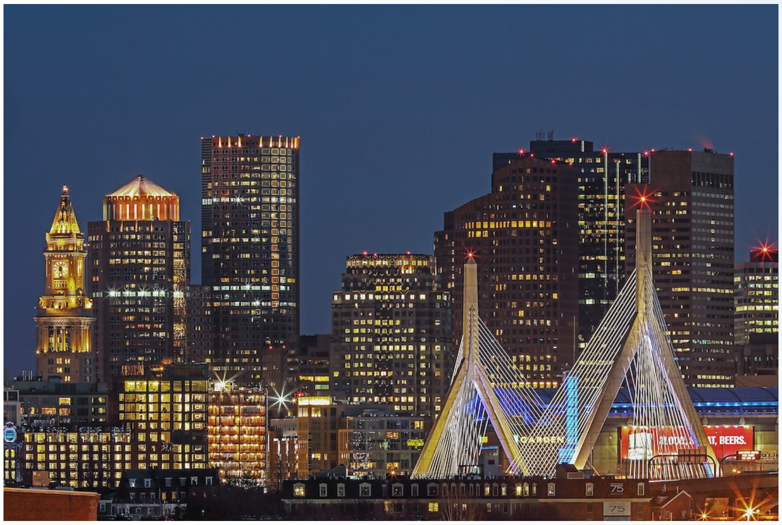

THOMPSON HENNESSEY & PARTNERS
COMMERCIAL REAL ESTATE ADVISORS

Commercial Real Estate Insights

Newsletter Highlights

- Understanding your Lease
- Potential Relief Options
- Step by Step Approach
- Restructure Options
- Monetizing Owned Real Estate
- Where the Market is Trending

COVID-19 Bulletin: Issues affecting tenants and suggested resolutions for business owners

The effects of COVID-19 are being felt by businesses owners and individuals in every sector of our economy. While the long-term effects are unknown, certainly in the near term every business will be experience declining, and in some instances, receive no revenue whatsoever. Yet most will still incur business operating expenses including office space overhead.

While most landlords may be anticipating the need to work with tenants experiencing financial difficulties, bear in mind that your landlord will also be experiencing financial challenges including their need to continue to pay vendors and service their debt obligations. Each owner's ability to provide assistance will vary depending upon many factors including whether they are publicly or privately held, the capital stack (debt and equity) structure of each property, the nature of the tenancy, and whether an asset is owned individually or in a portfolio of other properties.

For many tenants a two-fold need is arising. The first may be short term financial relief until such time as they are able to re-occupy their premises and begin to deliver goods and services. The second may be the need for longer term relief in the form of an overall restructured lease if a company is fundamentally sound but may not be profitable again until later this year. The following are some strategies to help both you and your landlord reach a mutual resolution so both can remain financially viable. **While legal action may be an option, we strongly urge that you first start with an open honest dialogue clearly articulating your needs and not simply take an adversarial position.**

While these events will have a dramatic negative financial effect on every business, this presents an opportunity for companies to re-evaluate their operations including seeking ways to reduce real estate expenses and improve operating efficiencies going forward. For the foreseeable future expense reduction, not increased productivity, will be the key to maintaining solvency.

A STEP BY STEP APPROACH

1. **Consult your advisors**. This includes legal counsel, accountant, real estate advisor, insurance agent and lender who all need to work in concert to develop a manageable plan of action.
2. **Understand the key terms of your lease** including Sublease and Assignment, Force Majeure and what may constitute a Default.
3. **Review your Business Interruption and other relevant insurance policies.**
4. **Determine what relief you are looking for.** As referenced earlier, given the long-term effects are unknown, it will be important to focus on what you will need for help in the near term. Just like a company seeking financing, you need to justify a fact-based case.
5. **Prepare comprehensive information for your landlord**: This includes detailed financials and projections including a description of how the rental relief will be applied back into your company.

YOUR LANDORD'S RESPONSE

"While everyone recognizes the unilateral effect this will have on every business, it is important that you evaluate your situation in a vacuum and specifically determine the best course of action for your company and employees"

1. **Request a form of Rent Relief Application from your landlord**. In it your landlord may include a request for a PFS, operating statements, receivables, and contracts.
2. **Present a fact-based business plan** outlining specifically what you need and why, including your strategy for business recovery <u>and succession plan.</u>
3. Should the parties agree, eventually **a legally binding lease amendment** will be executed. Possible terms are:
   - *Add deferred months to the end of the current term*
   - *Split deferred months into installment payments (6-12 months) which can be paid during the last year of the lease.*
   - *Amortize the deferred months over a 36-48 month period following the deferral period.*

Note: It will be important to understand what interest rate the landlord will be applying as there may be other credit facilities available including bank financing and other governmental assistance programs which may be more cost effective. It is also important that whatever information you provide to your landlord, they will in turn be providing to their financial institution and equity partners so your request *needs to be well-articulated, concise, and accurate.*

ADDITIONAL CONSIDERATIONS

Manage your expectations. Landlords will be inundated with requests from tenants including some threatening legal action. If your lease is expiring in the next 6-12 months, your landlord may be unable to discuss a long-term renewal or extension at this time. That being said, it will still be important to be mindful of your lease renewal notice dates, any "Holdover" language, and your obligations after your lease expires (Restoration Clause).

Avoid Default. While clearly these are extraordinary circumstances, you still need to be careful to avoid defaulting on your lease. Going forward many tenants may elect to sublease their premises so it will be important to understand your rights and obligations under that clause among others.

Overall lease restructure and extension

In the near term most may simply seek a for a deferral on rent and operating expenses. However, restructuring and extending your lease longer term may be of mutual benefit to both you and your landlord down the road. In some cases, a landlord may consider a lower rental rate or a modification of other terms such as an updated tax/operating expense base in return for an extended term. This is usually achieved through a financial exercise whereby the credit value of the newly restructured lease can be monetized by the landlord in a sale or refinance.

Monetizing owned real estate

If you own both a business and the real estate, there are a few ways that you may be able to raise capital. For fundamentally sound companies, financing owned real estate will continue to be an option as interest rates should continue to remain very low for the foreseeable future. In addition, a **Sale-leaseback** transaction whereby you sell your property and execute a long-term lease with the buyer, is an effective tool to raise capital and one for which investors continue to pay a premium.

Real Estate Building Vendors and Suppliers

While no one recommends taking advantage of your service providers during this difficult situation, the simple fact is that goods and services will be re-priced. As landlords work with their suppliers to reduce expenses, those savings should be passed on to tenants. That includes reduction in construction pricing, cleaning, utilities, insurance and property management services, as well as any reduction in the cost of debt when a building is refinanced.

WHERE IS THE MARKET HEADED?

General Expectations

It is clear that when companies return to work on a full-time basis, most will have suffered severe financial setbacks and in many cases will have already negotiated some form of rent abatement. Those companies entering into new leases will be seeking to reduce real estate expenses and therefore may take less space and at lower rental rates. Also, we expect a large amount of office space to become available through the sublease markets. The overall effect is that *vacancy rates will begin to rise and rental rates will begin to decrease*. We anticipate that the most affected sectors in the near term are retail, real estate, and hospitality with Class A and B multi-tenant office buildings also experiencing a correction.

The Incubator Effect

In most markets across the country, open shared office space providers have dominated the landscape. In fact, WeWork occupies nearly 1.7MM square feet of Class A office space in Boston alone. While WeWork was experiencing operating challenges before Covid-19, the effect on this industry and their landlords may be dramatic. In fact, We Work is currently in negotiations with many of their landlords to restructure leases including giving back space in some instances. Not only did experts feel that this industry was already saturated, but going forward employers and employees may not find an open, highly dense, office model attractive and revert back to more conventional office space.

The Good News

First and foremost, banks and financial institutions remain fundamentally sound as lending restrictions implemented during the financial collapse of '09 insured that leverage remained in check. While there may be instances of default, we expect that most lenders will be able to work with their borrowers to restructure loans in lieu of foreclosure. We also anticipate a continued low interest rate environment will enable investors to find capital for real estate, although obviously lenders will be very conservative including imposing more restrictive covenants. Many industries in the Greater Boston area including Life Science, Medical Manufacturing, Healthcare, R&D, Distribution, Financial Services, and Services Companies that support those sectors should rebound more quickly, while retail and hospitality may have a much longer road to recovery. *For office tenants, the good news is that real estate expenses which many feel have reached unsustainable levels, will re-adjust to more reasonable levels and better enable tenants to control operating expenses as an important measure to regain profitability.*

Return to Fundamentals

This global event will force companies to focus more on the reduction of expenses then simply on gross sales. In fact, CRE expense reduction may be an important key to profitability over the next 6-12 months. Structural lease changes, increased vacancy rates, decreases in building operating expenses, more efficient utilization of space and tactical tools like *operating expense audits, tax abatements and cost segregation studies can all contribute to substantially improving your bottom line.*

HOW WE CAN HELP

Our singular goal is to provide you with experienced, objective advise and counsel to ensure you make the most informed, cost savings decisions.

For over 30 years Thompson Hennessey & Partners has been providing specialized real estate advocacy services for business owners and tenants throughout New England. Our sole focus is to help our clients improve financial performance and increase profitability through the strategic use of real estate. Let our experience, unbiased counsel, and diverse expertise enable your company to not only sustain, but excel in these challenging times.

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