Real Estate Industry Alerts Tracker - June 26, 2020 Issue

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COVID-19 Related Tax Relief For Qualified Opportunity Funds

Much like it had done to relax the requirements for like-kind exchanges under Section 1031 during the pandemic, the Internal Revenue Service (IRS) provided similar relief to Qualified Opportunity Funds (QOFs) and their investors. Investors with like-kind exchanges in process were given additional time under Notice 2020-23. Now, the IRS has issued Notice 2020-39 and updated its FAQs to provide guidance for QOFs and their investors to provide similar relief in response to the pandemic.

- **180 Days to Invest:** Under Section 1400Z-2 of the Internal Revenue Code, taxpayers who sold property for an eligible gain would have had 180 days to invest in a QOF to defer that gain. Notice 2020-39 provides additional time if a taxpayer's 180th day to invest in a QOF would have fallen on or after April 1, 2020, and before December 31, 2020. Now, that taxpayer has until December 31, 2020 to invest that gain into a QOF

- **90% Investment Standard:**Notice 2020-39 also provides other relief from technical requirements for QOFs. Under Section 1400Z-2(d)(1), a QOF is required to hold at least 90% of its assets in qualified opportunity zone property, determined by the average of the percentage of qualified opportunity zone property held in the fund as measured on two testing dates: (1) the last day of the first 6 month period of the QOF's taxable year, and (2) the last day of the QOF's taxable year. If it fails to meet the 90% standard, under Section 1400Z-2(f)(1), the QOF must pay a penalty for each month that it fails to meet the standard. Under the new guidance, if either of a QOF's two testing dates falls within the period beginning on April 1, 2020, and ending on December 31, 2020, any failure by that QOF to satisfy the 90% investment standard for that taxable year is disregarded for purposes of determining whether the QOF or any otherwise qualifying investments in that QOF satisfy the requirements of section 1400Z-2 and the regulations thereunder for that year, and the QOF will not be liable for the statutory penalty under section 1400Z-2(f) due to such failure for that year.

- **30-Month Substantial Improvement Period for QOFs and Qualified Opportunity Zone Businesses:** Under Section 1400Z-2(d)(2)(D)(i), tangible property is treated as qualified opportunity zone business property if the tangible property is used in a trade or business of the QOF and satisfies three general requirements. One of the three requirements is that the original

> use of the tangible property in the qualified opportunity zone must begin with the QOF (referred to as the "original use requirement"), or the QOF must substantially improve that property (the "substantial improvement requirement"). The substantial improvement requirement is met only if, during any 30-month period beginning after the date of acquisition of the tangible property, there are "additions to basis with respect to such property" held by the QOF that, in the aggregate, exceed the QOF's adjusted basis of that property as of the beginning of that 30-month period. Under the new guidance, the 30-month substantial improvement period is tolled during the period beginning on April 1, 2020, and ending on December 31, 2020.

Additional information may be found here, the updated QOF FAQs may be found here and a copy of Notice 2020-39 may be found here.

Howard County, Maryland Passes Tenant Relief Bill

On May 23, 2020, the Howard County Council passed Bill No. 33-2020, the Rental Protection and Stability Act (the "Act") to provide rental relief to commercial and residential tenants during the pandemic. The Act is effective from the March 5, 2020, (the date Governor Hogan declared a public health emergency) until three months after the emergency ends or the Act is rescinded. During this period, landlords are prohibited from: (a) increasing rent (but the Act is silent on whether step up rent increases that are built into the lease are also prohibited); (b) unreasonably or arbitrarily decreasing the utilities or other services to which a tenant has been entitled; (c) terminating a tenancy, lease or rental agreement for monetary defaults; (d) charging or otherwise assessing a tenant for nonpayment or late payment of rent; and (e) otherwise materially altering the terms of a lease to the financial detriment of the tenant. Landlords are also prohibited from notifying a tenant of any change in a lease or taking any other action that violates the foregoing tenant protections and landlords must notify tenants to disregard any notice of such changes that may have been previously provided to a tenant. The foregoing does not apply to commercial tenants that were already in default at the time the health emergency was declared.

In addition, while the public health emergency is in effect and for a period of one year thereafter or until the expiration of the lease (whichever is longer), landlords may allow a rent payment plan if the landlord: (a) has 5 or more residential units for rent; or (b) receives rents or benefits for use or occupancy of a commercial unit. A tenant may participate in a payment plan if the tenant notifies the landlord of its inability to pay all or part of its rent as a result of the pandemic. Any payment plan must allow for payment in monthly installments and no charges, fees or penalties can be charged in connection with the payment plan. The payments are to begin at a mutually agreed upon date, and the term can be for one year or shorter (but a shorter term may only be at tenant's request). In addition, landlords are prohibited from: (a) requesting lump sum payments in excess of the amount required to be paid under the plan; or (b) reporting the tenants to credit bureaus as delinquent or providing other derogatory information about the tenants, as a result of landlord and tenant entering into the payment plan.

Landlords are required to establish application procedures for tenants to use to apply for a rent payment plan and they must allow for applications to be submitted online or by telephone. Any tenant requesting a payment plan must provide supporting documentation showing they are eligible to participate in the plan. Landlords may approve each application in which the tenant: (1) provides documentation evidencing financial hardship suffered directly or indirectly from the pandemic and shows that as result of those financial hardships it would not qualify for renting the unit under the original rental criteria, and (2) agrees in writing to make payments in accordance with the payment plan. Landlords are required to retain applications, whether approved or not, for a minimum of 3 years. Any tenant whose application for a payment plan is denied may file a written complaint with the Office of Consumer Protection (the “Office”) and landlords are required to provide the Office with a copy of the application.

A copy of the Act may be found here.

Philadelphia Courts Postpone Mortgage Foreclosure Sales

On June 18, 2020, Idee Fox, President Judge of the First Judicial District of Pennsylvania, issued Administrative Order No. 40 of 2020 delaying mortgage foreclosure sales. President Judge Fox issued the order due to concerns of limited access to City Hall for emergency relief, as well as public safety concerns associated with large crowds. The foreclosure sales were re-scheduled as follows: (a) the sales scheduled for July 7, 2020, were postponed to October 6, 2020; (b) the sales scheduled for August 4, 2020, were postponed to November 10, 2020; and (c) the sales scheduled for September 1, 2020, were postponed to December 1, 2020.

A copy of Administrative Order No 40 of 2020 may be found here.

Heard Around the Industry

The Pandemic’s Impact on CMBS Loans: New reports from Moody’s Analytics and special servicer CWCapital (the “Moody’s Report”), as well as Fitch Ratings (the “Fitch Report”) examine the impact of the pandemic on commercial real estate. To date, distressed CMBS loans are being transferred to special servicing at an unprecedented rate. According to the Fitch Report, 439 CMBS loans were transferred to special servicing during the months of March, April, and May. The total for these three month is 65% of total number of CMBS loans that went into special servicing all of last year, when 674 loans went into special servicing. Worse still, the value of the loans transferred for all of last year totaled $9 billion, whereas, the value of CMBS loans transferred to special servicing for the three months at the height of the pandemic totaled $21 billion. Fitch Reporting notes that only 8% of the loans have been reported as being caused by the economic shutdown imposed to curb the spread of the pandemic, but the actual number is likely much higher, as new guidelines on how to identify loans impacted by the pandemic were issued by CRE Financial Council (CREFC) on May 22, 2020, after many loans were already transferred to special servicing.

The Moody’s Report analyzed the impact of the pandemic across different sectors of the CMBS market. According to the Moody’s Report, 96% of loans secured by hotel and retail properties were transferred to special servicing from the beginning of March to the third week in May. CWCapital reported that $560 million of an $8 billion loan balance associated with relief requests has been transferred to special servicing. Of those relief requests, 84% came from the retail and hotel sectors (44% and 40%, respectively), as compared with office and mixed use each of which made up 5% each of relief requests.

The Moody’s Report notes that with hotel occupancy rates now in the low 20% range, hotel operators are unable to make full payments of principal and interest. Even as the economy is starting to re-open, with social distancing and occupancy restrictions in place for the foreseeable future, the Moody's Report predicts that the volume of distressed CMBS loans will continue to rise through at least the end of this calendar year. The Moody's Report is not all bad news, as it pertains to the industrial and multifamily sectors. As businesses have shifted to online retail sales, the need of industrial/warehouse space has increased, and the industrial sector of the CMBS market is performing much better than its retail and hospitality counterparts. The multifamily sector is also performing well because of the necessity for housing. With about $2.2 billion in loans issued roughly equally between quasi-governmental agencies (Ginnie Mae, Fannie Mae, and Freddie Mac) and non-agency lenders, the majority are current in rent payments. However, there is a disparity between loans issued by Ginnie Mae, Fannie Mae or Freddie Mac and other non-agency lender. According to the report, about 97% of multifamily property loans issued by Ginnie Mae, Fannie Mae or Freddie Mac were current, as compared with about 54% of loans issued by non-agency lenders.

Additional information may be found here and here.

New York City Residential Rates Falling: According to a report by StreetEasy, 24% of rentals throughout New York City are being discounted. In Manhattan, the rental discount was higher with 26.8% of rentals seeking a discount. Last year, through May 2019, only 15% of rentals were discounted. In addition to the increase in the percentage of rentals being discounted, the median discount also rose from 4.8% last May to 7.9% in May 2020. According to the report, this trend will likely continue, even as New York City enters Phase II and slowly re-opens. As more New Yorkers work from home, the demand for housing close to Manhattan offices is less of a priority. There are also other considerations that may result in decreased demand and greater discounts to attract renters. They include new hires and students who are starting jobs and school remotely, as well as New Yorkers fleeing New York City either due to job loss or to find more affordable housing. According to Zillow, the trend is not limited to New York, as rents are falling in 16 of the largest 35 markets.

Additional information may be found here.