Real Estate Industry Alerts Tracker - July 24, 2020 Issue

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Real Estate Lobbying Groups Pitch Expansion of Main Street Lending Program

In a letter this week to Representative Mike Crapo and Rep. Sherrod Brown, the Chair and Ranking Member of the Senate Banking Committee, the Commercial Real Estate Finance Council (CREFC), the Mortgage Bankers Association (MBA), the International Council of Shopping Centers (ICSC), and organizations representing the interests of hoteliers, developers and builders urged revisions to the Main Street Lending Program (MSLP) for commercial real estate owners and tenants, noting that the current eligibility rules of the Paycheck Protection Program (PPP), the MSLP, and the Primary Market and Secondary Market Corporate Credit Facilities have effectively excluded real estate owners. In lieu of creating new legislation, such as the proposed HOPE Act that is expected to be introduced this week (reported on in last week's Kelley Drye Real Estate Industry Tracker), the organizations suggest several changes to the MSLP, including:

- **Expand Eligibility:** Currently, the MSLP uses the Small Business Administration's (SBA) eligibility requirements, which exclude business entities with passive real estate investments. The organizations suggest that Congress make clear that all businesses of a certain size can qualify for the MSLP.
- **Extend the Program:** The current MSLP application deadline is September 30, 2020. Since the program did not start until mid-June, they suggest extending it to December 31, 2020.
- **Modify Asset-Backed Underwriting Methodology:** Currently, the MSLP limits a borrower's maximum loan amount to a multiple of its EBITDA. However, EBITDA is not a standard underwriting metric for real estate and some other asset-based businesses. The organizations suggest that lenders be provided the flexibility to adjust the underwriting criteria based on the assets involved or to increase the EBITDA multiple substantially. They suggest using the following metrics for the real estate industry:
  - For construction loans, development projects, and hotels: 75% maximum loan-to-cost; and
  - For other loans: a maximum 80% loan-to-value or a minimum debt service coverage ratio of 1.2x based on 2019 operating income.

The letter also noted that the MSLP could be modified to include the same preferred equity backstop that the anticipated HOPE bill would create. The managing director of one organization noted that modifying the MSLP to address the concerns of commercial property owners may be more politically feasible than getting entirely new legislation adopted (such as the HOPE bill).

A copy of the letter may be found here.

Freddie Mac and Fannie Mae Updates

On July 15, 2020, Freddie Mac and Fannie Mae provided updates to their COVID-19 servicing guidelines. Freddie Mac's 2020-29 Guide Bulletin provides updates to insurance loss requirements, original security instrument document custody requirements and certain additional guide updates and reminders. Fannie Mae's Lender Letter 2020-02 also focuses on insurance losses and the disbursement of insurance proceeds. It also provides certain other updates to prior lender letters. On June 30, 2020, Fannie Mae also provided updates to its "COVID-19 FAQ's", which address credit reporting, incentive fees, retention workout options, and other matters.

A copy of the Freddie Mac 2020-29 Guide Bulletin may be found here.

A copy of Fannie Mae's updated Lender Letter (LL-2020-02) may be found here.

A copy of the updates to Fannie Mae's COVID-19 FAQ's related to servicing may be found here.

Philadelphia Enacts Emergency Housing Protection Act

Last month, the Philadelphia City Council unanimously passed a package of bills in the Emergency Housing Protection Act (EHPA) aimed at protecting tenants from being evicted during the pandemic. The legislation was signed into law by Philadelphia's mayor earlier this month. Among the tenant protections afforded under the bills:

- **Bill No. 200295** provides that, until August 31, 2020, the only legal basis for evicting either a residential or small business tenant in Philadelphia is "to cease or prevent an imminent threat of harm by the person being evicted, including physical harm or harassment." It is unlawful for a landlord to take any steps in furtherance of recovering possession of a premises occupied by a residential or small business tenant during that period for any other reason.

- **Bill No. 200305** requires landlords to enter into a "Hardship Repayment Agreement" with a residential tenant that has been unable to pay rent due to a qualifying financial hardship related to the pandemic, from the beginning of the emergency period (March 1) through August 31, 2020. A tenant seeking a hardship payment agreement must provide the landlord with: (a) a certification of hardship; and (b) documentary evidence of the loss of income. The tenant will be required to pay the full amount of past rent due over a period of nine months after August 31, 2020 (by May 30, 2021). Beginning on September 1, 2020, the tenant is obligated to pay the full rent, plus a minimum of the lesser of: (i) 30% of the full monthly rent; or (ii) the total past due rent divided by nine. A landlord is not permitted to include a consent judgment or similar agreement as part of the hardship agreement. The bill does not apply to tenants that receive certain federal housing subsidies, or if the loan financing the premises is federally insured.

- **Bill No. 200294** creates an “Eviction Diversion Program” for residential tenants. It requires landlords and tenants to attempt to conciliate any claims for rent prior to landlords opting for eviction proceedings. The bill also requires landlords to inform tenants of their rights under the Eviction Diversion Program, and it prohibits landlords from evicting any tenants unless they have participated in a conciliation conference with their tenants. The conciliation conference requirement expires on December 31, 2020.

Copies of all three bills and additional information may be found here.

Biden Tax Plan Would Limit Like-Kind Exchanges

Former Vice President and presumptive Democratic nominee Joe Biden proposed the funding of a program for child and elder care by eliminating tax deferred exchanges for investors with annual incomes greater than $400,000. His proposal would also limit investors’ ability to offset real estate losses from income tax bills. Real estate industry experts noted that efforts to cut tax deferred exchanges have been made before but have not passed. Other industry experts note that the efforts to eliminate tax deferred exchanges results from a lack of understanding of their economic benefits, particularly during an economic downturn with limited access to capital.

Additional information may be found here.

Hotel Lobby Asks Congress for Additional Aid

This week, the American Hotel & Lodging Association (AHLA), a lobby group for the hotel industry, sent a letter to Congress requesting assistance for the industry, which has been decimated by the pandemic. According to the Bureau of Labor Statistics (BLS), the leisure and hospitality sector lost 4.8 million jobs since February. This figure exceeds the total combined job losses for the construction, manufacturing, retail, education and health services industries. CBRE and SRT estimate that the hotel sector will lose more than fifty percent of its total revenue in 2020, an amount exceeding $120 billion. The AHLA wants Congress to consider the following in order to help the hotel industry survive:

- Recapitalize the Paycheck Protection Program (PPP) and establish clear parameters limiting access to businesses (such as the hotel industry) that can demonstrate severe economic losses year over year; and to increase the maximum loan amount for PPP loans to cover expenses such as payroll, debt service, taxes, insurance and utilities needed to keep hotels in business.
- Establish a Commercial Mortgage Backed Securities (CMBS) market relief fund as part of the Federal Reserve’s lending options, with a specific focus on the hotel industry.
- Make structural changes to the Main Street Lending Facility established under the CARES Act to ensure hotel companies can access the program, since the industry’s asset-heavy business model effectively shuts hotels out of the program due to the rigid EBITDA test.
- Provide a limited safe harbor from exposure to liability claims related to the pandemic for hotels that reopen and follow proper public health guidance to protect employees and guests.
- Include targeted tax provisions that will benefit severely impacted businesses and their employees, such as: (a) tax credits for capital expenditures or expenses to meet the industry’s

Safe Stay initiative; (b) enhanced Employee Retention Credit for hotels that have maintained salaries and employer-paid health insurance during the economic crisis; (c) a temporary travel tax credit; (d) exempting taxation on phantom income from loan modification forgiveness or cancellation; and (e) allowing full deductibility of the food and entertainment business expense.

Additional information may be found here and a copy of the AHLA's letter to Congress may be found here.

Heard Around the Industry

New York City Business Leaders Ask Political Leaders to Consider Cutting Subsidies: The Partnership for New York City, a group of nearly 300 chief executives from New York City's top companies, issued a report outlining various ways the pandemic has negatively impacted the region and recommendations on ways to stem the collateral damage caused by various measures aimed at stopping the spread of the pandemic. The report includes contributors from 14 consulting firms as well as other experts. It also includes recommendations on how to make the region a more competitive tax environment for business. Some immediate suggested measures include:

- Restoring the full federal allowance for state and local tax deductions.
- A moratorium on competitive economic development incentives among the seven Northeast states that are collaborating to fight the pandemic (Connecticut, Delaware, Massachusetts, New Jersey, New York, Pennsylvania and Rhode Island).
- Reviewing recommendations for reductions and new revenue options that were recommended in 2013 by a state commission, which included reductions in tax subsidies.
- Revising the New York City real estate tax code to: (a) reduce the burden on regulated rental housing and pass the savings through to tenants or abate the cost of improvements; (b) eliminate the commercial rent tax on small and medium sized businesses; (c) reduce the rate for utilities paid by customers; and (d) create comparable assessments and rates for cooperative apartments, condominiums and private homes.

The report also warns against raising taxes on the wealthy, noting that the top 1% of earners in New York account for 40% of the State's tax revenue with such taxpayers having ample resources to relocate permanently if their taxes increase.

A copy of the Partnership for New York City's report may be found here.

Manhattan Asking Rates Stay Steady in Q2 but Expected to Drop: CBRE's quarterly market report shows 2.15 million square feet of leasing activity in Manhattan for the second quarter – a 65% decrease from the first quarter of 2020 and 69% below the five-year quarterly average. Even still, asking rents essentially stayed the same quarter-over-quarter at an average of $81.30 per square foot, which is actually a 1% increase as compared to Q2, 2019. According Nicole LaRusso, director of Research and Analysis for the CBRE Tri-State area, "[w]hile asking rents have not yet budged as a result of the drop in market demand, we do expect them to fall by 10% to 16% by the first quarter of 2021 before beginning to recover."

Additional information may be found here.

Fifth Avenue Luxury Retail Rents Drop: The pandemic and related business closures, stay-at-home orders and travel restrictions all seem to have caused luxury retail tenants to lose interest in retail space on Manhattan's Upper Fifth Avenue – the 10-block luxury retail strip between 49th and 59th Streets that has historically been known as the world's most expensive and premier retail corridor. According to CBRE's second quarter Manhattan Retail report, the average asking rent in the luxury retail section of Upper Fifth Avenue declined to $3,000 per square foot at the end of June, which represents a nearly 5% decrease as compared to the same time last year, and a decrease of approximately 25% from 2018. Prior to the pandemic, Upper Fifth Avenue was usually packed with crowds of local shoppers and tourists. Recently, the strip has generally been empty except for a few scattered pedestrians donning masks. Even as the City reopens in phases, many New Yorkers continue to shop online and it remains to be seen when Upper Fifth Avenue will be bustling with tourists once again.

A copy of the CBRE report may be found here and additional information may be found here.**Industrial Rents Up in the Tri-State Area (NY-NJ-CT) Due to Increased Demand:** According to a report by CBRE, asking rents for industrial space in New Jersey increased 1.4% year-over-year in the second quarter of 2020, while leasing activity increased 36% over first quarter market activity. Asking rents in the industrial market also increased in New York City's outer boroughs, especially in the Bronx where industrial asking rents jumped 25% year-over-year. Industrial vacancy rates in the outer boroughs also decreased in most markets, with Staten Island's vacancy rate decreasing from 10.3% to 2.4% year-over-year. The lone exception to this trend is the Bronx, which saw an industrial vacancy rate increase from 5.9% to 7.5% year-over-year.

Additional information may be found here.

Rental Tracker Shows Increase in Residential Rental Payments: According to the National Multifamily Housing Council (NMHC), almost 88% of residential tenants made full or partial rental payments for July by July 13, an increase from the 77.4% that had paid full or partial rent for the month by July 6. NMHC's rental tracker also shows that almost 96% of residential tenants made full or partial rent payments in the month of June. However, NMHC cautions that many tenants may have relied on the $600 weekly unemployment benefit from the federal government that is set to expire at the end of July and additional assistance may be needed to protect individuals and families during the economic upheaval caused by the pandemic.

Additional information may be found here.

Estimated Performances in the CMBS Market: A new report from Fitch Ratings analyzed the CMBS market and how it is expected to perform this year amid the pandemic. According to the report, the industrial sector is expected to remain healthy in 2020, as more industrial space is needed for order fulfillment given the consumer shift to online shopping. However, due to the overall decline in economic activity caused by the pandemic, Fitch anticipates slower growth in net operating income for the industrial sector in the coming years. Fitch revised its outlook on office space from "stable" to "negative" in March, as demand for office space evolves as a result of the pandemic. A quick resolution to the crisis could put an end to the diminished demand for office space, but if most employees continue working from home the downward trend is likely to continue. In its report, Fitch adjusted its forecast for multifamily properties from "stable" to "negative" in March, and it downgraded the hotel sector from "stable/negative" heading into the pandemic to "negative" in March.

Additional information may be found here.

Demand for Multi-Temperature Cold Storage Facilities at an All-Time High: While the retail sector as a whole has seen an 8.7% decline during the pandemic, food and beverage sales increased by 25.6% in March, 2020. This is in part due to social distancing mandates and stay-at-home orders, and the related spike in demand for online grocery sales. Stock prices for some of the largest publicly traded grocery chains have increased by 12% on average from the end of last year through the middle of April, 2020. According to a report by Savills, a global real estate services provider, Amazon stock grew by 25% during the same period and Kroger's, a regional grocer, saw an increase of 10% during this period. With the grocery sector being the main consumer of multi-temperature cold storage facilities, the demand for such facilities is at an all-time high. Another factor causing the spike in demand is the limited supply of cold storage warehousing space, which is due in part to the high costs and complexities of constructing such facilities.

Additional information may be found here.

Senior Housing Deals Hit 7-Year Low: According to a report by Irving Levin Associates, a provider of market intelligence in the senior care and healthcare industry, mergers and acquisitions within the senior housing/care sector dropped in the second quarter of 2020 to its lowest level since the second quarter of 2013. As a result of the pandemic and the ensuing economic turmoil, only 59 senior housing and care acquisitions were announced for the second quarter of 2020. This is the first time since the second quarter of 2013 that fewer than 60 such transactions occured. In addition, spending on senior housing deals dropped nearly 50% from $2.7 billion in the first quarter of 2020 to $1.35 billion in the second quarter.

Additional information may be found here.

Office Leasing Plummets During Pandemic: In a Yahoo Finance-Harris poll conducted in mid-June, 40% of respondents were working at home full-time as a result of the pandemic, while another 13% were working from home part-time. Of the respondents that started working from home during the pandemic, only 4% have returned to their regular physical work spaces. A new report issued by a prominent real estate service company reveals the impact that working at home is having on the office sector. According to the report, almost 15% of U.S. office space remains unoccupied and there was approximately 14.2 million more square feet of unleased office space in the second quarter of 2020 as compared to the first quarter. Although office tenants signed leases for 24 million square feet in the second quarter, this figure is 53.4% less office space than leased in the first quarter. The largest losses were in areas with the highest rates of infection, such as New York City, New Jersey, Houston and San Francisco. As a result, asking rates have fallen, but only by 0.2% for the time being. Actual rents have fallen between 10%-15% in a tenant's market, with rental rates expected to continue to decrease until there is a treatment or vaccine to curb the economic recession cause by the pandemic. Some real estate experts are concerned that the pandemic may trigger a permanent shift to work at home jobs, while others expect the office sector to recover with companies retaining space but redesigning it to more easily allow for social distancing.

Additional information may be found here and here.