LEGAL SECTOR COVID-19 UPDATE

CUSHMAN & WAKEFIELD

Prior to COVID-19, the legal sector was changing at lightning speed. With recruiting and retention, fee compression, and technology being the top three issues affecting a law firm's business (per Cushman & Wakefield's 2019 Bright Insight Survey), combined with the current global health crisis, we are seeing additional issues impacting the sector. Some of these are temporary and some will continue to drive industry-wide change in the years to come.

The Business of Law

Business activity in the legal sector is mixed. The pipeline of litigation and restructuring continues to be active but many transactions and cases are delayed or suspended. Market Watch reported in February that year-to-date M&A activity was already down by nearly 50% from the same period in 2019[1]. This change is causing some companies to be more realistic on pricing and deal activity is anticipated to pick up in the latter part of the year. The impact on law firm financial health has been significant, and firms are paying close attention to reputational risk, making strategic tradeoffs between short-term cuts and long-term impact on their business

Preserving cash is the current priority and top challenge for the legal sector. After taking care of clients and their own personnel, firms—even the biggest and best—are then scrutinizing expenses and deferring payments where possible. Firms are drawing on bank credit lines and, in some cases, deferring payouts to partners or making partner capital calls to get through the current cash crunch. Firms are proactively looking to reduce expenses in other ways, including but not limited to:

- Deferred payments to all personnel
- Staff reductions
- Changes to summer associate programs
- Temporarily eliminating matching contributions to retirement plans

1 Saigol, Lina. "IPOs are being put on ice as coronavirus fears rock markets." MarketWatch, https://www.marketwatch.com/story/companies-put-ipos-on-ice-as-coronavirus-fears-rock-markets-2020-02-24. Accessed April 10, 2020.

Real Estate Impact

Due to the legal sector's need to preserve cash, rent relief requests have been common in recent weeks. Generally speaking, landlords are responding favorably to legal sector rent relief requests by firms seeking three months of rent relief with an interest-free rent payback commitment by year end.

Most landlords are seeking written justification for rent relief needs, which can be burdensome to some firms. Each circumstance and request is being reviewed on a case-by-case basis taking into consideration the market, building, ownership and lenders. Owners that are more entrepreneurial and have less stringent lenders are in a better position to provide rent relief flexibility compared to buildings with lenders that are more institutional – REITs, pension funds and insurance companies, for example.

Besides rent relief, common requests have included using cash security deposits to pay the firm's rent and landlords reducing letters of credit being used for security deposits so the firms' lines of credit can be increased. Tapping into these lines of credit enable firms to preserve liquidity until cash flow improves, hopefully in the second half of this year. It is noteworthy that Citigroup has seen a six-fold increase from the law firms activating or creating lines of credit.

Read more about Lease Renegotiation and Rent Reduction Considerations here.

Read more about Other Lease Provisions to Explore here.

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Construction Freezes

Construction freezes in New York City, San Francisco and London are impacting occupancy schedules and triggering lease holdovers in some cases. While many landlords are working in a cooperative fashion, it is anticipated that there will be long-term litigation and cost implications with the current construction freezes.

Some landlords have been willing to delay interior construction with the agreement that the tenant will add additional months to the lease equal to the delay. A balance must be struck with landlords wanting justification for delays versus the potential reputation impact on the tenants.

Workplace Impact

Prior to COVID-19, the legal sector was experiencing major workplace shifts including expanded investment in technology and increased office density. Targeted square footage ratios are now hovering at 600 square feet per attorney, driven by an increase in single size offices, doubling up of associates, interior attorney offices, and integration and expansion of hoteling and remote working policies.

Firms recognize the need to balance traditional and remote working options, understanding that remote working reduces opportunities to mentor associates, particularly at early stages of their careers. The balance between working and collaborating in-person daily versus a combination of in-person and virtual working will be a challenge for firms to test and evaluate to find the right mix for their firm, employees and clients.

Read more about Re-Balancing the Work Life Experience in our podcast series here.

Last year over 55% of law firm leases in the top ten U.S. markets were relocations, with balance being renewals. Many of those relocations were to new construction. The COVID-19 impact on new construction lending and development may offer fewer options for firms to relocate in the near-term, triggering more early restructures and renewals. Many of those will continue the trend of right-sizing and giving back space. In 2019, when firms in the top ten U.S. markets relocated, they reduced their overall square footage on average 29% vs 19% when a firm restructured/renewed[2].

Engage Your Real Estate Partner

As always, we are here to work with and for you. We are ready to review your current portfolio, discuss changing space needs and engage with your landlords. While negotiated rent concessions are surely on the minds of many, it is important to note that landlords who carry debt service on their buildings would likely need to review the terms of their loan documents and potentially engage in conversations with their lenders. Finally, we are carefully considering the necessary shape and scope of lease terms for new deals in a post COVID-19 world. Beyond acting as your trusted real estate advisors, we hope that you and your families, friends, and colleagues are feeling and faring well. As we navigate through this period of uncertainty, please know that we at Cushman & Wakefield remain steadfast and ready to help you however we can. We will overcome this challenge together.

2 Cushman & Wakefield Research.