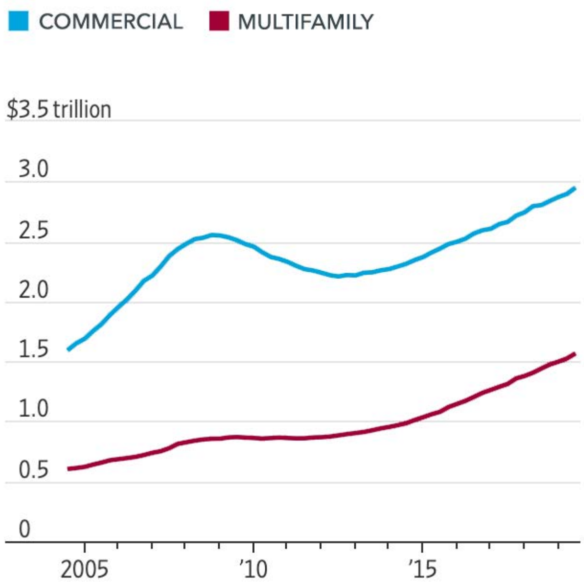
HOW TENANTS, LANDLORDS, AND LENDERS ARE REACTING TO COVID-19

Governments around the globe have issued stay-at-home public health mandates to combat the effects of the COVID-19 pandemic. These mandates, however, have caused massive economic slowdowns: whole industries have either shut down or are now on pause, and workers are either working from home, unemployed, or on furlough. As the CRE sector is not immune to this new economic reality, here's how tenants, landlords, lenders, and governmental bodies have reacted in response.

OUTSTANDING MORTGAGE DEBT IN THE U.S.



Note: Commercial refers to nonfarm, nonresidential mortgages
Source: Federal Reserve Bank of St. Louis

1. TENANTS HAVE LEARNED THAT FORCE MAJEURE PROVISIONS IN THEIR COMMERCIAL LEASES DO NOT NECESSARILY OBVIATE THEIR OBLIGATION TO PAY RENT TO THEIR LANDLORDS.

Firms have learned that although their business might be shut down or on pause, their obligations to pay rent have not necessarily ended. Almost all commercial leases contain language stating that force majeure may "not be raised as a defense for a tenant's nonperformance of any obligations with regard to the payment of rent."[1] As a result, federal, state, and municipal governments have sought to provide relief to firms. For example, in New York State, landlords currently cannot pursue legal claims against defaulting tenants. New York State has halted all nonessential court functions, including evictions, until further notice, and has instituted a 90-day moratorium (from March 16) on residential and commercial evictions.[2] Landlords may serve rent demands, but they cannot commence litigation against tenants, such as eviction proceedings. New York City has expressly warned that tenants are not excused from paying rent during the COVID-19 crisis, even if their revenues have declined precipitously. However, a bill that has been introduced in the New York State Senate – but has not yet been enacted – would "suspend rent payments and certain mortgage payments for certain residential tenants and small business commercial tenants for ninety days."[3] Other states, such as New Jersey, have put certain other moratorium relief in place. Unfortunately, not all states have followed New York's example. In California, for instance, there is no moratorium on evictions. Instead, the governor's executive order has merely delayed possible evictions.[4] Firms truly must be attentive to their state's policy changes, seek counsel, and renegotiate with their landlords for relief.

2. ALTHOUGH THE LAW IS IN THEIR FAVOR, MOST LANDLORDS ARE SEEKING TO PROVIDE SOME KIND OF RELIEF TO THEIR TENANTS, PARTICULARLY TO SMALL AND MID-SIZE FIRMS.

Owing to the fact that that it would be foolish to attempt eviction proceedings on defaulting tenants since (a) finding another tenant is almost impossible in the current context, and (b) a number of U.S. cities and states have put a moratorium on evictions, most landlords have sought to provide rent relief to their tenants. For example, the Irvine Company is offering up to three months of rent relief with repayment due in 2021 at zero percent interest.[5] In Detroit, Bedrock, the real estate development and property management firm of Quickenloan billionaire Dan Gilbert, will not collect rent or fees over the next three months from nearly any of its small business tenants. In many cities, an initiative by a single landlord would be ignored. Bedrock, however, owns about 50% of the leasable commercial real estate space in Detroit's 1.4-square-mile downtown business district. Bedrock estimates its program covers nearly 40% of downtown restaurants and retail.[6] Similarly, Blackstone has offered to defer rent payments by three months. Moreover, it is offering millions in support to "individual tenants who are facing extreme hardship."[7]

In addition to these programs, many landlords are assisting their tenants by helping them take advantage of keep provisions of the federal CARES Act passed by the U.S. Congress. For instance, to cite three provisions of the bill pertinent to small businesses:[8]

- The legislation includes $454 billion in support of business, States and municipalities, in the form of loans, loan guarantees, and other investments through programs or facilities established by the Federal Reserve.
- The legislation allows employers and self-employed individuals to defer payment of the 6.2 percent employer share of the Social Security tax they are responsible for paying to the federal government. The provision requires that the deferred employment tax be paid over the following two years, with half of the amount required to be paid by December 31, 2021, and the other half by December 31, 2022.
- The legislation creates a new $349 billion SBA lending program, modeled on existing 7(a) program, with 100% government guarantee. Eligible small businesses are those defined by SBA size standards (generally up to 500 employees) and include (but are not limited to)
    - Businesses in the accommodation and food services sector (restaurants and hotels) are eligible with up to 500 employees at each location.
    - Non-profits with fewer than 500 employees who are 501(c)3s and do not receive Medicaid funding.
    - Sole proprietors, the self-employed and independent contractors.

3. WHILE TENANTS HAVE RECEIVED LEGISLATIVE RELIEF, LANDLORDS THUS FAR HAVE NOT YET RECEIVED SIMILAR PROTECTIONS FROM BANKS AND OTHER LENDING INSTITUTIONS.

Although governors such as New York's Andrew Cuomo have urged banks to waive mortgage payments for three months, they cannot order them to do so by executive order since they lack the authority.[9] While state lawmakers have proposed legislation to suspend mortgage payments for three months for property owners, none have yet passed.[10] However, at the federal level, the CARES Act incentives banks and other lenders to offer relief by authorizing the Treasury Secretary to implement a program to provide financing to banks and other lenders.[11] Moreover, lenders and banks are asking regulators to roll back certain measures put in place after the '08 crisis. Their requests range from lowering liquidity and capital buffers to loosen rules on bad loans.[12] Nonetheless, if property owners default on their mortgages en masse, banks might be forced to write down loans and raise capital to cover for their losses.[13] Commercial mortgage debt has increased to nearly $3 trillion, up by 33% from its low eight years ago and well above its 2008 levels, according to the Federal Reserve Bank of St. Louis.[14]

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[1] Ron Camhi: https://bit.ly/39MjQXf
[2] NYS Exec. Order No. 202.8
[3] NYS Senate Bill 8125
[4] L.A. Times: https://lat.ms/2xNTk2y and Governor's Executive Order on Evictions N-37-20: https://bit.ly/3aGWe7O
[5] Lee & Associates Research
[6] WSJ: https://on.wsj.com/2XaLuLg
[7] F.T.: https://on.ft.com/3dWb4ti
[8] REBNY: https://bit.ly/2xR5Iz2
[9] NYT: https://nyti.ms/2UIaSpS
[10] Ibid.
[11] REBNY: https://bit.ly/2xR5Iz2
[12] Bloomberg: https://bloom.bg/2wTyq29
[13] WSJ: https://on.wsj.com/2X6O4BE
[14] WSJ: https://on.wsj.com/2wiOkTm