitled to terminate the lease due to rent arrears of the tenant between 1 April 2020 to 30 June 2020 as of 1 July 2022. The COVID-19 Act does not stipulate a remission of the obligation to pay rent.

Economically the suspension of the landlord's right to terminate the lease does not constitute an interest-free loan from landlord to tenant. As the rent remains due and payable, but only the right of the landlord to terminate the lease due to non-payment as a result of the pandemic is suspended, interest accrues on the outstanding rent payments at the applicable rate.

The COVID-19 Act is silent on whether the landlord can call on the rent security (if any) provided by the tenant, which in German commercial lease is often three months net rent, ie would exactly cover the initial time period (1 April to 30 June) stipulated by the Act. Calling on the rent security could indeed be an option for the landlord, whereas the feasibility depends on the particulars of the individual case. The same applies with respect to the statutory lessor's lien (*Vermieterpfandrecht*) pursuant to section 562 of the German Civil Code (*BGB*) as the COVID-19 Act does not expressly prohibit a landlord to take recourse if rent payments are not made.

Furthermore, it may be worth scrutinising whether any insurances covering business interruption/loss of rent are in place which may cover a loss of rent incurred by the landlord. There is no general answer as to whether or not this is the case.

Rather, the wording of each insurance policy will need to be reviewed individually.

Finally, the COVID-19 Act does facilitate amicable agreements between landlord and tenant eg regarding a moratorium of the obligation of the tenant to pay rent by introducing limitations regarding the risk of the landlord to be subject to claw back rights (*Insolvenzanfechtungsrechte*) of an insolvency administrator in the event of the occurrence of an insolvency of the tenant.

It is not entirely clear whether by the introduction of the COVID-19-Act, the rights of tenants to reduce rent or to ask for an amendment of the lease agreement pursuant to the rules of frustration of contract (*Wegfall der Geschäftsgrundlage*) have been excluded. As the COVID-19-Act has strengthened the position of the tenant by temporarily excluding the right of the landlord to terminate the lease, the legislator may have expressed its opinion that this shall be the only relief granted to the tenant, and all other measures of the tenant shall be excluded, which is supported by the general principle in German lease law that the tenant bears the economic risk whether the leased premises are suitable to conduct business. In case the upcoming court verdicts do not follow such line of argument, it will be very difficult to assess what exactly the rights of tenants are. In this respect, it needs to be taken into account that due to the German federal systems the state governments have recently taken measures to provide some relief from the current lockdown. Namely on 15 April, the German Federal Government and the 16 state governments have agreed to allow businesses to reopen to some degree, depending inter alia on the line of business, the size of the sales area, and in any event subject to compliance with certain rules of procedures safeguarding continued social distancing and compliance with strict hygiene requirements. In light of this, each individual case will need to be assessed when determining the rights of tenants with respect to rent deferral or reduction, and amicable discussions between landlord and tenant aimed at finding a suitable compromise for both parties seem to be a prudent way to handle the current situation of uncertainty.



## France

The French government, empowered by Article 11 of the Emergency Act of 23 March 2020, has taken measures, by the Order No. 2020-316 of 25 March 2020, in an effort to contain the economic

consequences caused by Covid-19. Article 4, in particular, specifies that individuals and legal entities governed by private law exercising an economic activity that are likely to benefit from the solidarity fund as defined in Article 1 of the said Order cannot be held liable for “financial penalties or interest for late payment, damages, penalty payments, enforcement of a termination clause, penalty clause or any clause providing for the forfeiture of rights, or activation of guarantees or securities, due to non-payment of rent or rental charges relating to their professional and commercial premises, notwithstanding any contractual terms”. The eligibility criteria were specified by Decree No. 2020-378 of 31 March 2020 (ie the leased area is affected by the prohibition to receive public or has suffered a loss of over 50% of turnover for the period between 1 and 31 March, has a maximum of 10 employees and an annual turnover for the previous year not exceeding 1 million euros and, and a taxable profit not exceeding 60,000 euros for the previous year). These provisions apply to rents and rental charges for which the due payment date is between 12 March 2020 and the expiration of a period of two months after the end date of the public health emergency. As a reminder, the end of the public health emergency has been set for 24 May 2020, subject to subsequent modifications. Decree No. 2020-378 of 31 March 2020 stipulates that any person wishing to benefit from these provisions must produce a sworn statement certifying that he or she meets the conditions for benefiting from them.

It is important to note that Article 4 of the Order does not provide for the suspension or deferment of rents and charges but only for the absence of financial penalties or interest for late payment, damages, penalty payment, enforcement of a termination clause, and penalty clause. It is, therefore, only a neutralisation of penalties for non-payment of rents and charges due between 12 March 2020 and a period of two months after the end of the public health emergency.

Therefore, a strict application of this text shows that the obligation to pay rent is still applicable, but the effects of the non-fulfilment of this obligation are suspended. The tenant will have to pay his rent arrears after at the end of the protection period imposed as part of the public health emergency.

For tenants who are not eligible to this procedure, negotiations in good faith with the landlord are still possible.

Furthermore, leases, as contracts, but without distinction as to the quality of the tenant, are affected by Order No. 2020-306 of 25 March 2020. Therefore, the provisions of Article 4 of this Order are applicable to them. In practice, this

implies that the landlord cannot invoke a termination clause for a breach that occurs during a period equal to the duration of the public health emergency plus one month, ie at this stage as of 24 July 2020. Article 5 of this order also covers the renewal of agreements. This article specifies that the periods for renewal are extended to end three months after the end of the public health emergency. We believe that this extension should apply to all leases for which the period for requesting renewal must end between 12 March 2020 and 24 May 2020.



## Italy

One of the key considerations for landlords in Italy is whether a tenant may successfully argue for a reduction or deferral in the rent payable under a lease, and whether an argument that a lease is at an end based on force majeure, or any other basis, has any likelihood of success. It is conceivable that a commercial lease might contain a specific force majeure clause which would entitle either party to suspend the performance of the contract and, in cases of prolonged impossibility beyond a certain term, terminate that contract. Similarly, the parties may have negotiated the inclusion of a ‘hardship clause’ in a lease providing that, in cases of defined hardship, the parties must attempt to renegotiate the lease terms, and, if the parties cannot reach agreement, an independent expert will decide on the substituted terms.

However, in the absence of such express provision, it is necessary to look to the Italian Civil Code (‘ICC’) for guidance on the rights and responsibilities of both parties to a lease. The ICC does not provide for the general concept of force majeure, whether in relation to all contracts or in the context of commercial leases. However, guidance can be drawn from the general rules on the position where it is impossible (either temporarily or permanently) to fulfil a relevant obligation (articles, 1218, 1256, 1463 and 1464 of the ICC) and termination of contracts where performance is excessively onerous (article 1467 of the ICC).

Commercial leases generally attract the provisions of the ICC in relation to temporary impossibility. Normally, where a contract cannot be performed due to temporary impossibility, the contract remains fully effective, but the defaulting party will not be liable for the delay in performing its duties under the contract (ie the landlord in

making the premises available) because the defaulting party is considered to be blameless (article 1256). Therefore a landlord acting in accordance with the ICC 'good faith' principle, may consider negotiating with its tenant(s) to agree a deferral in the payment of rent (without interest or penalties), or, eventually, a repayment plan for any unpaid rents. Tenants, acting in accordance with article 1464, are entitled to a reduction in the amount of rent payable under the lease, and even to unilaterally withdraw (*recesso*) from the lease if the landlord does not enter into negotiations for possible deferrals or reductions in the rent payable.

However, in the case of the Covid-19 pandemic, it is generally thought that 'temporary impossibility' arguments will not succeed, as the premises themselves continue to physically exist and remain at the tenant's disposal.

Tenants are likely to have a greater degree of success in arguing that the contract became excessively onerous and seek termination (*risoluzione*) by a Court, with effect as of the date of filing of the claim. Under this principle, a tenant could conceivably request that the lease be judicially terminated as the relevant '*factum principis*' (ie the lockdown restrictions on people and businesses) irreversibly alters the balance between the landlord and tenant. Landlords will assess requests on an individual basis, considering the landlord/tenant relationship, the terms of the lease and the duration of the government-imposed restrictions. Alternatively, tenants may formally request from their landlords a reduction in the rent payable under a lease. Should a landlord be minded to grant a reduction (for a fixed period of time), the agreement may be registered with the Internal Revenue Service, which would have the added benefit of not being liable for stamp and registration tax, and also allowing a landlord only to pay tax on the rents actually paid and not those agreed under the original lease.

Additionally, tenants could attempt to withdraw from a lease for 'material reasons' as provided for under Article 27, para 8 of Law 392/1978. 'Material reasons' have been held to be events which are both unforeseeable and beyond a tenant's control, or such as would make it extremely burdensome for the tenant should the lease continue. The burden of proof would lie with the tenant, and would include an objective assessment of the landlord/tenant relationship, contractual risk and the duration of the government-imposed restrictions. Six months' notice of the purported withdrawal must be given. It is however common for so called 'major leases' (ie commercial with an annual rent in excess of €250,000) to waive the ability to withdraw from a lease on this basis.

Finally, it is worth noting that the Italian Government issued the so-called "Cure Italy" Law Decree under which tenants of shops and workshops are entitled to a tax credit (*credito di imposta*) amounting to 60% of the lease fee paid for the month of March 2020 in relation to business premises.



## Spain

We are of the view that, with the current wording of the approved regulations, the burden to shut down the activities lies on the operators/tenants, and not on the landlords.

The above implies that, since the closure is not imposed on the operators/tenants and the operators/tenants are currently using the premises for other purposes (storage, advertisement, etc.), there are less grounds to justify a default in the payment of rent, while we understand that landlords are in a stronger position to request the payment.

Notwithstanding the above, this is the first time that the state of emergency has been declared for sanitary reasons for such a long term, and the wording of the approved regulations are sometimes not entirely clear (as they are being drafted within a short term not following all of the customary approval processes due to the current scenario). Therefore, we are facing uncharted territory, as there is no case law in place for similar situations, and we cannot foresee what decisions the courts will issue in case of litigation.

Therefore, our opinion is that, if tenants approach a landlord requesting a moratorium/waiver in the payment of rent (outside of the measures approved by the Spanish Government referred to below), a renegotiation of the contract terms on the basis of good faith and fair cooperation between parties may be the best path to overcome the current situation, although, in case of denial by tenants of such renegotiation, judicial action may be initiated (as further detailed below).

### Potential termination of the lease agreement as a consequence of tenants' default in payment of rent

Outside of the measures approved by the Spanish Government referred to below, non-payment of the rents may be qualified as a material breach under the lease agreement and, therefore, may entitle the landlord to terminate the lease agreement and, eventually, to request the eviction of the tenant.

If the landlord initiates civil proceedings to claim for the eviction of the premises (as a result of the non-payment of rents) the tenant is entitled – subject to certain conditions – to pay the outstanding debt and inactivate the eviction (ie eviction proceedings will be filed and the lease agreement will remain in effect).

A letter announcing the tenants' intent to not pay the following monthly rents may also be qualified as a material breach and, therefore, may lead to the termination of the lease agreement.

## **New measures approved by the Spanish Government in relation to commercial leases**

The Spanish Government approved on 21 April 2020 a rent payment moratorium for commercial and industrial leases. However, this measure is only applicable to those tenants who are entrepreneurs (*autónomos*) or PYMES (*pequeñas y medianas empresas*) (ie it will not be applicable to large corporations). In this context, those entrepreneurs or PYMES whose landlord is a company, a public entity or a large real estate holder may request (and the landlord must accept) a rent payment moratorium which will apply automatically during the period of time that the state of alarm and its relevant extensions last. If that period is insufficient in sight of the impact caused by COVID-19, the rent moratorium could be extended to the following monthly instalments, such monthly extensions to be conducted one by one, up to an aggregated maximum term of four months.

The payment of the relevant monthly instalments will be deferred without any interest or penalties accruing, by means of the division or fractioning of said monthly instalments for a term of two years.

In case the landlord is a small real estate holder (ie different from the ones referred to above), the tenant may request a temporary and extraordinary postponement of the payment of the rent.

## **Potential outcome from judicial proceedings on the termination of the agreement (in the context of the COVID-19 crisis)**

In the context of a potential lawsuit on the payment of monthly rents during the COVID-19 crisis, we cannot rule out that Spanish judges will be specially sensitive to tenants and try to reach equitable solutions for both parties. In this regard, any litigation arising from the current situation will be adjudicated in the future, with severe action likely against the party whose conduct is not in line with good faith principles.

In addition, and as a result of the state of emergency situation, the courts are currently closed (except for urgent measures). Therefore, any claim requesting the payment of monthly rents and/or the eviction of tenants should be initiated after the ending of the state of emergency (ie not before 9 May 2020).

Finally, there are two practical considerations regarding the potential actions that the landlords may file against the tenants: (i) any judicial claim will entail costs for the landlords (ie attorneys and court representative's fees); and (ii) for commercial reasons landlords may not request the termination of lease agreements, but only the payment of the due amounts (plus the relevant interest).



## **England & Wales**

On 26 March 2020, the Coronavirus Act 2020 (the 'Act') and the Health Protection (Coronavirus, Restrictions) (England) and (Wales) Regulations 2020 (the 'Regulations') were brought into force with immediate effect.

The Act prevents landlords forfeiting leases of commercial premises where a tenant has failed to pay its rent, whether the motivation for non-payment relates to COVID-19 or not. It applies to all tenants and lawful occupiers of commercial premises, whatever sector in which they operate, whether the tenant is permitted to open for business or faces any restrictions on trade, and regardless of the tenant's financial standing and resources. The definition of 'rent' includes any sums which a tenant is liable to pay under a lease, whether reserved as rent or not. The restrictions on forfeiture remain in force until 30 June 2020, although this date may be extended. In this time, a landlord cannot progress any Court proceedings for possession of premises where tenants have failed to pay rent.

The Act in no way removes a tenant's obligation to pay rent; it merely suspends a landlord's right to forfeit should a tenant delay in paying the rent that remains due. A landlord cannot inadvertently waive a right to forfeit, as, under the Act, any waiver must be made expressly and in writing. The right to forfeit is therefore preserved until the current suspension ends. The remaining rights and obligations of landlord and tenant under the lease remain, including any liability on the part of the tenant to pay interest on late payments.

Limitations have since been imposed which further restrict a landlord's ability to pursue remedies for recovery should a tenant fail to pay

any sums due under its lease. From 25 April 2020, landlords are also unable to exercise rights under the Commercial Rent Arrears Recovery scheme for unpaid principal rent, unless the amount of principal rent owing is equal to at least 90 days' principal rent. This restriction is expected to remain in place until 30 June 2020. Again, these restrictions only delay a landlord's ability to recover monies in this way, they do not remove the right to collect this rent in the future. The Government has also announced that where a tenant cannot pay its rent or other outgoings due to the landlord 'due to COVID-19', a landlord will be prevented from issuing a statutory demand or presenting a winding up petition. Legislation to bring these changes into effect, and give greater clarity as to their timing, scope and impact, is expected shortly. The Act (at present) does not limit a landlord's right to pursue other remedies should a tenant fail to pay any sums due under its lease, such as drawing down on rent deposits; claiming against guarantors, former guarantors or former tenants; and issuing Court proceedings for debt. The Act also includes provision to stop a landlord from opposing the right of a protected tenant to take a new lease after the expiry of its existing one, based only upon the tenant's failure to pay rent during the suspension period.

Landlords face a further restriction as the Civil Procedure Rules, which govern the way in which litigation is conducted, prevent landlords from recovering possession of land for any reason, save for when land is illegally occupied by 'persons unknown' (squatters). This restriction will remain in place until 25 June 2020. Court actions for injunctions requiring that a person vacates a property or face action for contempt of Court are still available.

The Regulations set out the businesses and venues that are required to close entirely, those which are permitted to remain open but with limitations on the type of trade that they can conduct, and those which are permitted to remain trading on the same terms as they were previously. Criminal liability for continuing to operate a business in breach of the Regulations 'without reasonable excuse' falls on the business itself, and its owner and manager. The Regulations were initially in force for three weeks, and have recently been extended for a further three week period, expiring 11 May 2020. There is provision for the Regulations to be extended again.

Nothing in the Act or Regulations affects a tenant's underlying liability to pay the rent due under its lease. Any suggestions made by tenants to argue that the rent is not due in full, or that a lease is at an end, would be based on

the interpretation of the terms of their leases and the common law position. The arguments that a tenant may put forward in this situation, but which would not usually be successful, are:



1

**Rent suspension** – provisions which suspend the payment of rent when there is physical damage so that a tenant cannot use its property. It would be unusual for a commercial lease on reasonably standard terms not to link the rent suspension to damage to property, so such clauses are unlikely to offer a tenant a valid basis on which not to pay rents due.



2

**Frustration of the lease** – this common law doctrine allows a party to treat a contract as at an end where there has been a supervening event that was not in the contemplation of the parties and which renders it impossible to perform. Recent case law suggests that this is a high bar in relation to commercial leases, and the criteria are unlikely to be fulfilled.



3

**Force majeure event** – this would be a possible argument if a lease contains an force majeure provision that is drafted to create consequences such as rent suspension or termination of the leases. Such clauses are uncommon in modern commercial leases.

## For more information please contact



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