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Covid-19 and its impact on loans and real estate arrangements

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In the wake of the spread of the Covid-19 global pandemic, the real estate and loan markets in Kenya are bound to be affected.

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On 16 March, Uhuru Kenyatta, president of Kenya, revealed that three (and now 25) patients had tested positive for the virus, culminating in presidential directives towards preventing its spread to the rest of the population. These directives included recommendations for employers to allow their employees to work from home. Further, foreigners outside the country (save for permanent residents) will not be allowed into the country for 30 days. The threat of the spread of the virus will certainly impact the labour market, business operations and financial credit, rendering it difficult to perform loan obligations and real estate contracts in many respects.

Businesses countrywide are already scaling down significantly or shutting down entirely. Employees are either being placed on compulsory leave or have been asked to work remotely. The option to work remotely is barely feasible for employees in the majority of the commercial and industrial sectors where onsite manual labour is involved. The situation is more critical for informal workers who make a living from day to day and thus cannot afford to be out of work. Those in self-employment are also taking precautionary measures to avoid contracting the virus, including closing down their businesses. In light of this, there are real concerns about the liquidity of businesses and individuals and their ability to perform their contractual obligations during this period.

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Loans and real estate transactions

For loan facilities, there are concerns about debtors' ability to meet their payment obligations. Typically under borrowing agreements, the failure to meet the obligations to repay a loan or mortgage facility constitutes an event of default, invoking a lender's right to exercise its remedies towards recovery of the entire outstanding debt. In the prevailing circumstances, especially with the looming possibility of a complete lockdown, moving for recovery is not feasible for lenders considering the logistical and legal difficulties arising from the ongoing suspension of court proceedings and scaling down of key service providers such as lawyers and auctioneers that will render it almost impossible for lenders to exercise their statutory power of sale and other remedies.

The challenges are further exacerbated by the volumes involved since the threat of the coronavirus has had widespread impact on many businesses and individuals. It is very likely that a lender moving to recover a debt will be significantly unsuccessful due to the simple fact that debtors may not be liquid enough at this time to service the borrowings due to the unexpected changes in circumstances brought about by Covid-19.

Payment holidays

Further, in light of the circumstances, this move could dent a lender's public image. In recognition of this, banks in the United Kingdom are introducing mortgage payment holidays suspending loan repayment obligations for three months during the outbreak period for later payment. This is backed by a commitment by the UK government to guarantee loans to businesses and to offer tax breaks and other reliefs to businesses and struggling households. The Kenyan government and banks have also taken action to cushion debtors. So far, the Central Bank of Kenya has brokered the waiver of fees charged on mobile payments until 30 June 2020. Lenders have also been urged to give relief on personal loans and SME loans.

On 19 March, the Kenya Bankers Association announced that reliefs will be granted to borrowers affected by Covid-19 if their repayments were up to date as at 2 March 2020. Effectively, banks would consider issuing extensions for repayments and other restructuring arrangements to these borrowers. For construction and other real estate transactions, cash flow for financing projects and for servicing any development loans will be severely constrained. Shortage of labour may also pose a problem as employees avoid work to avert contracting the virus.

Shortage of supply of building materials is an added concern as businesses in countries which supply materials, such as China and Italy, slow down to tackle the pandemic. There is a real possibility that contractors will be unable to complete construction projects within agreed timelines rendering developers in possible default of their obligations to purchasers and project lenders. There is also the likelihood of default by purchasers and tenants if they are unable to meet the payment obligations for purchases and rent, respectively, as agreed with the sellers and landlords due to the change in circumstances. In recognition of this, countries such as France have taken steps to suspend rent payment for businesses during the Covid-19 outbreak period.

Force majeure to the rescue

Notwithstanding the gloomy circumstances, many real estate and loan agreements permit for relief in the event that contractual obligations cannot be met due to unforeseen circumstances beyond the control of the parties to a contract. This is known as the force majeure clause. A force majeure clause cannot be implied into a contract. A contract would typically describe what circumstances amount to an event of force majeure. Depending on the individual terms of contract, the threat of Covid-19 would most likely qualify as an event of force majeure.

The consequences of occurrence of a force majeure event also depend on the terms of each agreement. In some cases, the party who is unable to perform his/her contractual obligations is allowed an extension of the period prescribed for performing the obligation. This could mean extending the completion period for construction and real estate transactions or extending the period for loan repayment so that payment becomes due at a later date. Rent due could also be agreed to be paid at a later date. In essence, this option delays the triggering of an event of default to allow parties to remedy any defaults or mitigate anticipated defaults until an agreed future date. If the force majeure event persists at the end of the extension period, an event of default could be triggered allowing the aggrieved party to pursue remedial action against the party in breach.

There is also an option to suspend the performance of the contract until a future date. In this case, the parties may agree to retain status quo as at the date the force majeure provisions are invoked until such time that they will be able to resume performance of their obligations. In essence, the parties in this case delay the termination of the agreement on grounds of frustration until a future date when it is clear that performance of the contract will not be possible.

Termination on grounds of frustration

An agreement could also be terminated on grounds of frustration if unforeseen circumstances make performance radically different from what the parties had committed to. The legal threshold here is quite high and the mere fact of a contract becoming more difficult or expensive to perform does not in itself give rise to valid grounds for termination on grounds of frustration. Where a contract is frustrated, the parties are typically discharged from the contract in part or in whole. The burden of the loss suffered by reason of frustration will be shared according to the parties’ agreement. Typically, the parties will need to take steps to place each other in the same position as would have been had the contract not been entered into in the first place. For example, in a property sale transaction, a purchaser would be reimbursed their purchase price in exchange for giving up all claims against the property. The parties can also agree on how to share the losses without invoking any penalties against any party for breach of contract.

However, where the parties have made significant investments pursuant to a contract or the parties have significant future obligations to fulfil, particularly in executory contracts, termination could culminate in greater losses to the parties, making the option to opt out of a frustrated contract commercially unviable. Loans and real estate contracts usually permit the parties to renegotiate the terms of the contract where changes in circumstances arise. This is typically the preferred way to mitigate losses arising from significant changes in circumstances. It is, therefore, anticipated that lenders, borrowers, developers and contractors will take advantage of these provisions and pursue debt restructures and variations to real estate agreements.

It is too early to comment on the long-term effects of Covid-19, but we are certainly compelled to evaluate the likely impact on real estate, property and financial contracts.

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