# Real Estate Industry Alerts Tracker - July 31, 2020 Issue

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## HOPE Act: Congressmen Taylor, Lawson and Barr Introduce Legislation to Address the Pending Crisis in the Commercial Real Estate Market

Texas Representative Van Taylor, Florida Representative Al Lawson, and Kentucky Representative Andy Barr introduced legislation in the House of Representatives to provide economic support to the commercial real estate market, particularly for businesses with CMBS debt. The bill (H.R. 7809) is called the "Helping Open Properties Endeavors Act of 2020" or the "HOPE Act of 2020" (the "Hope Act"). The Hope Act is intended to provide financial assistance to commercial real estate borrowers, including borrowers with CMBS debt, by the Federal government guaranteeing the purchase by eligible financial institutions of preferred equity instruments issued by eligible borrowers. The Secretary of the Treasury (the "Secretary") would guarantee 100% of any purchase made under the Hope Act. The loan facility would be funded by utilizing amounts already appropriated for providing liquidity to eligible businesses under Section 4003(b)(4) of the CARES Act.

**Borrower Eligibility:** Borrowers must generally establish that they have been adversely affected by the pandemic and that the revenue from the property in question was not significantly reduced immediately prior to the pandemic. A borrower may qualify for a loan equal to 10% of the outstanding debt owed on its commercial mortgage. The preferred equity investment would be subordinate to the perfected loans and unsecured debt. As drafted, in order to be eligible:

- a borrower's revenue from the property during any consecutive three-month period between March 1, 2020, and February 28, 2021, would need to be at least 25% less than the revenue generated from the property during the same consecutive three-month period in the previous year;
- the borrower has not received written notice of a monetary default on any existing mortgage encumbering the property in question within the previous year that has not been cured as of March 1, 2020;

- the property's debt service coverage ratio must have been at least 1.3x on an annual basis during 2019, or its debt service coverage must have been at least 1.3x on an annual basis during both 2017 and 2018;
- the property securing the mortgage cannot be owner occupied, except to manage the property or de minimis occupancy as otherwise provided by the Secretary;
- the borrower or a parent company has not acquired the subject property after March 1, 2020 through a foreclosure process; and
- the borrower has not already received financial assistance under the Hope Act with respect to the property in question.

**Preferred Equity Terms:** The following are the requirements for the preferred equity instrument:

- borrowers have one year to draw down the amount;
- the instrument must be unsecured and provide no right of foreclosure;
- it must prohibit voting rights;
- it will have an annual interest rate of 3% calculated on a monthly basis on all amounts drawn down, of which 0.5% is to be transferred to the Secretary;
- it may be redeemed by the borrower at any time, without penalty;
- it shall require payment to be first due after the end of the two-year period beginning on the earlier of: (1) the date on which all funds have been drawn down by the borrower; and (2) the end of the one-year period beginning on the date the preferred equity purchase is made;
- it must amortize over a seven-year period beginning on the date the initial payment is due;
- it must be redeemed if there is more than a 50% change in the ownership structure of the borrower since the date the instrument was purchased (excluding transfers by devise or descent on the death of an owner);
- until the instrument is redeemed, the borrower is prohibited from paying dividends or taking any other distributions from the revenues generated by the property and if there is an affiliated property manager, its management fee cannot be increased;
- it must be approved in advance by the Secretary;
- the proceeds may only be used for: (1) payment to the parent company of the borrower for charges related to the management of the borrower, ownership or operation of the borrower or to a subsidiary entity of the parent company for the same or similar expenses; (2) the benefit and operation of the property securing the commercial mortgage; (3) payments of the preferred equity interest (i.e., principal, interest, insurance, taxes, utilities and fees, operating and payroll expenses; and (4) lender reserves such as capital expense reserves; and
- it shall require a non-recourse indemnity in favor of the financial institution and the Secretary for certain bad acts.

**What if a Borrower fails to Make Payments**:

- During the first year in which payments are due, the interest rate will increase to 3.5% for the remainder of the loan, beginning at the end of the first year.
- During the second year in which payments are due, the interest rate will increase to 4.5% for the remainder of the loan, beginning at the end of the second year.
- During the third year in which payments are due, the interest rate will increase to 5.5% for the remainder of the loan, beginning at the end of the third year.
- During the fourth year in which payments are due, the interest rate will increase to 6.5% for the remainder of the loan, beginning at the end of the fourth year.
- During the fifth year in which payments are due, the interest rate will increase to 7.5% for the remainder of the loan, beginning at the end of the fifth year.
- During the sixth year in which payments are due, the interest rate will increase to 8.5% for the remainder of the loan, beginning at the end of the sixth year.
- During the seventh year in which payments are due, the interest rate will increase to 9.5% for the remainder of the loan, beginning at the end of the seventh year.
- After the last year in which payments are due under the amortization schedule, the interest rate increases to 13% permanently, beginning at the end of such year.

Any interest owed above 2.5% will go to the Department of Treasury.

**Lender’s Failure to Assess Interest:** If a lender fails to charge interest or to notify the borrower of the required interest for a period of 3 months or more, it is only eligible to receive one-half of its service fee during the period of such failure.

**Lender Servicing Fee:** The Secretary will pay the financial institutions that purchase a preferred equity instrument an annual servicing fee equal to 1% of the outstanding balance.

**Lender Origination Fees:** Participating financial institutions will receive origination fees from the Department of Treasury based on the same criteria set as forth in the PPP program, which is: (a) 5% for preferred equity purchases of $350,000 or less; (b) 3% for purchases greater than $350,000 but less than $2,000,000; and (c) 1% for purchases of not less than $2,000,000. However, if a borrower defaults on 90% or more of the amount drawn down, the financial institution must repay the origination fee paid by the Secretary.

**Sale of Instrument to the Treasury; Foreclosure:** A financial institution may sell a preferred equity instrument to the Secretary at the end of the 10-year period from the date it purchased the instrument at par plus interest, less the origination fees. If there is a foreclosure on the property securing the mortgage related to the preferred equity instrument, the financial institution is required to sell the preferred equity instrument to the Secretary within 90 days after the foreclosure at par, plus interest and origination fees.

A copy of the proposed bill may be found here and additional information can be found here and here.

# New York Councilman Proposes Bill to Waive Commercial Rent Taxes During the Pandemic

Currently, New York City has a commercial rent tax of 3.9%, which is chargeable to Manhattan businesses located south of 96th Street that pay $500,000 or more in rent annually. The tax impacts almost 5,500 businesses in Manhattan. Under a bill proposed by Councilman Keith Powers, the commercial rent tax would be temporarily suspended for Manhattan-based businesses with a base rent of less than $1 million for the period beginning June 1, 2020. The suspension period would end on the day before the tax quarter following the end of New York State's or New York City's state of emergency, whichever is later. Councilman Powers, along with the NYC Hospitality Alliance and the Manhattan Chamber of Commerce, also released a report on Tuesday, July 29, 2020, in response to the economic impact felt by small businesses due to the pandemic.

Additional information may be found here and a copy of the report can be found here.

# New York Law Firm Sues Landlord for Rent Abatement

A major law firm sued its New York landlord for failing to acknowledge its right to a rent abatement, alleging $8 million in damages. The law firm's 1987 lease contained a "relatively unique clause" for rent abatement circumstances. The lease includes a provision that entitles the tenant to a rent abatement when it is unable to use its offices for at least 60 days for "force majeure" events, which includes situations where the government pre-empts its right to occupy in connection with a national or public emergency. The law firm argued that it has not been able to use its offices since the State of New York declared a public emergency on March 22, 2020. Although New York City entered "Phase II" on June 22, 2020, which would have permitted a partial re-opening of its offices at 50% capacity, the firm has still not re-opened. It claims that due to the State's order containing substantial other social distancing and hygiene restrictions, it still has not been able to use its space and has vacated the premises.

Additional information can be found here.

# Oregon House Bill Restricts Lender Remedies

Earlier this month, the Oregon legislature enacted House Bill 4204 in response to the pandemic.  The bill, dated July 7, 2020 and effective June 30, 2020, established temporary restrictions on the exercise of certain remedies by commercial and residential lenders until at least September 30, 2020 (but subject to extension if Governor Brown extends the "emergency period"). The bill prohibits any foreclosure during the emergency period and automatically voids any foreclosure judgment unless it was issued or given prior to March 8, 2020 (when Governor Brown declared the state of emergency). Any foreclosures during this period would not be able to be reinstated until the emergency period is over. During the emergency period, if the borrower notifies its lender that it will be unable to make a periodic installment payment and the borrower and lender cannot reach a modification agreement, the lender shall:

- defer from collecting any periodic installment payment during the emergency period and permit the borrower to make the deferred payments at the loan's maturity;

- not impose or collect fees, penalties or attorneys' fees for late payments or other defaults; and
- not impose a default interest rate due to the borrower's failure to make a periodic installment payment during the emergency period.

In addition, the lender cannot require or charge for an inspection, appraisal or a broker opinion of value if such report or related cost is not otherwise permitted in the absence of a default. For commercial loans, the lender cannot initiate a cash management agreement or lockbox procedure unless the same were already in effect prior to the bill's effective date. A commercial lender cannot take control of operating revenue generated by the property, unless such control was established before the bill became effective.

Lenders authorized to do business in Oregon are required to provide their borrowers with written notice of the borrowers' rights under the bill within 60 days of the June 30th effective date, and borrowers have a private right of action to cover actual damages if suffering "an ascertainable loss of money or property" as a result of a lender's failure to provide such notice. In such an instance, borrowers may also recover attorneys' fees and costs.

A copy of the bill may be found here.

# Heard Around the Industry

**Retail REIT Rent Collections Jump:** A report prepared by the National Association of Real Estate Investment Trusts (NAREIT), analyzing rent surveys and publicly disclosed data, showed an upward trend in collections for free standing and small mall-focused real estate investment trusts (REITs). In addition to the retail sectors, it also surveyed industrial, office, apartment and healthcare sectors. Highlights of the report include:

Rent collections were strong in June, with collections between 94 - 99%.

- Free standing retail showed the biggest jump in rent collections, with an increase of 12.1 percentage points in July with rent collections increasing from 79.3% in June to 91.4% in July.
- Shopping centers showed an 8.9% increase in collections from June to July (60.6% in June to 69.5% in July).

Free standing and shopping center REITs also reported a decrease in deferred rent and forbearances.

- Free standing REITs reported granting rent deferrals for over 17% of rent in May and June, but that decreased to 7% for July rent.
- Shopping center REITs also reported a decrease in rent deferrals, from 9% of rent in June to only 1% of rent in July.

Office and apartment rent collections for July were at 96% and healthcare rent collections were reported at 95%.

Additional information may be found here and here.

**CMBS Delinquencies on the Decline:** According to a report issued by Trepp, preliminary numbers indicate that the delinquency rate for CMBS loans is set to decline significantly. The data shows that the volume of loans reverting to “current” or “within grace period” payment status (both of which are categorized by Trepp as being current) is outpacing loans that are becoming newly delinquent. In total, more than $8 billion in loans were moved to “current” status in July. Accordingly to Trepp:

- Of the loans that became “current”, about $1.4 billion were marked “current” as a result of the loan being extended, either through a modification agreement or an extension option included in the original loan documentation.
- Excluding loans that reverted from delinquent to “within grace period” or “beyond grace period status”, about $3.4 billion were truly “current”.
- Of the $3.4 billion in “current” loans, only about 10% (by balance) have commentary for a special servicer or watchlist stating that loan relief was granted. The other 90% had relief cancelled commentary and the loans were brought current.
- About $1.2 billion in “delinquent” loans were moved to “beyond grace period” and about $215 million in loans were moved from “delinquent” to “in grace period”.

Additional information may be found here and here.

**Pandemic Wreaked Havoc on Construction During the First Half of 2020:** Dodge Data & Analytics, a provider of market forecasting and analysis for the construction industry, analyzed the impact of the pandemic on the construction industry. It analyzed the “commercial and multifamily” group, including office buildings, stores, hotels, warehouses, commercial garages and multifamily housing. However, it did not include institutional building projects (such as schools, hospitals, convention centers, casinos, transportation terminals), manufacturing buildings, single family housing, public works, or electric utilities/gas plants.

According to Dodge Data & Analytics, commercial and multifamily construction starts increased by 1% over the first quarter as compared to the first quarter of last year and came to a halt beginning in April.  Although construction resumed in some areas in May, the damage to commercial and multifamily construction during the first half of the year was “palpable.” Other than warehouse construction starts, which posted a very small gain, construction starts for commercial and multifamily projects plunged 22% as compared with the first half of 2019.

In the top 10 metropolitan areas, commercial and multifamily starts slid 21% as compared to the first half of 2019. In ranked order:

1. The New York metropolitan area held on to the top spot for construction starts with $11.5 billion, representing a 24% decrease as compared to last year.
2. Washington D.C. fell 42% to $4.2 billion.
3. Dallas, Texas fell 2% to $3.8 billion.
4. Los Angeles fell 18% to $3.3 billion.
5. Chicago fell 9% to $3.0 billion.
6. Boston fell 31% to $3.0 billion.

7. Miami fell 16% to $2.8 billion.
8. Phoenix increased by 82% over the first half of last year to $2.8 billion.
9. Austin, Texas fell 12% to $2.4 billion.
10. Houston, Texas fell 38% to $2.4 billion.

Additional information may be found here and here.

**Sales Transactions Fell 68% Across All Property Types in the Second Quarter:** According to data released by Real Capital Analytics, sales transactions fell 68% in the second quarter across all property types compared to the same period in 2019. While near-record amounts of capital appear to be available from some of the world's biggest real estate investors, potential buyers and sellers remained far apart on pricing. According to Simon Mallison, an executive managing director at Real Capital Analytics, sellers don't feel forced to sell "because there's no realized distress," while at the same time, buyers are waiting because they think there will be distress resulting in lower pricing. According to Real Capital Analytics, second quarter sales plunged 70% for apartments, 71% for offices, 73% for retail, and 91% for hotel. While pricing also dropped in the industrial sector in the second quarter, the drop was only 50% as compared to 2019. The smaller drop in sales for the industrial sector is attributed to the need for additional industrial space, as online shopping thrived in the second quarter and manufacturers leased space to avoid supply chain disruptions.

Additional information may be found here.

**Retail-to-Industrial Conversions Accelerate Across the U.S.:** According to a research survey by CBRE, there are 59 projects completed, proposed or underway to convert underperforming retail sites into industrial space since 2017, up from 24 such projects in January 2019. The projects total approximately 13.8 million square feet of retail space that have been converted to 15.5 million square feet of industrial space. According to CBRE, underperforming retail sites have become ideal locations for warehouse developers because they are often located within population centers, connected to utilities and have large parking lots with multiple ingress and egress points. Additionally, retail centers with free standing big box stores typically have existing dock doors and ample height for industrial use. The top five markets for these conversion projects are in the Midwest, due to the number of "dead malls" in that region. Milwaukee, Cleveland, Chicago, Omaha and Dallas/Ft. Worth, account for one-third of the total number of retail to industrial conversion projects nationally.

CBRE expects this development strategy to extend to higher growth markets in the Southeast and West regions due to the growth of online shopping and the increasing demand for industrial space.

Additional information can be found here and here.