



**A RISING TOGETHER POLICY BRIEF**  
December 2020

# Keeping the Lights On

Addressing the rent crisis for small  
businesses, landlords and lenders

# Acknowledgments

**This policy brief is part of Rising Together, SPUR's policy response to the impacts of the COVID-19 pandemic.**

[spur.org/risingtogether](https://spur.org/risingtogether)

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Many thanks to the small business representatives, property owners/landlords, financial institutions and others who participated in a convening in October 2020 to brainstorm solutions to the challenges facing small businesses and landlords due to the COVID-19 pandemic.

Special thanks to our co-hosts and partners who conceived of this summit: Gwyneth Borden, Ground Floor Experiences; and Sharky Laguana, small business owner and president of San Francisco's Small Business Commission.



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# Introduction

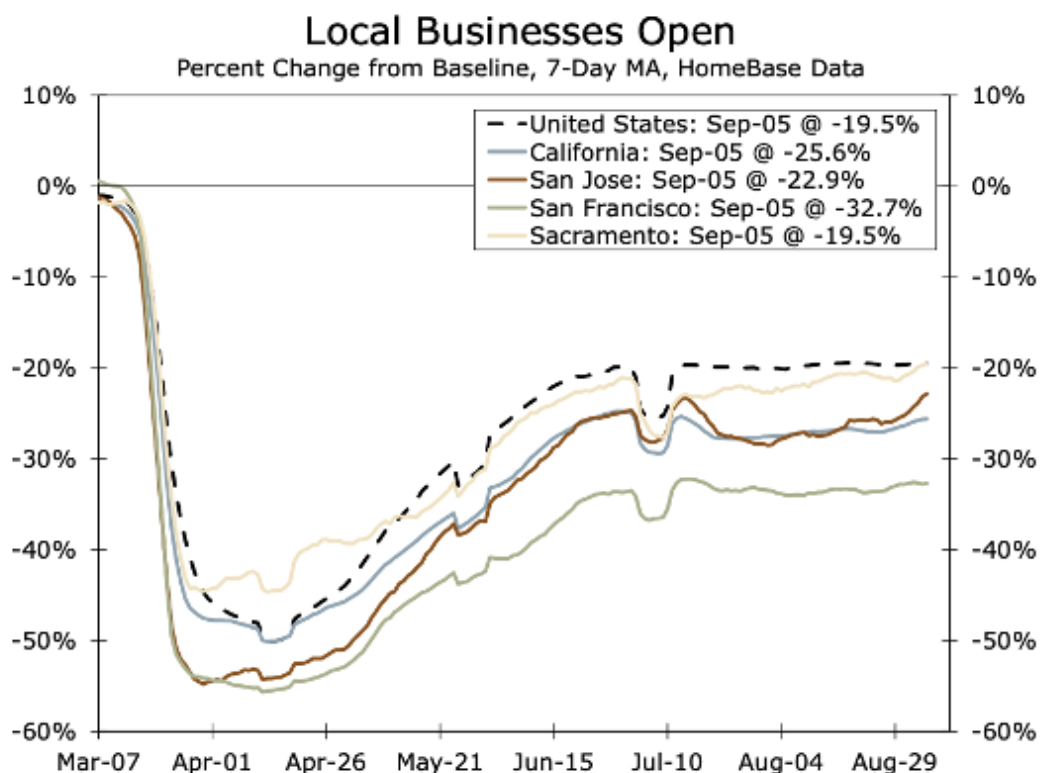
The COVID-19 pandemic and subsequent shelter-in-place orders have thrown businesses — and especially small businesses — into survival mode. Storefronts are boarded up. Restaurants have pivoted their business models or are desperately hoping to ride out the pandemic with limited tools. Entertainment venues are temporarily or permanently shuttered. These full and partial closures have impacts beyond the businesses themselves. If they're not open, they're not making money and are unable to pay their rent.<sup>1</sup> Landlords who aren't receiving rent may not be able to pay their mortgages and expenses, subsequently impacting banks and lenders. If businesses don't get help, it will shock the entire system, with implications not only for owners and workers but also for the local economy, our neighborhoods and our culture.

Are there ways to help businesses so that pandemic-induced failures don't ripple through the real estate and lending industry? Are there ways to strike a balance so that all parties give up something in order to save the whole? In collaboration with small business owners and advocates, this fall SPUR convened a group of people from small business, real estate, banking and government to discuss possible solutions to these challenges. The ideas in this briefing paper stem from those conversations.

<sup>1</sup> Chuck Custo, "Alignable: 44% Of Minority-Owned Small Businesses Can't Afford To Pay Full Nov. Rent," Alignable, November 8, 2020, <https://www.alignable.com/forum/alignable-44-of-minority-owned-small-businesses-cant-afford-to>

# Initial Efforts to Support Small Businesses

The COVID-19 pandemic's impact on the economy has been decidedly uneven so far. The national economy has been recovering faster from the initial shutdown than expected, yet unemployment remains high and minority-owned businesses have been notably impacted more than white-owned businesses. While overall consumer spending in August 2020 exceeded pre-pandemic patterns, service spending and consumer spending in certain categories remains below February 2020 levels.



Source: Mark Vitner, Managing Director & Senior Economist, Wells Fargo Securities, "Economic Outlook" presentation to SPUR Small Business + Real Estate Summit, October 08, 2020

In California, unemployment remains higher than in most of the country. And while local business openings are better off than at the most extreme point of closures in April, both the Bay Area and California as a whole are still 20% to 30% below the March baseline.

Many observe that this economic slowdown is accelerating existing trends. Businesses and business models that were already struggling will be the ones that don't survive, and this shift could create more opportunities and room for new entrepreneurs. There may be some truth to this observation, but the challenges are so great that many successful, relevant businesses will not be able to survive, either.

Early in the pandemic, the federal and state government took several immediate actions to help save the economy. As the pandemic rages on, these interventions have proven to be both essential and also not enough:

### 1. Paycheck Protection Program and other loans

The Paycheck Protection Program (PPP) was the main federal stimulus for small business in the CARES (Coronavirus Aid, Relief and Economic Security) Act, passed in March 2020. The program funneled \$659 million to the Small Business Administration to provide businesses with forgivable loans to help retain employees. PPP and other programs have provided important relief for small businesses and their employees, but they limit the amount of a PPP loan that could go toward rent expenses.

### 2. Commercial eviction moratoriums (but not rent abatement)

Early on, Governor Newsom issued an executive order allowing local jurisdictions to enact commercial eviction moratoriums. Separately, the California Judicial Council adopted emergency rules to prevent courts from moving forward with commercial evictions through early September 2020. The governor's order was extended to the end of March 2021. This extension followed weeks of pressure from mayors and county officials throughout California who predicted a wave of commercial evictions if no action was taken. Some of the local moratoriums have expired, though many have been extended. Importantly, the eviction moratoriums didn't address rent payment relief for small businesses. Accumulating unpaid rent remains an issue to be addressed when the moratoriums inevitably come to an end.

### 3. The failure of proposed rent deferral

Early in the pandemic, Senator Scott Wiener introduced legislation that would have created a broad statewide commercial eviction moratorium and allowed for lengthy repayment of back rent. Through negotiation it was narrowed to support only small businesses and nonprofits. SB 939 would have established a rent deferral and repayment schedule for small businesses and nonprofits impacted by loss of revenue due to COVID, and it would have given hospitality businesses the ability to renegotiate their leases.<sup>2</sup> The real estate advocacy community strongly opposed and ultimately killed the legislation, expressing concerns that the bill would undo contract law in California and upend the real estate market.<sup>3</sup>

## Challenges

The pandemic is imposing enormous challenges on businesses in the Bay Area, particularly in making rent. At the same time, failed rent payments trigger a series of serious failures across the local — and ultimately national — economy.

**The challenge for small business: Lack of capital and severely diminished operating income make it difficult to pay rent.** While some major costs (staff and materials) can flex up and down, rent is the largest fixed cost to businesses. Many businesses have been able to negotiate with their landlords, but others have had difficulties in getting rent relief, especially from smaller landlords who may have less capital and flexibility themselves.

**The challenge for landlords: Monthly financial obligations depend on rental income.** Landlords range from established firms with large portfolios to individuals with a single asset. Mom-and-pop landlords rely on rent in a much more direct way than institutional landlords and don't have the same ability to adjust the timing and size of rental payments. Some landlords may be forced into debt themselves

<sup>2</sup> California Legislative Information, SB-939 Emergencies: COVID-19: commercial tenancies: evictions (2019-20), [https://leginfo.ca.gov/faces/billTextClient.xhtml?bill\\_id=201920200SB939](https://leginfo.ca.gov/faces/billTextClient.xhtml?bill_id=201920200SB939)

<sup>3</sup> Laura Waxmann, "California bill allowing struggling commercial tenants to break leases dies in committee," San Francisco Business Times, June 18, 2020, <https://www.bizjournals.com/sanfrancisco/news/2020/06/18/ca-bill-sb-939.html>

for expenses they cannot pay and could face possible default on their loans next year. Most landlords have had positive experiences coming to agreements with their tenants but, inevitably, there are some tenants taking advantage of the situation to skip paying the rent.

**The challenge for banks: Regulation by the federal government limits flexibility.** Over the long term, it will be difficult to bail out borrowers without federal assistance or federal direction on how lenders can or should modify loans. The rules for PPP loans continue to evolve, and lenders are currently awaiting guidance from the federal government on how forgiveness will work. Banks warn that it's not as simple as prohibiting foreclosures: If banks are unable to foreclose on loans that aren't being repaid, this will increase the rates at which they lend money in the future. Expensive and lengthy foreclosures aren't the desired endgame for banks and in large volumes would have a negative impact on the overall economy and financial sector. This means federal assistance and alternative solutions are needed.

## A Toolkit of Possible Solutions

Right now, small businesses are shouldering the majority of the financial loss in the economy. Understandably, no one else — landlords or lenders — wants to be left holding the bag, either. How can the burden be shared such that most parties in this system can survive?

Already landlords and tenants are working out creative solutions that enable mutual relief.

### Privately-Negotiated Rent Solutions

Options include:

- 1. Deferring rent for** 12 months (or some other period). This is currently the most common approach but can take several forms:
  - Extending the lease for the same length of time (so with a 12-month deferral, a 5-year lease would become a 6-year lease).
  - Converting deferred rent into business equity, giving the landlord some ownership in the business.
  - Converting deferred rent to credit from the business (gift cards, membership, meals, etc. depending on the nature of the business) for the value of the deferral.
- 2. Modifying or reducing rent**, which can be done in different ways:
  - Utilizing “percentage rent,” where the tenant pays a percentage of their gross income instead of a fixed monthly amount. This might extend only for the term of the pandemic or a defined period (e.g. until full or 75% occupancy for 60 consecutive days), or it might be continued later.
  - Reducing rent for a defined period (12-18 months) with repayment stretched over the rest of the lease term. For example, the rent could be set only to cover real estate taxes, building insurance and maintenance expenses for a period of time.
  - Renegotiating current rent (e.g. to percentage rent) and scale with CPI or renegotiate fair market rate at a future date (April 1, 2021).
- 3. Forgiving** some portion of rent, or all of rent, for certain months.
- 4. Mixing the above approaches**, for example:

- Using a “blend and extend” approach, which lowers rent and extends the lease to cover the lowered amount of rent, or the tenant adds time to the term but the rent is lowered to be closer to today’s market
- Using all of the above: paying a portion of rent, deferring a portion and forgiving a portion. For example, a tenant and landlord might negotiate a rent reduction to 50% of the original rent, deferring 25% to be paid later and forgiving 25% outright.

While these solutions are promising, much more needs to be done. Clearly financial assistance from any level of government is important and should be pursued. The federal government should pass another stimulus package, and the federal or state government could offer mortgage relief to landlords who pass along part of the benefit to tenants. The state could give landlords property tax relief in exchange for not collecting rent or reducing rent. But forthcoming federal assistance is likely to be limited, and California’s budget is already under severe strain, so throwing money at the problem will not be sufficient. In convening this conversation, we sought to find meaningful solutions that go beyond financial relief.

It will also be difficult to legislate a solution, given the range of circumstances for businesses and landlords. Some tenants have been able to pivot their operations and are doing better than before, while others are barely surviving. Some landlords have the flexibility to navigate foregone or delayed rent payments, others have no options. Some tenants are behaving badly, some landlords are not acting in good faith. Every negotiation between a commercial landlord and tenant has taken a different form, making a single legislative response difficult. Until the economy fully reopens, it is likely that property owners and tenants will continue to operate week-to-week and month-to-month to continually amend leases and make accommodations. Still, the legislature should consider taking further action.

## Potential Legislative Solutions

Some ideas for the state legislature include:

1. Establishing commercial eviction moratoriums for the entirety of widespread stay-at-home orders. This approach would provide critical relief to some, though it runs the risk of being too blunt of an approach.
2. Creating the equivalency of bankruptcy court for commercial tenants during an emergency period. This would create an administrative remedy before eviction, allowing for a judge to set the share of rent burden/deferral between landlord and tenant (similar to what was proposed but not passed at the state level for residential tenants in [AB 828](#)).
3. Requiring full financial disclosure between landlords and tenants for some emergency negotiation period. Typically tenants are asked to disclose all of their financial information to landlords but have little information about the landlord’s situation. This puts tenants at a disadvantage and can lead to bad faith negotiation.
4. Requiring “good guy” clauses or guarantees in leases, as New York does. These clauses provide a mechanism for tenants to get out of their lease as long as they are not in default of the lease and they leave the property in good condition. This helps tenants avoid unnecessary costs and helps landlords avoid a long and expensive eviction process.
5. Providing longer payment deferrals for utilities (power, water, garbage, etc.) that are necessary to run small businesses but punitive if you can’t pay, as they can stop service and shut down your business. Also suspend the right for utilities to lien, or make a legal claim, against real estate during this deferral period.

Lastly, what is the role of banks? We need leadership at the federal level — since several federal agencies regulate the major lenders — that can provide guidance to banks on what they can and cannot do. One innovative proposal brought to our discussion would use private-sector financing to help solve these issues. Modeled on Property Assessed Clean Energy (PACE) financing mechanisms, a Property Assessed Emergency Rental Relief (PAERR) program<sup>4</sup> would utilize private capital to provide a loan to property owners who forgive up to a year’s worth of rent to tenants (commercial or residential). The loan would be added to the property’s tax roll and be repaid in annual assessments over 30 years. While the burden is ultimately borne by the property owner, it would be a meaningful option for landlords experiencing distress due to tenants not paying their rents. Further, it would enable mortgage lenders to avoid spending time and money on foreclosures. This program would not require any public funding or federal enabling legislation, but to be implemented in California, it would need state enabling legislation.

## Next Steps

The COVID-19 pandemic presents a serious threat to interconnected health of small businesses, their landlords and the lenders who underpin them. All parties in this system have a compelling interest in solving the problem for the whole. We are finding that generally people are acting in good faith and working out these challenges in partnership. But it’s complicated. Each situation is different, each set of circumstances is unusual and requires its own negotiation. And while these one-off negotiations are necessary, these agreements won’t last forever. One key question that no one can answer today is: How long will the pandemic last and for how long must the public health response be this extreme? The timeline and the uncertainty of the timeline have impacts on the decisions that all players are making.

While we sought local and state government solutions — and financial assistance from all levels of government will be key — the economy ultimately needs more action from the federal government, which has more resources and regulates the financial sector. If there is another federal stimulus package, future loans could allow more dollars to flow to rent, and regulations could help delegate how the burden gets split across small businesses, the real estate industry and financial institutions.

Big challenges to small business remain, and we don’t know how long this situation will drag on. It remains important to ensure that dialogue across the sectors continues. Tenants need to understand that landlords are suffering financially, as well. Property owners will benefit from sharing stories with each other to understand how others are faring and looking at solutions. To the extent that additional market-based solutions like PAERR are possible, they should be surfaced and vetted, and future legislative solutions should be taken seriously by all parties. Our economy, neighborhoods and residents rely on the survival of small businesses through the pandemic, and it’s unlikely that that can happen without dialogue, collaboration and compromise.

<sup>4</sup> For more detailed information on the PAERR proposal, please contact Randell Leach at [rleach@beneficialstate.com](mailto:rleach@beneficialstate.com)



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