

## Covid-19 Coronavirus: Real Estate and Covid-19 The questions we are being asked in Spain

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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 Spain as a result of the Covid-19 pandemic.

We have made a general analysis of the issues set out below, but it must be noted that each issue is usually the subject of extensive negotiation and its outcome largely dependent on the agreed contractual terms. As a result, our conclusions on each of the scenarios considered below must be analysed taking into account the actual terms and conditions of the relevant sale and purchase/construction/lease/finance documents (as applicable) and the factual circumstances applying to each of the cases. This note assumes the position under an English law financing (following LMA recommended form) backed with Spanish real estate. Should the financing be subject to Spanish law, the analysis on certain matters would vary.

As such, this note provides only a general analysis of issues likely to arise and it is not intended to provide legal advice in respect of any specific situation.

### 1. The occupational tenant wants to terminate its lease.

- a. **If you are the landlord**, unless your tenant has a contractually negotiated break right which can be exercised in case of extraordinary changes of circumstances or material adverse events occurring during the state of alarm period (a term which would be unlikely to have been included in a Spanish commercial lease agreement), it is unlikely that the tenant will be able to terminate the lease only as a result of the Covid-19 pandemic and the enactment of the state of alarm, even if the relevant business activity has been temporarily suspended by the Spanish government as a result of the state of alarm.

Your tenant may try to claim that its lease should be frustrated as a result of the Covid-19 pandemic measures because it cannot use the premises and the use of the premises is the principal reason why the lease was entered into. However, if we follow the currently-existing case law in Spain, frustration has been restrictively applied by Spanish Courts to cases where the impossibility to carry out the activity is total and definitive, so it should not apply for temporary situations. In case the state of alarm continues over time for a substantial period and that entails that the prohibition of the activity remains in place, it cannot be discarded that the abovementioned line of interpretation may change, although in general terms Spanish Courts tend to protect the continuity of contracts.

- b. **If you are the lender**, your borrower (the landlord) is most likely under an obligation under the facility agreement to request your consent to terminate the lease. However, if the tenant successfully terminates the lease, 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 argues that it is entitled not to pay rent under its lease.

- a. **If you are the landlord**, taking into account that many businesses have been suspended in Spain, if you are the landlord of premises devoted to a business included in the list of suspended activities it is likely that you have already received or will receive a notice from the tenant requesting to renegotiate aspects in relation to the rent.

It is important to check in the first instance if the lease agreement has any specific provision with regard to this point as, if existing, such regime will bind the parties.

In the absence of specific contractual provisions, there are two main scenarios applicable:

### *Cases falling within the scope of RD 15/2020*

Spanish Government has approved on 21 April 2020, Royal Decree-law 15/2020 regulating, among others, certain measures on deferral of rent in commercial and industrial lease agreements (RD 15/2020). Such measures can be summarised as follows:

- i. **Moratorium on rent payments applying to institutional landlords:** Applicable to public entities, legal entities or "institutional property owners" (*grandes tenedoras*), defined as companies or individuals owning, at least, (a) 10 urban properties in Spain (excluding parking spaces and storages) or (b) property(ies) with a constructed surface exceeding 1,500 sq. m.

In those cases, the tenant is entitled to request to the landlord, within a maximum term of one (1) month as of 23 April 2020 (i.e. one day following the publication of RDL 15/2020), a moratorium on rent payments. Once requested, the rent payment moratorium will be applied automatically during the state of alarm period decreed by the Government, and if the negative impact on the activity of the tenant remains in place after the lifting of the state of alarm, also during the following monthly payments due, extendable one by one, but with a maximum overall moratorium period of 4 months. No reference is made to service charges so payment of these amounts will not be subject to the moratorium.

Tenants will have the right to distribute the rent amounts subject to the moratorium (without any penalty or delay interest being applicable): (i) amongst the rent payments of the following 2 years after the moment the moratorium term has lapsed or, if shorter, (ii) during the period running up to the end of the term of the lease agreement (including extensions).

RD 15/2020 suggests that if the landlord and the tenant have already reached an agreement different from the above in relation to rent discounts or moratoriums, this agreement will prevail over the abovementioned moratorium.

ii. **Moratorium on rent payments applying to other landlords: Applicable to landlords **different from those set out in section (i) above****

The tenant under a commercial or industrial lease agreement may request from the landlord, within one month from the entry into force of RD 15/2020, the temporary and extraordinary postponement in the payment of rent. RD 15/2020 does not provide for the obligation of the landlord to agree to such request, so we understand the agreement is voluntary as no compulsory moratorium is imposed for these landlords. Although this may initially look unnecessary, it sets out the basis for the application of the rules governing the use of security deposits set out below.

Within the negotiations, the parties may agree to use, totally or in part, the legal security deposit delivered by the tenant upon signing the lease agreement (an amount equal to twice the rent) in order to pay one or more rent instalments. In such event, the tenant must replace the amount of the security deposit (in order to reinstate it) within one year following the moment the agreement reached or, in any event, before the lapse of the lease term. Given that legal rent deposits must be deposited by landlords with the relevant regional authorities at the outset of the lease term, we understand (but RD 15/2020 is silent on that so it is unclear) that both parties must enter into a written agreement for the application of the deposit to the rent payment and in that case, the regional authorities will have to release such amounts in favour of the landlord.

iii. **Tenants who may request the rent moratorium**

RD 15/2020 states that the tenants that are eligible to request the application of the abovementioned measures are:

1. Self-employed individuals ("autónomos") when they meet the following requirements:
  - a) Be affiliated and registered, on the date of the state of alarm declaration, under the relevant Special Social Security Regime applicable to the same; and
  - b) its activity has been suspended as a result of the state of alarm declaration or subsequent governmental orders (e.g. hotels activity was prohibited through a special order); or
  - c) in the event that tenant's activity is not directly suspended, the tenant proves the reduction of the billing corresponding to the month immediately preceding the month in which the moratorium is requested in at least 75% as compared to the average monthly billing of the quarter (in the previous year) to which that month belongs.
2. Small and medium enterprises meeting the following requirements:
  - a) the limits set out in article 257.1 of the Spanish Companies Act are not exceeded: during 2 consecutive years (a) the total current assets of the company are not above € 4 million, (b) net amount of its annual turnover does not exceed € 8 million, and (c) average number of workers employed during the year does not exceed 50. It is not clear if the 3 or only 2 of such requirements must be met, given that the above referred article 257.1 deals with companies that can issue abbreviated accounts if they meet 2 out of the 3 requirements; and

- b) the tenant's business activity has been suspended as a result of the entry into force of Royal Decree 463/2020, declaring the state of alarm in Spain, or subsequent governmental orders; or
- c) in the event that tenant's activity is not directly suspended, the tenant proves the reduction of the billing corresponding to the month immediately preceding the month in which the moratorium is requested in at least 75% as compared to the average monthly billing of the quarter (in the previous year) to which that month belongs.

#### Cases falling out of the scope of RD 15/2020

Several tenants of premises which activity has been prohibited as a result of the pandemic will not be entitled to enjoy the rent moratorium of RD 15/2020 either because the landlord or the tenant do not meet the requirements sets out therein. The question that remains open is if such tenants will not be entitled to any moratorium and/or rent discount now that RD 15/2020 has limited the right to enjoy the moratorium to only certain lease agreements when the landlord and the tenant meet the relevant criteria.

Our view is that the provisions of RD 15/2020 should not limit the ability of other tenants to enter into negotiations with landlords in order to negotiate moratoriums or payments holidays with reasonable grounds. There are different provisions under Spanish law that foresee the right of the tenant to reduce the payment of rent or even to stop paying it (temporarily) in the event that the leased premises cannot be used (partially or totally). However, those provisions typically deal with either (i) other kind of situations such as works or damages in the premises that impede the use of the premises by the tenant, or (ii) rustic leases, so in the case at hand (suspended business in the relevant premises due to a government order) the tenants' position is not entirely clear. In this respect, several important authors defend the absolute right of the tenant to stop paying the rent during the period when the activity carried out within the premises remains prohibited because the landlord is not delivering to the tenant the peaceful possession of the premises.

Without prejudice to the above, it is also true that in case a negotiation between the tenant and the landlord does not come to an agreement and the matter becomes contentious, Courts may take into account that the Spanish legislator (through RD 15/2020) has only protected small/medium tenants of premises owned by large landlords, and there are provisions on RD 15/2020 that seem to indicate that even if the premises have been closed as a result of the pandemic, the tenant's obligation to pay rent remains in place. In our view, the position of tenants has therefore not been improved as a result of RD 15/2020 if they fall out of its scope of applicability.

- b. **If you are the lender**, your borrower is most likely under an obligation under the facility agreement to request your consent to change the payment terms requested by the tenant under the lease agreement. Your consent may be subject to a requirement that you must not unreasonably withhold or delay it. 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.

Lenders should also note that there is currently no legislation in place in Spain to grant any relief on interest payments for commercial mortgage loans (contrary to personal 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**, while there may not be an express right in your 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. We have seen many landlords accommodating requests in that respect, and actually some of the most high profile Spanish landlords (SOCIMIs – Spanish REITS) have offered tenants in their shopping centres a rent holiday period throughout the state of alarm period. So far it appears that landlords agreeing to these measures across their retail, leisure and hospitality portfolios tend to be those that own diversified portfolios and can also obtain income from other type of assets such as offices or logistics.

Other landlords are negotiating with each of their tenants on a case by case basis. Tenants are generally asking for discounts of part of the rent or rent holiday periods rather than for moratoriums. It is not possible however to give a specific range of the discounts that are being negotiated by landlords and tenants, as these are privately negotiated. In the cases we are seeing, however, the rent discounts that are being agreed are substantial and are limited, for the moment, to the period of suspension of business activities. There are many possible combinations of agreements that can be reached, including reductions in the minimum guaranteed rent in exchange for increases in the variable rent for a certain period after the state of alarm elapses, which would be a likely agreement in respect of leases of shopping centres.

Enactment of RD 15/2020 may have an impact in this negotiation trend, and it cannot be discarded that landlords may now feel more inclined to offer to tenants which premises cannot be operated rent moratoriums rather than rent discounts. Please see section 2.(a) above in this regard.

If you are a borrower and you are considering granting a rent concession to your tenant, you are most likely under an obligation pursuant to your facility agreement to request your lender's consent before granting that rent concession (please see in more detail below).

- b. **If you are the lender**, your borrower is most likely under an obligation pursuant to the facility agreement to request 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. 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) loss of rent in the context of insurance against damages is normally not covered by insurance companies in the Spanish market unless the triggering event of the loss of rent is a physical damage to the property, and (ii) it is also uncommon that events such as a pandemic outbreak are covered by insurance policies. However, as per our conversations with insurance brokers, if you have taken out specific insurance (different than damages insurance) covering loss of rent, this situation may also be captured so it is worth checking the terms and conditions of each insurance policy.
- b. **If you are the lender**, your facility agreement will most likely include an extensive insurance undertaking. However, for the reasons set out above, it is very unlikely that any insurance undertaking will cover insurance against the impact of pandemics.

## 5. Are occupational tenants/landlords able to shut down their premises?

- a. **If you are a landlord or a tenant**, you will need to follow the Spanish regulations in relation to the Covid-19 pandemic. In this respect, the situation is fluid given that the Spanish government is planning to reduce the list of suspended activities as the pandemic in Spain becomes under control.

Royal Decree 463/2020 (**Covid-19 Spanish RD**) came into force on Saturday 14 March 2020 and will be in force until 10 May 2020 (subject to extensions). Covid-19 Spanish RD suspended all retail activities involving sales to the public, with certain exceptions such as, amongst others: food and beverage, pharmacy and sanitary, veterinary, press, tobacco, gas stations, technology, laundry and dry cleaning. Order SND/257/2020 published on 19 March has established the suspension of all hotel commercial activity (with just certain exemptions) as from 26 March 2020.

Also, all non-essential activities (including construction and manufacturing of non-essential items) were suspended since 30 March. However, suspension of construction activity and manufacturing was lifted after Monday 13 April.

- b. **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. 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 as a consequence of the relevant legislation passed to this effect), any suspension or cessation of business is unlikely to trigger a default under that provision as the suspension or cessation is forced 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.

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

The suspension of the construction activity took place from 30 March until 3 April.

In respect of construction projects in Spain, it is not unlikely that construction agreements entitle a contractor to a time extension to complete their works as a result of, inter alia (i) interruptions of the construction activity by operation of law, and (ii) the impossibility to receive construction materials on time in order to comply with the initial construction calendar.

It is important to check in this regard if the construction contract has any particular definition of force majeure or refers to any particular events that will trigger a delay on the agreed construction calendar. It is usual that construction agreements expressly foresee the right of the contractor to delay the completion of the works if this is due to reasons that are inevitable, exceptional and out of its control.

The suspension of the construction activity in Spain appears to be a case of inevitable and exceptional circumstances that may be taken by contractors as a force majeure event in terms of delaying the construction calendar of the works, subject to the specific provisions agreed in this respect in the relevant construction contract. Other events that may have an impact on the contractors' ability to complete the works are restrictions on imports, lack of materials, etc. These situations will have to be analysed on a case by case basis in order to confirm if the relevant contractor has acted diligently and has made all endeavours to try to find alternative ways to meet its contractual obligations.

It is also important to analyse in each contract the provisions around how long and under which circumstances works can be suspended before either party's early termination right will kick in. If the contract foresees such an early termination event it will be important to start negotiations with regard to this point if any of the parties is not interested in such an early termination to take place.

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

- a. **If you are a buyer**, it will depend on what the sale and purchase agreement provides for in this regard. In our experience, it is usual that sale and purchase agreements include provisions dealing with the effects of a total or partial loss of the property before completion. However, sellers hardly accept any provisions that would entail the purchaser's right to pull out of a sale and purchase agreement as a result of a material adverse effect or a force majeure event that does not impact the physical status of the property. Therefore, unless expressly foreseen in the contract (which in our

experience is unlikely), the buyer has to comply with its completion obligations under the sale and purchase agreement.

- b. **For both buyers and acquisition lenders**, in respect of the Covid-19 pandemic potentially preventing funding by lenders at completion, unless the facility is being provided on a certain funds basis, please see answers to questions 8 and 9 below. If the facility agreement has an on-going certain funds obligation, it is unlikely that the Covid-19 pandemic will relieve a lender of its obligation to fund the acquisition, but every facility agreement should be carefully considered on a transaction by transaction basis.

## 8. Impact on drawing the facility.

- a. **In general**, in REF facility agreements the conditions that regulate the drawstop mechanism are 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 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**, a prudent lender should consider the circumstances carefully before drawstopping a facility on the basis of a minor default or valuation reduction, 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.



## 9. 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 drafted as follows:

**"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 (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 sufficient certainty that an event or circumstance has occurred which has had a MAE. As a result, MAE events of default are rarely relied upon or invoked in practice. The same would apply for lenders refusing a request for a loan on the basis of a MAE. 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.

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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