COMMERCIAL TENANTS:

LOVE 'EM LOSE 'EM OR PARTNER WITH 'EM

BY ANN FARMER • ILLUSTRATION BY MARCELLUS HALL

When the restaurant that occupies the ground floor of a 240-unit Murray Hill co-op got shut down in the early stages of the COVID-19 pandemic, Andy Leight, the senior vice president of operations at AKAM, arranged for it to defer its rent payments for a couple of months.

When the same establishment asked to remove a windowpane to create a portal for takeout orders, the co-op again granted the request. After the state lifted restrictions on outdoor dining, the co-op then allowed the restaurant to offer al fresco dining in its expansive Privately Owned Public Space alongside the building.

All that flexibility and accommodation paid off. The restaurant remains afloat while many others have folded, and it has squared up the back rent it owed. “Their success is helpful to us,” Leight says. “Because, obviously, if the tenant leaves, you have an inherent lost-income cost there. And who knows, in this climate, how long you’re going to sit out with an empty space?”

Time to Tighten Up

Co-op and condo boards across the city that lease commercial spaces are facing similar scenarios. The question becomes: How should they respond when their commercial leaseholders, trying to remain viable with a fraction of their former revenue, can no longer afford to pay the rent?

“A lot of people are paying slower or not at all,” says Carl Cesarano, a principal at the accounting firm Cesarano & Khan, noting that in one building he audits, only half of the commercial tenants are keeping up right now. Michael Mintz, the founder and CEO of the management company MD Squared Property Group, adds, “We have had a bunch of buildings that have commercial tenants – retail, specifically – who have not been paying because of COVID-related factors.”

Consequently, the accountant and the property manager have been strategizing with the boards for ways to plug the financial gaps and perhaps even jimmy the buildings into better fiscal health for the long term. Cesarano says the first step he takes is to re-examine the current budget and re-evaluate its priorities.

“The assumptions and assertions that were in those original budgets have changed,” he says. “You do all your due diligence at first. Loads of it. See what we can cut. See how we can fix our budget. See if maybe we have room to raise other charges. Then I look in the bank at what’s not segregated. You’re going down the line.”

Optional capital projects, for instance, may have to be postponed or even canceled. “We’re not going to be loosey-goosey,” Cesarano says. “We don’t have the luxury of saying, ‘We didn’t get all the bids.’ Everything has to be really tight.” He also encourages boards to approach vendors for concessions or discounts and to motivate resident slackers to catch up on their maintenance or common charges. “I wouldn’t leave any stone unturned,” he says. “Anything we can reduce, we want to reduce it.”

A Two-Way Street

Another course of action is to require unit-owners or shareholders to shoulder the loss of income from commercial tenants, at least for the short term. Gerard Picaso, a senior managing director at Halstead Management, says that as soon as his buildings’ commercial units had to close, he began operating on the assumption that they wouldn’t be able to pay the rent. He crunched the numbers to determine how much to assess shareholders to ensure that all essential operating expenses would be covered going forward, including the real estate taxes that were due in July.

In one of his buildings, two commercial tenants simply walked away. “They said: ‘We’re done. We’re not going to reopen. Here’s the keys,’” Picaso recalls, noting that one of those tenants had been operating a couture clothing

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shop for more than 40 years. In addition to financial challenges, the shop owner was concerned about her vulnerability to COVID-19. Once she reopened, she noted, people would be traipsing in and out, touching things, and she was uncomfortable with having to monitor mask wearing.

It was initially perceived that national chains and businesses deemed essential, including grocery stores and pharmacies, were ideal commercial tenants since they were better positioned to weather the shutdown. But with offices and many apartments still empty, and with the city's foot traffic severely diminished, even some anchor tenants are shuttering operations.

Meanwhile, commercial tenants who are sticking it out are asking to renegotiate leases.

"Now," Picaso says, "commercial tenants are saying to you, 'Look, I can go across the street to the empty store there. They are asking 30% less than what I'm paying now.'" As a result, he has been hammering out new lease agreements that provide at least some incentives for staying put. "Nobody knows what's going to happen," he says. "It's a very unstable market."

In his own lease renegotiations with commercial tenants, Mintz, the property manager, talks about a balancing act, noting that concessions need to go both ways. "We have been willing to give some relief in terms of rent for the periods of time that they were closed," he says, "as long as going forward they continue to pay. Usually we wanted some additional security or we wanted an extension of the lease term. It's not really fair to condo and co-op boards if the retailers get too much."

Luckily, Mintz says, most of his buildings had built up such healthy reserve funds that they have been able to forgo maintenance increases or assessments. Instead, they have tapped into lines of credit, capital reserves or other discretionary savings to compensate for the commercial rent arrears. "They have the cash to carry themselves through," he says, but there are limits. "If this goes through to the beginning or middle of next year, we'll be in a much worse place."

Some of his buildings took advantage of the Paycheck Protection Program, which offered forgivable loans to businesses that kept employees on the payroll. Mintz says there was some initial confusion over whether condo and co-op buildings qualified for the loans. "So many decided not to apply," he says. But for those that grasped the opportunity, it provided some welcome financial relief.

One upside of the pandemic has been lower utility costs after the state mandated the shutdown of gyms and other communal amenities. On the other hand, the enhanced cleaning mandated by the state may have canceled any savings.

And some boards have gotten creative. One of Mintz's


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Restaurant

buildings, which has a ground-floor commercial tenant shuttered by the pandemic, entered into an agreement with the restaurant next door to allow it to temporarily occupy the tenant's sidewalk space for outdoor dining. "So it's bringing in some income for that space while the retail is not paying," he says.

Everything Is on the Table

And finally, there's the elephant in the room: financially strapped shareholders and unit-owners who are falling behind on their monthly maintenance or common charges. In an act of generosity at a Brooklyn condo Mintz manages, the president of the board, who owns several units in the building, offset his neighbors' arrears by forking over six months of his common charges in advance. "He knows his neighbors and knows they're struggling," Mintz says.

On a positive note, mortgage rates are near record lows. Cesarano, the accountant, believes that buildings in a position to refinance should consider doing that to replenish their capital reserves and benefit from the lower interest rates.

"Every building is different," he says. "We're acting according to that building's particular situation. And I don't think anything is off the table at this point. You're going to have to do what you have to do to be viable." ■