



rent resolutions for a weak economy

IREM MEMBER REVEALS WAYS TO WORK WITH COMMERCIAL TENANTS IN HARD TIMES by Richard Muhlebach, CPM®

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any commercial tenants encounter financial challenges during a weak economy and some will have trouble keeping their rent current. Retail tenants are among the first businesses to suffer when the economy becomes fragile, as most people typically reduce their expenditures on just about everything except for essentials. National retailers will develop a



plan to survive a weak economy and often come out of it stronger by shedding poor performing stores, refocusing on their core cliental and cutting costs.

During an economic crisis, some national retailers will announce store closures and a few will file for bankruptcy. Local retailers, who make up a large percentage of the tenants in unanchored and anchored strip shopping centers, face additional challenges. They usually have one store, so the success of that store determines their fate. Because each retailer contributes to the success of a shopping center, if one is failing and eventually goes out of business it can cast a poor image on the shopping center. In a good economy this tenant is usually replaced in a few months and the shopping center continues to do well. However, in a poor economy, vacancies take much longer to lease and are often lease at reduced rents.

As property managers, our typical response to tenants

who cannot pay rent on time is to work with them for a only short period of time. If the problem persists, it may be easiest to replace the tenant. However, a weak economy can often make it difficult to replace tenants, so in these challenging times, property managers and property owners must find non-traditional solutions to the problem.

Some of the solutions provided below will sound distasteful to many property owners, but in extenuating circumstances they may be the only ways to save tenants and the rental stream the tenant spaces provide. Before considering any of these solutions, you should analyze the impact of vacancies on your properties, especially shopping centers.

MARKET FACTORS

The most important factor to consider is the financial status of the property and possibly the property ownership. Can the property absorb additional vacancies and loss of income? For how long? The next factor is the condition of the leasing market. How long will it take to re-lease a space? What will it cost in lost rent, rental concessions, tenant improvements and other leasing costs to replace tenants? If the property is a shopping center, what impact will additional vacancies have on the traffic to the shopping center, the image of the shopping center, and the morale of existing tenants and tenant prospects' perceptions of the shopping center?

As the property manager, if you determine the cost to replace a tenant who is experiencing financial difficulties to be too high or want to save a tenant who has been an asset

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to the property for several years, you may consider the solutions below.

DETECTING POTENTIAL PROBLEM TENANTS

The most obvious sign of a tenant with a potential financial problem is late rent payment. Other signs include declining sales, low inventory, old merchandise on the shelves, changes in the store hours and staffing, and a reduction in store advertising. A good rapport with your tenants will give them the confidence to be open about any financial problems they foresee or are experiencing.

A tenant who has serious financial problems is likely to ask for help, usually in the form of a rent concession. Before suggesting solutions to the property owner, you should obtain the tenant's current financial statement. If the tenant has multiple stores or businesses, the financial statement should be obtained for each. These additional businesses may generate enough cash flow to support the struggling store.

The tenant's personal financial statement should also be obtained. The net worth of the tenant may not justify any of the solutions suggested below. With this data you can recom-

mend to the property owner a discussion, and possibly an offer, of any of the following solutions to the tenant.

POSSIBLE SOLUTIONS

As a property manager, you can develop non-direct monetary and direct monetary solutions for tenants who are struggling during a weak economy and a depressed leasing market. The non-direct monetary solutions are usually permanent while the direct monetary solutions are typically temporary. Some of these solutions are primarily for retail tenants while others apply to all commercial tenants.

NON-DIRECT MONETARY SOLUTIONS Tenants may have more space than they need or may not be able to afford all the space they occupy. Reducing tenants' square footage will reduce occupancy costs. Base rent and pass-through charges will also go down. If tenants are in a shopping center, utility costs will be reduced as well. Smaller stores may also determine that they can operate with fewer employees and cut labor costs.

Relocating a tenant to either a smaller space or a space with a lower rent is another non-direct monetary solution. The factors that determine whether or not this is a viable option are the tenant costs to relocate and the availability of smaller spaces.

It may also be beneficial to expand a retailers' use provisions to allow them to sell additional merchandise. However, you must be certain this will not have a negative effect on the tenant mix at the shopping center, or on the sales of other retailers.

Many local retailers do not have the resources for training, so you may wish to consider hiring consultants to present mini seminars and one-on-one consulting sessions for your tenants. These programs should not be motivational, but provide retailers with insight into developing a merchandising plan, markdown policies, in-store signage, window and in-store displays, budgeting and selling techniques. The goal is to help retailers become more successful merchants. Retailing consultants typically charge \$1,500 to \$3,000 per day. Three two-hour seminars with 15 hours of consulting time for 10 merchants could cost between \$4,500 and \$9,000, plus travel expenses.

If an owner of a shopping center is considering whether or not such a program is worthwhile, you can tell the



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owner that the expenditure is an investment into the shopping center's most important assets—its tenants. Many regional malls have implemented these programs during weak and strong economies.

A mutual lease cancellation is another option. The property owner should expect a lease cancellation fee from the tenant. There is no rule of thumb for what a lease cancellation fee should be. A lease cancellation eliminates a problem tenant, but it also creates a vacancy.

DIRECT MONETARY SOLUTIONS Offering a tenant any form of direct monetary relief is a very unappealing solution to property owners; however, this is sometimes the only way of saving a tenant, avoiding a vacancy and collecting some rent. Listed below are different forms of rent relief:

Deferred Rent • The tenant's current delinquency and some future rent, possibly the next six months rent, is deferred and paid back during a later period such as the last 12 months of the lease. The entire monthly rent or a portion of each month's rent can be deferred for six to 12 months. Some property owners want to charge interest on the deferred amount, but the total interest amount is insignificant. Why add that burden to a struggling business?

Percentage Rent Only • Most retail tenants pay more than their minimum rent or rent based on a percentage of their sales. Merchants whose stores are underperforming will often pay minimum rent and no percentage rent because of low sales. A tenant's lease can be amended so the tenant pays only percentage rent for a specific period, such as one year. The percentage rate can be the current rate in the tenant's lease or it can be increased a few points. When the year is over, the rent returns to the minimum rent versus rent based on a percentage of sales.

Rent Forgiveness • This is the most difficult form of direct monetary relief for property owners to accept. All or a portion of each month's rent for a specific period is waived and not paid back. Again, the purpose is to help the tenant survive and to collect full rent again in the future.

The property owner may require that a percentage of the rent forgiven be used for additional advertising by the tenant or for new merchandise.

Security Deposit • All or a portion of the security deposit may be applied to rent owed or future rent. The property owner is not giving up anything since the security deposit would be used to partially cover the tenant's monetary default if the tenant is evicted for nonpayment, or if he vacates the premises owing rent.

RENEGOTIATING THE LEASE

If a rental concession is offered, you should review the lease for any onerous lease provisions. These lease provisions can be renegotiated or eliminated as a concession to providing direct monetary relief. Any concession should be documented in a lease addendum. The addendum should also include a confidentiality provision stating that if the tenant discloses the concession, the agreement is immediately cancelled, and the rent and other charges revert back to what they were. It is rare for a tenant to tell neighboring tenants his business is doing so poorly that he requires rent relief from the landlord. The addendum should also state that the tenant has no claims against the landlord.

Although non-direct monetary solutions, and especially direct monetary rent relief are not advocated in every situation, they do offer temporary solutions to immediate problems in a difficult economy. In some cases rent relief may be the only solution. ■



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