

Ripple effects of supervening impossibility on commercial lease agreements

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During this challenging time of the novel coronavirus (Covid-19) and national lockdown, it is appropriate when considering commercial lease agreements to also consider the moral, social, ethical and economic issues arising from such agreements.



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The national lockdown imposed by the government to combat the spread of Covid-19 will, in most cases, prevent landlords of commercial properties from performing their obligations to provide their tenants with beneficial occupation of leased premises. Tenants may, in response to not having beneficial occupation and as a result of not being able to operate their businesses from the leased premises during the lockdown period, claim supervening impossibility and exercise their rights, subject to the terms of the lease agreement and our common law, to refuse to perform their corresponding obligation to pay to the landlord the monthly rental.



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This will no doubt cause the landlord to suffer loss and in all likelihood have a bearing on the manner in which the landlord will deal with the tenant in the immediate future following the termination of the lockdown period. The tenant's position could become vulnerable when the lease comes to an end and it requests its landlord to enter into a new lease.

Should the landlord agree, it may insist on a higher rental than that which it would in the ordinary course have required in order to recoup the losses it sustained during the lockdown period. If the location of the leased premises is integral to the tenant's business, the tenant may have no choice but to agree. The tenant's decision to withhold rental may also negatively affect the landlord's willingness to grant any indulgence which the tenant may seek from the landlord after the lockdown period has ceased and beneficial occupation of the leased premises has been restored.

As the operator of a business, a landlord is required to honour its obligations and pay its expenses, such as bond repayments, employees' salaries, municipal rates and taxes, utility consumption services, security services and the like, on

time and in full. In this respect, a landlord's business is no different to any other business and, accordingly, it cannot afford to pay expenses without receiving income.



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Seemingly endless ripple effect

The adverse ripple effect is exacerbated where the landlord, as a result of not receiving rental income, becomes unable to pay its service providers. Such non-payment, in turn, adversely affects the service providers' businesses, which in turn become unable to pay their respective employees and creditors and so on. At this point, it seems that the ripple effect is endless.

To alleviate and minimise this ripple effect, landlords and tenants are encouraged to communicate with each other and meaningfully exchange and consider their respective expectations and financial constraints in an attempt to arrive at a mutually acceptable solution which will ensure the continuity of their respective businesses and business relationship during and after this pandemic. Depending on each other's financial position, potential solutions available to the parties could take the form of a rent holiday or a rent discount.



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- A **rent holiday** arrangement allows a tenant to withhold payment of rental during (i) the lockdown period; or (ii) the lockdown period plus a certain number of months after it has ended, so as to lessen the impact on the tenant's financial position during such period. This will afford the tenant an opportunity to resuscitate its business. In terms of

such an arrangement, the parties also agree to extend the lease period to enable the landlord to recoup the loss of rental it suffered during the rent holiday period. The tenant must however anticipate that, in arriving at such an arrangement, the lease may need to be extended by a period which is longer than the rent holiday period. Simply extending the lease period by the same amount of time as the rent holiday period will not serve any material financial benefit to the landlord, inasmuch as it will only begin to recoup after the original lease period has come to an end; or

- A **rent discount** arrangement allows a tenant to pay the landlord a reduced monthly rental during (i) the lockdown period; or (ii) the lockdown period plus a certain number of months after it has ended, for the same reason as contemplated in the rent holiday arrangement. In terms of such an arrangement, after the reduced rental period has elapsed, the tenant is obliged to repay the landlord the amount of the discount afforded to it during the rent discount period. The parties may agree that such amount be paid in full on a set date or by way of instalments over a certain number of months (potentially with interest being levied on the balance owing). The parties may also agree to a combination of repayment by the tenant coupled with an extension of the lease period, in order for the landlord to recoup the amount it would have received had there not been a discounted rental period.

Relief from banks, municipalities

It is unfortunate that to date our banks and municipalities have not found their way clear to come to the aid of landlords. Any relief which our banks and municipalities could provide would no doubt go a long way towards ensuring business continuity for both landlords and tenants.

It is accordingly critical that before making and implementing any decision based on their legal rights, both parties seriously consider the effect that such a decision will have on their relationship and business dealings, both during and after the lockdown period. Landlords and tenants must also take into consideration the effect that their decisions and actions will have on the lives of people who are not parties to their lease agreement but who will be financially affected and exposed as a result of such decisions and actions. The financial loss suffered by these outside parties and their employees could have a devastating effect on their and their respective families' lives - the so-called collateral damage of this "viral war".



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Amicable, constructive engagement

We, therefore, strongly encourage landlords and tenants to engage with each other in order to find solutions that will alleviate, contain and minimise the adverse effects on both parties and to be mindful of all of the economic and social effects of their actions. It is imperative that their engagement is amicable and constructive and the relationship between the parties is nurtured as the lockdown period is only temporary.

As the global community is facing the ramifications of Covid-19, it is clear that landlords and tenants of commercial properties in South Africa have not been spared. The losses suffered on both sides are mounting and at this stage it is unknown how long the lockdown will actually endure. Tenants are losing revenue and landlords are losing rental income - both parties will incur substantial losses as a result of Covid-19. The question may arise – which party is worse off? The answer is simply, both.

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