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Rent concessions during the pandemic:
*Considerations for tenants
in the art and antiques market*

The UK arts and antiques market as a significant sector in the UK economy

The United Kingdom remains one of the major centres of the international art market, retaining its second position with a 20 per cent market share, equivalent to circa US\$12.7 billion, closely behind the United States and ahead of China. In 2019, prior to the COVID-19 pandemic, UK auction sales accounted for US\$4.3 billion in sales, down by 20 per cent year on year, roughly in line with the change in total auction sale volumes worldwide, excluding private treaty sales.

Like all other art market centres, the UK market was fundamentally affected by the COVID-19 pandemic, with a large number of art fairs cancelled, dealers and galleries closing for several months during the national lock-down, and economic uncertainty contributing further to declining sales. UK galleries expected a 79 per cent drop in revenue in the year 2020, according to an Art Newspaper survey from April 2020.

According to the first comprehensive analysis of the impact of COVID-19 on the gallery sector, published by Art Basel and UBS, art gallery sales fell by an average 36 per cent in the first half of 2020 with sales continuing to decrease for the rest of the year. Earlier research by ArtTactic found that auction sales fell by 49 per cent for the leading auction houses in the first half of 2020. At the same time, the pandemic accelerated the move by auction houses, dealers and art fairs to online platforms, viewing rooms and transactions. According to Art Basel and UBS, the share of online gallery sales rose from 10 per cent of total sales in 2019 to 37 per cent in the first half of 2020. Galleries are now re-opening to visitors but many art fair exhibitions are being postponed for the time being.

As COVID-19 continues to circulate in the UK and across Europe throughout 2021, it remains to be seen whether the UK art market is both sufficiently resilient and innovative to weather the coming months. Galleries are particularly vulnerable in this crisis because their operations often rely on physical interaction and global travel. Many galleries were also already at risk financially before the crisis began.

Accordingly, priorities for galleries have altered in the past 18 months in response to the COVID-19 pandemic. Back in 2019, galleries reported that their key priorities were their art fair exhibitions and widening the geographical reach of their client base. These priorities shifted markedly over the first half of 2020 to trying to boost online sales, cutting costs to maintain profitability, and maintaining relationships with existing clients who were seen to be critical to their survival.

This change in priorities has resulted in a reappraisal by galleries of significant business costs, of which rents and other property outgoings are foremost. What follows is a summary of the COVID-19 legislation as it applies to gallery tenants within the commercial property market, and a discussion of how we can assist you to reduce or defer costs to maximise profitability.

No forfeiture of commercial leases for non-payment of rent until 25 March 2022

In an effort to mitigate the consequences of the COVID-19 pandemic, the government has intervened to impose regulation on the economic relationship between landlords and their tenants through a variety of measures.

Section 82 Coronavirus Act 2020 prevents any forfeiture between 26 March 2020 and 25 March 2022, whether by proceedings or peaceable re-entry, of the vast majority of commercial leases for non-payment of any sums due under the lease. In addition to rent these sums include service charge, insurance payments, utilities and so on. Failure by the tenant to pay rent during the moratorium period is also removed as a ground of objection by a landlord to a new tenancy under the Landlord and Tenant Act 1954. In all cases sums under the lease remain due and only an express waiver will waive the right to forfeit when the restricted period ends.

This means that, whilst the moratorium is in place, a landlord will not be able to evict a tenant for non-payment of rent. Crucially, there is no requirement that the tenant's failure to pay the sums due must have been as a result of COVID-19. Accordingly, the restrictions on forfeiture during the moratorium period apply irrespective of the tenant's reasons for non-payment.

However the landlord is not prevented from enforcing a right of re-entry for a breach of other covenants for example. The landlord could conceivably, therefore, still forfeit for breaches other than the non-payment of rent. Nevertheless, the landlord should have regard to the tenant's ability to remedy a breach during the COVID-19 outbreak when considering what a reasonable period of time is for the tenant to remedy a breach, give-up possession or apply for relief.

Once the legislation has lapsed (currently scheduled for the end of 25 March 2022) a landlord will be able to claim for forfeiture for both payments that became due during the moratorium period, and for any becoming due but unpaid after it ends, though it should be noted that the government has recently announced plans for a binding arbitration scheme to resolve disputes between landlords and commercial tenants once the moratorium has expired.

The legislation does not apply to a short lease (i.e. a lease for less than six months.) Landlords whose tenant is on a lease of 6 months or less can therefore still forfeit their tenant's lease.



Commercial Rent Arrears Recovery (CRAR)

COVID-19 legislation originally prevented landlords from using CRAR unless an amount of at least 90 days' rent was due (it had previously been seven days or more). This amount has been increased several times and reached 554 days' rent on 24 June 2021.

The government has announced its intention to further extend the end of the relevant period until 25 March 2022, and confirmed that the minimum net unpaid rent that must be outstanding before CRAR can be used will remain at 554 days.

It appears that the increase in the minimum amount of net unpaid rent may also apply to a superior landlord's right to recover rent from an undertenant under section 81 of the Tribunals, Courts and Enforcement Act 2007.





Statutory demands and winding-up

The presentation of debt-related winding-up petitions where a company cannot pay its bills (including rent) due to COVID-19 is restricted under COVID-19 legislation.

These restrictions were due to end on 30 September 2020, but regulations have been made which have extended them initially to 31 December 2020, then to 31 March 2021, then to 30 June 2021 and subsequently until 30 September 2021.

Accordingly, a creditor cannot present a winding-up petition against a company based on a statutory demand that was served between 1 March 2020 and 30 September 2021, nor present a winding-up petition between 1 March 2020 and 30 September 2021 based on a company's inability to pay its debts (including rent) unless the creditor has reasonable grounds for believing COVID-19 has not had a financial effect on the company, or that the company's debt issues would have arisen in any event.

What is the impact of such COVID-19 legislation?

Landlords can wait until the moratoria are lifted and seek the recovery of the unpaid rent by threatening their tenants with forfeiture and/or insolvency proceedings. However, the good news is that many landlords (particularly smaller private investors) are increasingly agreeing to give such concessions in return for their tenants agreeing to resume paying some rents.

In the final analysis, landlords and tenants are both affected by the pandemic and it is in the interests of all parties to come out of this context as unscathed as possible. Accordingly, the best solution is to come to an arrangement which meets the needs of both parties and then to formally document that arrangement.

Given the particularly adverse financial impact on tenants in the arts and antiques sector, a common question is whether tenants can refuse to pay rent, pay less rent and/or seek to terminate the lease prematurely. The starting point is to review the terms of the particular lease. The relevant provisions to consider include:

1. Any break clause that may enable the tenant to terminate the lease early;
2. Any turnover rent provisions that are dependent upon the income generated from the premises; and/or
3. Any force majeure clause (although these are rarely found in commercial leases and there is no common law right to terminate for force majeure).



Most modern commercial leases will provide for rent to be payable without deduction or set off. In those circumstances a tenant is unlikely to be able to withhold payment of rent for COVID-19 related reasons unless any specific provision in the lease enables it to do so, or unless it reaches an agreement with the landlord for rent deferral or concession.

What options are available to commercial tenants?

There are several options and strategies in terms of structuring a rent deferral or concession including:

1. A release from current arrears (a 'rent holiday');
2. A 'turnover-based' rent, where the rent is determined as a proportion of the turnover generated by a business. However, we would caution against this because tenants should not agree to long term measures to address what is, in essence, a short term issue. Once the art industry emerges fully from the pandemic, any turnover-based rent may be a disadvantage to gallery tenants in financial terms;
3. A direct discount to the current passing rent;
4. A composite approach – part fixed rent, part variable with the ability to revert to normal terms should a tenant's performance warrant it;
5. Offering to stay in rent free (bar service charges) on a flexible exit basis so the landlord can find a new tenant and not have to worry about a vacant property or rates;
6. Offering other post-COVID inducements (e.g. a share in profits or a return to prior lease terms, if performance warrants);
7. Where the tenant has multiple properties with a landlord there is also the option to agree a portfolio deal – exit certain leases but extend the terms of others, which may be attractive to the landlord.

It is also important to consider whether there are any other covenants in the lease that should be waived during the concession period, for example the user clause, signage restrictions or keep open covenants, all of which will be particularly relevant to gallery tenants.

It is likely that the landlord will be particularly keen to obtain the consent of any guarantor under the lease, as a material variation made to the lease without the guarantor's consent could release the guarantor as security for the tenant's obligations.

What happens when the current restrictions come to an end?

When the current restrictions from forfeiture come to an end on 25 March 2022 (or later, should the moratorium period be extended again), a landlord could forfeit a lease on the basis of the tenant's non-payment of the rent, which accrued during the suspension if it remains unpaid. To successfully forfeit a lease, the landlord will need to establish the right to do so. Non-payment of rent is considered a breach of covenant, and usually provides landlords with the right to forfeit.

This illustrates the importance of entry by the tenant into a properly negotiated and recorded rent deferral or concession. An appropriately documented concession will protect the tenant from forfeiture for non-payment of rent once the current restrictions come to an end.

Conclusion

Whilst the various items of COVID-19 legislation to protect tenants are not a magic panacea for tenants looking to manage their cashflow, they do provide some significant and much needed breathing space for gallery tenants. Tenants should however be aware that following the expiry of the moratorium period, the right to forfeit will arise again, unless the period is extended further. Where a tenant has withheld payment of historic rent without its landlord's consent, it would therefore be well advised to open a dialogue with the landlord before the end of the moratorium period.

Our commercial property team here at Hunters Law LLP is well placed to assist with such enquiries. Please contact a member of our commercial property team for further information.



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