Buen Taco: A case of (f)acts impacting landlords and tenants

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ABSTRACT

This case involves a second-generation authentic Mexican restaurant and specialty grocer located in a retail strip-center in Sarasota, Florida. The family-run business recently suffered financial impacts from gentrification caused by large-scale development in the surrounding area and closure of roadways for infrastructure improvements. The business is behind on its monthly rental payments to the landlord.

The landlord is planning to retire, has a pending offer to sell the strip-center to a developer of chain-style restaurants, and is incentivized to terminate the lease.

This case introduces various ethical, social, legal, and financial impacts landlords and tenants must skillfully define, analyze, and resolve.

Keywords: real estate, ethics, gentrification, law, problem-solving

ACT I - BACKGROUND

Buen Taco (BT) is an established second-generation authentic Mexican restaurant and specialty grocer located in east-central Sarasota, Florida. BT has enjoyed an established clientele since moving to its new location six years ago. The business is owned by Enrique Bolvera. Enrique's wife, children, and two other relatives earn their sole incomes cooking and serving at BT. The restaurant specializes in gourmet tacos, fajitas, and puchero, along with offering a variety of specialty ingredients and authentic homemade grocery items for sale.

BT leases 3500 sq. ft. of a 15,000 sq. ft. strip center owned by Retail Holdings, LLC, (Retail Holdings) on the southeast corner (SEC) of Washington Boulevard and 17th Street in Sarasota, Florida. Rent is \$14.50/sq. ft. plus an additional \$1.75/sq. ft. for common area maintenance (CAM) with an initial lease term expiring April 1, 2021. Bolvera is the personal guarantor of the lease.

BT moved from a smaller location with less visibility about a mile away based on market projections and favorable lease terms presented by Retail Holdings. Bolvera believed the move would better serve BT's existing clients while generating additional revenue through shorter walking routes to core demographics and an uptick from the average daily retail spending in a one-mile radius. The population within a three-mile radius of the new BT site was 60% Hispanic for the five years leading up to 2018 until three large high-end apartment communities were developed in adjacent neighborhoods, along with an outdoor food hall and a new Costco all within one mile of BT. New developments have pushed rents higher for older apartments and rental homes in the immediate vicinity, and demand is high for additional redevelopment sites. As a result, a large percentage of the Hispanic community has relocated to other nearby neighborhoods. Residents have organized a strong and vocal base to preserve the cultural heritage of these neighborhoods, and believe that maintaining local business shops in the Retail Holdings strip center is critical to preventing further gentrification of the area.

To further support new development, the City recently announced a road and sewer infrastructure improvement plan that includes closing 17th street for six months during the summer of 2019 to install a new sewer main, new intersection signal controls, and widen the road.

BT's gross revenue for fiscal years ending 2016-2017 averaged \$950,000 per year. Net profit before taxes was roughly 8.25%. The annual profit was shared equally by each of BT's employees pushing their average annual income to \$43,700. In 2018, gross revenue dropped to \$750,000 and the average annual income of employees was \$32,775. Bolvera contributes the decline to a shift in demographics with new residents in the community preferring chain-style restaurants.

Road and sewer construction commenced in March 2019. 17th Street was completely closed one block east and west of Washington Boulevard. Access to the center from Washington Blvd. remained open to business traffic, but traffic heading north and south had to detour around the closed intersection. In March gross revenue dropped to just under \$42,000 which was insufficient to timely pay vendors and employees. Bolvera failed to pay March rent by the 1st of the month and was concerned he wouldn't be able to pay the entire monthly rent and CAM charges until road construction was completed and normal business traffic resumed.

Retail Holdings, LLC is a single-member limited liability company owned by Carla Markson. Markson owns three retail strip centers in town consisting of 47,000 net rentable square feet of class B-C retail space. Markson supports her and her husband on the rent generated by her commercial real estate operations with all their retirement equity in the properties. Markson and her husband are planning to retire at the end of 2020. As a result, she's planning to sell the commercial properties and purchase a retirement home in Morocco, Spain.

In February, Markson was approached by NTB Acquisition, LP (owner of commercial properties and a chain of "Near the Border" restaurants) about purchasing the commercial center at 17th and Washington Blvd. The offering price was substantially higher than the value Markson could expect to receive based on current cap rates for a 20-year-old retail center with no credit-rated tenants. The agreement was conditioned on Markson not extending or renewing any leases of the property. Closing was scheduled for September 1st. NTB indicated that it planned to remodel the center and raise rents, but Markson's instincts led her to assume that NTB intended to let existing leases expire according to their terms or buy-out leases and replace the BT space and others with a Near the Border Mexican restaurant. Bolvera knows nothing about Markson's intent to retire or the pending sale of the center to NTB because the pending sale cannot be disclosed pursuant to the confidentiality terms of the purchase agreement.

On April 10th Markson became aware that Bolvera hadn't paid April rent. That same day Bolvera reached out to Markson requesting a full rent and CAM abatement until 60-days after road construction is complete. The lease clearly states no rent abatement is permitted except as a result of a full taking of the site through eminent domain. Bolvera never obtained business interruption insurance as thas was not a requirement in the lease. Markson and Bolvera agree to meet the next day to discuss the impacts of lost business traffic from the road closure and demographic shifts.

DECISION AND DISCUSSION EXERCISES

1. Identify and discuss arguments supporting and opposing the gentrification issue.
2. Prepare a spreadsheet showing BT's trending loss of revenue that can be used for the discussion with Markson.
3. Develop an ethics-based decision theory to help Markson determine how to address Bolvera's rent abatement request. Be sure to consider how any decision could impact the pending sale to NTB.

ACT II – THE MEETING

After a brief cordial conversation about family and work, Markson opens the meeting by stating that she cannot permit a rent or CAM charge abatement for any amount or length. Bolvera proceeds to show Markson his year-to-date financial statement and a proforma showing the tending loss in revenue and explains that he's also late on payments to his two largest food vendors because of the under-estimated revenue losses for March. Markson reviewed the financial statement and suggested that Bolvera make some radical changes to operations and marketing until things returned to normal. Markson further pointed out that rent and CAM charges are roughly 11% of gross revenue for March and that would be an acceptable rent allocation for any operation. Markson suggested that Bolvera lay-off some of the family members so they could draw unemployment, or convert them to delivery drivers working for tips and attempt to increase the delivery business.

Bolvera adopted the operational changes suggested by Markson and revenue only slightly declined in April and May. Bolvera paid March rent, but only paid ½ the rent and CAM charges for April and May. Bolvera left Markson several voicemail messages in April stating that BT would begin making weekly rental payments with interest and late fees and that by the end of September BT would be caught up on all the back rent and CAM charges.

Markson and NTB executives spoke regularly regarding due diligence investigations impacting the pending sale. During their last call, Markson informed NTB that BT was delinquent more than 30 days for the balance of April rent and several days delinquent for May rent and CAM charges. NTB indicated they would increase the purchase price by $50,000 and move closing up 30 days if Markson was able to terminate the BT lease before closing. During that call, NTB disclosed its intention to redevelop the property and convert the BT space and the adjacent 4000 sq. ft. into a Near the Border Mexican Restaurant, and that the timeline for redevelopment would now be early 2020. Markson indicated that he would discuss an early lease termination with BT but wanted the termination to be effective July 31st the day before the sale to NTB, and that any rent collected or due and owing from BT would belong to Markson. NTB agreed with this approach and reiterated to Markson that the terms of the sale shall remain confidential.

May 15th the City announced the road and sewer project was progressing ahead of schedule and that 17th Street would be open by the end of July.

BT and Bolvera were technically in default under the lease and personal guaranty payment terms that required all rent and CAM charges to be paid on the 1st of each month, in advance. Markson had accepted the partial rent payments without indicating to Bolvera that acceptance of partial rent was an amendment of the lease terms. The lease provides that a default notice is not required for any monetary obligation that is delinquent and there is no time provided beyond the due date to cure such defaults. Further, common law in Florida provides commercial landlords with the option of using extraordinary measures to secure premises from a defaulted tenant. These extraordinary measures include changing the locks, seizing the tenant's personal property, and terminating the lease. The lease also states these extraordinary default measures are available at the option of the landlord.

DECISION AND DISCUSSION EXERCISES

1. Discuss how Bolvera could have presented his case for rent abatement differently. What other facts and what measures could he have taken to gain long-term buy-in or a commitment from Markson to extend payment terms or to insure that Markson wanted BT as a tenant?
2. What other changes could Bolvera adopt to offset the loss in revenue?
3. Develop an ethics-based decision theory based on the facts and provide recommended guidance to Markson on how she might propose terms for terminating the BT lease.

ACT III – PROPOSED LEASE TERMINATION

Markson and Bolvera meet the next day. Markson suggests that Bolvera agree to a lease termination effective July 31st and vacate the premises on that date. In exchange, Markson would accept half the rent for April through July and refund the security deposit to assist with relocation expenses. Bolvera is visibly upset by the unexpected suggestion to terminate the lease. Bolvera asks Markson to explain why she wanted to terminate the lease when none of the events causing the lease default were within Bolvera's control. Markson simply says that she has other plans for that space and the center. Bolvera, in frustration, tells Markson that rent in other parts of the neighborhood is significantly higher and there is no way that he can afford more rent until the business recovers from the road closure. Bolvera explains that he will need a couple of days to calm down before he can respond to such an undeserved move by Markson. Markson gives him until noon two days later.

DECISION AND DISCUSSION EXERCISES

1. Provide recommendations for Bolvera's response to Markson.

ACT IV – THE FINAL SCENE

When Bolvera told his family about the conversation with Markson and the increased costs BT would incur trying to move the restaurant and grocery to a new location, the immediate and extended family came together and agreed to loan Bolvera all the money needed to keep rent current until the road opened and business-traffic resumed. Further, neighborhood residents were made aware of the situation and offered support through petitions and calls to Markson.

Bolvera called Markson the next morning and explained that his extended family was loaning him the money and that he would have all the delinquent rent and CAM charges paid to Markson by the noon deadline tomorrow. Bolvera further offered to extend the lease at the current market rate at the end of the original term.

Markson rejected Bolvera's proposition and stated that half the rent in exchange for the lease termination July 31st is the only acceptable solution. Bolvera begs for Markson to change her mind. When Markson says no, Bolvera states that he is being left with no choice but to hire an attorney.

That night after BT closed, Markson seized the property by changing the locks on the doors and hanging a sign on the front door stating "Out of Business."

DECISION AND DISCUSSION EXERCISES

1. Apply various ethics-based decision theories to analyze Markson's decision to seize the property.

2. What other options could Markson have pursued that would have kept the sale to NTB intact and allowed BT to continue operating?