

Addressing fixed costs to keep small businesses afloat during COVID-19 shutdowns

Submitted by the Toronto Association of Business Improvement Areas (TABIA) and Save Small Business

Issue

The package of economic support announced to date for businesses in response to COVID-19 leaves a critical gap for many small businesses. Without assistance with fixed costs, many small businesses could become insolvent as a result of forced shutdowns. This note presents policy options to support commercial rent abatement.

Current status

- The federal government has announced significant support for businesses anchored by the Canada Emergency Wage Supplement (CEWS), federally-backed credit, and deferred income and sales tax remittances. The Canada Emergency Response (CEBR) also provides income for some self-employed owners and furloughed workers ineligible for the wage subsidy.
- These initiatives leave a significant gap for local businesses, both because they may not be eligible and because the package is not responsive to their needs.
- Without a reduction or waiver of commercial rent, many local businesses may close permanently in the coming months. Nearly 70% of businesses surveyed by savesmallbusiness.ca expect to default on their lease by May 1st. Four in ten businesses surveyed by the Canadian Federation of Independent Businesses did not pay their April rent in full.
- This requires a public policy response. Case-by-case negotiations with landlords are not achieving scale, and surveys by savesmallbusiness.ca and the Canadian Federation of Independent Businesses make clear that affected small businesses cannot carry further debt to cover rent, even at favourable terms.
- With no guiding policy, responses by commercial landlords vary significantly. Most tenants have not yet received any abatement. Landlords in turn often have significant mortgage obligations.
- The actual delivery of subsidy payments is not urgent, but the prompt announcement of a program is. A consistent and fair framework for landlord-tenant negotiations, with incentive for immediate abatements, would prevent many businesses from closing. Paired with support from banks on mortgage deferrals, funds could flow to landlords at a later date.

Response: The Small Business Emergency Rent Abatement

- The federal government can underpin the survival of small businesses with a commercial rent abatement program that shares burden between the federal government, landlords, and tenants.
- The program would be complementary to existing wage subsidy and credit initiatives by supplementing for businesses and non-profits who need assistance with fixed costs to remain solvent and addressing gaps in existing programs.

- Proposed program structure:
 - The federal government would reimburse 66% of any commercial rent abatement provided by landlords to tenants, up to a maximum of \$6,600 of federal support per tenancy per month for up to three months between April and July 2020 (i.e. up to \$10,000 per month in commercial rent reduction from landlords).
 - Eligibility would be limited to businesses and non-profits with gross annual revenue of less than \$5 million in 2019 and within business categories most affected by COVID-19. (As an example, the UK's qualifying criteria is in Appendix A)
 - Upon announcement of clear details of the program, landlords could provide tenants with rent abatements immediately, without waiting for the federal application. Tax remittance deferrals, and deferral terms from lenders, should provide flexibility for landlords to offer immediate relief on promise of future reimbursement. This depends on unambiguous and simple program design. This could allow the application design to be sequenced after the CEWS and CERB and draw lessons from the rollout.
 - An alternative but more delayed payment method would be to design this as a refundable tax credit for landlords who provide rent abatements.
 - To facilitate a timely response, the program could have a very simple design and application process. Landlords would provide proof of rent amount and abatement (through a signed declaration from their tenant and bank statements). Confirmed rent abatement could be verified on the landlord's next tax year and with a transparent reporting of properties that have received support (allowing tenants to verify).
- As with the CEWS, there is some risk that funds will be misallocated to landlords that would have provided abatement without support or to tenants that could have maintained their rent anyway. This is a legitimate concern but outweighed by the substantial macroeconomic risk of inaction. Survey evidence suggests landlord response has been minimal to date and very few businesses retain sufficient revenue to meet their fixed costs.
- Working directly with landlords provides for a simplified application process and allows landlords to provide immediate relief while awaiting federal reimbursement.
- We estimate the cost of this program at between \$0.9 billion and \$1.5 billion, depending on take-up. Please see appendix B and attached for details.

	Example 1:	Example 2
Current rent	\$3,000	\$15,000
Landlord abatement	\$3,000	\$10,000
Federal subsidy	\$1,998	\$6,600
Net rent for tenant	\$0	\$5,000
Net proceeds for landlord	\$1,998	\$11,600

Key considerations

Urgency of response

- A rent abatement strategy is needed immediately. A significant percentage of small businesses are unable to make April rent and that surges as emergency shutdowns extend into May
- Many local small businesses have seen revenue declines over 80% and have already laid off most, if not all, of their staff. The little revenue they have left is often insufficient to pay fixed costs. Without immediate relief they could be locked out of their properties or bankrupted by the time they can re-open.
- The majority of surveyed small businesses have personally guaranteed their leases, amplifying the personal and systemic risk.

Limits of debt

- Relying on debt is an insufficient solution to the current shutdown. Business owners report that their revenues would not support increased debt loads in normal times, and they are already being pushed to debt to address other costs that have not been relieved.
- For businesses that are unsure whether they will re-open, additional debt tips the scales toward permanent closure. More than half of businesses surveyed in BC are concerned they will be insolvent or unable to restart their business.
- Less than half of business surveyed by CFIB expect to take on loans from the Canada Emergency Business Account. Others do not qualify or are too concerned about taking on more debt.
- Debt solutions also fail a fairness test. As businesses have been shut down by government requests and orders to keep communities safe, it is unfair to ask them to bear the costs with revenue they will never recover. The proposed abatement approach shares that risk between businesses, landlords, and the public who benefit from the public health measures.

Property tax and utilities

- After rent, the next largest category of fixed costs for most local small businesses are property taxes and utilities. Some, but not all, leases pass on property tax and utility costs to tenants. This proposal would be made more effective if paired with property tax and utility reduction relief.
- Some provincial and local governments are already supporting some relief and deferral for small businesses. For example, British Columbia has already moved to cut its school taxes for commercial properties in half, which likely provides around 20 percent relief in overall property taxes for the year. However, responses to date are uneven and insufficient.
- The fiscal capacity of local governments and some provinces to offer this type of relief is limited and under severe strain from COVID. A one-time federal transfer could support provincial and local government fiscal capacity to ensure equal access to services for all Canadians regardless of where they live.

Role of financial institutions

- Financial institutions have a critical role to play in supporting commercial rent abatement. Reports to date suggest that landlords and homeowners are getting slow responses from banks in structuring payment deferrals, and are being offered deferrals on principal only, with interest accruing on the deferred amount. This may ease cashflow but does not represent burden sharing on the part of banks to support rent relief.
- The economic costs of the public health intervention should be shared by government, landlords, businesses, and financial institutions. A meaningful response by the financial institutions would include deferral of principal and waiver of interest on mortgages for participating landlords. Australia has implemented guidelines to encourage banks to support landlords that are abating and deferring rent for tenants.

Appendix A: United Kingdom eligibility for small business support

The United Kingdom is offering full relief from business taxes for the 2020 to 2021 tax year for the retail, hospital and leisure sectors.

Eligibility

You are eligible for the business rates holiday if:

- your business is based in England
- your business is in the retail, hospitality and/or leisure sector

Properties that will benefit from the relief will be occupied properties that are wholly or mainly being used:

- as shops, restaurants, cafes, drinking establishments, cinemas and live music venues
- for assembly and leisure
- for hospitality, as hotels, guest & boarding premises or self-catering accommodation

<https://www.gov.uk/government/publications/guidance-to-employers-and-businesses-about-covid-19/covid-19-support-for-businesses>

Appendix B: Approach to cost estimate

Our cost estimates are based on Statistics Canada Canadian Industry Statistics data for businesses with less than \$5 million in revenue in the five industries most likely to have been affected by the restrictions put in place due to COVID-19. These are: retail trade; restaurants and eating places; arts, entertainment and recreation; other services; and health care and social assistance. This dataset provides information on the number of businesses and their average annual rent.

We made the following assumptions in our estimates.

1. Some of the premises leased will have rent that is higher than \$10,000 per month, and that will be included in the data. We reduced the total rent by 20% to account for this.
2. Not every landlord will take up this offer, as some will have tenants whose operations remain strong during COVID-19. We assumed a take-up rate of between 40% and 70%.

Using these assumptions, the estimate per-month range of cost to the government is \$285 million to \$498 million, leading to a three-month estimate of approximately \$900 million to \$1.5 billion. These assumptions assume a simple and inclusive program design that drives very high take-up.

It should be noted that any static estimate remains an overstatement of the net cost to government. Some of the rent that would be paid through this program would otherwise have been paid using a CEBA loan. This program will likely serve to reduce the requirement for CEBA loans, or the total amount that businesses will borrow and have forgiven.