Commercial real estate in the midst of the COVID-19 pandemic - by Brian Sahn & Jane Chen

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In early 2020, the economy was on a steady climb and real estate was humming along. Then came COVID-19. As society adapts to the new norm, so too must the real estate and commercial lending markets. While we all await a vaccine rescue, innovators in the real estate market are developing new ways to mitigate risks and financial exposure, while maintaining balance sheets, tenant rosters, etc. Lenders will, however, only have so much tolerance for forbearance. Landlords will do their best to collect rents and cover operating expenses, taxes, insurance, etc., and tenants will seek to avoid or defer rent liability. All of this comes with an overriding concern of rising delinquencies in commercial mortgage-backed loans. The following looks at two of the many concerns.

Impact on the Commercial Real Estate Market

During the second week of March, when the government declared that COVID-19 was a pandemic and society ground to a halt, the financial markets responded rapidly with the S&P 500 experiencing sharp declines and the lending industry treading with extra caution given the enhanced risks and the uncertainties brought on by the degrading markets. According to Trepp LLC, a data and analytics provider, about 9.02% of commercial mortgage-backed loans were delinquent at the end of August, which was a decline of 58 basis points from July with about $6.5 billion in loans cured (meaning loans that were deemed delinquent in July reverted to current or within the grace period) according to the August 2020 U.S. CMBS Delinquency Report. Some of these cures resulted from forbearances and other financial accommodations granted by the lenders. Forbearance agreements, which provide the borrower with some time to repay the delinquent mortgage sums, also benefit the lender by avoiding expensive and time-consuming foreclosure proceedings, especially in a time where the courts were not fully functioning and open. Further compromising any enforcement efforts, in New York, on October 20th, 2020, governor Andrew Cuomo signed Executive Order No. 202.70 extending the state’s moratorium on COVID-19-related commercial evictions and foreclosures through January 1st, 2021, with a possibility of further extension.

Impact on Co-operative Corporations & Condominiums

While COVID-19 cases appear to be more contained, and governor Cuomo has implemented various phases of reopening, restaurants, bars and in-store retail have slowly started to come back to life. Yet, many establishments are struggling to make ends meet with reduced capacity and traffic, and others businesses have simply given up and closed. In urban areas such as New York City, many of these businesses were tenants in co-op buildings owned and operated by cooperative corporations. When a commercial tenant is struggling or walks away, the residential unit owners can get stuck holding the proverbial bag. This is especially problematic in that the hole in tax payments will become the residential unit owner’s burden to make up the difference left by the departure of the commercial tenant, thus exposing the co-op unit owners to higher maintenance or assessments until new tenants are in place. At a time when people are struggling, co-op boards may not have the ability to raise or collect additional maintenance. They may have to rely on cash reserves, thereby creating other problems such as depleting their reserve funds and creating unstable balance sheets that will be viewed less favorably by lenders for potential buyers of co-op units. Thus, co-ops may opt to impose a special assessment, an increase in monthly maintenance charges, or even both. Under the proprietary lease, the shareholders would be required to pay such impositions as they bear the risk as a community to cover operating expenses. If they fail to pay, they too would become delinquent in their obligations to the co-op.

Condominium units, unlike co-ops, which are separately owned and taxed individually, may afford some protection to condominium associations. Yet, the association still has to maintain the common areas, the costs of which are shared by the unit owners. Since the commercial tenants are responsible to pay the commercial unit owner directly as opposed to the association, their delinquencies may have less impact on the association. The commercial unit owners would be responsible to pay for their pro-rata share of the common charges. The condominium association also has the option to place a lien on the unit if the unit owner continues to default on common charge payments.

Conclusion

It is important to review commercial loan and lease agreements and safeguard your rights. While commercial tenants are temporarily shielded by governor Cuomo’s moratorium on evictions and foreclosures, it is important to make necessary arrangements prior to the moratorium being lifted in order to save time and avoid litigation.

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