Property law & the COVID-19 pandemic

Will the easing of lockdown restrictions also unleash a wave of property related litigation?

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Introduction

At this stage of the pandemic, it feels trite to say that the impact upon property law has been both profound and unprecedented. Even the devastating financial crash of 2008 did not have the same all-encompassing impact on the day-to-day use of property of all types. Faced with this crisis, the immediate focus has, of necessity, been on the rapidly implemented procedural restrictions (to say nothing of the practical problems of conducting litigation in lockdown). The general stay on possession proceedings implemented via PD 51Z has already been considered three times by the Court of Appeal: (*London Borough of Hackney v Okoro* [2020] EWCA Civ 681, [2020] All ER (D) 154 (May); *Arkin v Marshall* [2020] EWCA Civ 620, [2020] All ER (D) 65 (May); *TFS Stores Limited v The Designer Retail Outlet Centres (Mansfield) General Partner Limited* [2020] EWCA Civ 833). The moratorium on forfeiture for rent arrears and changes to commercial rent arrears recovery (imposed by s 82 of the Coronavirus Act 2020) have, at least so far, prompted less judicial scrutiny, but have had an equal, if not even greater, impact on both landlords and tenants.

However, in terms of impact on substantive property law, the biggest statutory intervention has not been a direct interference with contracts or proprietary rights, but rather indirectly (though no less dramatically) through the lockdown restrictions, dictating the compulsory closure of many businesses (see The Health Protection (Coronavirus, Business Closure) (England) Regulations 2020 (SI 2020/327) and The Health Protection (Coronavirus, Business Closure) (Wales) Regulations 2020 (SI 2020/326) as well as the introduction of stringent social-distancing requirements (The Health Protection (Coronavirus, Restrictions) (England) Regulations 2020 (SI 2020/350) and The Health Protection (Coronavirus, Restrictions) (Wales) Regulations 2020 (SI 2020/353)) effectively forcing the closure of others. There is also the mass of non-statutory guidance issued by the government setting out safe-working practices in various sectors. In late March and throughout April and May the regulations and guidance arrived at a dizzying speed and the position continues to change quickly. At the time of writing, the government has begun the process of relaxing restrictions. Non-essential retailers, along with pubs, restaurants and cafes, are open again (albeit operating with severe restrictions on capacity).

Accordingly, this two-part article proposes (not without a degree of trepidation) to take stock of some of the substantive issues of property law which have resulted from the pandemic and on which I and my colleagues at Falcon Chambers have been asked to advise in recent months. Given the scale of the impact, it is impossible to be comprehensive and, if we have learnt anything from the crisis, it is surely that any predictions for the future are mere folly. Nevertheless, it is now possible to tentatively identify some of the many issues which seem likely to give rise to litigation in the months and perhaps years ahead.

Do I have to pay?

Frustration and implied rent suspension?

Unsurprisingly, when the tidal wave hit our shores, the first question asked by tenants and landlords alike was whether there was any impact on the obligation to pay rent. So far at least, the government's policy response has been to delay the enforcement of substantive rights rather than intervene to change parties' ultimate liability. The government's view is that:

'The legal position is that tenants are liable for covenants and payment obligations under the lease, unless this is renegotiated by agreement with landlords. Tenants who are in a position to pay in full should do so. Tenants who are unable to pay in full should seek agreement with their landlord to pay what they can taking into account the principles of this code' ('Code of Practice for commercial property relationships during the COVID-19 pandemic', Ministry of Housing, Communities & Local Government, 19 June 2020 (the 'Code of Practice', (*https://bit.ly/3gxclHC*)).

Nevertheless, there has been a lively debate among practitioners about the extent to which tenants might rely upon the doctrine of frustration or assert the implication of a form of force majeure or rent suspension clause to resist the obligation to pay rent. See, for example:

- 'Does a Tenant really have to go on paying rent during lockdown? Perhaps we should ask the Officious Bystander…', Nathaniel Duckworth, Falcon Chambers (*https://bit.ly/3iGSojm*).
- 'Rent during Covid-19: landlords still hold the strongest hand', Kester Lees, *Estates Gazette*, 15 April 2020 (*https://bit.ly/2D9Za0P*).

The consensus of opinion, with which the writer agrees, is that it would likely only be in an extreme case (perhaps involving a very short lease granted for a particular purpose which is altogether prevented by the lockdown) in which such arguments might succeed. In the absence so far of a decided case dealing specifically with the effect of the pandemic on rental obligations, there may still be a fight to be had on this fundamental question. However, it

seems unlikely that frustration or an implied term will come to the aid of the vast majority of tenants.

The valuation conundrum

Assuming rent is still to be paid throughout, how much should it be? Both market surveys and anecdotal evidence suggest that new property transactions have come to an almost complete standstill since March. There are, of course, profound market and economic consequences which will flow from this. The unprecedented market uncertainty has caused major property investment funds to freeze their assets and, it is reported, those funds are likely to remain closed for months to come ('Frozen UK property funds face existential crisis', Reuters, 26 May 2020, (*https://reut.rs/2Z5icOn)*).

For the practitioner, however, the freeze on new transactions creates acute difficulties in all the many and varied situations where it may be necessary to have regard to comparable market transactions as part of a process of valuation. There will, undoubtedly, be many 1954 Act lease renewals and rent reviews which fall due either during the period of the lockdown or at any rate while the market uncertainty continues, to say nothing of development agreements or options which require open market valuations.

This gives rise to two related and equally intractable valuation difficulties (explored in greater detail in the Falcon Chambers podcast and accompanying notes prepared by Guy Fetherstonhaugh QC and Stephen Jourdan QC, 'Rental Valuations during Lockdown' (*https://bit.ly/31XWyxE*)).

- First, s 34 of the 1954 Act, which deals with the assessment of rent to be paid under the new tenancy, requires the court to determine the rent at which the holding might reasonably be expected to be let in the open market by a willing lessor. This, or a very similar, formula is incorporated into most rent review provisions, some of which will also dictate a review date falling due while the lockdown restrictions remain in place. The formula requires the court (or arbitrator) to assume a hypothetical negotiation between a willing landlord and a willing tenant. During the current crisis, however, there may not in the real world be any party that is prepared to take on a lease of, for example, a restaurant or pub, which has been forced to close. Is the result a purely nominal rent, or must the court assume that something would be paid? Support can be found for both views in the authorities. Accordingly, the degree to which the hypothetical tenant should be assumed to be actively seeking premises despite the current climate is likely to be the subject of considerable dispute.
- Second, rental valuations (and indeed many freehold or other property valuations) are typically undertaken using the comparable valuation method. As a result of the freeze in the market, valuers will be obliged to find ways to proceed in a world without direct comparables; there will be no new lettings of the restaurant or pub entered into while the lockdown is in place. It seems likely that the only answer will be to try and project forwards from pre-COVID-19 transactions or (when things are finally approaching normal again) backwards from post-lockdown transactions where, at least, the longer term impact on values might be better judged.

Turnover rents

One creative solution to these valuation difficulties (and to the financial crisis facing many tenants) would be for the parties to adopt a turnover or profit-sharing rent (the advantages and some potential pitfalls of these arrangements have been explored in greater depth in a helpful article by my colleague Janet Bignell QC: 'Turnover Rents for Retail – the Way Forward in Recession? Sharing the pain and (hopefully) the gain', Falcon Chambers, 11 May 2020 (*https://bit.ly/31OdlmG*)).

These arrangements, which may be suitable for where a tenant has been able to continue and/or resume trading to some extent, enables the parties to share the benefit of that limited trading and the economic pain caused by the lockdown. Agreements between landlords and tenants on this basis are certainly within the spirit of the Code of Practice.

Of course, neither party can *compel* the adoption of a turnover rent in place of the fixed rent reserved by the lease and so such arrangements are generally a matter only for commercial negotiation. However, an issue which may well require detailed consideration by the courts in the near future is the extent to which the court can direct that a new lease should include provisions for a turnover rent on a renewal under the 1954 Act. There is currently considerable uncertainty as to whether s 34 of the 1954 Act confers jurisdiction on the court to determine rent by reference to a formula as opposed to by a process of valuation and, if it does, the circumstances in which it would be appropriate to do so (see the discussion in *Renewal of Business Tenancies 5th Ed, Reynolds & Clark* para 8-99 *et seq*). The current crisis may well throw that discussion into sharp focus.

Side letters/concessions

The government has issued guidance urging parties to adopt 'responsible and fair behaviour' in performing and enforcing contracts where there has been a material impact from COVID-19 (initially the general 'Guidance on responsible contractual behaviour in the performance and enforcement of contracts impacted by the COVID-19 emergency', Cabinet Office (*https://bit.ly/2VW6fsy*), now the sector specific guidance in SIs 2020/350 and 2020/353). This has recently been supplemented by the Code of Practice, which is specific to the commercial property sector. Whether or not prompted by the non-statutory guidance, anecdotal evidence suggests many commercial landlords (left with virtually no enforcement options and recognising, no doubt, that it is preferable to receive some income rather than to force retail or hospitality tenants to the brink and be left with vacant premises, no income and liability for rates) have offered concessions to their tenants.

Where parties have agreed rent deferrals, reductions or other payment concessions it seems almost inevitable that these (alleged?) agreements will prove to be a fertile source of future dispute. Unsurprisingly, there have been many requests for advice about the form which side letters or agreements might take. Given the urgency and the pressure faced by many organisations the chances are that there will also have been many instances of discussions, or negotiations conducted hastily via email, Whatsapp or Zoom and which one party or the other now wishes to rely upon as a final and binding agreement. It is not hard to envisage that once the dust has begun to settle and there has been time to reflect, many such arrangements will be scrutinised and challenged.

Fortunately, the applicable legal principles are relatively straightforward. Provided that the side letter is personal to the current tenant and there is no attempt to vary the terms of the lease, then the formality requirements of the Law of Property (Miscellaneous Provisions) Act 1989 do not apply. Accordingly, a simple letter or exchange of emails may often be sufficient to create a binding agreement for a rent or other concession. However, it is important to bear in mind the requirement for consideration (the tenant will usually be agreeing to perform less than its existing contractual commitments and so, there may be a question about whether it has given good consideration for the landlord's forbearance). It is also important to bear in mind the position of a guarantor (who, depending on the precise provisions, may well need to join in as a party to be affected). Finally, the parties should, where possible, take proper advice as to any tax consequences,

particularly where the rent is subject to VAT, since a concession by a landlord may amount to a supply of services for VAT purposes.

Service charges

A related issue which may trouble courts and tribunals is the impact of the restrictions on the level of service charges which landlords can properly charge in respect of both residential and commercial properties. The social distancing regulations have caused all manner of practical difficulties in the proper and safe management of commercial and residential properties alike. The Code of Practice urges commercial landlords who have made savings on the services provided to buildings to pass those savings on to their tenants as quickly as possible, to assist with cash-flow, though the same guidance acknowledges that closure of premises will not always lead to costs savings and indeed in certain respects costs may be driven up.

In the residential context, disputes are likely to focus on the extent to which the landlord can or should continue to carry out maintenance and repairs or impose restrictions in the way in which common parts are used. For example, is it reasonable to continue monthly cleaning services? Should major works be deferred? The open textured nature of s 19 of the Landlord and Tenant Act 1985 (which imposes a requirement that residential service charges are reasonably incurred and reasonable in amount) provides ample opportunity for challenges by tenants who are unhappy with how their money has been spent in an effort to comply with safe-working guidance.

A more fundamental issue is whether tenants (whether commercial or residential) are obliged to continue to pay for services from which they cannot derive any benefit. Take, for example, the very common scenario of a restaurant located in a shopping centre. The centre and the restaurant are shut due to the lockdown, but the landlord has in place long-term contracts for the supply of security, staff, heating maintenance and so on (which may or may not have payment abatement mechanisms). Are the contributing tenants entitled to a reduction for the period in which the property is anyway closed?

As ever, the answer will almost certainly turn on the precise provision of the leases in question as well as the nature of the costs that are incurred. However, the authorities provide cold comfort for tenants, since the consistent position is that if the lease entitles the landlord to recover the cost of a particular service for the benefit of the estate at large, a particular tenant cannot resist payment merely because they do not happen to need or want the service. The classic example of this is a tenant on the ground floor of a block, whose lease obliges them to contribute to the cost of maintaining lifts which they do not need to use (eg *Solarbeta Management Co Ltd v Akindele* [2014] UKUT 416 (LC)). Nevertheless, there is, again, ample scope for argument as to whether qualifying provisions such as a *'fair and reasonable'* proportion or costs which are *'reasonably necessary'* would, in these circumstances, entitle tenants to a discount and one expects the limits of these provisions to be tested given that tenants will inevitably be seeking to reduce outgoings where possible. **NLJ**

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Pt 2 will focus on the use and occupation of property and performance of property contracts.