

## Lease Restructurings Now (Part 1)

PUBLISHED ON

**October 2, 2020**

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(**Note:** This is Part 1 of a two-part alert on lease restructurings during the time of the COVID-19 pandemic. Barley Snyder recently started a [Lease Restructuring Team](#) to assist landlords and tenants when lease agreements need to be changed.)

As parties to commercial leases, landlords and tenants often find that restructuring or amendment of a commercial lease may be beneficial. Sometimes, in conditions of either individual or widespread economic distress, the adjustment of lease obligations may be the only way to avoid legal conflict. Lease restructurings are not a new part of the legal landscape, but the COVID-19 pandemic seems to have triggered the need for lease restructurings to occur more quickly and in a way which is far more prevalent than prior economic downturns.

Landlords and tenants have been attempting to address what are primarily tenant defaults while preserving the relationship. In more limited instances, there is the potential for a landlord default. These lease arrangements methods and their related concerns typically fall into several buckets:

**Extension of lease term.** This approach usually involves a period of rent abatement and an extension of the lease term by a similar time period.

**Rent forgiveness.** Landlords have occasionally agreed to a partial or full abatement of rent for a specific time period, particularly where the landlord has realistic hope for the future of the tenant and concern about the difficulty the landlord may experience in replacing the tenant. The forgiveness should only occur after full performance of the balance of the lease by the tenant.

**Rent deferral.** Landlords and tenants have come up with different forms of rent deferral, involving a "moratorium" on rent payment for a fixed time period and requiring payment of the deferred rent either at the end of the deferral period or at some other time. Many of these arrangements involving payment immediately following the rent deferral period, essentially "kicks the can down the road." It requires the tenant to pay a substantial sum at the end of the deferral and gives rise to a repeat of the original problem. Some of the rent deferral arrangements involve deferral until a much later date or the spreading of deferred rental payments over time. Again, the landlord may choose a particular direction with respect to the deferral of rental payments based upon the landlord's perception of the tenant's viability and the possibility of further tenant financial distress.

**Alternative temporary rent.** Another option for landlords and tenants to consider is setting an alternative rent structure during the period of crisis. Rather than basing rent on square footage rates or fixed gross rent amounts, rent could be based on the financial status of the tenant during the crisis period. It could be based

on a percentage rate of sales or the tenant's break-even point of sales on what it can afford to pay for rent after all standard operational costs have been paid. In this scenario, the tenant will pay the regular base rent each month but if it has sales that surpass the break-even point in rent, then the tenant will pay an extra amount above the break-even point. But if its sales are below the break-even point in rent, then the tenant will get a credit for next month's rent in the amount below the break-even point.

**Security/credit enhancement.** Often times, commercial leases provide for cash security deposits to secure rental payments, the condition of the property and other costs or obligations. Sometimes leases require the delivery of a guaranty by a third party or principal, or a letter of credit, to enhance the credit profile of the tenant. Part of a lease restructuring may include changes to these pre-existing arrangements or the creation of new arrangements, such as additional guaranties or letters of credit, assuming their availability from the tenant. Security deposits may also be deployed to pay rent and may or may not be replenished.

**Termination of lease.** There may be an agreement to terminate the lease. The termination arrangement may or may not involve a one-time payment by the tenant. In some cases, landlords prefer to obtain possession and the ability to seek a new tenant rather than becoming involved with an extended period of tenant occupancy without rental revenue. In termination deals, the landlord should anticipate and address the potential for subsequent fraudulent transfer claims, whether or not in a bankruptcy.

**Remedies.** In some jurisdictions, such as Pennsylvania, landlords should assure they are properly preserving their right to confess judgment for money or possession as part of any lease amendment.

(Coming next week is Part 2 on why bankruptcy matters in lease restructuring.)

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