

Tenant's Comprehensive Guide to Rent Relief




Tim O'Brien,
CCIM, SIOR,
LEED AP

COVID-19. We are in the midst of a modern-day global crisis. There is no playbook. No one has all the answers, and everyone is adapting on the fly – some better than others. The best decisions are typically educated ones, so the intent of this guide is to arm you with information that applies to all commercial leases: office, industrial, medical, and retail space.

IMPORTANT NOTE – If your lease is expiring within the next 12 months, DO NOT sign a lease extension longer than 18 months. 6 months, 12 months, and even month-to-month are all options. The real estate market is changing significantly in your favor. We just want to buy time, and your landlord will be glad to keep you. If your lease is expiring in 12-36 months, DO NOT sign an extension yet – just wait. I know this is difficult for many decision makers who feel their landlord is making a compelling case otherwise but resist and just wait. It will pay off.

This market is fluid and changing rapidly, and markets (at least real estate markets) can be somewhat predictable. After the tightening creating a “landlord’s market” over the last few years, we anticipate a significant swing in the opposite direction that will inevitably produce tremendous opportunities. It will take some time (likely into 2021) to fully materialize, so be patient and do not be fooled into thinking you have favorable terms – you do not. Locking into a long-term lease now will preclude you from capitalizing on softer market conditions yet to come.

 **To the right are several options for rent relief. In virtually all cases, interest and late fees are being waived in conjunction with the rent relief.**

Knowing the potential ways to structure the relief is just the beginning. You need market intelligence to know specifically on what terms deals are being done. You should also consult your advisors and gather information to prepare for a dialogue with your broker and the landlord.

THE OPTIONS

There are a variety of methods to structure rent relief. The most common options are:

- **Rent Abatement:** Free or waived rent (2 months free)
- **Rent Reduction:** Partial rent, such as 50% rent
- **Late Rent** (aka Delayed Rent): Pay later in the month instead of on the first
- **Rent Deferral:** Repayment of a deferred amount by amortizing it over a defined period, adding it to the end of the lease term, repaying it with a lump sum on or by a specific date, or in exchange for extending the lease (e.g. for 1 year). One of the most prevalent strategies proposed by landlords.
- **Application of Security Deposit:** Use the security deposit to help offset the rent burden.
- **Promissory Note:** Convert the amount of debt (i.e. rent) forgiven by the landlord to a separate promissory note.

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STRUCTURING REAL WORLD DEALS - Think about what works best for your firm. You may prefer 50% rent over a longer period instead of everything frontloaded, or you may have a short-term cashflow issue and therefore want 100% free rent with all of it up front. Every company's need is unique.

Examples: (*Again, NO interest or late fees*)

- 2 months of rent waived...period; no repayment.
- 2 months of building operating expenses only (may or may not be required to repay rent portion)
- 3 months of rent reduced to landlord's debt service plus building operating expenses; no repayment
- 3 months of rent at 50% plus normal operating expenses; no repayment
- 3 months of rent deferred, to be paid back:
 - o By adding 3 months to the end of the lease
 - o Over the first 3 months of 2021 (in essence, double rent for those three months)
 - o Amortized over:
 - The remaining term of the lease
 - The next 12 months
 - 12 months in the calendar year 2021
 - The number of months through the end of 2021
 - The number of months until the next rent escalation
 - o Not repaid in exchange for 12 month lease extension
- 3 months of the following:
 - o 1/3 of monthly rent waived; no repayment required
 - o 1/3 of monthly rent deferred; repaid using one of the above methods
 - o 1/3 normal rent plus normal operating expenses
- 4 months of 50% rent, to be paid back using one of the above methods
- Use security deposit: If 1-month security deposit, apply 50% to rent across 2 months, thereby reducing out-of-pocket rent obligation by 50% over that period. In exchange, the tenant agrees to re-fund the security deposit within a certain period of time (perhaps using PPP?).

Gather Information - Everything is time-sensitive, so be proactive and immediately consult your advisors. Talk to your attorney, accountant, insurance agent, and real estate broker to fully understand the circumstances and all options on the table. Lean on them for their expertise. Below are a few of the questions you should be asking:

Questions for attorney:

- Does Force Majeure apply?
- Is the Interruption of Services clause applicable?
- Does our community have "just cause" eviction ordinance?
- Should business interruption insurance apply?

Questions for insurance agent:

- Does this qualify for business interruption coverage under your policy?

Question for YOUR real estate agent (not your landlord's):

- When does your lease expire?
- What, if any, is the amount of your security deposit?
- If your lease is secured with a letter of credit, is the landlord (and bank) waiving your balance obligations?
- Does your lease have a personal guarantee?
- What restrictions do you have on subleasing per the lease?
- Do you have a right to cancel or right to contract in your lease?
- What are the terms of your holdover clause, should it come into play (only if your lease is expiring soon)?

Questions for accountant:

- Will any debt (i.e. rent) forgiveness, deferral, or abatement be considered taxable?
- What amount of PPP or other assistance through the CARES Act may I apply to rent?
- Recognize that your accountant has no prior experience with the CARES Act either.

DEVELOP A PLAN - How has the crisis impacted your company and what are you doing to fix it? If you haven't already, develop a plan on how you are positioning your company to survive the fallout from the pandemic, and how it will subsequently thrive. Be prepared to validate and substantiate any of your relief requests.

In essence, you are presenting a business plan demonstrating you have a viable and sustainable business. While it is not a cash payment, you are asking the landlord to invest in you by forgoing their contractual rights. They do not want to invest in a sinking ship. At the same time, vacant space doesn't do them any good either.

Be prepared to provide a financial accountability, clearly demonstrating the impact (and thereby the need), an outline of measures being taken to stem the impact on your business, and a clear plan for the path forward:

- **YTD and prior year's (or two years') financial statements, including:**
 - **2019 P&L and balance sheet as of December 31, 2019**
 - **Balance sheet as of request date**
 - **Monthly or weekly YTD P&L and cash flow statements**
- **Proforma of anticipated income and expenses through the end of the year**
- **Proposed amount and method of rent relief (be specific in this request)**
- **Repayment plan (if applicable) for the deferred rent**

Your broker's role is important in these conversations. As a professional real estate advisor to tenants, I advise having your broker involved in all conversations regarding your lease or modifications to any business terms.

FRAMING THE DISCUSSION - Remember that you are asking for help. You have a legal document in the form of a lease for which you are contractually obligated. In most cases, those obligations will not or cannot simply be forgiven. The primary concept is to seek relief from those payments until such time that you can reasonably expect to repay them or restart your normal payment schedule. Remember that your Landlord has a variety of partners including investors and the mortgage lender. They often can't offer compromises without broad consent of those partners.

As an industry colleague wisely noted, this pandemic is a hardship on landlords too. While the landlord is not unsympathetic to their tenants' challenging circumstances, they are faced with equally difficult circumstances, and their mortgage payment and fixed expenses are largely still due.

You should know some landlords are restricted in what they can do regarding lease modifications by their loan documents. Just work within the framework you're given.

Expect to make sacrifices across the board – this is about your business' survival. Be prepared to have your broker explain the measures taken demonstrating your efforts to mitigate costs and the negative effects on revenue. Show that you are in this together, taking measures to reduce overhead while maintaining revenues.

Of course, there is shared risk. If your business fails, the landlord will be faced with an empty space in a challenging market. You both benefit if your business succeeds. Naturally, landlords would rather receive full rent than discounted or no rent, and they would prefer repayment of concessions over not, but that just may not be realistic. Market demand has largely evaporated. The tradeoff between a tenant missing a few months of rent is still going to be less costly to landlords than that space being vacant.

The dialogue with your broker and the landlord should be open and transparent, but not without strategy or intent. Negotiate in good faith. Try to find a mutually agreeable amicable solution. Like all negotiations (make no mistake – this is a negotiation), it is important to have a plan. You and your broker should be prepared with a specific request and a corresponding repayment plan (if applicable). We want to be on the same team working toward the same goal.

Timely and clear communication is critical. Remember that this is a relationship and not just a lease document. Most relationship problems come from poor communication.

DOCUMENT IT - Once you have an agreement, request a lease amendment or letter documenting the agreed upon terms. Check to make certain that everything is included and that it accurately reflects your arrangement. Finally, be sure to have both parties sign the document to signify acceptance, and deliver the fully executed agreement to the other party.

SAMPLE LETTER / EMAIL TO LANDLORD

Dear [LANDLORD],

As you know, the COVID-19 crisis and corresponding stay-at-home orders have had a substantial impact on the economy and businesses everywhere. Unfortunately, [COMPANY] is not immune and is being significantly affected. The revenue effects have been severe and immediate.

We are taking significant measures to reduce costs and mitigate the effects, and are pursuing emergency loans and grants to help with liquidity, but need additional help. We are reaching out to you as one of our key partners (amongst others) to see if you can provide any sort of relief.

Ideally, we are seeking [INSERT SPECIFIC RELIEF REQUEST HERE].

Please call me as soon as possible to discuss this situation. I will have financials and our action plan available for your reference. Thank you.

OTHER ALTERNATIVES - Consulting your legal, real estate, financial, and insurance advisors may yield other alternatives, such as force majeure, subleasing, or business interruption insurance. Subleasing may be a viable option to help mitigate overhead, but is not typically a quick, short-term solution. It should be pursued in conjunction with rent relief if you foresee permanent operational changes in your need for space. Ideally, we would like to see the market rebalance and stabilize first, but regardless this can be an appropriate and necessary strategy. Be sure to have your real estate broker check your lease to understand any restrictions on your ability to sublease.

SUMMARY - To achieve the best rent relief package, be certain to start early, consult your professional advisors, map out a specific plan – both for your business and for your rent relief request, include your real estate broker in your dialogue with the landlord, be reasonable, and over communicate. Leaning on the expertise of your team and using the examples included above as your guide, you should achieve a favorable outcome.