

# Working Together as a Team: Negotiating With Tenants and Leasing Space During COVID-19

The coronavirus pandemic has had a broad impact on local economies across the U.S. and Canada. Mandatory closures and reduced consumer expenditures have impaired business operations across many industries, making it difficult for some commercial tenants to pay their rent on time and in full. Although less severely affected by the outbreak than hospitality or retail tenants, some office and industrial tenants have asked building owners for assistance in the form of rent abatements or deferrals. A small minority of these tenants have simply refused to pay rent.

Building owners have quickly developed strategies to respond to struggling tenants without jeopardizing their own financial health. At the same time, they have also adapted their leasing strategies to changed market conditions while updating the way they show spaces to facilitate social distancing.

Most North American localities have relaxed the regulations that required widespread business closures in March and April, but concerns are growing that an increase in infection rates may require another round of closures in some parts of the U.S. High rates of unemployment and reduced consumer expenditures may also lead more tenants to seek relief, even when their businesses remain open. Concerns about potential infection from face-to-face contact are also unlikely to disappear in the near future. For these reasons, practices that owners developed in the first months of the pandemic are likely to remain useful until the coronavirus and its economic effects have abated.

This research brief draws from interviews with brokers and building owners, news sources, NAIOP webinars, and NAIOP survey data to identify best practices for triaging office and industrial tenant requests, offering reasonable accommodations to those tenants who need short-term assistance, and responding to uncooperative tenants. The brief also examines how owners are adapting the ways they show and lease space to new tenant preferences and safety expectations.

## Key Findings

- **Respondents spoke favorably about offering tenants reasonable rent relief packages to help them weather short-term disruptions associated with COVID-19.** Owners most commonly offer tenants a few months of deferred rent that can be repaid over the remainder of the lease or rent abatement in exchange for a longer lease term.
- **Owners commonly request tenant financials to demonstrate they have a COVID-related need for assistance.** Lenders require financial documentation before consenting to a lease modification, and financials can also help owners identify tenants who may be unable to resume regular rent payments.
- **Many owners seek assistance from lenders to help them pay for property maintenance, taxes and insurance during periods when tenants are deferring rent payments.** Lenders have generally been willing to allow borrowers to defer principal payments, as long as they can demonstrate need and maintain their properties.
- **Industrial leasing activity remains robust, though shorter-term leases are more common than they were before the outbreak.** Some office building owners have begun to respond to a softer market by offering more lease concessions.
- **Respondents reported greater tenant interest in suburban office properties.** Suburban office buildings are usually less expensive and more accessible by car than those located in dense urban areas.
- **Prospective office tenants expect buildings to have standard health safety protocols in place** and are frequently more interested in buildings that have additional safety features, such as automatic doors and touchless fixtures.
- **Virtual tours are quickly becoming commonplace.** In-person tours are now smaller, and brokers are taking several measures to improve tour safety.



## Negotiations with Existing Tenants

Widespread mandatory business closures in late March and April led many commercial tenants to seek rent deferrals or abatements. Retail and hospitality tenants were more widely affected than others, but many owners have fielded at least some relief requests from office or industrial tenants. The NAIOP Coronavirus Impacts Survey revealed that about half of office and industrial building owners and operators reported that more than 10% of their tenants had requested relief in April. This ratio has declined since April, to 32.4% of office and 25.5% of industrial building owners and operators in July. Only 11.5% of office and 7.1% of industrial owners and operators reported that more than one quarter of their tenants had requested relief in July.<sup>1</sup>

Interviews with brokers and building owners also suggest that very few industrial tenants have sought rent relief, and that the office sector is also relatively healthy, with a small minority of office tenants requiring relief.

**Jonathan Kingsley**, executive managing director of Office and Industrial Services at Colliers International, indicated that about 95% of collections for industrial tenants in South Florida continue to be status quo. Rental relief requests have primarily come from smaller industrial tenants—those occupying less than 20,000 square feet—who are typically more exposed to a decline in demand. Those industrial tenants who have requested relief have only asked for short-term assistance.

Conditions for office tenants vary depending on their size and industry, but most have continued to make regular payments in recent months. For example, Kingsley estimated that roughly 15% of office tenants in South Florida had requested some form of relief since the outbreak began. Respondents suggest that medical tenants may have experienced a sharper initial decline in revenues than many other tenants, but

they expect the sector to recover soon since patients are likely to seek care that they may have postponed during the first months of the pandemic. For example, **Brandon Bergman**, president of 2000 Development in Wisconsin, indicated that his firm was offering rent abatement to a medical tenant in exchange for a lease extension because the tenant had been unable to access local hospitals for two months.

## Working with Tenants Who Need Help

The NAIOP Coronavirus Impacts Survey has shown that commercial building owners and operators are generally willing to provide tenants with some form of relief, as long as they can demonstrate that they need assistance. Owners and operators most frequently reported providing tenants with the ability to defer rental payments and amortize them over the remainder of the lease (77.5% of respondents in July), and a majority (55.4%) have also provided rent relief in exchange for a longer lease term. Most (71.1%) requested that tenants provide them with financial statements or other proof of distress. Some also reported asking tenants about their business-interruption insurance policies (35.8% of respondents) or have helped them apply for CARES Act benefits (29.4%).<sup>2</sup>

Interview respondents confirmed that building owners are generally willing to offer assistance to tenants in need, but they also expect tenants to demonstrate a temporary financial hardship. Requiring tenants to produce financial records that support their claims has helped owners avoid making unnecessary concessions to tenants who have not been significantly affected by the outbreak. Kingsley said his team had fielded relief requests from 47 office and industrial tenants from a range of industries in South Florida by the seventh week of quarantine, but roughly half of these dropped their requests when it became clear that owners required their financials, proof they had applied for PPP loans, and a detailed description of how the outbreak was affecting their businesses. Most of the remainder demonstrated an authentic need for short-term relief, which they were willing to repay in the future. Only one ultimately broke their lease because they did not expect their business would recover.

Reviewing tenant financial records has also helped owners develop suitable relief offerings and determine whether a tenant is likely to be able to fulfill their terms. For example, Bergman's firm uses a tenant's financial records to assess their ability to make future rent payments and to develop a package tailored to their situation. Tenant financial records are also needed if an owner seeks to obtain a deferral or loan modification from a lender.

The terms of a rent relief arrangement can vary between different markets and between building owners. Owners also frequently tailor their offerings to individual tenant conditions and the length of term remaining on a lease. However, interviews suggest that they have most frequently been willing to offer two to three months of assistance and that rent-deferral arrangements are more common than rent abatement in exchange for a lease extension.



Owners generally appear open to offering abatement in exchange for a longer lease, but some noted that this option is less appealing to tenants. **Brian Adamson**, development partner at ICAP Development in Wisconsin, indicated that few tenants had expressed interest in an offer of several months of rent forgiveness in exchange for several additional years of lease term. Most instead opted to defer rent that they would pay back over a scheduled period of between six and 18 months, depending on the amount of remaining term in the lease. He speculated that tenants avoided extending their leases because they were wary of making longer-term commitments given increased uncertainty due to the pandemic. He also indicated that a deferral may require fewer approvals on the tenants' end than a lease extension.

Adamson was careful to point out that ICAP opted not to make formal lease modifications when granting deferrals. The firm instead sent tenants a letter stating that it was willing to accept non-payment for a period of time. ICAP chose this approach so it could continue to classify deferred rental payments as accounts payable. In the event that a tenant does default, ICAP will seek all outstanding rents, not just those that were deferred. Others may prefer to create a formal agreement that identifies how long rent will be deferred and when it will be repaid. In a recent *Development* article, Michael Stewart, a member at Bass, Berry & Sims, recommended that owners document deferrals in a lease modification or forbearance agreement, but with a clause making any deferred rent and associated landlord costs (including legal fees) payable upon any default.<sup>3</sup>

Both Adamson and Bergman noted that there is an advantage in proactively reaching out to tenants to let them know that assistance is available. Bergman said reaching out to tenants first has allowed his firm to open negotiations with the terms it prefers. His firm developed a 15-point approach to working with tenants in response to COVID-19 that is centered on open communication and teamwork between tenant, landlord and lender. Adamson's firm took a similar stance: once mandatory business closures went into effect, the firm reached out to all its office tenants to let them know their options. ICAP took this approach to pre-empt adversarial defaults or rent withholding.

Although respondents generally highlighted the advantages of offering accommodative rental payment plans in response to the pandemic, some noted that offering concessions can present risks. One risk is that a tenant might ultimately not be able to resume regular rent payments after a deferral or abatement. A careful evaluation of tenant financial health can mitigate this risk. Kingsley cautions owners to be careful in what they offer and to whom. If an owner does not have confidence in a tenant's financial health, it can sometimes be better to let the tenant go. Bergman also noted that offering a

short-term rent abatement in exchange for a lease extension could result in an effective loss if inflation significantly decreases the real value of future rent payments.



## Working with Lenders

Building owners usually need a lender's consent before offering a tenant rent relief, and many also seek a lender's help with loan payments during the term of an abatement or deferral. Attorney **George Pincus** of Stearns Weaver Miller, P.A., noted in a recent NAIOP webinar that preserving control of an asset is a principal objective for both owners and lenders when rent collections are significantly impaired. Pincus recommends that owners prepare detailed operating budgets showing how cash flow will cover costs to maintain the property and pay for taxes and insurance if tenants are granted rent relief. If owners need assistance from a lender, they should also be ready to review a loan's covenants and other terms and seek flexibility where appropriate. For example, if meeting a loan's minimum debt service coverage ratio requires that a borrower pay down a loan out of their own pocket, they should ask their lender to forgive any prepayment penalty that might apply.<sup>4</sup>

Interview respondents indicated that building owners are working closely with lenders on the terms they offer to tenants and to obtain loan payment deferrals. **Michael Riopel**, assistant general counsel for Northwestern Mutual, noted that loan documents typically require owners to obtain a lender's consent before making a material modification of a lease. Before granting their consent, most lenders are requesting evidence to substantiate that tenants need some form of relief. Riopel identified several documents Northwestern requires before it will consent to a lease modification. These include:

- Evidence that a request for relief is related to COVID-19.
- Evidence that a tenant has made a claim on business-interruption insurance that has been denied.
- Evidence that a tenant has sought relief from applicable government programs.
- Specifics about the form and length of relief requested.

Riopel observed that owners may request loan payment deferrals that match the length of rent relief they offer tenants or may seek slightly longer deferrals so that they have some additional time to service the debt. Before granting loan deferrals, Northwestern is asking that owners provide the same range of evidence that the firm requires from tenants, plus evidence that insurance and property tax payments are up to date.

Adamson stated that both banks and life insurance companies have proved willing to offer assistance with loan deferrals, but local banks have been more generous with their terms. In his experience, local lenders were willing to offer deferrals that would improve his firm's cash flow, while life insurance companies were only willing to offer a deferral if a debt service coverage ratio appeared likely to drop below 1.0. Bergman agreed that local banks had been easier to work with, requiring less paperwork and granting deferral requests more quickly than life insurance companies. These observations echo reports that local and regional banks have been more willing to offer relief than other lenders, in part because they are receiving nearly free credit from the Federal Reserve with the expectation that they use these funds to help borrowers.<sup>5</sup>

## Responding to Tenants Who Do Not Pay Rent

Some tenants have indicated they will not make rental payments because they claim that mandatory business closures due to the coronavirus constitute force majeure or that the outbreak has otherwise impaired their business operations. Although this has been a more significant problem among retail tenants, some interview respondents indicated they have seen similar letters from a small number of office and industrial tenants.

Pincus recommended that owners respond to these letters by disputing the legal basis claimed by the tenant (i.e., force majeure or impossibility of performance do not excuse payment of rent) and clearly stating that the owner is not waiving any rights or remedies afforded to them under the lease's terms or the law. A standoff with tenants could result in tenant default and eviction, or it could lead to more constructive negotiations between tenant, owner and lender.<sup>6</sup>

Kingsley cautioned that tenants who approach landlords asking for a period of free rent without a corresponding lease extension or later repayment risk sabotaging negotiations. He has advised tenants who may need help to ask owners for assistance that is within reason and is consistent with terms that other tenants in their local market have received. Similarly, Bergman has noted that some national tenant representatives have been overly aggressive in their demands and negotiating tactics and have subsequently missed out on

advantages they could have obtained through an abatement and lease-extension package.

Riopel noted that owners need to be aware of any state or local regulations related to COVID-19 that might affect rent collections. For example, Washington, D.C., developed stringent regulations requiring owners to allow tenants to defer and repay rent as part of a set repayment plan. Riopel observed that these types of regulations can give tenants more leverage in negotiations than they would normally have.

## Attracting New Tenants

Respondents also provided insights into how the coronavirus has affected tenant preferences and owner leasing strategies, as well as how owners and brokers show spaces. Interviews revealed that while the pandemic's effects on demand for real estate vary between different geographic markets, more universal concerns about the virus have affected tenants' locational preferences and their expectations for building safety.

Although Kingsley noted that some smaller industrial tenants have been negatively affected by the virus, respondents reported that industrial vacancy rates remain low. However, disruptions associated with the pandemic appear to have had an effect on preferred lease lengths. Adamson noted that he has seen an increase in demand for shorter-term (six- to 12-month) leases. He attributed this shift to logistics firms responding to shorter lead times and disruptions to supply chains by temporarily increasing their capacity through short-term leases.

Demand for office space is more varied and has generally been weaker than for industrial space. Kingsley reported that office tenants continue to sign long-term leases in South Florida. However, many have carefully adjusted their expected space needs to account for more remote work arrangements, and they have allocated more space to facilitate social distancing for those workers who will remain in an office. He also noted that tenants in the cruise industry were downsizing their leases and looking for shorter terms in response to the difficulties unique to that industry.

**Terence Kirk**, executive vice president of Occupier Services at Colliers International, described a more challenging office market in the Los Angeles area. Since the outbreak, tenants have been looking for shorter-term leases and ways to lower their capital expenses. The market slowed dramatically in the first months of the pandemic, but he has seen a recent uptick in leasing activity. Larger firms have executed leases that are small relative to their budgets, but many organizations continue to avoid signing new leases that would account for a large share of their operating expenses.

Owners have responded to weaker demand by offering more concessions, and Kirk has also seen some lower rental rates to attract tenants.

Bergman's experience suggests that the office market in the Milwaukee area is active, but with softer pricing than before the pandemic. Development 2000 has adapted to recent market conditions by directing listing agents to use concessions such as initial base rent abatements, moving-cost reimbursements or below-market rents to attract new tenants. The firm has been particularly willing to offer concessions to prospective tenants who are currently in Class A space to attract them to Class B+ office buildings in the firm's portfolio.

## Shifting Tenant Preferences

Respondents noted that locational preferences for office tenants in their respective markets appear to have shifted in response to the pandemic. Kingsley observed that tenants are now much more comfortable with suburban office locations than dense urban locations. Some of this comfort level is tied to the layout of individual buildings, with tenants preferring two- to six-story walkable buildings over tall buildings that require they use elevators. Tenants also appear to be more comfortable with locations that are easily accessible by car and offer free parking, as they are now more concerned about their employees commuting on public transit. Additionally, tenants are attracted to lower rental rates for suburban offices. This allows them to reduce overhead or increase their footprint so that workers can spread out more.

Kirk also suggested that tenants will be wary of dense urban environments like those in New York or San Francisco. He predicted some will opt for a hub-and-spoke model for their offices, with workers spread out across multiple smaller suburban locations instead of a single large office in a central business district. He suggested that organizations with an agile workforce structure, or those that had adopted activity-based work arrangements within their offices, will be more likely than others to adopt a distributed workforce.

These trends may also extend to smaller metropolitan markets. Bergman indicated that 2000 Development is testing whether tenants in urban Milwaukee are interested in the firm's suburban properties located west of the city. While many urban tenants may be interested in relocating, it remains to be seen whether there will be a significant trend

toward suburban office space.

In addition to new locational preferences, respondents have noted that office tenants closely consider a building's safety features and protocols when evaluating leasing decisions. Kirk stated that all office building owners will need to follow local government requirements at a minimum, and those who can create an environment that feels safe will have a competitive advantage.

Kingsley has also seen prospective tenants raise questions about building safety while touring office properties. Every building he has visited has implemented at least some safety measures, such as signage to encourage social distancing, and providing

masks and PPE to visitors. However, Kingsley noted that buildings that have adopted more extensive safety features are more attractive to tenants. He suggested that prudent building owners will opt for more permanent measures to improve building safety, such as the installation of touchless fixtures and automatic doors. These measures can represent a significant upfront investment, but in his experience they tend not to be particularly costly on a per-square-foot basis.

Kingsley observed that safety concerns play less of a role in

industrial leasing decisions because tenants generally expect to be responsible for safety measures within the spaces they lease. However, he noted that tenants have taken a variety of measures to improve safety within their facilities so that employees feel comfortable. For example, one tenant of a 300,000-square-foot building at PortMiami has invested nearly \$200,000 on automatic hand sanitizers, automatic sinks, automatic toilet flushers, automatic doors and signage to direct safe occupant traffic flow.

## Showing Space and Executing Contracts

Safety concerns have also reshaped how owners and brokers show spaces to prospective tenants. Respondents reported that video tours are now a minimum requirement for showing industrial or office space before an in-person walk-through, and most recommended that owners offer virtual tours, which have rapidly become mainstream. Kingsley indicated that virtual tours that contain detailed plans with 3-D views and illustrate a space with labeled dimensions are becoming standard in South Florida. Bergman has been impressed with the quality of virtual tours and notes they are relatively



inexpensive, at a cost of roughly four or five cents per square foot. Prices have gradually come down as more virtual-tour vendors have entered the market.

Interviews revealed that while tenants expect the ability to explore a property remotely, video and virtual tours have not fully replaced in-person tours. Most tenants still physically tour a property before signing a lease. However, in-person visits look much different than they did before the pandemic. Brokers wear masks, practice social distancing, and provide tour participants with masks and disinfectant. Kingsley said that brokers are carefully considering building layouts and tour timing to ensure that they can safely give tours while also being respectful of occupant safety.

Respondents also reported that tour groups are smaller than they used to be. Adamson noted that tours often consist of just a broker, a decision-maker for the tenant and maybe one other person. He also said that prospective tenants are touring fewer properties in person before making a decision. They instead rely on video and virtual tours to narrow down which properties merit an in-person visit.



Although no respondents indicated that they had seen tenants lease space based solely on a virtual tour, Kirk did help broker a lease when the tenant was unable to physically walk through the property. Acting as the tenant's representative, he toured an office property with the tenant on a video call and provided them with live feedback about the property that can usually only be obtained in person. While this approach has worked as a stop-gap measure, Kirk suggested it is unlikely to be a common practice once the pandemic is no longer a significant concern.

Expectations around lease execution have also shifted subtly. Overall, tenant leasing decisions now face greater scrutiny and are frequently subject to additional review. Respondents also reported that physical lease signings have largely become a thing of the past. While most parties were already used to signing documents digitally, very few now expect to receive a hard copy with a wet signature.

## Conclusion

The coronavirus pandemic has disrupted a broad range of businesses and presented an unprecedented challenge to the commercial real estate industry. Many tenants have been adversely affected by mandatory business closures, and some have cited the pandemic as a reason not to pay rent. However, interviews suggest that when owners, tenants and lenders are willing to work together, they can often find a compromise that meets their respective needs. Many successful negotiations have stemmed from a shared understanding of the difficulties that the pandemic presents for each party involved.

This research also confirms that safety concerns related to COVID-19 have reshaped how tenants evaluate and tour properties. Owners, brokers and prospective tenants are mindful of the unique challenges that the pandemic presents to safely showing properties. Although some of the more restrictive safety protocols developed during the pandemic will likely be relaxed in the future, the widespread adoption of virtual tours may be more lasting. Similarly, while it remains to be seen whether COVID-19 will lead to a durable competitive advantage for suburban office properties, recent experience may lead tenants to develop a long-term preference for safety features such as automatic doors and touchless fixtures.

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## Interview Participants

**Brian Adamson**, development partner, ICAP Development

**Brandon Bergman**, president, 2000 Development

**Jonathan Kingsley**, executive managing director, Office & Industrial Services, Colliers International

**Terence Kirk**, executive vice president, Occupier Services, Colliers International

**Michael Riopel**, assistant general counsel, Law Department, Northwestern Mutual

## About NAIOP

NAIOP, the Commercial Real Estate Development Association, is the leading organization for developers, owners and related professionals in office, industrial, retail and mixed-use real estate. NAIOP comprises some 20,000 members in North America. NAIOP advances responsible commercial real estate development and advocates for effective public policy. For more information, visit [naiop.org](http://naiop.org).

The NAIOP Research Foundation was established in 2000 as a 501(c)(3) organization to support the work of individuals and organizations engaged in real estate development, investment and operations. The Foundation's core purpose is to provide information about how real properties, especially office, industrial and mixed-use properties, impact and benefit communities throughout North America. The initial funding for the Research Foundation was underwritten by NAIOP and its Founding Governors with an endowment established to support future research. For more information, visit [naiop.org/researchfoundation](http://naiop.org/researchfoundation).

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## Disclaimer

This project is intended to provide information and insights to industry practitioners and does not constitute advice or recommendations. NAIOP disclaims any liability for actions taken as a result of this project and its findings.

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## Endnotes

- <sup>1</sup> Shawn Moura, "NAIOP's July Coronavirus Impacts Survey Results: CRE Continues to Recover," Market Share, August 3, 2020, <http://blog.naiop.org/2020/08/naiops-july-coronavirus-impacts-survey-results-cre-continues-to-recover/>
- <sup>2</sup> Ibid.
- <sup>3</sup> Michael Stewart, "Five Issues Landlords Should Consider Regarding a Pandemic's Impact on Commercial Tenants," *Development*, Summer 2020, <https://www.naiop.org/en/Research-and-Publications/Magazine/2020/Summer-2020/Marketing-Leasing/Five-Issues-Landlords-Should-Consider-Regarding-a-Pandemics-Impact-on-Commercial-Tenants>.
- <sup>4</sup> Trey Barrineau, "COVID-19 Challenges: Approaching a Mortgage Lender for Help," *Development*, Summer 2020, <https://www.naiop.org/en/Research-and-Publications/Magazine/2020/Summer-2020/Finance/COVID19-Challenges-Approaching-a-Mortgage-Lender-for-Help>.
- <sup>5</sup> Beth Mattson-Teig, "Lenders Provide 'Mixed Bag' of Relief to CRE Borrowers," *National Real Estate Investor*, June 29, 2020, <https://www.nreionline.com/distressed/lenders-provide-mixed-bag-relief-cre-borrowers>.
- <sup>6</sup> Ron Derven, "Negotiating with Tenants During a Major Economic Disruption," *Development*, Summer 2020, <https://www.naiop.org/en/Research-and-Publications/Magazine/2020/Summer-2020/Marketing-Leasing/Negotiating-with-Tenants-During-a-Major-Economic-Disruption>.