

NAIOP

COMMERCIAL REAL ESTATE
DEVELOPMENT ASSOCIATION
PITTSBURGH CHAPTER

NAIOP Response: COVID-19

COVID-19

COVID-19 RESPONSE

**STRATEGIES FOR COMMERCIAL PROPERTY
OWNERS & TENANTS TO AVOID RENT
FORBEARANCE DISPUTES**

In Partnership with the

ura | Urban
Redevelopment
Authority
of Pittsburgh



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INTRODUCTION

The emergence of Coronavirus 19 (COVID-19) has halted local, national, and international economies. Almost all industries are seeing dramatic impacts following the emergence of this pandemic. In the Commercial Real Estate (CRE) sector this has also been true. While not all segments of the CRE sector are affected equally, COVID-19 is making its impact on property owners and tenants, especially in the retail and hospitality segments. In the short-term, many firms in these segments will need government support and many may need help in avoiding commercial lease disputes. To this end, NAIOP Pittsburgh and the Urban Redevelopment Authority of Pittsburgh (URA) have come together to create this guide for property owners and tenants to address their individual concerns. The goal is to provide a guide that illustrates equitable strategies for rent relief in various forms.

****This is not a legal document or legal advice. All parties should consult with their counsel for legal advice. Additional expertise from brokers, accountants, etc. should be considered. ****

1. EXECUTIVE SUMMARY

There are many things property owners and tenants can do to avoid legal disputes. This is true in ordinary times and especially true during times of crisis, such as this pandemic. In this guide we outline several strategies that each the tenant and owners can utilize to maximize communication and transparency, while avoiding legal deliberations that can be harmful to both parties. These strategies are as follows:

Tenant Strategies

- 1. Proactive Outreach Is Best:** Approach your landlord before you need to withhold payment. Transparency earlier in the process is key to maintaining working relationships to get through tough times.
- 2. Review Your Lease with Your Counsel:** Review the lease and other related documents to determine rights and remedies.
- 3. Provide Documentation:** Be sure to document how COVID has impacted your business's financials.
- 4. Expect to Pay Something:** Covering operating expenses is a base case, landlords will need to receive some level of income to maintain their financing and maintain their property.
- 5. Think About a Repayment Strategy:** How and when will you be able to repay? Would you be comfortable with an amortization of deferred amounts or extension of term on lease?
- 6. Communicate:** Overcommunicate rather than under communicate. Silently not paying could erase all hope of a working relationship.
- 7. Seek Out Experts:** If you do not have internal expertise on any subject important to your lease discussions, please seek out the help of experts.

Property Owner Strategies

- 1. Maximize Tenant Retention:** Finding new tenants is more costly than keeping current ones. If you can avoid legal disputes, do it. You also get the benefit of establishing a long-term relationship that will last long past this pandemic.
- 2. Research Resources Your Tenants Can Utilize:** Become aware of all the resources your tenants can tap into, including federal, state, and local support. For nonprofits, this could include support from foundations. Share this information with your tenants.
- 3. Develop a Rent Forbearance Application:** While these decisions will be case-by-case, you should develop a standard form for these requests so that you ensure you are getting similar information from all of your tenants.

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4. Determine Your Preferred Repayment Strategies:

- a. Rent Reduction
- b. Rent Deferral
- c. Rent Abatement
- d. Loan Conversion
- e. Application of Deposit
- f. Subletting

5. Contact Lending Institutions: Depending on your type of loan and its clauses, you may need to contact your lender prior to changing your lease terms.

6. Work with Tenants to Achieve a Solution: Try to work towards a decision and resolution.

2. TENANT CONCERNS & STRATEGIES

Tenant Concerns & Strategies

In the current environment, tenants are squarely focused on making it through this period of crisis with the least amount of long-term damage to their businesses. Many have had to furlough or layoff some portion of their employees. Small businesses are looking for ways to mitigate risks that could permanently shutter their business. While their concerns might be different than a property owner, there are a lot the two parties can relate to, which can help drive empathy and common cause. Below are some strategies tenants can deploy to help their cause during this pandemic.

- **Proactive Outreach:** We are amid an international crisis driven by the COVID-19. If your business is experiencing hardships because of this pandemic, one of the best things you can do is proactively reach out to your landlord to discuss ways to avoid litigation and potential plans for short-term rent relief or modifications.
- **Review Your Lease with Your Counsel:** Work with your legal counsel to review your lease to see if your rent is simply base rent or if it includes pass-through expenses. Make sure you know if any of these expenses are scheduled to increase or decrease. Determine the length of your lease and any renewal options. Key questions you should know:
 - Simple rent or pass-through?
 - Length of your lease?
 - What constitutes a default of the lease?
 - What tools are available to the landlord in such a case (penalties, eviction, interest, etc.)?
 - Does your landlord hold a security deposit? If so, how much is it?
- **Provide Documentation:** Work with your CFO or tax counsel to document your financial situation. Key questions:
 - What was your planned revenue, expenses, and net income?
 - What are your current budget projections?
 - What are your best case and worse case scenarios?
- **Expect to Pay Something:** Landlords are not likely to remove the burden of paying rent in total—they continue to pay some operating expenses that apply to your space. There are many options to explore to determine other forms/structures of payment. Some options:
 - Rent Reduction
 - Rent Deferral
 - Rent Abatement
 - Loan Conversion
 - Application of Deposit

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- Subletting

- **Think About a Repayment Strategy:** While we are in the middle of a global pandemic and it is hard to determine when your business will bounce back, you still need to attempt to determine when your ability to pay your lease will return. If your business was shutdown via state law, follow the news about when your state will allow opening your operations. Try your best to project what your situation will be.
- **Communicate:** In this current environment, overcommunication is optimal. After consulting with your legal counsel and reviewing the abovementioned strategies, be sure to engage your landlord and communicate your concerns and status.
- **Seek Out Experts:** If there are deficiencies in your internal expertise, seek out the help of professional experts, such as brokers, lawyers, accountants, etc. This ensures you have the best advice possible to make short-term and long-term decisions.

3. PROPERTY OWNER CONCERNS & STRATEGIES

Property Owner Concerns & Strategies: Property owners and landlords have unique concerns and, depending on their lending terms and financial positions, have varying abilities to help tenants during this difficult time. However, the overwhelming majority of landlords want to maintain their current tenant base and the relationships they have established. Property owners should seek to implement some of these strategies to address their unique concerns:

- **Maximize Tenant Retention:** In a time of broad economic uncertainty, the tenant you know and trust is better than the potential tenants that you don't know. Now is the time to reach out to tenants to see how you can help them through this difficult time. This does not have to be strictly about lease terms and rent. Discussion can address how to help them with keeping their employees healthy, or how to help them re-open their business if they were forced to shut down. Finding new tenants is more costly than keeping current ones. If you can avoid legal disputes, do it. You also get the benefit of establishing a long-term relationship that will last well past this pandemic.
- **Research Resources Your Tenants Can Utilize:** Be sure to find out as much information as possible about support for businesses affected by COVID-19. Not only is this information helpful to you, you can also help your tenants with this information. Information about the Federal CARES Act¹ or other state and local support can be vital to firms in the current environment. Health code updates or other public policy changes are also important to share.
- **Develop a Rent Forbearance Application:** While decisions on forbearance decisions will be case-by-case decisions, property owners should develop standard processes and forms for their tenants.² This ensures a transparent process that is unbiased toward any certain tenant. Work with your legal counsel and other consultants to ensure this form is not a legal liability.

¹ https://www.naiop.org/en/Education-and-Career/COVID-19/Legislative-Actions/~/_link.aspx?_id=2D932EDB335A47B9B391DD2B19E0C9E9&_z=z

² <https://www.multifamilynw.org/news/new-forms-rent-forbearance-request-and-emergency-covid-19-agreement>

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- **Determine Your Preferred Repayment Strategies:** Only you and your ownership team know your finances. You should explore the options for rent relief and deploy the best one for your financial situation. According to the CCIM Institute³, some of the options include:
 - **Rent Reduction:** The landlord can choose to reduce the tenant's rent for a portion or all of the term left on the lease. The usual forms of rent reduction are to reduce the base rent, operating expenses, or both. For retail, it is possible to convert base rent to percentage rent. This is the least attractive option to most landlords.
 - **Rent Deferral:** The property owner can defer a portion of the tenant's rent but would require them to repay the rent deferred at a later time, either in a lump sum or by increasing subsequent payments.
 - **Rent Abatement:** If a tenant is significantly past due on rent payments, a landlord may agree to forgive a certain amount of the past due rent if the tenant remains current thereafter.
 - **Loan Conversion:** Rather than abating past due rent, a landlord may agree to convert the past due rent into a loan payable over time. The tenant would, however, continue to pay the current rent. The loan is then evidenced by a promissory note that is cross-defaulted with the lease.
 - **Application of Deposit:** If the landlord holds a deposit, this amount could be credited against the tenant's current obligations. Often landlords may require replacing this deposit over time.
 - **Subletting:** Bringing in a new tenant (for part of or all of the rented space) could reduce or eliminate the rent obligations while replacing revenue for the landlord.
- **Work with Tenants to Achieve a Solution:** Unresolved and unaddressed concerns are not good for either owner or tenant. It is in the interest of both parties to seek a resolution and avoid litigation if possible.

³ <https://www.ccim.com/rentrelief/?gmSsoPc=1>

4. CONCLUSION

While there are no certainties in these turbulent times, we believe that both property owners and tenants can avoid legal disputes by utilizing the strategies outlined in this guide. Additionally, we believe that by following these strategies, our city and region can avoid the domino effects from this economy. At the end of the day, it will be up to the property owners and tenants to work these issues out on a case-by-case basis, but we hope everyone remembers that this is a time for compassion. A small amount of deference and sacrifice can go a long way and keep relationships intact. These relationships will be key to getting this economy growing again. We at NAIOP Pittsburgh and the City of Pittsburgh hope this guide is helpful to you and your companies.

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