Tips for Navigating Financial Duress for Commercial Real Estate Assets

The pandemic may present many difficulties, but asset holders and small business owners have options that can help them navigate this challenging time.

By Sam Newman and Gabrielle Cuskelly

Government leaders have expressed frustration and an inability to reach a deal on extensions of programs designed to protect the economy from pandemic stress. Critical aid will begin to expire over the next several months, and if no further programs are authorized, businesses will begin to suffer the true impact of the economic dislocation wrought by the pandemic.

Government Programs

Some businesses may still be able to access federal or state aid programs. Small businesses that meet certain criteria (which may exclude those with only passive real estate investors), may be able to apply for Economic Injury Disaster Loans from the U.S. Small Business Administration; loans in connection with the California Capital Access Program for Small Business; and loans guaranteed through IBank's Small Business Loan Guarantee Program. Certain other relief or moratoriums may apply on a county-by-county basis throughout California.

Third-Party Investors

Those that do not benefit from these programs will need to develop strategies to navigate through the down-turn. Such businesses might consider involving third parties that may be looking to either invest or acquire distressed assets — particularly in industries where investors anticipate less of a long-term impact from COVID-19. Other investors may be willing to provide bridge financing to businesses that are in need of a short-term infusion of cash to carry them through a return to normalcy, especially where such financing is at highly favorable terms to the investors to counterbalance the risks involved. In either case, both struggling businesses and investors may be able to reach mutually beneficial arrangements satisfying each of their unique needs.

Restructuring

Businesses that are not able to adjust to the new economic conditions or obtain access to capital will have to address their problems through debt restructuring transactions. In many cases, the easiest solution is to obtain the consent of creditors to alter payment terms. With mutual consent (or the consent of required lenders under many loan facilities), dramatic changes can be made to allow a business the time to recover and repay its creditors.

Chapter 11

In some cases, lenders are unable or unwilling to make such accommodations. In these cases, Chapter 11 bankruptcy can be an important tool to place an improved capital structure on a business. The Chapter 11 process provides substantial leverage to help a struggling business regain its footing. In the real estate context, a debtor is empowered to assume or reject leases and contracts, allowing the business to jettison burdensome agreements with damages capped in many cases. This cherry-picking can be a tremendous asset to retaining brick-and-mortar businesses as they re-tool for the post-COVID environment. Unprofitable locations can be done away with and the business can enhance its leverage to improve terms on locations that it wants to keep.

A business can also use Chapter 11 to right size its balance sheet, stretching out time to repay creditors and, in many cases, reducing the total amount of re-payments required to more closely reflect expected cash flows in the new economic reality. In many cases, clients have been told they have no alternative but to sell their business or shut down. However, a careful review of the Chapter 11 process has identified alternative paths forward to restructure their debt to preserve value for equity when the economy stabilizes.

This period of stress can also present opportunities for acquisition and the re-purposing of assets. We have seen many clients buy distressed assets through foreclosures and bankruptcy sales. They are essentially taking advantage of the ability to leave old debts behind through “free-and-clear” sales or allowing the unburdening of assets through rejection of contracts and leases. Bankruptcy courts have broad powers to require the re-purposing of assets to achieve the best value available.

In many cases, bankruptcy has been unavailable to smaller businesses because of the expense associated. Bipartisan legislation known as the Small Business Reorganization Act of 2019 (SBRA) was passed to make it easier, faster and less expensive for a small business debtor to file for bankruptcy in the U.S. This new process eliminates much of the oversight and duplication that makes Chapter 11 prohibitively expensive, and is available to many businesses.

At the end of the day, the economy has suffered greatly from COVID-19. The necessary delivering will be a painful process, but long-term American business will re-grow on a sounder footing.

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