

SPECIAL EDITION ISSUE

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COMMERCIAL REAL ESTATE

DEDICATED TO HELPING TENANTS

WITH EXPERT CONTRIBUTIONS FROM STAWOWSKI MCGILL & LINLEY WELWOOD LLP.

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# RENT PAYMENT CONSIDERATIONS IN UNPRECEDENT TIMES / COVID 19

After more than 25 years in real estate, one tends to think they've seen it all . . . . Not so.

Over the years, we've worked with hundreds of commercial tenants to secure thousands of locations, reduce risk and negotiate favorable lease terms.

Over the past three years, we have completed numerous rent restructures and have become proficient at solving problems when tenants cannot pay their rents. Little did we think our life raft would suddenly be asked to take on thousands of desperate companies as we have been overwhelmed by frantic tenants wondering what to do.

Given that we can't keep up with the volume or book enough calls, we figured it was time to release one of our research papers. We've been writing these for years (and they typically cover technical real estate factors that help tenants mitigate risk or save money). While nobody likes reading the instructions on a fire extinguisher until they absolutely need to, we have a fire on our collective hands. Given the circumstances, we are releasing this latest research paper without charge beyond the wall typically accessible to our clients. We've also collaborated with industry leaders such as

Stawowski McGill and Linley Welwood while reviewing numerous legal default communications. Fortunately (or unfortunately), we've become a repository for "force majeure", "rent restructure" and "rent relief" provisions and process. So without further delay, here are some quick tips we have for you in your time of need.



## TIP: Communication

If you are unable to pay your rent or the full portion of rent, it is important you notify your landlord in advance. We'll circle back to this shortly. Communicate with your peers and fellow tenants as there is safety in numbers - and these are unprecedented times. We recommend you contact your legal counsel, accountants and real estate advisors if possible, but also remember that it is unreasonable to expect an accurate answers or foolproof solutions from anyone at this time regardless of their experience.

## TIP: Decision Making

Right now, the best you can do is to know your business, obtain information, and assemble a plan. Analyse the situation, determine odds when possible, communicate, be **TRANSPARENT AND STRAIGHTFORWARD**, and try to make measured, calculated decisions. Then revisit again and again as needed. We would suggest that it is probably not the best time for long term real estate commitments expectations or solutions.

**"UNPRECEDENTED TIMES  
MAY CALL FOR  
UNPRECEDENTED DECISIONS"**

## YOUR COMMERCIAL LEASE

Remember that 70 page document you never read but signed? This is where your commercial real estate advisor and lawyer earned their weights in gold. Inside those leases, you might find a term that has suddenly risen to the top of every google search called "Force Majeure". In addition to lease content defining "defaults", force majeure is crudely defined as an unforeseeable circumstance that prevents someone from fulfilling a contract.

### What is "FORCE MAJEURE"?

CONTRIBUTION FROM:



The authority for invoking Force Majeure to provide for relief from performance comes from the contract (except in Quebec). The contract must contain a force majeure clause which specifies a type of event capable of encompassing the COVID-19 outbreak. It is important to note that there is no generic definition of force majeure in common law. It is a matter of contractual interpretation in each case. The defaulting party must prove that:

- one of the events referred to in the force majeure clause has occurred.
- it has been prevented, hindered or delayed from performance by that event.
- its non-performance was due to circumstances outside of its control.
- there were no reasonable steps that it could have taken to avoid or mitigate against the event.

For a force majeure clause to engage, there are often different thresholds drafted in: for example in some contracts performance has to have been rendered impossible, whereas others, performance need only be hindered or delayed. Similarly, a downturn in economic conditions (even if caused by an event like COVID-19) will generally not constitute force majeure. However, government interference or anything referring to illness, pandemic or epidemic may be included as part of the force majeure clause(s) in your leases. Some force majeure clauses will suspend party's performance of the contractual obligation (eg. Payment of rent), others allow for termination of the contract, usually if the event persists for a certain period of time.

#### Frustration

If the force majeure clause does not cover an event such as the COVID-19 outbreak (or there is no force majeure clause at all), consider the question of whether the contract has been frustrated. A contract will terminate automatically when a frustrating event occurs, i.e., one which is: (1) unexpected; (2) beyond the parties' control; and (3) makes performance impossible or radically different from that which the parties contemplated at the time of entering into the contract. The frustrating event must "significantly change the nature of the outstanding contractual rights or obligations." Following the 2003 SARS epidemic, the Hong Kong District Court held that a 10-day period in which a property was uninhabited did not frustrate the tenancy agreement, which had a two-year term.

#### Mitigation

Wherever losses are likely to be incurred, contractual parties have a duty to mitigate damages. Force majeure and frustration are last resorts which will not be applied if parties have not exhausted the options available to them to perform their obligations under the contract. A party must show that there were no commercially reasonable alternatives that would have mitigated the impact of the event on the other party.

#### Approach

- Step 1: Check whether the contract has a force majeure clause that could cover COVID-19.
- Step 2: Check whether there is a causal link between the force majeure/frustrating event and non-performance.

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Step 3: Write to your counterparty and (i) provide full explanation of why performance is now physically/legally impossible, (ii) provide evidence of steps you are taking to mitigate and (iii) regular updates on efforts to resume performance. Also see ("Next Steps" below).

Step 4: If you are satisfied with the response, consider entering into a written variation to the contract. If not, consider escalating to dispute resolution.

## WHAT IS YOUR BUSINESS TYPE?

### Higher

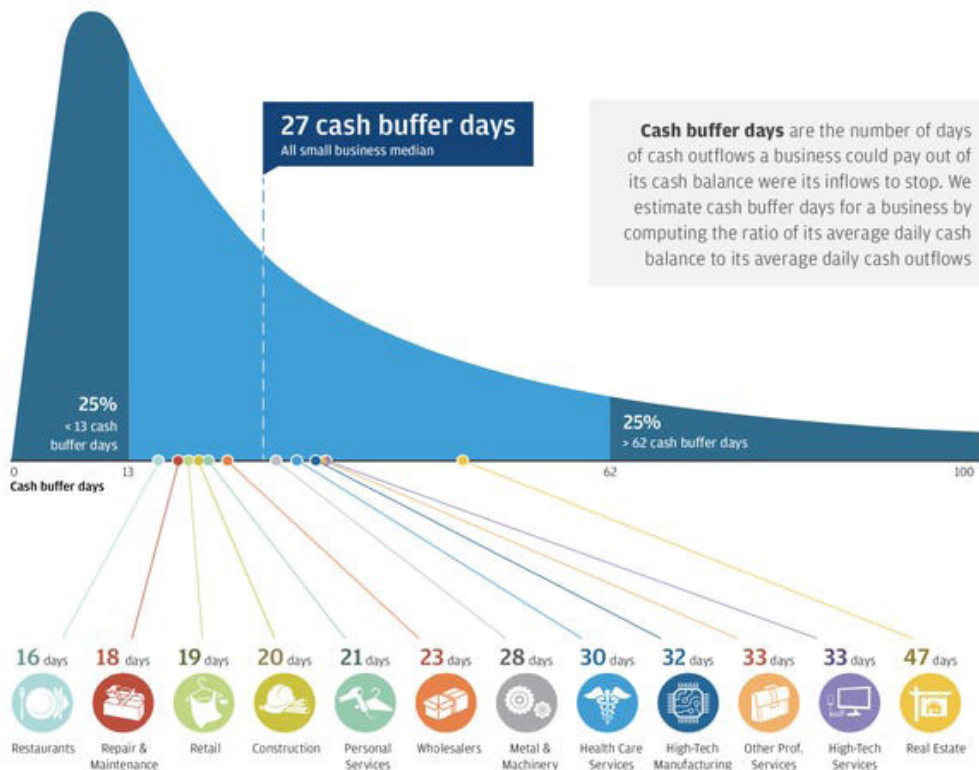
Restauranteurs, retailers and many service providers typically conduct business with a relatively high velocity of cash flow. For example, restaurants often rely on one week's sales to pay salaries for the very next week and generally are unable to carry high levels of cash reserves.

v

velocity of  
cash flows

### Lower

Consulting firms, fitness clubs, commercial real estate brokerages, accountants, etc. typically have slower velocity on cash flows whereby fees are paid yearly in advance, monthly, or there is a long gestation period between the service and the receivable. Typically (but not always) higher amounts of working capital are needed for these types of businesses and the cash crunch shock is not as acute.



SOURCE: JP MORGAN CHASE

## TIP: Understand the Type of Landlord You Have

Landlords already know that a massive tidal wave of rent defaults (and rental abatement requests) are coming. They are keenly aware and will also be scrambling for ways to take the same approach with respect to paying their lenders. Most recognize it is unrealistic to expect the weight of this pandemic to be borne on the backs of the average tenant. They also know that governments are pumping billions of liquidity into banks and its unrealistic for them to be caught in the middle. We won't have time to explain each of the details for the various types of landlords (structure/debt/ownership etc.), but each will have different pressure points to consider as you move forward. These questions can be answered by engaging an expert tenant advisor.

**Pension Funds:** Large entities that own/invest in real estate on behalf of the pensioners and use rental proceeds for pension distributions.\*

**REITs (Real Estate Investment Trusts):** Large entities that own, and many cases operate income producing properties on behalf of the unit holders. Rental proceeds are distributed to unit holders.\*

**Syndications:** Typically owned by a group of investors.\*

**Private Entities:** There are a wide range of private entities that own real estate from very small to very large. A few private wealthy individuals own properties debt free.

**Publicly Traded Companies:** Own real estate on behalf of shareholders which are traded on an exchange.\*

\*Debt is almost always used to increase leveraged returns.



## NEXT STEPS:

### LANDLORD DECISIONS

In addition to Force Majeure events, prudent landlords will generally consider your business type when accommodating deferrals, abatements or other types of rental amendments (hereinafter defined as "Rent Restructures"). First and foremost, they'll want to determine if a tenant's request is legitimate by looking at your financial statements. That said, that isn't really an option given the unprecedented pace of changes related to the Covid-19 pandemic.

Therefore, some brief and transparent information on the current situation should be provided. Landlords will want to assess your current revenues in relation to your expenses and the smart ones will consider the "velocity" that we spoke about previously. If sales are down by >50%, it doesn't take a business degree to understand that restaurants and smaller retailers will not be able to pay any rent almost immediately. For others, a portion of a rental payment might be a prudent consideration (depending on reserves).



## More Tips:

CONTRIBUTIONS FROM:  Stawowski McGill  
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### DON'T BE A "LOOTER"

No doubt you've seen people loot stores in times of crises or scammers try and take advantage of people in need. For example, we just heard of one case where a law firm requested 6 months of free rent only a couple days after sending partners to work from home. A stunt like this is likely to permanently damage any type of relationship with their landlord and not something we would advise. This is a time where your longterm relationship with a landlord partner can either be bolstered or ruined based on the reality of your ask.

### BE CREATIVE ...AND KIND

Do you have safety or rent deposits that your landlord is holding? One option is to collaborate to have those applied. Free rent and / or extending a lease term are also options that could be considered. Numerous government programs are likely to be released in the upcoming weeks as well - so keep informed!

Remember, the vast majority of us are in the same boat where we are just trying to survive. Prudent landlords will do everything they can to extend concessions to tenants and seek lender / government relief as they also know that vacancy in the next 12 months could skyrocket.

### REVIEW CASH NEEDS

Regardless of whether you feel your company is on the edge of depleting it's cash resources or you can see it coming in the next few months, use your cash flow models to determine your needs as accurately as possible. It is recommended that you start with the "worst case cash flow scenario" and work back from there. You want to know the amount of relief you might need, when you will need it and where it will likely come from. While these models are, at best, "approximately correct", they assist greatly in validating your requests for rent adjustments or deferral and the timing thereof (among other things).

## IMPORTANT DISCLAIMERS

We are in unprecedented times with rapidly moving events. Some parts of this research paper may be "stale" within weeks if not days given the rapidly changing conditions with the pandemic and some of this content may evolve or be inapplicable based on your circumstances. Our recommendations and tips may change as well. This research paper does not provide legal advice. The information contained herein is confidential and provided solely for review purposes. It is not to be used for any other purpose or made available to any other person without the prior written consent of ORANGE GROUP COMMERCIAL REAL ESTATE INC., STAWOWSKI MCGILL AND LINLEY WELWOOD. The information was compiled from data furnished by sources deemed reliable. Every effort has been made to ensure the accuracy of the information at the time of its compilation, but it is not guaranteed and no representation or warranty as to its accuracy or completeness is implied. This document is protected by copyright and any reproduction in whole or in part in any way, is strictly prohibited without the express prior written consent of ORANGE GROUP COMMERCIAL REAL ESTATE INC.

## A LITTLE ABOUT US

Orange is a business advisory firm that focuses on real estate exclusively acting on behalf of commercial and office tenants. We partner and align with companies where location, position, and rent have a tangible effect on financial performance. Our mission is to assist our clients to achieve their corporate goals through real estate.

Orange combines innovative thinking with industry leading programs, processes, analysis, and experience to ensure our clients obtain and maintain great locations at favorable terms.

Please visit our website at [www.orangegroup.ca](http://www.orangegroup.ca) or contact Han Kim at [hkim@orangegroup.ca](mailto:hkim@orangegroup.ca) for more information.

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