



Property, Town Planning and Community Schemes Team

Legal Update
8 April 2020

Our Cox Yeats Property, Town Planning and Community Schemes Team is committed to keeping you informed on pertinent legal issues, as well as developments within our firm.

RETAIL PROPERTY LEASES, THE POTENTIAL CONSEQUENCES OF THE LOCKDOWN AND THE COVID-19 BLOCK EXEMPTION REGULATIONS FOR THE RETAIL PROPERTY SECTOR, 2020

RETAIL TENANTS NOT ABLE TO TRADE DURING THE LOCKDOWN PERIOD

The Covid-19 pandemic and current lockdown has created an environment where retailers (especially those who trade in non-essential goods and services and for whom business has effectively ground to a halt) may not be in a position to pay the rentals due by them on a monthly basis. This will add to the pressures already being experienced by retail landlords in the current volatile economy. Unfortunately, even in these early days of lockdown, a number of retail landlords have already received communications from their tenants notifying them that, due to the nationwide lockdown and the restrictions imposed on the sale of non-essential goods and the provision of non-essential services, they will not be able to trade and therefore will not be able to service their rental commitments. Retail landlords also have substantial monthly financial commitments and the non-payment of rental by retail tenants could have catastrophic consequences and possibly even result in the closure of malls and severely impact on retail property businesses.

In an attempt to try and protect this area of the South African economy, to minimise the negative impact on the retail property sector and to ensure business survival and continuity after the national disaster, the Government has introduced regulations known as the Covid-19 Block Exemption For the Retail Property Sector 2020 ("the Regulations"). These Regulations were promulgated on 24 March 2020, remain in force for as long as the declaration of Covid-19 as a national disaster subsists under the National Disaster Management Act (Act No 57 of 2002) or until withdrawn by the Minister of Trade, Industry and Competition, whichever comes first, and apply to:

Retail Property Landlords – this includes a number of possible stakeholders who facilitate and let space in the retail property sector and who are defined in the Regulations as "*businesses that are involved in the supply of rentable space in the retail property sector such as retail shopping centres among others. The categories of landlords may include, among others, real estate investment trust companies, property developers who own or operate retail shopping centres and other intermediaries through whom the letting of rentable space in the retail property sector is facilitated*"; and

South African Retail Tenants – this includes businesses that lease retail property and who are involved in various trades including those relating to clothing, footwear, home textiles, personal care service and restaurants and which are defined as "*a firm which is a retailer of goods or services that leases retail property from a retail property landlord, which is incorporated, established or formed under the laws of the Republic of South Africa and whose place of effective management is the republic of South Africa.*"

This is an attempt by the Government to encourage landlords and tenants to enter into agreements regarding the payment of rental and other charges so as to ease the financial burden on retail tenants during the lockdown period by the management of their finances and to enable them to continue normal operations beyond the national disaster that we are currently facing. This type of action is not usually permitted and is in fact prohibited by virtue of the provisions of sections 4 (agreements between competitors) and 5 (agreements between suppliers, firms and customers) of the Competition Act (Act No 89 of 1998) which prohibits what can be seen as price - fixing between groups of competitors as well as suppliers and customers. However, the Regulations provide that sections 4 and 5 of that Act will not be enforceable against any schemes designed to ease the burden that the lockdown will have on certain classes of retail tenants.

It must be noted that these exemptions only apply to agreements or practices specified in paragraph 3 of the Regulations, namely:

- **payment holidays and/or rental discounts for tenants;**
- **limitations on the eviction of tenants;**
- **the suspension or adjustment to lease agreement clauses that restrict the designated retail tenants from undertaking reasonable measures required to protect viability during the national disaster.**

The Regulations have effectively removed the restriction on retail landlords entering into these types of negotiations with retail tenants but do not impose any obligation on the landlords to do so, however, paragraph 3 of the Regulations seems to indicate that the exemption only applies if the action is “*undertaken at the request of, and in co-ordination with the Department of Trade, Industry and Competition...*”. At this stage the process to be followed is not entirely clear and we will update this aspect further once more information is to hand. It is also not clear why the Department of Trade and Industry limited the exemption to a fairly narrow category of businesses and this will undoubtedly result in numerous applications from other categories of tenants for the exemption to be extended to them.

It is also important to note that the Regulations only apply to certain classes of retail tenants, namely:

- **Clothing, footwear and home textile retailers** – these are defined as “*retailers of wearable garments and products including menswear, ladieswear, children’s clothing, clothing for infants, sleepwear, underwear, intimate apparel including lingerie, hosiery and socks, millinery (hats and caps), ties, school uniforms, sportswear, swimwear, protective clothing, workwear, hospital apparel, branded corporate wear, bespoke tailoring, footwear and home textile products including sheets, pillows, towels, table cloths, carpets, terry towels and blankets*”;
- **Personal care services** – these are defined as “*retail outlets providing personal grooming services such as hairdressers, health and beauty salons*”; and
- **Restaurants** – defined as “*a business that prepares and serves food and drinks to customers*”.

Given the unpredictability of managing the Covid-19 pandemic, the Regulations provide for the designated retail tenant list recorded in Annexure A thereto to be expanded or reduced by the Minister, and in addition provide for retail property landlords and retail tenants to identify additional agreements or practices outside of paragraph 3 of the Regulations and to request the Minister to expand the scope of the exemption.

In terms of the ban on general trading, tenants which do not fall within the exempted categories will be prohibited from trading for at least the lockdown period or for any other period that may be determined by the Government. It is inevitable that the retail tenants who are not able to trade will not have the full beneficial occupation of the premises leased by them and therefore may be entitled to a remission in rental depending on the provisions of their lease agreements. It is likely that a total rental remission will not be entertained by landlords, especially in view of the fact that the tenants assets would still be situated in the premises during the lockdown period. Every request by a retail tenant for any relief set out in the Regulations will have to be viewed having regard not only to the Regulations but to the terms of the lease agreement concluded between the parties. Landlords and tenants in the retail sector will have to be careful to ensure that in entering into negotiations in terms of the aforementioned Regulations they do not otherwise fall foul of the Competition Act.

RETAIL TENANTS WHO ARE INVOLVED IN THE MANUFACTURING, SUPPLY OR PROVISION OF AN ESSENTIAL GOOD OR SERVICE

All businesses which are involved in the manufacturing, supply or provision of an essential good or service are permitted to trade during the lockdown. In general, due to the fact that these types of companies are allowed to operate during the lockdown they will not be entitled to a reduction of rental, payment holiday or rental suspension. If such companies voluntarily take a decision to close down (they may decide to do so to protect their employees and to reduce the spread of the virus) they still have an obligation to pay rent to the landlord and failure

to do so may constitute a breach of the lease agreement affording the landlord the right to either terminate the lease, demand specific performance or claim damages as a result of the tenants failure to perform under the lease.

LEGAL AND OTHER RELEVANT CONSIDERATIONS

Force Majeure

One of the aspects that needs to be considered is whether or not the lease agreement contains a **force majeure** clause. Force majeure clauses regulate the liability of the parties and the effect on the lease when certain events which are beyond the control of the parties e.g. war, strike, riot, natural disaster etc. or an act of God e.g. flooding, earthquake etc. prevents one or both of the parties from fulfilling their obligations in terms of the lease. A force majeure event ultimately suspends the ordinary consequences that would ensue in the event of a breach of the lease, but it is important to ensure that the force majeure clause has been triggered prior to making such a statement to the other party to the lease as the un evidenced statement of a force majeure could lead to a breach of the lease. Reliance will have to be placed on the provisions of the lease in order to determine whether either party can be temporarily absolved from complying with its obligations in terms of the lease. In dealing with the aspect of force majeure in the context of the Covid-19 pandemic it must first be established that the provisions of the lease are wide enough to include this specific pandemic. If the lease includes a force majeure clause the parties will have to rely on the relief provided for in that specific provision of the lease. If the lease does not contain a force majeure clause and is otherwise silent on the issue of force majeure the parties may be able to rely on the common law principle of **supervening impossibility of performance**.

Supervening impossibility of performance

A general principle of our common law is that, if after the conclusion of an agreement, the performance thereof becomes objectively impossible without any fault on the part of either party as a result of some unforeseen event, a party's failure to comply with its obligations under the agreement is excused. This is known as supervening impossibility of performance. If the supervening impossibility is permanent in nature, then the contract comes to an end. If it is temporary, then the obligations under the contract are suspended for the duration of the circumstance giving rise to the temporary impossibility. The general rule, however, does not override the express terms of the contract or the terms implicit in the contract which can allocate the risk to one or other of the contracting parties. Again, whether or not this will excuse or suspend performance of obligations by contracting parties is fact specific and legal advice should be sought before parties take steps to alter performance by suspending, delaying or terminating performance in terms of any agreement.

Insurance

Many lease agreements require tenants to obtain and keep in place insurance in respect of the businesses and assets. Both landlords and tenants should review their respective insurance policies to determine whether or not they have business interruption coverage. If they do have this insurance cover, claims may be made which may cover the payment of rent in the current circumstances i.e. where leased premises are forced to close due to the lockdown in force as a result of the Covid-19 pandemic and the declaration of a national disaster. Standard business interruption cover does not usually cover this type of situation and typically covers a situation where the business is unable to continue its operations due to, for example, physical damage to the property so it will be necessary to examine the specific wording of the respective policies to determine whether the relevant cover extends to the current pandemic and consequent lockdown.

Practical Considerations

It is important for tenants to be mindful of the fact that retail landlords also have expenses that they are required to pay regardless of whether the shopping centre operates or not e.g. rates and taxes, mortgage payments and operational expenses. It is also important for landlords to acknowledge that retail tenants may experience very real and challenging financial consequences as a result of this unprecedented set of events and it is therefore recommended that landlords and tenants engage with each other at the outset, before any party takes any unilateral action, and that they endeavour to find reasonable solutions to address the issues that they face, but without compromising their respective legal positions.

Industry Response

During the week of 23 March 2020, the major representative bodies for real estate in South Africa, namely the SA Reit Association (SA REIT), SA Property Owners Association (SAPOA) and SA Council of Shopping Centres (SACSC) formed a collective known as Property Industry Group. This newly formed collective speaks for the commercial real estate sector in South Africa which includes the country's large property owners.

On 7 April 2020 the Property Industry Group announced an industry-wide assistance and relief package for retail tenants that have been most affected as a result of the Covid-19 pandemic and consequent lockdown. Although the initiative focusses primarily on supporting

affected SMME's across all sectors (categorized by the Department of Trade, Industry and Competition as having an annual turnover of up to R 80 million), the group has also included providing support to large retailers affected by the lockdown.

The basic principles of the package offered by the group are as follows (and are expanded upon in the tables below):

- Currently, the main object of the group's initiative is to preserve jobs for retailers, their suppliers and service providers. What this means is that in order to qualify for the relief benefits offered, retail tenants will need to undertake not to retrench staff during the relief period.
- All retail tenants whose accounts were in good standing at 29 February 2020 can be assured that there will be no evictions for the next two months.
- Retail tenants who have been prevented from trading in compliance with the Governments mandatory lockdown (non-essential services) and in good standing at the end of February 2020 are offered some form of assistance from landlords and the extent of such relief depends on the severity of the impact.
- For April and May 2020 retail landlords will offer relief in the form of rental discounts where rental will be waived partially or fully and interest free rental deferrals where the deferred rental will be recovered later over a period of six to nine months from 1 July 2020 onwards.
- Rental includes rent, operating costs and parking rental but excludes all rates and taxes recoveries, utility cost recoveries and insurance which all retail tenants are required to pay in full for April and May 2020.
- Each retail landlord is entitled to use its discretion in the relief and assistance that it gives to a retail tenant but the property industry package stipulates the minimum that qualifying retailers can expect.
- Landlords will, on a case by case basis, also consider providing relief to office, industrial and hospitality tenants where the lockdown has severely impacted the tenant and where it is justified.
- The package assumes that the lockdown does not extend beyond 21 days. If this turns out not to be the case then the group's view is that stimulus packages will have to be offered by the government, banking sector and Solidarity Fund.
- The package allocates less support to retail tenants that have insurance cover or receive relief from other sources in order to focus benefits on retail tenants that do not qualify for other assistance.

TABLES SETTING OUT RELIEF OFFERED

SMME RETAILERS (categorized by the DTI as having annual turnover of up to R 80 million)

Category	Basic assistance and relief	Interest-free deferment recovery period
Level 1: Highly impacted retailers (e.g. companies selling time and services such as restaurants, hairdressers, travel agents, take-aways, etc.)	<p>April 2020 35% to 100% of April 2020 rental and further potential relief could be in the form of rental deferrals</p> <p>May 2020 Up to 50% of May 2020 rental and further relief could be in the form of rental deferrals</p>	Over six to nine months from 1 July 2020
Level 2: Medium impacted retailers (e.g. companies selling product that doesn't have a limited shelf-life, etc.)	<p>April 2020: 35% to 50% rental discount and further potential relief could be in the form of rental deferrals</p> <p>May 2020: Up to 25% rental discount and further relief could be in the form of rental deferrals</p>	Over six to nine months from 1 July 2020

- Tenants' financial position and strength of balance sheet to be assessed by landlord to classify in an impact category
- Landlords have flexibility and discretion, on a case-by-case basis, to adjust parameters; however, minimums are set as the base guideline
- Normal or better trading assessed considering rent-to-sales ratios, balance sheet, stock availability, etc.

NON-ESSENTIAL GOODS/SERVICES

Category	Basic assistance and relief	Deferment recovery period
SOE and Government tenants	No relief offered – 100% of rent payable (excl. temporary testing, laboratories and healthcare services housed free)	N/A
All retailers with annual turnovers above R80 million (including local and international listed/publicly-traded retailers and large unlisted retailers)	April 2020: 35% rental discount and 15% rental deferment May 2020: 15% rental discount and 35% rental deferment	Over six months from 1 July 2020

ESSENTIAL GOODS/SERVICES

Category	Basic assistance and relief	Deferment recovery period
Retailers offering more than 75% essential services	No relief offered – 100% of rent payable	N/A
Retailers offering essential services but electing to close	No relief offered – 100% of rent payable	N/A
Retailers offering partial essential services, less than 75%	Essential goods/services – 100% of rent payable Non-essential goods/services – as per retailers with annual turnovers above R80 million Pro-rated by essential goods/services turnover vs non-essential good/services turnover (or gross lettable area if specifically agreed)	For non-essential goods/services portion: over six months from 1 July 2020

The payment for rental for the month of April and May 2020 should be done by no later than the 17th of April and the 7th of May respectively and apply to all discounts and deferrals.

GOING FORWARD

Should you require any advice regarding:

- assessing your leases to ascertain any possible legal risks and potential implications
- assisting you in finding possible solutions
- engaging with landlords/tenants in order to negotiate a solution

- restructuring leases and/or recording interim and/or final payment arrangements and drafting the required documentation necessary to record any interim and/or final solutions agreed to between landlords and tenants

do not hesitate to contact one of our team members below and we will assist you.

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