

REFLECTIONS OF A LANDLORD'S ATTORNEY ON 2009 AND A LOOK FORWARD TO 2010

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The numbers are in for 2009, and the news is no surprise. It was an ugly year for landlords. Dozens of national tenants filed bankruptcy, and hundreds of smaller tenants failed locally. As one who speaks with landlords daily, I think I can make a fair assumption that most of the surviving tenants are struggling to make ends meet. Rent reduction amendments are occurring locally by the hundreds, and landlords are struggling to pay their mortgages as a result. However, there may be some hopeful signs in these early months of 2010.

In Sacramento's Bankruptcy Court, bankruptcy filings increased 95% in 2007, 71% more in 2008, and 48% more in 2009, to a 2009 total of 28,768. The number of tenant bankruptcy cases handled by our firm for landlord clients increased 83% in 2007, 144% in 2008 and 200% in 2009. While small business bankruptcies are on the rise, similarly, many regional and national tenants, like Mervyn's, Linens & Things, Circuit City, Washington Mutual, Financial Title, Gottschalk's and Hollywood Video, are also resorting to bankruptcy.

Commercial tenant evictions are also on the rise. In our firm alone, we opened 1,316 problem tenant files in the past three years, almost two per business day. As those of you in property management know, the increase in commercial cases, combined with dramatic increases in residential tenant evictions, has overwhelmed the court system, which is now operating on tighter budgets with many temporary court clerks. These delays have caused the commercial eviction process, that used to take about 35 days from start to eviction, to increase to two months or longer in some jurisdictions until the Sheriff actually removes the tenant. Routinely, once the tenant is out, we perform a detailed asset check of the former tenants to determine if it will be worthwhile to pursue collection of the judgment. What we are finding, time and time again, is that, especially with smaller tenants, there simply are no assets left with which to satisfy the judgment against the tenant and the guarantor. Home equity has evaporated, bank

accounts are empty and credit cards are maxed.

Obviously, the failure of tenants to pay rent is causing more and more landlords to lose properties. Through 2011, an estimated \$530 billion in commercial real estate loans are coming due. Foreclosure on retail properties has increased 500%, with office foreclosures increasing approximately 151%. A commercial borrower facing refinancing has to deal with lower property values, sharp declines in rental income and severely limited primary and secondary lending sources. The problem is only exacerbated by the fact that there are fewer prospective tenants available to fill the commercial vacancies.

The key for landlords continues to be the retention of existing tenants during the next two to three years until the economy and lending environment dramatically improve. Tenants are continuing to request rent relief from landlords, and many landlords, in order to retain tenants, will have to seriously consider some form of temporary rent relief. From the more than 100 rent relief amendments that we have handled, here are some negotiating strategies that we have seen:

1. Require the tenant to provide a business plan. What is the tenant going to do to increase sales? Would the landlord's dollars be better spent on promotions to bring people to the center in order to assist all tenants? Will increasing foot traffic to the center significantly assist all tenants, so that the net benefit to the landlord may be greater than by assisting a few tenants with rent relief?
2. If the tenant is a franchisee, consider rental reductions only if the franchise is a good franchise and the franchisor is willing to provide a similar reduction in the royalty fees. The landlord should not be the only party willing to make concessions to help a franchisee succeed.
3. Rent reductions should be temporary, not permanent. The length of any reduction depends on the overall viability of the center, the business acumen of the tenant, the nature of the tenant's business, and the number of years remaining on the lease term. Rent reductions for three to six months, but not more than 12 months, are recommended. If the tenant is in arrears at the time of the request, will the arrearage be deferred or forgiven? Again, the approach to this question depends on the financial stability of the tenant. However, if the tenant defaults at any time thereafter, all benefits should be revoked and all arrearages, plus the differential between the

reduced rental amount and the contract rental rate, should be due and payable immediately, even though the tenant likely will not be able to pay this amount.

4. If the arrearage is to be paid back, will the arrearage be amortized over the remainder of the lease term, or amortized over a shorter period of time? Another approach would be to forgive the arrearage if the tenant exercises an option to extend the lease term, or extends the lease term at the time of and as consideration for the rent reduction request. Yet another approach is to simply forgive the rental arrearage if the tenant completes the then-existing lease term without further default.

5. In return for the rent reduction, try and extract some benefit such as the extension of the lease term, waiver of any options to extend or early termination rights, waiver of exclusive uses, an estoppel certificate, a release of claims, additional forms of security, a personal guaranty or any other benefits.

In evaluating whether to agree to a temporary rent reduction, always anticipate the likelihood of a subsequent bankruptcy. The terms of any rent reduction should always be memorialized in writing, whether in the form of a lease amendment or, following a rental default, through the use of stipulations for judgment.

For the landlord's benefit, a unilateral termination or recapture right might be advantageous during the rent reduction period, or at any time through the balance of the lease term, as consideration for rent relief. The memorializing document should contain estoppel language in favor of the landlord to prevent the tenant from asserting any claims against the landlord.

Landlords might also consider obtaining a security interest in the tenant's trade fixtures and equipment as consideration for the rent relief and as security for future performance of the lease. This is particularly important if the trade fixtures and equipment will improve releasing efforts.

The playing field has been dramatically changed during the past few years. Yet, even in this economy, there are strategic options available to landlords to make the best of a difficult situation. For more case-specific ideas, contact "Candy Harper." :mailto:charper@trainorfairbrook.com

On the positive side, during the first two months of 2010, problem tenant files handled by our firm have dropped almost 50% over the first two months of last year. Whether that means the economy is improving or the majority of the weak tenants have been weeded out remains to be seen. However, it does appear that leasing activity is increasing, albeit at tenant friendly lease rates. Nevertheless, in this economy, anything positive is a welcome sign.