



Southern Nevada
CCIM Chapter

PERSPECTIVE

Guidance for Rent Relief Requests and Other Commercial Real Estate Tenant / Landlord Issues

Courtesy of
The CCIM Institute

The COVID-19 pandemic continues to disrupt public health and economic activities across the globe. While the full effects of the virus remain to be seen, commercial real estate professionals need to be prepared for what could be a challenging time.

Relationships between tenants and landlords will be disrupted as millions of people shelter in place, thousands of businesses close their doors and the U.S. economy faces its biggest challenge since the 2007-2009 Great Recession.

With contributions from CCIM Institute Instructors Cynthia Shelton, CCIM, Mark Cypert, CCIM and Capital Rivers Commercial, we've gathered some resources to help you navigate potential issues among tenants, landlords and lenders.

How Landlords Can Respond

As retail outlets across the country close, it is only a matter of time before tenants approach landlords about negotiating rents. When a business closes suddenly, even if it's temporarily, the tenant cannot produce rent, meaning a landlord may have difficulty paying a mortgage (if there is one). There are no winners in this situation. Here are some viable alternatives to mitigate this issue:

- **Rent Reduction.** The landlord can reduce the tenant's rent for a portion or all of the term left on the lease. The usual forms of rent reduction are to reduce the base rent, operating expenses, or both. In regard to retail, it is possible to convert base rent to percentage rent.
- **Rent Deferral.** In this case, the landlord can defer a portion of the tenant's rent but would require them to repay the rent deferred at a later time, either in a lump sum or by increasing subsequent payments. A variation of rent deferral could be to cap or set a base year to operating expenses for a short or extended period of time.

- **Rent Abatement.** If a tenant is significantly past due on rent payments, a landlord may agree to forgive a certain amount of the past due rent if the tenant remains current thereafter.
- **Loan Conversion.** Rather than abating past due rent, a landlord may agree to convert the past due rent into a loan payable over time. The tenant would, however, continue to pay the current rent. The loan is then evidenced by a promissory note that is cross-defaulted with the lease.
- **Application of Deposit.** If the landlord holds a deposit, this amount could be credited against the tenant's current obligations.
- **Subletting.** Bringing in a new tenant (for part of or all of the rented space) could reduce or eliminate the rent obligations while replacing revenue for the landlord.

How Tenants Can Respond

- Review your lease to see if your rent is simply base rent or it includes pass-through expenses. How much are these expenses and are they set to increase?
- When does your lease end? What renewal options are available?
- What constitutes a default of the lease? What tools are available to the landlord in such a case (penalties, eviction, interest, etc.)

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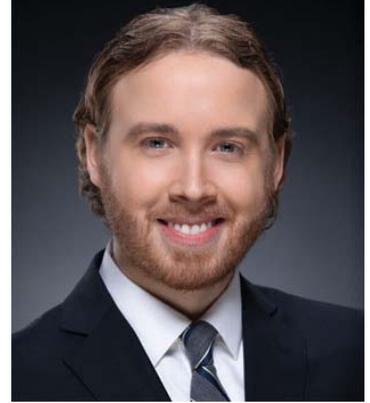
OUR PROFESSIONALS MAKE THE DIFFERENCE

Legal Briefs

Rolling the Dice with Uncertain Lease Options

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Fluctuations in the real estate market prevent most landlords and tenants from comfortably agreeing to a set rent schedule for more than a few years at a time. For example, no one can predict when the next Great Recession will hit, or if the property will be re-zoned resulting in substantially higher rent rates. Thus, in the context of a long-term commercial lease with options to extend, many people – landlords and tenants alike – may find appeal in the flexibility of agreeing to hold rent “to be agreed” at a later date. If crafted carefully, utilizing this technique can avoid potentially detrimental harm from shifting market conditions. However, entering into an “agreement to agree” is betting that the parties are actually able to agree in the future. Rolling the dice on this flexibility can create significant legal hurdles and unexpected consequences if an agreement is not reached.

Agreements become enforceable contracts when the parties agree to essential terms. Which terms are “essential” generally depends on the type of agreement. Long-

standing Nevada law provides that enforceable lease options must contain the same essential terms of an ordinary lease: (1) the names of the parties, (2) a description of the property, (3) the amount of rent, (4) when rent is payable and (5) the duration of the lease. Thus, any lease (or lease option) which does not specifically state any of these five terms will have issues.

Consider the following likely scenario (based on an actual Nevada case): Landlord and Tenant enter into a lease for a given property for 20 years, providing for monthly rent beginning at \$5,000.00 and increasing by \$100.00 every year. The lease further provides that Tenant has an option to extend the lease by an additional five years, and that the option period will be based on “the same terms as the original lease, at a monthly rental to be determined at that time.” In year 15, the national economy begins a steep decline, resulting in severely decreased income for Tenant’s business for the next several years. In year 19,
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Legal Briefs

Rolling the Dice with Uncertain Lease Options

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Tenant seeks to exercise the option and suggests to Landlord that rent should be reduced to allow the business to get back on its feet. Landlord, meanwhile, would prefer to keep the regular \$100.00 annual increases. Although negotiations continue, the parties fail to come to an agreement by the end of the 20-year lease term. At the beginning of year 21, Tenant begins paying monthly rent in an amount it believes to be reasonable, rather than increasing rent by \$100.00. In this situation, the law would normally dictate that the option period lacked a definite rent amount (which is an essential term), and thus that the option is unenforceable. In other words, the lease ended at the end of year 20, and Tenant is in possession of the premises as a month-to-month holdover tenant, by default. This can be problematic for both parties, as Landlord may want the certainty of a long-term lease to keep a tenant who has proven to be reliable, and Tenant may not want to have to go through the expense of moving and starting over somewhere else.

Despite this general rule, the Nevada Supreme Court has developed a special exception to allow the parties to enforce a lease during an option period, if rent is the ONLY essential term that is not agreed on. In the above

scenario, either party could file suit seeking to enforce the option. Then, if the court finds that all essential terms except for rent were agreed upon (as is the case here), the court can fix the rental rate for the option period at a “reasonable rent,” based on economic conditions at the time. Of course, the determination of what rent is “reasonable” will typically require in-depth factual analysis including comparable leases and the details of the negotiations between the parties. Moreover, the specific wording of the option provision may be relevant, such as an option which provides that rental “increases” will be negotiated.

To ensure that an option at an indefinite rental rate can be enforced, great care should be taken to provide all other essential terms for the option in the lease. Further, while negotiating rent for the upcoming option period, one should be particularly aware that, if an agreement is not reached as to rent, an intervening court may set rent at what it believes to be a “reasonable” rate. This sort of outcome may not make either party happy, so taking the time when drafting a lease to think through these potential issues can save a lot of time, money and stress – and add some predictability to what could otherwise be a roll of the dice.



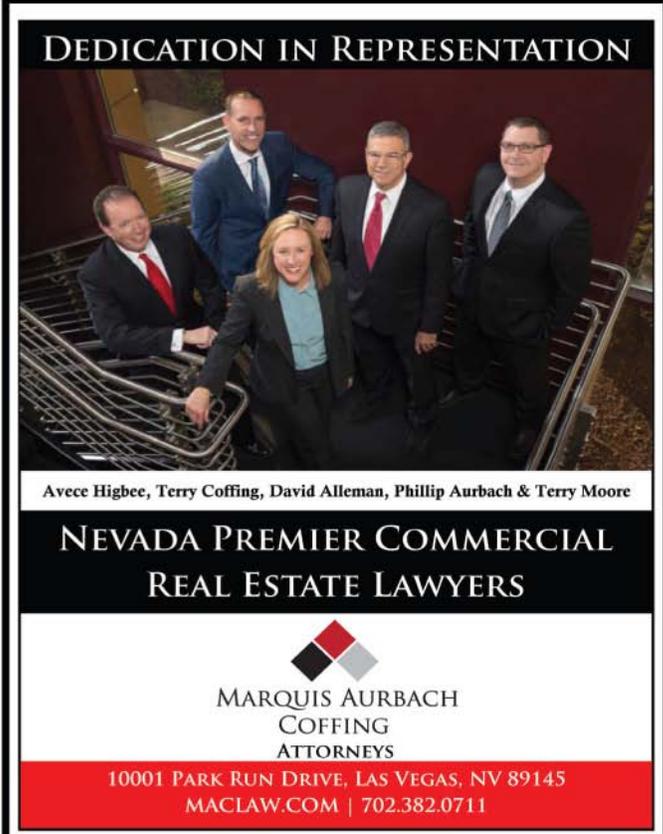
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