



COVID-19: THE IMPACT ON COMMERCIAL LEASES IN HONG KONG

April 2020

Landlords and tenants are facing unprecedented challenges in the wake of the rapidly evolving COVID-19 pandemic. Many retail and leisure premises are now closed and office buildings are impacted in light of the latest surge in the number of confirmed cases and the Government's enactment of new regulations under the Prevention and Control of Disease Ordinance (Cap. 599) (the **New Regulations**). Rent is the major cost of many tenants and the risk of breaching a lease has become more imminent under this prolonged period of shutdown.

Are tenants required to pay their rent?

Abatement of rent

Leases commonly provide for rent abatement if the premises are damaged or rendered inaccessible by insured, and in some cases uninsured, risks. The detail should be checked carefully.

Frustration

Currently, it seems unlikely that the results of the current pandemic will be sufficient for a lease to be set aside on the basis of "frustration". While it is possible for a lease to be frustrated, the bar is a very high one. The outbreak of SARS in 2003 had not been ruled as a frustrating event for a lease, because the period interrupted by the outbreak was not a long one. Whether the current outbreak constitutes frustration is something that may well be challenged, particularly if the COVID-19 restrictions are prolonged and the

interruptions (for example a forced closure by the regulations) last for a long period of the unexpired term of a lease.

Agreed concessions

That said, many landlords are agreeing to restructure their lease which includes rent reductions, rent deferrals, monthly payments or other concessions in the circumstances. Service charges may also be reduced if savings can be made as a result of reduced services, although that may not always be possible.

Landlords are likely to be able to draw on any rent deposits, but many are electing not to do so (at least for the time being). If they do make a withdrawal to cover rental shortfalls, landlords may be willing to defer or waive their entitlement to a top up.

Early and frank engagement between the parties will be critical in the face of the current challenges. The Government has also urged landlords to fulfill their social responsibilities by providing more substantial rent reductions for tenants whose businesses are in distress.

Will landlords close their buildings?

The position so far

The recently announced regulations under the Prevention and Control of Disease Ordinance have not required landlords to close buildings (such as multi-let offices or shopping centres). These regulations targeted businesses and premises that are likely to invite public

gathering and / or are seen as a risk for transmission of the Covid-19.

While the catering business is required to comply with measures to lower the seating capacity and enhance hygiene of the catering premises, premises such as fitness centres, cinemas and amusement game centres must be closed for business for 14 days from 6:00pm on 28 March 2020.

A lease confers a right for the tenant to occupy its premises. It is not generally permissible for a landlord to prevent a tenant's access to its premises, even if that may be a prudent step in light of current guidance.

It is also worth noting that many leases will contain "keep open for business" covenants on the part of tenants, which are unlikely to be enforceable in the current circumstances.

What next?

It remains to be seen if the Government will impose further measures or make suggestions that impact landlords and tenants to commercial leases. They are advised to monitor carefully any further guidance or directions issued and take steps to ensure compliance. This depends on the development of the Covid-19 virus in the region.

How will the prohibitions on group gatherings affect landlords and tenants?

The New Regulations prohibit group gathering of more than four persons in a public place, which is defined as a place where the public may be permitted to have access whether by payment or otherwise. Therefore, properties under commercial leases are likely to be governed by such regulations.

Importantly, both landlords and tenants may be subject to criminal liability under these regulations. For a person who owns, controls or operates the place (i.e. including the

landlords and the tenants of the place) in which a prohibited group gathering takes place, it is an offence to knowingly allow the gathering to take place. Such person may face a jail sentence for up to six months and fined up to HK\$25,000. Some group gatherings are exempted, for example, people gathering at a place of work for the purposes of working and at a healthcare facility for obtaining healthcare service.

In addition, authorised officers may, in order to ascertain that the prohibition on group gatherings is being complied with, enter and inspect any public place as they reasonably consider necessary. For the same reason, they may also require a person who owns, controls or operates the place to produce documents in his or her possession that relate to activity carried out in the place that the officer reasonably believes to be a prohibited group gathering, or to furnish any information in his or her possession that relates to the activity. Persons who fail to comply with the authorized officers' request is liable to a fine of HK\$10,000.

What support is the Government offering for commercial property?

In February 2020, the Government set up a HK\$30 billion Anti-epidemic Fund, which is a subsidy scheme for hard-hit sectors such as retail, licensed guesthouses and travel agents. Rental waivers are given to tenants at the Science Park, industrial estates and Cyberport.

In the same month, the Financial Secretary announced the 2020-2021 budget, which stated that rates for non-domestic properties for 2020-2021 will be waived, subject to a ceiling of HK\$5,000.

The Government may roll out more supportive measures in view of the recent development in Covid-19 cases and new regulations affecting many businesses' operations.

If you would like further information about the impact of COVID-19 on your business, please speak to your usual Slaughter and May contact.



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