Intelligence MEMOS

From: Michael O'Connor and Benjamin Tal

To: Bill Morneau, Minister of Finance

Date: April 24, 2020

Re: **Integrate Programs to Help Commercial Landlords and Tenants**

The federal COVID-19 response has been swift and sizable, but more targeted support to Canadian businesses is needed.

Specifically, we need a more immediate and direct solution to address commercial rents for SMEs, because there is a great risk of losing a very large number of businesses unable to pay the rent on their locked down premises. The inability to pay rent will force SMEs to lay people off and reduce their participation in the wage subsidy program, further frustrating the economic recovery.

The federal government announced that it intends to provide loans and/or forgivable loans specifically to commercial property owners, who in turn will lower or forego the rent of small businesses for the months of April (retroactive), May and June, through a new program that would be called the Canada Emergency Commercial Rent Assistance (CECRA). No details have yet been announced.

This will be a good first step, but more is needed. Ottawa, working with the provinces, could develop national guidance for landlords and tenants for the proportionate sharing of the financial burden through rent reductions or deferrals. And when a landlord/tenant agreement is reached, the government should extend the level of forgiveness of Canada Emergency Business Account (CEBA) loans used to pay for rent, providing an additional incentive to enter into such agreements. The uptake in the CEBA program is far from overwhelming as many businesses don't meet the requirements to qualify for the loans, and many SMEs are simply reluctant to take on more debt.

Tenants face multiple months of reduced revenues and there is no time to reinvent the wheel. The fundamental issue in developing a solution for commercial rents is who will suffer the loss when premises cannot be occupied; the landlord, the tenant, or governments.

Generally, tenants suffer the loss, unless they walk or fail, and then landlords (and by extension, investors) suffer. Governments at all levels suffer when tax payments by landlords and related businesses dwindle. A government subsidy may be warranted, but must be balanced against the moral hazard of bailing out the landlord's investment risk.

New Zealand may be a model for post-COVID-19 risk sharing between landlord and tenant. The Christchurch earthquake a decade ago spawned a risk-sharing clause in commercial tenancy agreements where a tenant is unable to gain access to premises to fully conduct the tenant's business due to "an emergency" situation.

In this case "a fair proportion of rent" simply ceases to be payable for the period of the closure. That clause is active now, and New Zealand commercial tenants are already negotiating rent relief, subject to "fairness."

Australia's federal government has gone a step further than most and issued specific guidance to landlords of businesses eligible for its wage subsidy program on the need to proportionately share the financial burden between landlord and tenant. Mainly, landlords must offer SME tenants proportionate reductions in rent through waivers and deferrals of up to 100 percent of the amount ordinarily payable, with rent waivers constituting at least 50 percent of the relief. Deferrals are repayable over the term of the lease or 24 months, if shorter. While the guidelines are specific to SMEs, they are an important nudge for all landlords.

In developing guidance for landlords and SMEs on proportional sharing, Ottawa could integrate its guidance with support delivered through CEBA and the upcoming CECRA.

To encourage landlords and tenants to enter into deferrals or rent waivers, we suggest extending the level of forgiveness of CEBA loans used to pay for arm's length rent that has been reduced or deferred by the landlord. This will incent rent deferrals or waivers and SME tenants to seek the support of the CEBA program to honour a fair payment of rent.

CEBA already is interest free until the end of 2022, and 25 percent is forgiven if repaid by then. The level of forgiveness could be increased to 50 percent or higher, if in addition the SME qualifies for the wage subsidy program and the landlord agrees to defer or waive rent during the closure and into the restart. Additional incentives to landlords could be given **through the tax system**.

Extending CEBA forgiveness through a cost-sharing approach involving landlords, tenants and the government would help ease the financial pressure facing many commercial tenants, increase the attractiveness for the CEBA program, and could be financed by related government savings and preservation of tax revenues. It will also increase the effectiveness of the wage subsidy program, thereby limiting the rising unemployment rate and maintaining the crucial employer-employee link.

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