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THE IMPACT OF BANKRUPTCY FILINGS ON THE COMMERCIAL REAL ESTATE SECTOR

The economy might be leaps and bounds ahead of where it was a few years ago, but some well-known names are still struggling. For this reason, it's important for landlords to consider the effects a bankruptcy may have on their tenant roster.

By Victor Sahn

Many well-known retailers filed bankruptcy cases in late 2014 and into 2015. A number of them are on their way to liquidation or on the brink of reaching that point. This will present tremendous challenges to the commercial retail sector. These added vacancies may very well hamper the business ventures of landlords throughout the country. Major mall operators may have to address ever-increasing vacancy rates in order to reduce costs and operating losses as bankruptcies continue.

Some of the most notable bankruptcies of 2015 include RadioShack, Wet Seal, Delia and Deb Stores, Annie's Fabrics, Caché, Quizno's and Sbarro. Significant filings in 2014 included Coldwater Creek and Loehmann's. Many of these bankruptcy cases have resulted in liquidations of these companies, with the exceptions of Sbarro and Quizno's. Even more significant are the companies on the watch list. Landlords stand to lose a substantial

number of retail tenants as a result of the store closings and liquidations that clearly lie ahead.

There have been thousands of store closings and tens of thousands of jobs lost throughout the retail sector, which is not good news for commercial landlords. At the same time, however, it is nothing compared to the avalanche of store closings that will arise if the companies that are on the watch list file their bankruptcy cases or close a significant number of stores. Commercial landlords will not readily replace these tenants, and the resulting loss in foot traffic in the malls around the United States will significantly affect their business.

Even companies that were believed to be healthy and profitable have recently announced significant store closings. Gap recently announced it was closing 175 of its 675 stores in North America, which will include 140 stores that will close by next January. The apparel company attributed

the closings to a downturn in same-store sales and reduced traffic in a number of retail malls where its stores were located. On the plus side, analysts noted retailers like H&M, which are much less expensive and are able to bring new fashions to their stores with lightning speed, can fulfill much of this current market demand.

Any retail company hoping to survive in the long term must also create a significant internet presence and learn to drive sales from that important source. Landlords are going to be severely tested in their ability to keep important tenants as these bankruptcies and internet sales continue. The trends identified above certainly are powerful forces working against landlords. They will need to be understood and overcome.

Fortunately, there are a few steps landlords can take to protect themselves against tenants that file bankruptcy and attempt a store closure before these events ever happen.

Landlords should obtain a letter of credit (as opposed to a cash deposit) as a security deposit from the tenant and file a proper unlawful detainer complaint if the tenant fails to pay rent. They can also obtain a waiver from the tenant of their right to relief from a lease termination under applicable law. Naturally, thorough credit checks on proposed tenants are always a wise idea. Landlords should also obtain guarantees where possible, and secure financial statements from proposed tenants and the guarantors — both initially and annually — after the lease commences. Though these steps will not guarantee the prevention of a vacancy, they can help landlords see their leases through completion.

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