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"Relief For Retail Tenants in the Post-Bailout Era"

We doubt that anyone would quarrel with the statement that the economic shocks of the current mortgage meltdown are giving everyone anxiety except the bankruptcy lawyers (our firm doesn't do it!). But as a distinguished Omaha investor once said, "Be greedy when everyone else is cautious and cautious when everyone else is greedy". Otherwise put, retail tenants may soon see a silver lining in the present economic crisis. Even the most cautious landlord is faced with the realities posed by the current credit markets, which may impact its ability to meet mortgage payments and pay other operating costs. If the building or mall containing your store was purchased during the years of plentiful credit, it is probably subject to high debt and your landlord in a difficult bind when dealing with tenants facing sales downturns and wobbly margins. Because the owner is faced with meeting its own substantial debt-service payments (in addition to other expenses which have inched upwards, such as maintenance, payroll, insurance and the like), it may find its options severely limited. Owners may expect to receive, at least over the near term, a steady parade of tenants seeking concessions not only due to a slowdown in consumer spending but also to vacancies in the neighborhood and related factors. And while there is some humor in the old story about the tenant who never asks permission to pay more rent when times are good, the reality is that most landlords want to be in a position to accommodate a long-time reliable tenant, for doing so not only creates obvious good will, but cuts down on re-leasing costs such as upgrades, leasing commissions, "dark" time and so on. Many owners have that invaluable "slack", if you will, to take a hit on the rent in order to keep you as a tenant.

It would thus seem that now is the time to seek rent relief or other form of landlord assistance. It is important to do whatever due diligence of the landlord is possible since the landlord may have its own problems such as short mortgage maturity, tenant issues and a need for working capital which may limit your landlord's choices. For today, owners seeking working capital must deal with investors holding back because of a perceived lack of credit available to refinance the building, thereby attributing to it a diminished value.

What to do? There are avenues on which to approach your landlord, each of which hold out advantages for you, but potential disadvantages to the landlord. It is essential to have a concrete proposal in mind and be sensitive to the landlord's needs.

Possible proposals may follow several templates:

- reduce the base rent – this will lower your total monthly carrying costs the most, as well as free up cash for operations. Disadvantage to landlord: reduces landlord's cash flow and may put landlord in default under its loan agreements; it may also signal to other tenants weakness on the part of the landlord

- reduce contributions for real estate taxes and other reimbursements. Disadvantage to landlord: exposes landlord to payment of the charges if the economy deteriorates further and vacancies occur

- defer a portion of the monthly rent by accruing rent to maturity or an extended date; while reducing monthly costs, it poses the threat of a high payoff at maturity, when credit may be even tighter, and adds payables to the balance sheet. Disadvantage to landlord: it will wait longer to recover its investment, compromising credit quality and possibly diluting opportunities to refinance its loan, as well as presenting collection issues

- take advantage of so-called concessions – these are frequently used as a means of reducing financial obligations of tenants while allowing the landlord to preserve its "face" rent under the lease. These take the form of assisting in tenant buildouts, picking up advertising and promotion costs, subsidizing taxes and insurance, funding brand development and the like. Depending upon tax considerations affecting the parties, the tenant in exchange may offer the landlord a participation in the equity of her company, or a direct profits participation in the business through a joint venture, carried interest or similar arrangement. The advantages to the tenant of lowering rents are obvious, but the giving away of potentially valuable equity is not. The short-term amelioration delivered from loosening the rent noose may be costly later. From the landlord's point of view, it makes much more speculative the landscape from which investment recovery may be viewed.

- Re-set basic lease terms in order to obtain indirect relief. These take the form of reducing or reconfiguring space, permitting subtenants or leased departments and the like. These often result in less pain to the landlord and may be worth pursuing in lieu of the alternatives discussed above--they raise complexities, however, which should be reviewed in advance with a real estate professional.

Weighing the pros and cons of the various approaches is the most difficult part of the exercise, which should be performed in conjunction with accounting and legal advisors, bearing in mind first and foremost obtaining the greatest advantage to your business plan with the least cost. We have found the current market to be conducive to open and frank discussions on both sides, which is the one possible improvement over market conditions we enjoyed in the boom times of the early decade.

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