To Keep Your Real Estate Deals Moving, Consider a Pause Provision

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Within less than a month, the outbreak of COVID-19, and government countermeasures deployed to blunt its effect, has brought a vibrant economy grinding to a halt. In particular, what was a lively commercial real estate market buttressed by strong economic fundamentals, only weeks ago, is beginning to slow due to the uncertainty caused by the pandemic.

At the individual deal level, parties are running into practical difficulties in performing under their contracts due to social distancing restrictions, office closures, and the inability of key parties to adequately and efficiently perform their obligations under the purchase contract. Buyers are beginning to run up against due diligence deadlines, which are forcing them to consider cancelling the transaction to avoid running past contingency deadlines and obligating themselves to close the deal without having had sufficient opportunity to perform due diligence, clear title matters, and seek all desirable assurances and approvals. Landlords and tenants may be having issues completing tenant improvements that often trigger rent commencement dates. Additionally, willing parties are trying to figure out how to enter into new deals amidst today's uncertainty.

Parties having difficulties determining how to keep deals moving during the pandemic may want to consider entering into a "pause" provision specifically designed to deal with the unusual and unforeseen circumstances created by the COVID-19 outbreak. In existing agreements, the purpose of such a provision is to avoid having a transaction fall through on account of the parties' temporary inability to perform due diligence or achieve various benchmarks because of outside restrictions, not within the control of either party, related to COVID-19.

Even parties whose deals are not currently affected by COVID-19-related restrictions but are considering entering into new agreements may want to consider inserting a pause provision into their agreement so they can better control and define the rights and recourse each party will have should the outbreak's effects reach their deal.

For parties currently under contract, a pause provision negotiated or entered into now would toll contingency deadlines or certain identified performance obligations until such time as the ordinary course of business of the parties

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(pursuing the transaction in good faith) can resume in normal fashion as the effects and limitations of the COVID-19 outbreak abate. The pause provision would then provide a mechanism to restart the transaction clock once both parties have no further substantial restrictions that prohibit them from performing under the purchase contract, other than those common to typical transactions. There are at least two options for the parties to consider.

The parties could identify “hard” triggers that would cancel the transactional pause such as a specific governmental restrictions being rescinded, an emergency declaration expiring, or certain administrative or service functions being restored. Doing so creates a bright line for the parties to locate as to when the transaction resumes, but it also requires substantial forethought and negotiation as to what event or events will operate as a triggering condition. It also limits the parties’ real-time evaluation of the situation and reduces their flexibility to match the transactional pause to the actual effect of the restrictions on the parties in fulfilling their obligations under the purchase contract.

On the other hand, the parties could agree to a “soft” trigger in which one or either party would hold the right to terminate the pause upon its reasonable determination and notice that the ordinary course of business of the parties is no longer substantially restricted. Such a “soft” trigger provision would need to include deadlock and dispute resolution language should the parties disagree as to whether the pandemic’s effects are still impacting the ability of a party to perform sufficient to require the transactional pause be continued.

A potential dispute resolution method would be to hand the determination over to a third-party arbitrator as to whether the ordinary course of business of the parties is still being impacted by COVID-19. The arbitrator’s decision would be binding on the parties. The parties would identify either specific individuals to serve as an arbitrator or a method to choose an arbitrator. The provision should also provide guidelines for procedures to submit position statements and supporting proofs on an expedited time frame.

An effective and well-drafted pause provision, whether a predefined “hard” trigger or party-exercised “soft” trigger, would ensure that a transactional pause occurs and continues only so long as the transaction’s progress is being affected by direct pandemic-related disruptions, but not because of the derivative financial effects of COVID-19. Those latter concerns can be dealt with in the normal course of due diligence. The provision should be narrowly tailored to prevent a party from placing a transaction in stasis for a mere “wait-and-see” purpose to assess project viability, unless the parties expressly desire to do so.

Any comprehensive pause provision should also contemplate a future in which governmental restrictions may be lifted but later re-imposed to address future outbreaks. In addition, it may be advisable, whether using a “hard” or “soft” trigger mechanism to lift the pause, that an outside deadline be set out by which the pause would automatically cancel. This would provide an exit strategy for both parties in the unfortunate case that this outbreak lingers longer than anticipated.

Finally, for clarity moving forward once the transaction resumes, the pause provision should also obligate the parties to enter into an amendment restating any tolled deadlines for contingencies or performance obligations.

These unusual times may end up causing a fair number of commercial real estate transactions to fall apart due to apprehension and fear of the uncertain economic forecasts. But, if the underlying financials of the deal appeal to both parties, or are at least desirable enough to continue exploring its possibility, the parties should consider a pause provision.