A "TENANT'S PLAYBOOK" TO COVID-19

Newmark Knight Frank's Tenant Playbook is intended to be a resource to help tenants gain a clearer understanding of existing leases and challenges and devise a strategy, during the pandemic.

DEVISE A COHESIVE STRATEGY

Most important to a tenant's business continuity, today, is understanding and staying up-to-date on the evolving situation; implementing a flexible strategy; and remaining focused. A well-thought-out and tailored preparedness plan impacts tenant survival now and into the uncertain economic future.

CASH IS KING

In this environment, protecting cash-on-hand is essential for businesses and tenants. Considering natural fluctuations in business (e.g., seasonal sales), comparing current and historical financials provides a tenant an intimate understanding of the pandemic's impact on the top-line (gross revenue) and bottom-line (net profit). Rent obligations will stand out among the largest impacts to cash-on-hand.

COLLABORATE TO FIND A LEASE SOLUTION

Reviewing and scrutinizing the existing lease prior to a conversation with the landlord allows a tenant to approach the situation with one solution, or several options. Asset owners, tenants and their advisors must work collaboratively to identify a path forward. A trusted advisor, such as Newmark Knight Frank, can guide tenants through the process:

STEP 1 LEASE AUDIT

Review the following sections of the lease agreement:

- **Rent –** What does the rent payment comprise (e.g., base rent, pass-through expenses) and what are those amounts? When is the next scheduled increase and what is the amount?
- **Lease Expiration and Options –** When does the lease term end? What option(s) remain (renewal, cancellation, contraction) and what are the business terms of the option(s)?
- **Default –** What constitutes a default of the lease and what are the landlord's remedies if a default occurs (late penalties, interest, eviction, damages)?
- **Guarantees –** Outside of the tenant's business, who may be liable in the event of default?
- **Security Deposit –** Does the landlord hold a security deposit, and if so, what is the amount?
- **Operating Covenants and Co-tenancy (applicable to retail centers) –** Is the tenant required to stay open for business, and if so, are specific hours and days required? Is the landlord obligated to maintain certain tenants or a certain occupancy-level?

- **Insurance –** What coverage is each party required to maintain? *(Note: relevance of coverage to the current situation should not be assumed; seek the advice of an insurance agent.)*
- **Force Majeure –** Does the "Act of God" clause excuse either party's performance when outside circumstances intervene? *(Note: Force majeure clauses differ; an attorney should analyze each clause to determine what triggers it and the results before making a final determination on a given lease.)*

STEP 2 PREPARE

- Insurance coverage may provide parties the best recourse in the current situation; an insurance provider can outline the possibility of a claim under policies carried by either tenant or landlord. However, the insurance industry's exclusion of disease outbreaks from many policies (in response to the 2003 SARS outbreak) makes coverage uncertain.
- Government relief programs, such as the Coronavirus Aid, Relief and Economic Security (**CARES**) Act and its fiscal measures (stimulus, tax relief, etc.) should be evaluated by tenants. Additionally, the Small Business Administration (**SBA**) has provided online resources for companies with under 500 employees that may be eligible for government funding to cover payroll, lease and utility payments.
  - Consulting a lawyer with relevant expertise will help tenants determine available legal options, including those that don't appear within the four corners of the lease agreement.
  - Tenants should take note of the length of tenancy and whether there have been past instances of default.
  - Based on an evaluation of the tenant's financial position, propose the terms of a realistic rent concession in both a best-case and worst-case scenario.

STEP 3 LANDLORD DISCUSSION

- Contacting the landlord directly or enlisting an advisor to set a meeting, the tenant should effectively communicate the current impact on its business and be transparent, collaborative and in possession of the information outlined above. An open conversation between tenant and landlord is necessary to help identify a solution or combination of solutions agreed to by both parties.
- There are numerous creative ways a solution could be structured, including:
  - **Rent Reduction** – The most likely solution is a rent reduction or deferral. The reduction or deferral could be for a certain time period, on a month-to-month basis terminable by the landlord with 30-days' notice, or structured as a deferral, requiring that rent be repaid at a later date. If conditional, rent is forgiven based on a future condition such avoiding default, or if absolute, no repayment is required. With an absolute rent reduction or deferral, a small consideration (such as a maintenance obligation) should be offered in exchange for enforceability. Landlord incentives - likely necessary for a rent reduction - include:
    - In a deferral, tenant adds interest or straight-line amortizing to the future rent repayment obligation;
    - Tenant commits to an extended term, at a market rental rate with market concessions;
    - Tenant provides the landlord with new security such as a personal guaranty from tenant or a credit-worthy "co-signer."

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- **Application of Deposit** – If the landlord holds a security deposit and the tenant has been good to-date, the deposit could be credited against current rent obligations.
- **Transfer** – A tenant might approach the landlord about the subletting or assignment of space, which could reduce or even eliminate a tenant’s rent obligations. If space can be shared or subdivided, the current tenant could continue to operate. The landlord might know a potential replacement subtenant, or the tenant could identify a replacement (or work in conjunction with an advisor such as Newmark Knight Frank).
- **Buyout** – Another option is a lease buyout, meaning the landlord agrees to terminate the lease in exchange for a (hopefully affordable) payment. This may allow the tenant to continue operations at a new location, perhaps after a short hiatus.

- For most landlords, losing tenants is disruptive and costly, incurring major costs in the form of income loss and expenditures such as legal fees, brokerage commissions and tenant improvement costs. Landlords have mortgage commitments and may have co-tenancy covenants in other leases or loan documents. Worse yet is a tenant bankruptcy, which subjects the landlord to bankruptcy rules and puts control of the lease in the hands of a bankruptcy court.

CHALLENGING, BUT ESSENTIAL

Though addressing and re-evaluating this business component in a time of crisis is a difficult task, lease obligations are an important consideration for any business that operates out of rented space and, as such, the process warrants careful attention. For further advice from experienced and dedicated industry professionals, please contact Newmark Knight Frank.

WE ARE HERE TO HELP!