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Rental Relief-Necessary Evil or Delaying the Inevitable?

By Natalie Dolce



Nielsen

ORANGE COUNTY-Given the economic conditions everyone is currently experiencing, a question that continually arises in the industry from tenants is "How do I get my rent reduced," or from landlords: "Should I agree to reduce my tenant's rent?" And when rent is typically one of the highest expenses as associated with running a business, more and more tenants are requesting a rent reduction from their landlord. However, under what circumstances does a rent reduction make sense to both the tenant and the landlord? Brad Nielsen, a partner in the office of the law firm of Allen Matkins Leck Gamble Mallory & Natsis LLP, and Randolph Mason, a senior vice president and one of the partners of Lee & Associates - Irvine Inc., take a look at this

question in the article below, and explore compromises they currently see in the marketplace.

Landlord's View:

One might ask, "Why would a landlord ever reduce its tenant's rental obligation when there is a valid and enforceable lease contract in place?" The bottom line is: if a tenant goes out of business in this economy, it's possible in many markets that the tenant's space will sit vacant for many months. In this scenario, the landlord will neither be receiving base rent nor will they receive a reimbursement of any of the property's operating expenses from the tenant, such as taxes, insurance, maintenance, landscaping, etc. For this reason alone, some landlords are willing to work with the tenant and agree upon a rental amount that tenant's business can sustain during the short term.



Mason

Now, assuming tenant and landlord can come to an agreement on a reduced rental amount, typically the landlord will ask for an extension in the tenant's lease term (in order for the landlord to recoup its temporary reduced rent), along with other assurances that the tenant will continue to timely make its rental payments throughout the extended term. Such other assurances that may be considered would be: an increase in the security deposit (however, most likely the tenant does not have the extra cash, otherwise they would have been timely making their prior rent payments); a letter of credit for a specified amount; or a personal guaranty on the lease from a credit worthy entity or individual affiliated with the tenant. Such assurances allow landlord to

become comfortable that the tenant is committed to keeping its business running and paying its future rental

obligations.

However, landlords providing rental reductions pose various obstacles. First and foremost, landlords typically buy buildings with debt with the belief that the rents received will offset the mortgage and other expenses and hopefully provide some level of return on investment. Any rental reduction will obviously affect the landlord's return on investment. Decreased rents can also impact the ability of the landlord entity to maintain and provide certain services to the building, which in turn can affect the likelihood of leasing vacant spaces, which further impacts the cash flow of the property. As a result, a rent reduction may not be an alternative available to every landlord out there.

Tenant's View:

Differing greatly from landlord's intentions, tenant's typically ask for rental relief due to the fact that the cash flow from their clients is decreasing or their accounts receivable is aging longer into the future, both circumstances creating a precarious position for the tenant to pay their bills. Case in point, a client recently showed us a letter that one of their clients systematically distributes to all of their vendors asking for a no questions asked 10% decrease in funds due. It was pretty much, please sign this form and we will continue to use your services. A few nationwide retail tenants have also sent out similar letters to "all" of their landlords across the country.

We also have numerous other clients whose gross revenues are off dramatically and who are attempting to renegotiate their leases with their existing landlords. The landlords are asking for current income statements and balance sheets, along with an explanation as to how the tenant proposes to increase their future revenues in order for them to stay in business. Basically, the landlord is looking for their business plan, a reason to grant a rent reduction and comfort that the tenant is going to survive the current down economy. As a result, a tenant seeking a rent reduction should gather all this information upfront and approach its landlord with its best foot forward. Landlords need to believe that it is worth "betting" on its tenant's business and that the landlord's loyalty will pay off in the future.

Conclusion:

We believe we will see more of these requests coming in the future months and there needs to be some up front, candid discussions early on between the tenant and landlord. Additionally, the tenant needs to understand a landlord's motivation and vice versa. No one wants to "delay the inevitable," so tenants should come to the table armed with evidence of how it plans on weathering the current economic downturn.

The views expressed in this article are those of the author and not GlobeSt.com.

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