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Real estate update

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Navigating coronavirus: Top real estate industry considerations

On Wednesday, 11 March 2020, the World Health Organization (WHO) declared the spread of coronavirus a global pandemic and on Friday, 13 March 2020, President Trump declared a national emergency in the United States. Guidance from U.S. and global health authorities describes best practices for mitigation of the developing pandemic, which include drastically reducing human-to-human contact, resulting in people working remotely, avoiding restaurants, and entertaining themselves from the isolation of their living rooms. The corresponding volatility in the financial markets has been severe and immediate. For the United States real estate sector, this response has, and will continue to have, far-reaching consequences for investors, operators, lenders, and tenants.

We have received inquiries from clients requesting legal guidance for navigating these uncharted waters, as the risk of pandemic may not have been one that was allocated in any specific document. Although our perspective continues to evolve as we obtain updates about the coronavirus and its impact, we have identified below a handful of legal topics for real estate industry stakeholders to consider while assessing the impact of this changing environment.

Lease considerations

As businesses begin to shudder for undetermined lengths of time, landlords and tenants should know what each tenant's rights and obligations are with respect to operating covenants in their lease portfolios. Absent specific closure rights, if a tenant elects to "go dark" and close its business, whether temporary or permanent for either economic reasons or out of health concerns, is such closure a default of the lease? Tenants and landlords should evaluate whether such rights exist, taking into account lease provisions that discuss emergencies or what are referred to as "Acts of God" or "force majeure" events, or applicable state or local laws that may inform the analysis.

Additionally, would a landlord expose itself to liability by remaining open or requiring a tenant to remain open during a pandemic? Such compulsion could be an act of negligence by the landlord that could result in legal liability, because it would be reasonably foreseeable that requiring a tenant to remain open could result in spreading the virus. Conversely, consider whether landlords have an obligation to close buildings, or, by the terms of their leases, have the discretion and ability to do so. If tenants and landlords choose to remain open, what are their obligations, contractual and otherwise, to each other and to visitors to ensure a safe and healthy environment?

If landlords do not shutter buildings, they should consider the operational changes necessary to address the pandemic. Such changes may include closing portions of properties to public access, ensuring employees are fully informed of the crisis and risks and other circumstances surrounding their health and the health of those with whom they interact, increased and more-focused cleanings and sanitation, distribution of educational materials and sanitation products, and ongoing communication with tenants, investment partners, and lenders. Owners and their property managers should consider what additional costs they will incur as a result of such operational changes, and whether those costs are appropriate to be passed through to tenants as operating expenses or otherwise.

Insurance risks

If you currently hold an insurance policy that contains business-interruption insurance, consult

your insurance provider and review your policy to determine whether closing, shuttering operations, or otherwise curtailing business are covered events. If an event is indeed covered, the details and interpretation of the policy will determine when your claim is valid for reimbursement. The triggering event for coverage may not match the date upon which losses accrued, and disputes may arise with your insurer as to whether certain losses should be covered. We expect a number of lawsuits will arise over coverage disputes in the aftermath of this pandemic. You should keep highly detailed notes about any issue that you might claim is covered by business-interruption insurance, paying attention to what happened, why it happened, who was affected, how you changed operations, and when the changes occurred. Our insurance team has put together its latest thinking on the insurance issues raised by this crisis, which can be found here.

Standard of care

Consider what standard of care your borrower, investment partner, or operator owes you (or you owe them) in your operations or partnerships and how that standard of care may change in the weeks and months to come. Often, contracts will rely on either an explicit or implicit standard of "reasonableness," but what was reasonable one month ago may not be reasonable today, and stakeholders need to be prepared to adapt to that changing landscape and to demand their counterparties do the same. Though COVID-19 testing in the U.S. may still be limited, most businesses have adopted basic precautions when possible, including more-flexible working arrangements, cancelling travel for employees, and required quarantines for anyone showing symptoms.

Consider whether you and your business partners are acting in accordance with best practices and have precautions in place that demonstrate the standard of care you owe any counterparty. Also, consider how that standard of care changes across asset classes. In nursing homes and medical facilities, operators need detailed protocols for identifying and isolating those who may be infected, but consider what standards are appropriate for those in the office space or restaurant space, where the risk may be less obvious, but nonetheless present. And, as noted above, consider what costs are associated with adhering to this standard and who bears those costs. Note that, above all, given the widely available information about the virus and how it spreads, coupled with the WHO pandemic declaration, and the United States' declaration of a national emergency, every business will be held to a negligence standard by which acting contrary to basic, now-well-known procedures for limiting the spread of the virus could lead to liability.

HIPAA concerns

Putting aside the shortage of COVID-19 tests currently available in the U.S., one suggestion that we have heard from clients is to simply test residents, tenants, or employees in order to better assess risks or protect a subject property from infection. In addition to raising privacy questions about compelled testing, as well as many questions about the follow-on responsibilities that acting like a health-care provider could lead to, the Health Insurance Portability and Accountability Act (HIPAA) limits what health information can be shared with third parties. However, our data privacy team believes, that in certain contexts, the results of a coronavirus test may be shared with outside parties without violating HIPAA, so long as patient-identifying information has been stripped and certain other conditions have been met. Particular asset classes may be more affected by an infection than others; for example, a nursing home where the virus spreads may jeopardize the reputation and financial solvency of the operation quicker and with more-devastating effect than an office building. Lenders assessing collateral, and purchasers of real property should assess whether obtaining coronavirus-related disclosures is appropriate or helpful.

Employment concerns

The coronavirus outbreak poses a number of challenges for employers as well. For example, the Americans with Disabilities Act (ADA) limits employers' abilities to require employees to respond to "disability-related inquiries" or undergo "medical examinations," which limits an employer's ability to ask an employee about sensitive medical information relating to COVID-19 or to require an employee to take a test relating to COVID-19 (such as a temperature screen). Employers also face hard choices in deciding what to do when they learn an employee or visitor to the office is or was infected with COVID-19, was only exposed to COVID-19, or merely showed symptoms. Each of these scenarios also raises concerns about how the employer must handle confidential medical information, which must be considered against a need to keep the rest of the workplace safe. Also, if an employer sends an

employee home, the employer must ensure that it is complying with payment requirements in federal and state wage and hour laws, paid sick leave laws (applicable in some states as well as for certain federal contractors), and other leave laws (such as the Family and Medical Leave Act and state equivalents). Employers who may conduct layoffs or furloughs may also face substantial requirements and potential liability under the Federal Worker Adjustment and Retraining Notification (WARN) Act and state law. In grappling with these and other challenges, employers must keep apprised of rapidly changing requirements—including pending federal leave legislation and unique guidance issued for specific jurisdictions in the United States. All in all, employers face significant risks and uncertainty. For more employment-related advice, our employment team has written at length about issues raised by this crisis in a format designed for employers in the U.S., which can be found here. For further information, please see the Hogan Lovells employment blog.

Force majeure

For any current construction or development of real property (including building-out of tenant improvement spaces), clients should carefully read force majeure clauses in their leases and other contracts, and analyze whether a pandemic fits within the scope of such clauses. Typically, it will. Now that the President has declared a national state of emergency, analyzing whether the coronavirus outbreak qualifies as a force majeure event may have become even easier. However, if the clause does not mention a declared state of emergency or a pandemic as a force-majeure event, would it qualify under a more vague term such as an Act of God? Another consideration may be that perhaps only certain effects of the coronavirus outbreak are covered, such as a shortage of materials or a shortage of labor. Depending on the specific construction of your force majeure clause, it may not clearly grant you relief from your contractual obligations. We're here to help you sort through what is covered and what is not.

Practical economic assessments

While the long-term effects are not yet known, certain stakeholders may experience near-term liquidity issues stemming from the coronavirus outbreak. A commercial tenant may experience a sharp drop in revenue across all of its locations, and may not have the cash on hand to operate its entire portfolio at a loss. Owners of real property with significant debt obligations may find that expected cash payments have ceased from multiple tenants that are simultaneously experiencing financial troubles, thus creating loan default implications for the property owner.

Such parties should evaluate their goals in the long term and take actions consistent with those goals. Landlords may be wise to consider rent abatements in exchange for extensions of lease terms or other negotiated considerations to ensure they have an operational tenant for years to come. Or, landlords may be willing to share in the short-term risk for the potential longer-term gains by increasing their percentage-share of rent after the rent-abatement period ends. Lenders may elect to provide forbearance for owners that have slipped below compliance with their debt coverage covenants if general pre-pandemic fundamentals are strong. When such considerations are implemented, they should be done through written agreements that clearly define the scope, parameters, and timing of any change in contract terms. Real estate industry professionals should assess the business objectives of their organizations and formulate solutions that are both consistent with those objectives and practical given the economic effects of the coronavirus outbreak.

The above represents our latest thinking in "real time" and will likely evolve over the coming weeks and months. Our teams of lawyers across the globe are continuing to compile the latest thinking and legal guidance on the coronavirus outbreak. To track our latest updates, which will include more specific discussions of particular contractual concepts, we encourage you to check the Hogan Lovells COVID-19 Topic Center, which covers a wide variety of practice areas across the globe.

These are only general considerations and should not be relied on as legal advice in relation to a particular transaction or situation. If you have any questions or would like any additional information regarding this matter, please contact your relationship partner at Hogan Lovells or any of the lawyers listed below.

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