ALLEN & OVERY

Covid-19 Coronavirus: Real Estate and Covid-19

The questions we are being asked in the Netherlands

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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 the Netherlands 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,** your tenant may have contractually negotiated break rights which can be exercised in the near future. Under Dutch law such break rights in retail lease agreements will require court approval since these will amount to deviations from the semi-statutory termination grounds for retail leases. If no break rights are included in the lease, the tenant will, in principle, not be able to terminate the lease since the parties are, in principle, bound by the rights and obligations as laid down in the underlying lease.

However, depending on the length of period of the Covid-19 pandemic, a tenant may request a court to (partially) terminate or amend its lease on the ground that the Covid-19 pandemic is not, implicitly or explicitly, accounted for in the lease and will therefore qualify as an unforeseen event within the meaning of article 6:258 DCC. These circumstances must be of such a nature that, it cannot be expected from the debtor to perform under such agreement based on the principle of reasonableness and fairness. The principle of reasonableness and fairness as laid down in article 6:248 DCC and 6:2 DCC (i) requires the parties to a lease to consider each other's legitimate interests when executing their lease and (ii) can supplement or restrict the legal consequences following from the lease. The tenant will therefore assert that the economic equilibrium of the lease will have changed to such an extent that the continuation of the lease in an unaltered manner cannot be reasonably and fairly expected. The courts will apply high thresholds when assessing whether

an agreement should be amended or terminated on the basis of the principle unforeseen circumstances.
We deem it more likely that a court will temporarily suspend certain obligations under the lease based on the restrictive effect of the principle of reasonableness and fairness, then that it will terminate the lease on the basis of the principle of unforeseen circumstances.

b. **If you are the tenant,** you may teriminate the lease on the basis of a contractually agreed break right. If no break rights have been agreed, a tenant may request a court to (partially) terminate or amend its lease based on unforeseen circumstances as set out above. In case the tenant is declared bankrupt, the trustee in bankruptcy is entitled to terminate the lease based on the Bankruptcy act (*Faillissementswet*), with due observance of a notice period of three months.

c. **If you are the lender,** your borrower, as landlord under the lease, 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 that terminates the lease on the basis of contractual termination right or a termination by court order (although as noted above we deem such a termination by court order less likely). 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 tenant will most likely not have a right to withhold, suspend or reduce the rent, or alter the way in which their rent is paid as a result of the Covid-19 pandemic. The Dutch market standard general conditions for the lease of commercial space (the **ROZ** or Raad voor Onroerende Zaken general conditions) preclude a tenant from reducing, settling and suspending the rental payments. This may be different in case of government intervention. However, please note that no rent holiday schemes or other rent moratorium arrangements have been announced by the Dutch government to date.

As discussed under 1.a above, a landlord may however be required to enter into renegotiations of certain obligations under the lease for a temporary period, including the rental payment obligation, based on the principle of reasonableness and fairness.

b. **If you are the tenant,** as discussed under 1.a above, your landlord may be required to enter into renegotiations on certain obligations under the lease for a temporary period, including the rental payment obligation, based on the principle of reasonableness and fairness. When applying the principle of reasonableness and fairness it is important to consider the developments on the Dutch real estate market (such as the collective agreements referred to under 3.a below) which is an indicator for the generally accepted view (*verkeersopvattingen*) in the Netherlands.

c. **If you are the lender,** your borrower, as landlord under the lease, 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 consent may be subject to a requirement that you must not

unreasonably withhold or delay it. Even if not, you may still be subject at law to a general requirement not to act irrationally. 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, 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,** as a preliminary remark, please note that the Dutch government has not implemented a total lockdown as in other European countries. While restaurants, cafés, bars, sports and fitness clubs, childcare facilities and schools have been ordered to close as of 15 March 2020 up to and including 28 April 2020, such measures have not been implemented with regard to non-essential businesses or retail shops. In spite of the fact that it is unlikely that there will be a right in your tenant's (or other tenants') leases to withhold, settle or suspend the rent (please also see 2a above) 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 are seeing many landlords accommodating requests by tenants to pay rent monthly rather than quarterly in advance in order to preserve cash flows. Some tenants have also been requesting (and receiving) rent free periods (i.e. rent holidays) of up to three months and/or rent deferrals (i.e. where the rent is deferred for a specified period but will ultimately still be paid to the landlord). Landlords should be clear as to whether they are agreeing a rent deferral or they are actually foregoing rent.

   We note that an agreement was reached between the branch organizations of retailers, such as Detailhandel Nederland and Nederlandse Raad Winkelcentra (NRW) with Dutch branch organizations for landlords (Vereniging van Institutionele Beleggers in Nederland (IVBN), Vastgoed Belang (association of private investors) and Vastgoedoverleg (VGO)) and landlords on 24 March 2020 with regard to amongst others:

   - the deferring of rental payments for April until 20 April;
   - the conversion of quarterly rents for Q2 2020 into monthly rents; and
   - the waiver of penalties or interests due over deferred rent payments.

   A further agreement was reached on 10 April 2020 between the abovementioned branch organizations of retailers and landlords, in addition to the agreement on 24 March 2020, with regard to amongst others:

   - suspension of rental payments (between 50% and 100% of the due rent) for a period of three months as of 1 April 2020, for retailers with a proven loss of turnover of at least 25%;
   - landlords and financiers will not claim under the bank and/or parent company guarantees provided by the tenants and borrowers; and

- a possible remission of the suspended payment obligation. This remission will be assessed by the landlord and tenant after Q2 2020 on the basis of the exact impact of the Covid-19 pandemic on a tenant.

These agreements are recommendation and the parties to a specific retail lease remain free to implement it or not. The Dutch Banking Association has however called on all retail landlords and retailers to abide by this arrangement.

Landlords are facing 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.

If you are 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, on which please see more below.

b. **If you are the tenant,** you will take the view that you can only improve your position by asking your landlord for a rent holiday and/or a deferral of rent. In doing so, you may benefit from the fact that other tenants confront their landlords with exactly the same type of request. As stated under 2.b above, when applying the principle of reasonableness and fairness, it is important to consider the generally accepted view on the Dutch real estate market. If your landlord does not accept your offer for a rent concession, you will refer the landlord to the collective agreements as set out under 3.a above and claim that this agreement is to be considered as the generally accepted view in the Netherlands.

c. **If you are the lender,** your borrower, as landlord under the lease, 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, you may still be subject at law to a general requirement not to act irrationally. 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) 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.

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 claiming under the bank guarantee provided by your tenant which generally covers three monthly rental payments including VAT and service charges. The bank guarantees issued in the Dutch market to cover a tenant's rental payment obligations under a lease are generally of an abstract nature with the banks assuming the payment obligation to the landlord as an own obligation. Once the landlord has made use of its bank guarantee the tenant is in principle obliged to refill the bank guarantee and to compensate the guarantor under the issued counter guarantee.

b. **If you are the tenant,** you will assert that under the agreement which was reached between Dutch branch organizations for retail companies as described in 3.a above and landlords have committed themselves not to claim under the available rental security if the parties have agreed to abide to this collective agreement. As stated in 3.a above, the collective agreement is a recommendation and the parties to a specific lease remain free to implement it or to deviate from it. Nevertheless, a tenant may assert that an important part of the retail market has committed itself to this collective agreement entailing that it is to be considered as the generally accepted view in the Netherlands.

c. Whether a court will support the landlord's strategy to enforce the rent security to cover rental losses during the critical period from 1 April to 30 June 2020 will depend on the circumstances of the case and to what extent this can be considered reasonable and fair in light of the current unforeseen cirumstances.

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

a. **If you are a landlord,** it should be considered that under the Dutch market standard general conditions (ROZ general conditions), the tenant has the obligation to (i) follow governmental orders and (ii) fully operate the leased premises for the entire duration of the lease term. Since no governmental closure orders for retail stores have been issued in the Netherlands to date, the tenants that have shut down their retail stores have done so at their own initiative. However, the question may arise whether a tenant is able to continue its business operations considering the fact that the Dutch government has advised individuals to keep a distance of 1.5 meter from others

during the Covid-19 pandemic and will issue fines to retailers that do not take appropriate precautionary measures.

b. **If you are the tenant,** you will generally have an obligation to operate your retail store under your lease agreement. However, in the context of the Covid-19 pandemic, landlords have generally accepted that this obligation to operate cannot be upheld, also because of the precautionary measures required by the Dutch government. We deem that a court will generally accept that, in the context of the current Covid-19 pandemic, the tenant cannot be reasonably and fairly held to operate the premises.

c. **If you are the lender,** if your borrower, as landlord under the lease, 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 result in far-reaching consequences 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.

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 the Netherlands, specifically those which utilise the UAC (Uniform Administrative Conditions) general conditions (as is the case in most real estate related projects), 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 Dutch 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. However, where it is not defined, it will be necessary to analyse and assess each relevant circumstance in accordance with article 6:75 DCC (force majeure). It seems that the Covid-19 pandemic may well be covered by the concept of force majeure, being an event that is outside of the control of the parties; but 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. 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 Dutch government requires construction sites to close due to the Covid-19 pandemic, this would constitute an event that potentially entitled contractors to more time in its own right.

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 UAC-based contracts; although this will ultimately depend on the specific contract terms, facts and circumstances in each case. Such construction contracts commonly allow contractors more time for other "non-fault' events, such as exceptionally adverse weather, storms, civil commotion, strikes, etc. However, contractors will usually have a duty to warn employers about delays and potential delays and contractors are generally required use their best endeavours to prevent delays. They will also need to substantiate any claims.

It is uncertain, at the time of writing this note, whether employers or contractors will be responsible for any contractors' losses and expenses arising from delays caused by the above events.

The types of practical issues resulting from the Covid-19 pandemic that could arise on construction projects include the following:

- factories closing and materials not being available. The usual questions will need to be asked here, e.g. why did the factory close? Can the materials be sourced from elsewhere? Can alternative materials be used? Are the materials on the critical path? Can the works be re-sequenced to avoid/minimise the consequences of any potential delay? Etc.;
- restrictions on imports;
- construction workers having to self-isolate. Unless there are significant numbers of employees self-isolating, this may be something that contractors can deal with, as they would ordinarily have some employees off sick at any given time; and
- construction workers now being required to implement social distancing. This is a grey area as employees will be following government restrictions, but they will not actually off work sick. Initially contractors may have to bear the risk of this, as it would be a situation arising from their staff, for whom they are ultimately responsible. But, if it caused significant impact on site, contractors may begin to seek to claim more time to complete their works citing force majeure and the impact of the Covid-19 pandemic as the reason; and
- sites having to shut down because the government imposes a lock-down. This may of itself be an event that entitles contractors to more time.

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 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. However, it may be that, in the circumstances, neither party actually wants to terminate.

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. Even delay in start-up insurance, if taken out, is likely to exclude pandemics such as the Covid-19 pandemic or, at the very least, have stringent limits on any recovery. Put simply, insurance is unlikely to provide relief.

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. 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 buyer,** most commercial property asset sale and purchase agreements do not contain a material adverse effect (**MAE**) clause, except for material damage or destruction of the property sold. Under most commercial property asset sale and purchase agreements, the risk passes on exchange and, if a buyer decides to pull out of a sale and purchase, a penalty will become due and is paid from the deposit paid to the notary or the issued bank guarantee. Whether the seller has additional rights to claim damages will depend on what has been negotiated in the sale and purchase agreement.

   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 a MAE clause, but this is unlikely to be a general market MAE clause and will usually only apply if there has been a breach of the interim covenants or the warranties above a certain threshold. As such, any such MAE clause is unlikely to be triggered by the Covid-19 pandemic alone. Share sale and purchase agreements are, however, more likely to be conditional contracts and, as such, parties may look to try to invoke such conditions, either to extricate themselves from a deal during a period of uncertainty or as a means of renegotiating the price.

   If you have reached understanding with a certain party on the sale of a commercial property (either via an asset sale or share sale), but no written sale and purchase agreement has been exchanged yet, please note that (i) a written agreement or an agreement on all details of the deal is not required for the creation of binding obligations between parties or conclusion of an agreement, as long as agreement has been reached on all essentials of the deal (ii) if parties have not yet reached agreement on all essentials of the deal (also called pre-contractual phase), they could be obliged to continue their negotiations until agreement has been reached, subject to an obligation to pay damages (and sometimes even compensation for lost profits), unless it has explicitly been agreed that the entire transaction is still 'subject to contract'.

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.

9. 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,** on investment deals that have not yet completed we understand that some jurisdictions have started seeing valuers qualifying 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.

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.

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

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