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Covid-19 Coronavirus: Real Estate and Covid-19

The questions we are being asked in Germany

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KEY INFORMATION

This note discusses a number of issues and queries that are arising in the commercial real estate investing and lending markets in Germany as a result of the Covid-19 pandemic.

It is a generic discussion of those issues, but each issue discussed is usually the subject of extensive negotiation when it comes to documentation. As a result, the terms and conditions of any sale and purchase/construction/lease/finance document (as applicable) should always be considered in the context of the particular document in which they are found and the specific facts and circumstances of the relevant deal.

As such, this note provides only a general analysis of issues likely to arise and it does not provide legal advice.

1. The occupational tenant wants to terminate its lease.

a. **If you are the landlord,** it is unlikely that your tenant is able to terminate the lease agreement. Under German law and in accordance with German market practice, leases cannot be terminated if they have been agreed – as usual – for a minimum term. Contractual termination rights could overcome this obstacle, but according to German market standards they are practically never agreed for scenarios such as the Covid-19 pandemic or other types of force majeure (except for destruction of the building). Your tenant might try to claim that its lease should be frustrated as a result of the Covid-19 pandemic. However, it is unlikely that such a claim would ultimately be successful, as frustration (i.e., the loss of the basis for the contract (*Wegfall der Geschäftsgrundlage)*) is applied extremely narrowly by German courts and, even if a German court did uphold the application of this concept, typically a claim would not result in a termination of the contract but rather in an adjustment to its terms and conditions (if at all). German courts tend to apply the concept of frustration of contract only in circumstances which lead to an existential danger for the tenant. Although tenants may encounter severe financial difficulties as a result of the Covid-19 pandemic measures taken by the authorities in Germany, it might be difficult for a tenant to argue that such high degree of threat actually results from a lock-down of several weeks.

b. **If you are the tenant**, you face the opposite situation to the landlord. The Covid-19 pandemic should not give rise to a termination right of the landlord; in particular, the landlord should not have the right to terminate the lease contract on the basis of frustration of contract. The shutdown will usually end

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quite a long time before the agreed expiry of the relevant lease. As set out above, the principle of frustration of contract should not be available for most tenants. Only if a tenant becomes insolvent will the insolvency administrator have a special termination right which would not be based on the Covid-19 pandemic but rather on German insolvency laws as such (however, please also note that far-reaching provisions have been enacted in Germany response to the Covid-19 pandemic in order to avoid insolvency filings). For details, please see our bulletin "Covid-19 coronavirus: Temporary suspension of obligation to file for insolvency in Germany" (https://www.allenovery.com/en-gb/germany/news-and-insights/publications/covid-19-coronavirus-temporary-suspension-of-obligation-to-file-for-insolvency-in-germany).

c. **If you are the lender**, your borrower is most likely under an obligation under the facility agreement to ask for your consent to terminate the lease. This will not however apply if it is the tenant who terminates the lease. In that case, your borrower will most likely be under an obligation under the facility agreement to use its reasonable endeavours to find new tenants for the space.

2. The occupational tenant does not want to pay rent or wants to renegotiate how it pays rent or says that it is entitled not to pay rent under its lease.

a. **If you are the landlord,** your case has recently been supported by the German government who have enacted the Act to mitigate the consequences of the Covid-19 pandemic in Civil Law, Insolvency Law and Criminal Procedure Law (*Gesetz zur Abmilderung der Folgen der Covid-19-Pandiemie im Zivilrecht, Insolvenz- und Strafverfahrensrecht – Covid-19 Act*) which will enter into force on 1 April 2020. When the Covid-19 pandemic crisis became visible many tenants claimed that they are no longer obliged to pay their rent when due (in part also retroactively for March 2020). The tenants based these requests in particular on the concept of frustration of contract (*Wegfall der Geschäftsgrundlage*). Tenants also tried to invoke the alleged impossibility of performance (*Unmöglichkeit*) arguing that the landlord no longer made the let premises available because it could no longer be used for the contractually agreed purpose. Even though the German government did not explicitly rule out the application of these two general principles of German law it is our view that the Covid-19 Act supports landlords (as outlined above).

Accordingly the only express protection tenants are granted who suffer losses resulting from the Covid-19 pandemic by the Covid-19 Act is a restriction on the landlord's statutory termination right to terminate the lease contract if the tenant is in arrear,in aggregate, for more than two months rent. According to the Covid-19 Act, rent arrears accumulated in the period from 1 April 2020 through 30 June 2020 (or to 30 September 2020 if the German government decides to extend the period) will be disregarded during the period until 30 June 2022 for purposes of such special termination right. Irrespective thereof, according to the official reasoning of the German government, the obligation of the tenant to pay the rent continues to exist, including the associated sanctions to pay e.g. default interest or damages resulting from the default.

According to the Covid-19 Act, the landlord is also not restricted from terminating a lease contract if a breach does not relate to non-payment by the tenant, e.g. in case of subletting without the landlord's consent. Even worse for tenants, the Covid-19 Act allows for termination due to rent arrears, unless the arrears accumulated from 1 April 2020 to 30 June 2020 were the sole reason

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(*alleiniger Grund*) for the otherwise possible termination. Accordingly, tenants who had already accumulated arrears before 1 April 2020 face the threat that their lease is terminated if their arrears hit the threshold of "2 monthly rents in the aggregate" because in that case the failure to pay the rent between 1 April 2020 and 30 June 2020 was not the sole reason of termination.

However, in practice landlords may not necessarily want to terminate the relevant lease contract in the current circumstances. A landlord may take into consideration that in the current crisis period it might be quite difficult to actually re-let the premise in the near future.

If you as landlord sued for the rent, your tenant may object that you have not been able to provide him with the possibility to use the rental premises for purposes for which they were demised. However, the widespread definition of the purpose of the lease use in German lease agreements is, according to the traditional understanding, not meant to imply a responsibility for the landlord to grant such use but rather a protection of the landlord against the tenant using the property for unintended purposes that might cause difficulties with other tenants or give rise to compliance issues.

On a more general note, the statutory role model of the BGB (*Bürgerliches Gesetzbuch*) for landlords and tenants allocates the responsibility for the use of the real estate to the tenant (which is also supported by the usual clauses that the tenant shall procure at its own cost and risk all permits required for its business operation). From this point of view, a landlord should be, if at all, only responsible for procuring the possibility to take physical possession of the leased premises which will not be at risk in the event of a mere shop closure but only if the access to the rented premises is forbidden.

b. **If you are the tenant**, you would first argue that the Covid-19 Act only provided for a limited relief against termination. However, the very fact that the German government has only dealt with the special termination rights shows from the tenant's point of view that the general principles of German contract law still apply. Accordingly, and in line with a significant number of tenants who have been sending similar letters to their landlords, the tenant will point out that the principle of frustration of contract has not been restricted or diluted by the Covid-19 Act. Instead, the sole purpose of this legislation was to establish an additional element of protection of the tenants against pressure from their landlords. It is remarkable to see that even legal scholars have started making comments pointing out that the Covid-19 pandemic is a model case for frustration of contract (such as warfare, hyperinflation or earthquakes).

c. **If you are the lender**, your borrower is most likely under an obligation under the facility agreement to ask for your consent to the changes to the lease payment terms requested by the tenant. Your borrower is not required to request your consent if a tenant is entitled under statutory law to refuse rental payments, reduce rent payments or defer rental payments (for reasons of frustration of contract or other reasons). Your consent may be subject to a requirement that you must not unreasonably withhold or delay it. Even if not, if the facility agreement is governed by German law, you may still be subject at law to a general requirement not to act against bona fide (Treu und Glauben), effectively requiring you to take legitimate interests of your borrower into consideration when exercising your rights under the facility agreement. In the context of the current Covid-19 pandemic and its economic consequences, a prudent lender should exercise caution before considering refusing consent to any such changes, unless it is evident beyond doubt that the changes requested by the tenant are themselves unreasonable in the current circumstances.

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Your borrower is also most likely under an obligation under the facility agreement to exercise its rights under each lease in a proper and timely manner. Due to the restriction not to terminate imposed by law, your borrower will not be required to assert a termination right.

Lenders should also note that, in contrast with some other jurisdictions, there is currently no government proposal to grant any relief on interest payments for commercial mortgage loans.

3. Are you seeing rent concessions in the market generally? Are there any issues with granting rent concessions to the occupational tenant?

a. **If you are the landlord**, whilst there may not be an express right in your tenant's (or other tenants') leases to withhold rent or have rent suspended, given the extraordinary circumstances of the Covid-19 pandemic, many tenants (particularly in the retail and hospitality space) are nonetheless requesting rent and service charge concessions, either in the form of a waiver of rent or at least a rent deferral. We are seeing many landlords considering accommodating such requests, at least to a certain extent. They seem to be open for granting rent deferrals or waiving the right for default interest should the tenant not pay during the Covid-19 pandemic. We have also seen numerous tenants seeking to obtain retroactive rent reductions for March 2020 (i.e. a period before the effectiveness of the Covid-19 Relief Act). Landlords should be clear as to whether they are agreeing a rent deferral or they are actually forgiving rental payments. In some cases, tenants with rather pessimistic business prospects have even taken the opportunity to ask for a long-time rent reduction after the acute phase of the Covid-19 pandemic based on the reasoning that it will take them several years to make up for the losses suffered from the pandemic.

   Be it as it may, landlords are facing unenviable commercial decisions as to how best to proceed. Whilst it may arguably be in the landlords' best long term interest to help keep key retail tenants solvent over the next few difficult months, agreeing to rent suspensions may cause substantial issues for them, in particular if they have payment obligations to their lenders. Ultimately, whether landlords agree to accept such requests will be a matter of commercial negotiation and also of handling a long-term relationship.

   A seemingly popular way to handle the issue is to overcome a certain inconsistency of this new law. According to the Covid-19 Act, the tenant who cannot pay the rent because of the current pandemic crisis, is only protected from termination of its contract but not from sanctions associated with payment default, such as default interest. As default interest amounts in Germany to a remarkable rate of 9 percent minus the statutory base interest rate p.a., as from time to time (currently -0.88 percent p.a.), i.e. to approx. 8% p.a. (for consumers as tenants approx. 4% p.a.), these default interests which contain a punitive element, appear to be a windfall profit for the landlord. Waiving such default interests and agreeing with the tenant on specific timelines for making good the arrears could be a concession relatively easy to give and fully in line with the legislator's intentions.

   If you, as a landlord, are also a borrower and you are considering granting a rent concession to your tenant, you are also most likely under an obligation under your facility agreement to ask for your lender's consent before granting that rent concession (for some further details please see below).

b. **If you are the tenant**, you will take the view that you can only improve your position by asking for a rent holiday and/or a deferral of rent. In doing so, you will benefit from the solidarity of hundreds

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of tenants who confront their landlords with exactly the same type of request. The sheer number of tenant requests may strengthen the case of those who view the Covid-19 pandemic as one of the rare scenarios where the principle of frustration of contract should apply in general, such as warfare or a hyper-inflation (i.e. scenarios where the former Reichsgericht was open to grant relief to the contractual party suffering from the new situation because they overwhelmed the entire society). This reasoning appears to be more compelling during the most critical period from 1 April 2020 to 30 June 2020 than in the subsequent period, where the tenant is supposed to compensate in the long-run for the rent unpaid.

c. **If you are the lender**, your borrower is most likely under an obligation under the facility agreement to ask for your consent before granting the rent concession to the tenant. Your consent may, under the facility agreement, be subject to a requirement that you must not unreasonably withhold or delay it. Even if not, if the facility agreement is governed by German law, you may still be subject at law to a general requirement not to act against the principle of *bona fide* (*Treu und Glauben*), effectively requiring you to take legitimate interests of your borrower into consideration when exercising your rights under the facility agreement. In the context of the current Covid-19 pandemic and its economic consequences, a prudent lender should exercise caution before considering refusing consent to the rent concession, unless it is evident beyond doubt that the rent concession proposed by your borrower is itself unreasonable in the current circumstances

4. Does loss of rent or business interruption insurance cover Covid-19 consequences?

a. **If you are the landlord**, the answer will ultimately depend on the specific terms of the insurance policies, but it is unlikely that any loss of rent or business interruption insurance that you (or your tenant) have taken out will cover insurance against the impact of the Covid-19 pandemic. This is because: (i) we understand that it is very uncommon for loss of rent or business interruption insurance to cover infectious diseases at all; and (ii) even if you (or your tenant) have taken out insurance that covers infectious disease, that cover will only be limited to a list of known notifiable diseases at the time the insurance was taken out and the insurance is therefore unlikely to cover Covid-19. In respect of loss of rent, this is usually linked to a loss of rent arising as a result of physical damage to the property (as per the rent suspension clause in the lease). Rent guarantee insurance (which is designed to protect landlords against rent arrears and rent defaults) may assist you if you are a residential landlord – but this is very rare in the context of commercial real estate.

b. **If you are the lender,** your facility agreement will inevitably include an extensive insurance undertaking. However, for the reasons set out above, it is unfortunately very unlikely that any insurance undertaking will cover insurance against the impact of the Covid-19 pandemic.

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5. Can the landlord enforce rental security during or after the Covid-19 pandemic?

a. **If you are the landlord**, you may consider that you are entitled to compensate any rental losses during the Covid-19 pandemic by using up the rental security (typically 2-3 monthly net rents in the German market, rarely more). Moreover, once rent security has been used, the tenant is in principle obliged to refill the rental security so that the use of the rental security in the period starting 1 April 2020 could be an easy way to by-pass the tenant protection under the Covid-19 Relief Act. This view is supported by the legal reasoning (*Gesetzesbegründung*) to the Covid-19 Act which explicitly confirms that tenants remain obliged to pay the rent resulting in a payment default (*Zahlungsverzug*). The only benefit for tenants from the new law is that the period from 1 April 2020 through 30 June 2020 (possibly extended until 30 September 2020) will be temporarily (until 30 June 2022) disregarded for purposes of a termination by the landlord based on rent arrears.

b. **If you are the tenant**, you will assert that the purpose of the Covid-19 Act is to effectively relieve the tenant from being ruined by the Covid-19 pandemic. The purpose of the law would be jeopardized if the landlord could simply enforce the payment of the rent during the period from 1 April 2020 through 30 June 2020 and immediately thereafter ask for a refill of the rent security. On a more general note (albeit only in the context of residential leases), the Federal Supreme Court has stated that rental security is held by the landlord as a trustee of the tenant and that it may, in principle, be used only for undisputed claims upon expiry of the lease (i.e. when the landlord may have lost the contact with the tenant). As a trustee of the tenant, the landlord must act in good faith (*nach Treu und Glauben*).

c. Based on this standard, it seems doubtful both for residential and for commercial leases that a court would support the landlord's strategy to enforce the rent security during the critical period from 1 April to 30 June 2020.

6. Are tenants/landlords able to shut down their premises?

a. **If you are a landlord**, and the owner of a shopping centre, you will be interested in maintaining the commercial operation of the lease object as long as possible at the highest activity level in order to keep the centre attractive as a whole. This is why lease agreements in shopping centres often contain a keep open clause (*Betriebspflicht*) for anchor tenants. However, most German states have meanwhile enacted temporary shutdown provisions for all retail businesses except for food, medical and other essential supplies. In the current situation, it will be obviously in the interest of the landlord to maintain at least these essential suppliers as long as it is legally permitted. This does not only provide relief for the tenants who can continue operating their business. It also prevents tenants who do not wish to pay their rent from arguing that the landlord has not provided physical access to the property and therefore is not entitled to receive rental payments.

b. **If you are the tenant**, your reaction will depend on the type of your business. Should the products you sell fall into the category of essential supply so that your shops can still be opened, you will not have an intention to ask for a shutdown. Demand may even be higher than in normal times. By contrast, if you operate a store where you are no longer allowed to sell your goods or where your customers are heavily discouraged from showing up, you may wish to reduce your costs by shutting down the shop entirely. However, shopping centre landlords often insist – at least vis-a-vis anchor

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tenants on keep open clauses the purpose of which is to ensure that the centre as a whole remains attractive for the public. Even though the topic has not been specifically addressed by the legislative reasoning (*Gesetzesbegründung*) it goes without saying that the "keep open" obligation is suspended as long as the opening of the shop is prohibited by law. However, even if your operation is in principle allowed, the duty to keep your shop open becomes doubtful if there is nobody else in the shopping centre. Therefore, in the context of the current Covid-19 pandemic and its economic consequences, a suspension or cessation of business is unlikely to trigger a default under that provision as the suspension or cessation is forced and hopefully temporary.

c. **If you are the lender**, if your borrower threatens to suspend, or does suspend, carrying on its business, this may technically be a cessation of business event of default under the facility agreement. Some facility agreements will also have a specific "keep open" covenant (for example, on a hotel financing). However, in the context of the current Covid-19 pandemic and its economic consequences (and especially if your borrower is obliged to suspend its business), any suspension or cessation of business is unlikely to trigger a default under that provision as the suspension or cessation is forced by operation of law and hopefully temporary. Moreover, most facility agreements will also include a general compliance with laws covenant and, if the relevant action is required by law, your borrower will need to comply with the law rather than any other contractual term of the facility agreement that would otherwise mean it is in breach of law.

7. A development is mid-construction and Covid-19 is going to result in delays or other issues with the contractor or construction programme.

In respect of construction projects in Germany, specifically those which utilise the German Construction Tendering and Contract Regulation Part B (*Vergabe- und Vertragsordnung für Bauleistungen (VOB) Teil B*) (**VOB/B**), which provides the mandatory terms and conditions for projects of public employers, certain potentially Covid-19 related events may entitle a contractor to more time to complete their works. Principally, these events are the following, but others may apply depending on the circumstances:

- exercise by the Federal or State government, any local or public authority of statutory powers (not as a result of a contractor's actions) that directly affects the execution of the works; and
- force majeure.

Where "force majeure" is defined, the definition will determine the circumstances that could give rise to an entitlement to more time. If the parties agreed to apply the VOB/B to their construction project, the agreed deadline for completion will automatically be extended if the execution of works is (actually) obstructed as a result of, for instance, actions the employer is responsible for, force majeure or other circumstances unavoidable for the contractor. The extension period will, as a minimum, cover the number of days of the respective obstruction. An extension will, however, only be granted if the obstruction was duly notified to the employer or obvious for it. In the case of a construction contract based on the respective provisions of the German Civil Code (*Bürgerliches Gesetzbuch*) (**BGB**), agreed completion dates will not be automatically postponed, however, the result will, practically, be the same as in the case of a VOB/B construction contract: The contractor shall not get into default with the performance of works for as long as performance is not made as the result of circumstances for which

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the contractor is not responsible (unless otherwise contractually agreed, the contractor is responsible for intent and negligence, i.e. not events of force majeure).

It seems that the Covid-19 pandemic may well be covered by the concept of force majeure, being an event that, pursuant to the German Federal Supreme Court (Bundesgerichtshof) (BGH), is *"an event external to the business, externally caused by elementary natural forces or by actions of third parties, which is unforeseeable according to human insight and experience, cannot be prevented or rendered harmless by economically justifiable means, even with the utmost care reasonably expected in the circumstances, and is not acceptable to the business operator because of its frequency"*. However, there could be debate around knowledge and foreseeability of events in more recent contracts. To avoid uncertainty, we are likely to see parties seeking to specifically address the Covid-19 pandemic in their contracts going forward and we have seen this being done in agreements for lease already. This will be another element of the overall negotiation and allocation of risk as between employers and contractors and it will inevitably be the subject of some considerable negotiation.

In any event, if the Federal of State government used any powers relating to the Covid-19 pandemic and the exercise of such powers directly affected the execution of the works, i.e. by requiring construction sites to close, this would constitute an event that potentially entitled contractors to more time in its own right. While no case law is available in this regard for construction contracts, several courts of instance have assumed force majeure in recent years in connection with travel contracts, if there is an epidemic in the destination country. The corresponding assessment for construction contracts is also backed by a decree of the German Federal Ministry of the Interior, Building and Community dated 23 March 2020 with regard to the construction sites of the Federal Republic of Germany: In principle, the Covid-19 pandemic shall be suitable to trigger the facts of force majeure within the meaning of the VOB/B. However, even in the current exceptional situation, the existence of the strict requirements of force majeure may not be assumed across the board, but must be examined on a case-by-case basis. As a matter of principle, the contractor invoking obstructions based on force majeure shall be required to explain and, if necessary, prove the underlying circumstances. This shall be deemed to be the case, for instance, if: (i) a large proportion of the workforce is quarantined by the authorities and it is not possible to find a replacement on the labour market or through subcontractors, (ii) the contractor's employees cannot reach the construction site due to travel restrictions and no replacement is possible, (iii) the contractor cannot obtain building materials (whereby cost increases are, basically, not unreasonable).

At the most basic level, delays to works caused by the Covid-19 pandemic are therefore likely to be an employer risk in terms of time in most German construction contracts; although this will ultimately depend on the specific contract terms, facts and circumstances in each case. However, contractors are generally required to use their best endeavours to prevent delays.

In the case of a VOB/B-construction contract, a party would be entitled to damages arising from delays if the obstructing circumstances are the responsibility of the other party. As no party is responsible for an obstruction due to an event of force majeure claims for damages would be excluded in this case. The same applies to a BGB-construction contract, as damages for delay in performance may be requested only if the contractor is in default with its obligations.

Additionally, the following matters should be considered, and they may become more relevant as the full effects of the Covid-19 pandemic are felt:

- contractors having solvency issues because they cannot cope with the financial consequences of the impact of the Covid-19 pandemic. The usual considerations will apply

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here in terms of available security, status of the works and how and when they are completed. There may of course be knock-on effects under agreements for lease and other relevant documents; and

- if works are suspended (whether by employers or by other events, including force majeure actions by the government), the contractual provisions around how long works can be suspended for before either party can terminate will kick in. In the case of a VOB/B-contract, if an interruption lasts longer than three (3) months, each part can terminate the contract in writing after this time. In the case of a BGB-contract, the situation in the case of only temporarily impossible works is less clear (such question is still being discussed in legal literature and no case law available). In any case, an employer may withdraw from a BGB-contract as soon as the performance of works by the contractor has to be considered permanently impossible (which assessment has to be made *ax ante* but should not apply yet).

At some point it may be necessary to ask whether contracts have been frustrated, but we do not think that the Covid-19 pandemic has led to that point yet – at the moment it seems that we are very much in the realms of some delays and how these can reasonably be prevented and mitigated.

Specialist advice should be sought on insurance, but it seems highly unlikely that any policy of insurance will respond to cover the financial consequences of the Covid-19 pandemic.

If the construction works feed in to an agreement for lease, or agreements for lease, it will also be important to consider the consequences of delays to the works on any target completion dates and long stop dates and any other potential consequences on the agreed arrangements, as well as on each lease. As mentioned above, we have seen landlords seek to include clauses which expressly push out target completion and long stop dates where delays to the works are a result of the Covid-19 pandemic. It may be that the events under the relevant building contract (discussed above) would have the same effect in any case, but parties are likely to want to make the position clear.

8. Could Covid-19 consequences prevent completion of any sale and purchase agreements?

a. **If you are a Purchaser,** most commercial property asset sale and purchase agreements incorporate the standard general commercial property conditions, which do not contain either a material adverse effect (**MAE**) clause or a force majeure clause, except for scenarios of destruction or massive damage to the building. Also, the fact that the Purchaser cannot obtain financing in a frozen lending market, will be the Purchaser's risk. Even worse, if a purchaser decides to pull out of a sale and purchase, it will face the risk that according to the standard wording of a German-style SPA to forfeit the deposit which is typically been agreed to secure the Purchaser's obligation to pay the purchase price (mostly 1-10% of the purchase price). Nevertheless, the Purchaser will try to justify the withdrawal from the contract on the grounds of frustration of contract or *force majeure*, pointing out that the forfeiture of a deposit would be inappropriate in such scenario. Moreover, as deposits are typically paid on an escrow account of the notary who recorded the sale and purchase agreement, they can try to stop the notary from releasing the deposit. As the notary acts as trustee for both the Seller and the Purchaser, he will be very careful if the Purchaser explicitly asks him not to release the deposit. In such a scenario, the easiest way out for the notary which is confirmed by

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the notary's professional law is to refer the case to the relevant responsible district court and only release or pay back the deposit in accordance with the district court's ruling.

b. **If you are a Seller**, you will point out that the sale and purchase agreement you entered into does – different from customary standards in M&A transaction – not contain a MAC clause covering worldwide circumstances such as pandemic events. Therefore, you will in principle insist on closing the deal but you may consider granting an extension to the Purchaser to obtain financing (rather than being left with the deposit which may even be blocked on the notary's escrow account).

c. Where a corporate structure has been used to sell a commercial property, similar principles will usually apply. The share sale and purchase agreement may contain an MAE clause, but this is unlikely to be a general market MAE clause and will usually only apply in the event of physical damage to the indirectly sold property.

9. Impact on drawing the facility.

a. **In general,** in (LMA style or similar) REF facility agreements the conditions that regulate the drawstop mechanism are typically the following:

   i. no default is continuing or would result from the proposed loan;

   ii. the repeating representations are true in all material respects;

   iii. (in investment facility agreements) loan to value not exceeding[, and debt yield/interest/debt service cover being at least,] a certain specified percentage immediately after the making of the loan;

   iv. (in development facility agreements) [loan to value and] loan to cost not exceeding a certain specified percentage immediately after the making of the loan; and

   v. (in development facility agreements) a certificate of the project monitor confirming such matters as, for example, that the proposed loan has been requested in respect of a cost which is included in the budgeted costs or that the remaining project costs to project completion are less than the available commitments.

   Drawstops are more likely to be an issue on investment deals that have not yet completed (and on which the final initial valuation has not yet been issued) and on development deals (which by their nature contemplate drawdowns throughout their life).

b. **If you are a lender**, their valuations by reference to the Covid-19 pandemic. While any such qualification would need to be reviewed on a transaction by transaction basis, a prudent lender should consider the circumstances carefully before drawstopping a facility on the basis of a valuation qualification, given how uncertain, volatile and politically sensitive the current circumstances are.

c. **If you are a borrower**, and your deal is a development deal, you will need to carry out an analysis of the impact of the Covid-19 pandemic on the time and cost of your development in order to determine whether a drawstop might apply. A prudent borrower will also do well to ensure it is currently compliant with any non-Covid-19-impacted obligations, to avoid inadvertently giving rise to potential hair-trigger drawstops.

d. **Please see question 9 below** for a discussion of potential material adverse effect drawstops.

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10. Is Covid-19 a MAE event?

a. **For both landlords/borrowers and lenders**, except in the case of deals featuring very strong sponsors, REF facility agreements usually include a MAE event of default.

The definition of MAE is usually negotiated extensively and can therefore vary considerably. The definition of MAE in the currently published version of the LMA REF facility agreements (which is acknowledged as being quite wide) is:

"Material Adverse Effect means a material adverse effect on:

i. [the business, operations, property, condition (financial or otherwise) or prospects of an Obligor; or

ii. the ability of an Obligor to perform its obligations under the Finance Documents; or

iii. the validity or enforceability of, or the effectiveness or ranking of any Security granted or purported to be granted pursuant to any of, the Finance Documents; or

iv. the rights or remedies of any Finance Party under any of the Finance Documents.]".

Although every MAE provision will need to be interpreted in the context of its facility agreement and the specific facts and circumstances of the relevant deal, the impact of the Covid-19 pandemic on deals (which is likely to be on the timing, cost and value of deals) may be expressly covered by other specific events of default.

Indeed, the usually generic nature of MAE provisions means that it is rare to be able to conclude with absolute certainty that an event or circumstance has occurred which has had a MAE. As a result, MAE events of default are rarely invoked in practice. However, every MAE provision and every transaction will be different and the circumstances of COVID-19 are new; therefore, borrowers should consider any MAE provisions, particularly in the context of drawstop situations, carefully.

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Please do not hesitate to get in touch with any of the A&O contacts listed below if you have any questions on any of the matters discussed in this note.

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