



Commercial Real Estate: Dealing with the Ongoing Impact of COVID-19

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With no end in sight to the public health and economic crises resulting from the COVID-19 pandemic, businesses across all sectors of the economy continue to grapple with the fallout. Those who own and manage commercial real estate face unique obstacles, and must plan strategically and act aggressively in order to navigate the challenges they face.

If you own and/or manage commercial real estate, there are a number of issues to consider and actions to implement that will help bolster the health and longevity of your business. The path forward may be rocky, but as with past cyclical downturns, there are steps you can take to protect yourself as well as opportunities for those who emerge on the other side.

What Has Led Us Here?

COVID-19 has sent shockwaves through commercial real estate markets worldwide. In the United States, various state executive orders forced the closure of many consumer-facing businesses and the mass exodus of white-collar workers from office space in favor of working from home. While many presumed during the early days of the pandemic that the disruption would be relatively short-lived, those hopes were misplaced.

For example, in Michigan, most restaurants are still severely restricted in terms of indoor dining capacity, event venues remain shuttered, and significant numbers of office workers remain at home. Nationally, many large employers such as Google, Microsoft and JPMorgan Chase have announced their intentions to allow workers to continue working from home, in some cases, well into 2021. Investments in communication technology have helped make remote work possible, and this "grand experiment" in distributed work has many businesses fundamentally rethinking how much square footage they need in the future.

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Working from home, of course, is not the only catalyst of change in commercial real estate. The shift from physical retail toward online shopping has negatively impacted mall traffic and brick-and-mortar stores. The lack of business and leisure travel has hit hotels.

All of these events—and others—have conspired to make 2020 a particularly challenging year for commercial real estate. Some estimates have shown that commercial real estate investment fell nearly 30% globally in the first six months of 2020 compared to the year-earlier period. However, consistent with the old adage that “opportunity lies in every crisis,” there are bright spots to be optimistic about. For instance, demand for warehousing, distribution, and logistics centers is growing, fueled by the e-commerce boom.

Ongoing Issues of Importance for Commercial Real Estate.

There are myriad issues that commercial real estate owners and/or managers must continue to grapple with moving forward. The challenges ahead include a blend of business and legal issues that require equal parts strategic planning and risk mitigation, and in many instances will call for the support and counsel of trusted advisors. A proactive, rather than a wait-and-see, approach is critical to strengthen your business.

Dealing with Tenants.

Most commercial landlords are dealing with tenants who are slow-paying rent or not paying altogether. At the beginning of the COVID-19 crisis, in anticipation of a relatively short-term business disruption, many landlords and tenants engaged in discussions and struck agreements for rent accommodations that were intended to help tenants preserve cash flow, and allow landlords to plan accordingly, until business picked back up over the summer. As the crisis has dragged on, those short-term lease modifications need to be revisited; unfortunately, many parties are avoiding having these difficult conversations. Therefore, it’s critical that landlords take it upon themselves, either directly or through legal counsel, to re-engage with their tenants and address the issue head on.

When engaging with tenants, insist on an honest, open-book evaluation. Getting all the facts on the table is the only way to craft effective solutions, be they further lease modifications or a more creative approach. For example, in the course of my negotiations with a tenant who had a strong business but no cash flow or borrowing capacity, we negotiated the sale of the business to the landlord. This was a win-win situation, allowing the tenant to get out from under debt and giving my client an asset they could sustain.

Unfortunately, despite best efforts, sometimes it is clear that there is no path forward. In such instances, it’s incumbent on landlords to take aggressive action. Once the facts are clear, there is no benefit from delay and procrastination, which will result in landlords potentially getting stuck behind other creditors who may take more decisive action to collect debts they are owed.

Regardless of the path forward, any agreement struck with a tenant should be documented in writing and reviewed by legal counsel.

Dealing with Lenders.





Just as tenants have financial obligations to landlords, most commercial real estate owners have obligations to lenders. The fact that many commercial real estate owners are dealing with slow-pay or no-pay tenants means that they may be struggling to keep up with their own debt obligations. As a result, they may need to restructure the loans secured by their properties in order to avoid loan defaults, foreclosures and the loss of their properties.

While the constraints of this article do not allow for a full discussion of all of the issues involved in a commercial loan workout, there are several important principles to keep in mind when dealing with lenders.

- **First, understand your lender's perspective.** Lenders are reevaluating their lending models based on the fallout from COVID-19. They are repricing loans based on new expectations regarding occupancy levels and borrower risks which have changed since early 2020. At the same time, most lenders do not want to be in the business of owning commercial real estate, so while they may drive a harder bargain, most are willing to engage in reasonable negotiations with borrowers to avoid foreclosure.
- **Second, be fully prepared.** Understand the root causes of distress and be ready to present a complete picture of your business to the lender. Your objective should be to fully address all issues so that any loan modification or restructuring can comprehensively address outstanding issues. If an agreement cannot be reached, know what your other options are with other lenders or investors.
- **Third, engage legal counsel.** When dealing with a sophisticated commercial lender, it's imperative to have experienced legal counsel on your side—you can be sure the lender will be similarly represented. You may only get one shot at striking an agreement that allows you to remain in control of your asset(s), so be sure to take all precautions to protect your interests.

Dealing with Executive Orders. The COVID-19 pandemic has created many unprecedented challenges related to the ownership and management of commercial real estate, and one of the most significant has been the impact of the flurry of executive orders intended to protect the health and safety of citizens. For commercial real estate owners and managers, these executive orders have created a great deal of confusion and forced them to incur significant costs.

One of the main reasons the executive orders, such as those that have affected foreclosures, limitations on business operations, sanitation and social distancing, have been problematic is that they are broadly applicable and therefore are often ambiguous. For example, defining an "indoor" space can lead to a dozen different interpretations with the wrong ones opening the offender up to financial or criminal sanction. Accordingly, it's important to work with legal counsel in order to try as best as possible to bring clarity to the ambiguities and remain compliant.

Further complicating the matter, Michigan's Supreme Court recently held that Gov. Whitmer did not have authority after April 30, 2020, to issue or renew any executive orders related to the COVID-19 pandemic (more information here). Accordingly, while next steps and timing are still unclear, landlords should prepare for a mishmash of local orders, imposing varying obligations, until the Legislature sets forth a particular plan which the Governor will adopt.

Conclusion



There is no escaping the challenges commercial real estate owners and/or managers will face over the coming months. Those who succeed (or, in particularly hard hit sectors, merely survive) will pivot in the moment and plan strategically for the future. If you have questions or require assistance with your commercial real estate needs, please contact Rob Hamor at 248.785.4737 or at RHamor@fosterswift.com
