

UK Real Estate: the now and the next

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The real estate market – the now and the next

As businesses continue to adapt to the current challenging times, we invited a group of our key clients of our Real Estate group in London to join us for a virtual roundtable discussion on the current real estate-specific issues, themes, trends and critical areas in the current market and what the future of the real estate sector will look like in the post-COVID-19 world.

This Reed Smith real estate roundtable event is part of a series we have developed and designed to create a platform for senior business leaders, general counsel, legal and business teams and senior management representatives to share experiences, discuss live issues and explore ideas for the future of legal service delivery.

Given that our roundtable events, in their virtual and in-person formats, are always held under the Chatham House rules, we have not provided specific names or examples and have kept the report confined to themes. This paper outlines the key themes, which emerged from our discussion with our clients with a spotlight on the “now and next” issues under each theme, which seemed to be highlighted during the discussion.

As ever, we are grateful to our clients for sharing their honest thoughts and feedback on the current issues they are facing within the real estate sector and we would like to continue the conversation with them on these issues going forward. The current economic climate is uncertain, volatile and unpredictable and the insights shared by business leaders into current and emerging issues enable us to provide pragmatic and commercial support to our clients.



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Is the real estate sector future-proofed and ready for the imminent changes in the market?

The impact of the government's intervention in the market

- The UK government has introduced various support measures to help business tenants deal with the current situation and benefit from the temporary removal of the most effective landlord remedies for non payment of rent, but the general view from landlords is that this has created **“the industry’s biggest problem in 2020”**.
- The overwhelming opinion is that COVID-19-related measures, whilst beneficial, have been open to significant abuse (by some tenants) and this has led to landlords effectively becoming the **“bankers of choice for tenants”**.
- The overall view is that some tenants have exploited support measures and used them as a **“cash preservation tool”**, thereby effectively using landlords as an **“easy bank”**.
- The lack of clear guidance by the government and distinction between small and big tenants, has led to exploitation by some tenants, particularly large corporate tenants.
- A general theme observed is that the smaller tenants have demonstrated a genuine willingness to meet their rental obligations compared to some of the larger corporate tenants.
- In summary, the government response to the COVID-19 crisis has been perceived as **“too early and an unnecessary intervention”** as little consideration has been given to what will happen once the government support packages have ended.

The now and the next

- Ongoing collaboration between landlords and tenants on devising viable payment plans has become a necessary requirement in the current climate.
- In response to any rental support plans or rental deferral requests, landlords should consider requesting tenants’ accounts for the last three years, to help assess their financial situation and determine their ability to pay their rent.
- Looking forward, landlords have an opportunity to deepen their relationships with their tenants and to move away from the negative press they receive, which is unsupportive and aggressive.



The market perception of landlords

- The current market situation has further highlighted the fact that **“the corporate real estate market has long been misunderstood by the public”**, and that there are many support schemes and **“unions”** for tenants whereas landlords do not have an effective lobbying system.
- There is a common perception that landlords are **“wealthy and only concerned with picking up cheques once per year...”**.
- There is a general feeling that most legal remedies are largely designed and geared towards protecting the tenants.
- The current situation has highlighted the long-standing poor relationship between landlords and tenants – with a common consensus being a desire to change and improve this dynamic in the future.

The now and the next

- While the general view is that landlords have **“lost the public argument”** and there is no desire to **“engage in a PR war”**, in practice many landlords are working and collaborating with their tenants to avoid court action and find mutually viable and financial solutions.
- Landlords are sympathetic to their tenants’ vulnerable situations and wish to work with them, instead of pursuing legal channels, where possible, in order to find mutually beneficial long-term solutions.
- Landlords do not readily wish to pursue legal action and wish to avoid further negative PR.
- Landlords should communicate concerns to their lenders. The banks have more lobbying power with the government.

The impact on different asset classes

The lack of demarcation between the different asset classes within the schemes introduced by the government, has led to exploitation and abuse by some tenants.

- Invariably, some industries have had a larger impact from COVID-19 than others, with retail, hotels and the restaurant sectors effectively **“closing their doors for business”**.
- Retail, in particular, is a good example where tenants have generally been less able to meet their rental obligations and have benefitted from the government support measures.
- There have been various operational challenges for some sectors, like care homes, which have had to adapt faster and more efficiently to the immediate challenges raised by COVID-19.
- Additional challenges for landlords have arisen where, for example, particular groups of tenants within asset classes have teamed up to **“create their own unions and are now firing shots”** at landlords.

The now and the next

- There is an **“image war”** between landlords and tenants; however, whether it is a small start-up business or a billionaire tenant, it should not matter. If there is a debt, it should not be about how wealthy the landlord is, but about the contractual obligations of each party and the legal redress available to both parties.
- A ‘one size fits all’ approach does not work.
- Landlords with large portfolios will need to adapt to the situation of the different asset segmentation, as there is a desire to be seen to be cooperating with tenants.
- There is a desire to see the government implement legislation that is flexed for different sectors to help both tenants and landlords.



The key legal and practical challenges facing the real estate sector

The COVID-19-related government schemes and economic packages have been described as the industry's biggest challenge.

- A general perception is that the recently introduced COVID-19-related schemes have emphasised a trend (generally seen for a while) to protect the **“small tenant”** with little consideration for landlords.
- In the short term, the rental collections in June will most likely be difficult and clients are expecting a significantly slower second quarter, compared to the first quarter.
- An immediate concern expressed was that the furloughing scheme having been extended until October 2020, may lead to an extension of the restrictions on landlords' ability to take action for non-payment of rent. The increasing concern is **“How do we get out of this situation in the long term?”**.
- Landlords are likely to see increased involvement from the banks in future as they have more lobbying power with the Bank of England, compared to landlords, with some landlords fearing that if this situation continues, this will be **“an existential threat to the industry”** and could lead to another loan crisis, similar to the global financial crisis in 2008.

The now and the next

- As there is no guidance issued on how the courts are supposed to assess tenants' ability to respond to their lease obligations, landlords should consider obtaining historic information on tenants' finances from public or alternative sources.
- Landlords need a clear 'route out' or a clearly defined exit strategy from the crisis as this will help both landlords and tenants better plan and prepare for the future.
- Better cooperation between landlords and the banking sector could lead to more effective resolutions when addressing tenants' compliance with their lease obligations and corresponding contractual breaches.
- Long-term planning: landlords should consider the long-term scenarios and issues, and what the future might look like in 6 , 12 or 18 months.



Future working trends

- A general emerging consensus is that remote working has proved possible for many businesses and teams, as the ability to work over the internet has been embraced. However, one observation was that remote working has been successful because of much invested “existing social capital”, i.e., established teams are likely to work better in a remote setting, as they have developed relationships that have made it possible to work in this way.
- Remote working does not lend itself to new relationship development or to effective learning opportunities for younger employees.
- The future of people working in offices may currently appear to be uncertain, but the general view remains positive – the demand to work in offices will continue and will be the preferred way of working in the future.
- To help ease the return to the office, the role of the government needs to shift from scaremongering (which is further accentuated by the media) to educating people about the impact of COVID-19 on different age groups, which should in turn ease the return to the office (there have been almost zero deaths below the age of 30 for healthy people, but this has been lost amongst the headlines).

The now and the next

- Landlords and employers need to find new and creative ways to get people “out of their gardens and country farms” and into the workplace.
- The current situation will only exacerbate the existing trends of moving towards more flexible working and more home working – and employers will need to make the office environment more creative and attractive to entice employees to come to the office.
- There will be fewer face-to-face meetings and less demand and need for international travel.
- The current situation has highlighted the need for change in the real estate sector as it adapts to the post-COVID-19 world.

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