

THE GREAT TENANT BAILOUT of 2009

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"I got the call today that I didn't wanna hear, but I knew that it would come"

Don Henley

If you are an owner, broker or manager of commercial real estate, it is a matter of when - not if – your commercial tenants will look to you for rent relief to help them survive these unprecedented times.

Blockbuster has hired KMPG to renegotiate or terminate the lease on every store in the chain. Mattress Discounters and Sleep Train are asking for across-the-board rent concessions. Starbucks has closed some locations and is asking to exercise its options for less than the contract rate on other locations. 2009 is starting to look like the hard-hit retailer's version of TARP, with unwitting Landlords playing Uncle Sam.

While retailers are currently the hardest hit amongst commercial tenants, office tenants are struggling too, particularly if they receive any funding from local or state governments.

Your response to these requests will determine the fate of some of these tenants –so how do you respond when they come knocking at the door?

First, gather all of the facts. The tenant should be prepared to provide you with recent, audited financial statements and sales records for the location in question if they are asking to change the terms of their contract.

Second, understand your options. A tenant with a cancellation clause in its lease has significantly more leverage than one with no outs. Similarly, a tenant with 18 months on their lease may elicit a different response than one with eight years remaining in their lease term.

Third, consider the source. Has your tenant always paid their rent on time and followed the terms of its lease? Or have you had to struggle to collect the rent every month? The credibility the tenant has developed with you to date will factor in to your decision about what concessions, if any, you are willing to offer.

Next, calculate the risk-reward ratio inherent in each request. You are within your rights to decline a request for a lease adjustment, but your tenant may be equally within its rights to reject your lease if it files for bankruptcy. Determining the best option is the hardest part of any lease re-negotiation, and the one most likely to cause some sleepless nights.

Finally, look for the silver lining. Is there a lease clause you'd love to eliminate? Reduced rent now for percentage rent on the back end? A skilled negotiator can find a way to make the situation more palatable for both parties.

As an example, Promus was recently approached by the long-term, primary tenant in an office building our clients had recently purchased. The tenant requested rent relief, and threatened to exercise their cancellation provision if help was not forthcoming.

A face-to-face meeting with the tenant's CEO revealed that the tenant really did not want to move, but had lost over 10% of its revenues and laid off staff due to recent government budget cuts.

This was a situation calling for a creative solution, and due to the tenant's non-profit status we were able to craft a win-win solution.

Non-profits are generally exempt from property taxes. As part of an overall re-positioning of the property, we negotiated a new lease, shifting the responsibility for property taxes to the tenant¹. The tenant, as a non-profit, can apply to the County for a waiver of these taxes.

We also agreed to take back about 20% of the tenant's space in return for a two and-a-half year extension on their lease and a slightly higher per-square-foot rental rate.

At the end of the day, the tenant reduced their total cash outflow by 13% and gave back excess space. The landlord, in turn, will reduce its exposure by adding multiple tenants to the building and will increase its cash flow by 12% over the previous lease when the spaces are leased. The extra cash flow will pay back the cost to re-tenant the spaces in six months, and add close to half a million in value to the property. What seemed a negative – a major tenant downsizing – had a positive outcome for both parties.

Landlords and tenants alike are entering uncharted territory in 2009. The economy is shriveling, and the bell tolls daily, it seems, for once-vaunted retail chains and financial institutions. Tenants are hurting and turning to their landlords – who may also be struggling – for help.

To help navigate the road ahead, it is wise to surround yourself with trusted advisors. Your CPA, legal counsel and CCIM advisor are all integral parts of the team.

Certified Commercial Investment Member (CCIM) is a designation bestowed upon less than 10% of commercial real estate practitioners nationally. CCIMs are highly skilled real estate practitioners, recognized as experts in the fields of commercial real estate and investment. They are a trusted resource to commercial real estate owners, and a great resource for tenant bailouts.

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¹ Each lease transaction is different, so contact your legal and accounting advisors before committing to a lease to ensure you understand the legal and tax ramifications.