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How property owners can deal with distressed tenants

By James Wacht

New York City property owners are going to be confronted with serious challenges over the next several years. In addition to the hardships imposed by softening rents, increasing real estate taxes and operating expenses, as well as the specter of tightening governmental regulations, property owners can also be expected to be affected by a wave of tenant defaults. How, then, can concerned property owners best protect themselves against these potentially serious problems?



James Wacht
Sierra Realty Corp.

1. **Be diligent:** each property owner should frequently review rent collection reports and follow-up with any tenant that falls behind in their rent payment. Be particularly concerned with any tenant who begins to deviate from previous payment habits. A tenant that always paid by the fifth of the month should be watched carefully if rent payments start coming in later. Follow-up with a phone call or visit to any tenant whose rent is late. Try to find out what is going on and what you can anticipate in the future.
2. **Start Legal Actions:** start nonpayment actions promptly. Do not wait. Time is a landlord's worst enemy. It can take many months to evict a nonpaying tenant. Typically, we start legal actions against any tenant that is more than one month and three business days late in the payment of rent.
3. **Offer Intelligent Rent Relief:** If a tenant approaches you seeking rent relief use this as an opportunity both to obtain concessions that are beneficial to you and to minimize your downside. Concessions can include renegotiations of lease provisions that are favorable to



the tenant, such as reassignment and subletting provisions, demolition clauses, renewal and additional space options, etc. It is also critical when granting a tenant rent relief that it be structured in a way so as to minimize the likelihood that the tenant will continue in occupancy if they stop paying rent. A property owner's worst nightmare is the tenant who stops paying rent but does not vacate the space given the cost and time involved in obtaining an eviction. Some suggestions of methods we've found effective include:

- * **Court Stipulation** - The best and most effective structure is to grant the rent relief in the context of a court ordered stipulation of settlement which provides for the immediate issuance of a warrant of eviction the execution of which is stayed pending the compliance by the tenant with the terms of the stipulation. If the tenant defaults, then the warrant can be executed very quickly. The preparation of such a stipulation is very technical and should only be done by an experienced landlord/tenant attorney.
 - * **Guaranty** - Demand that a responsible principal of the tenant execute either a full or partial guaranty of the lease as a condition to obtaining any rent relief.
 - * **Increased security/collateral** - Collateralize the lease by either obtaining a mortgage or a perfected security interest in some assets of the tenant or its principals.
4. **Deciding whether to grant rent relief.** When you decide to grant rent relief to an existing tenant, it should depend on a number of factors including:
- * **Track record of tenant:** A tenant who has a long-term, favorable track record with a property owner is more worthy of being granted relief than a tenant who has a history of non-payments and lease defaults.
 - * **Value of the space:** An assessment of the rental value of the space needs to be made. If the tenant is paying an above market rent, then having them go out of business and re-renting at a lower rent is not a good alternative. Don't assume that in today's economic environment you know the value of your space. Rent rates have and the time that it may take re-let the space may have increased significantly. Do your homework first and check with a knowledgeable broker about local market conditions.
 - * **Tenant's prospect of survival:** Don't throw good money after bad. An assessment of the likelihood that the tenant will survive a downturn needs to be made. Talk to the tenant about their business and their long-term prospects. Perform a new credit review and examine financials if possible.

But before granting any rent relief, perform your due diligence to make sure the tenant has not encumbered your space. Check for open violations and Department of Building applications. If the tenant has made significant improvements to your space have a UCC, lien and judgment search performed against the tenant to make sure that a creditor of the tenant has not encumbered any of the improvements to the space. This is particularly important with restaurant tenants.

Predictions are that it is going to get tougher before it gets better, but by taking a few precautions, property owners should be able to protect themselves against the risk of distressed tenants.

James Wacht is the president of Sierra Realty Corp., New York, N.Y.