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Coronavirus Q&A: Benesch Real Estate Leader

By **Andrew McIntyre**

Law360 (August 25, 2020, 12:41 PM EDT) -- In this edition of Coronavirus Q&A, one of Benesch's real estate leaders discusses the challenges retail owners continue to face as tenants have difficulty making rent and lenders are less likely to offer forbearance.

Jared Oakes

Jared Oakes, vice chair of the the real estate and environmental practice group at Benesch Friedlander Coplan and Aronoff LLP, counsels private equity shops, real estate investment trusts, developers, institutional investors and lenders on a variety of real estate matters.

Oakes, who works in the firm's Cleveland office, shared his thoughts as part of a series of interviews Law360 is doing with attorneys to discuss the ways the COVID-19 pandemic has created new legal questions and impacted businesses.

This interview has been edited for length and clarity.

Tell me what's the situation been like in Cleveland over the last few weeks, in terms of attempts to reopen certain sectors of the economy?

Ohio, generally, was early to the game of being careful and limiting activity and closed down early in COVID, and that created good results. COVID's impacts on Cleveland, they were felt, for sure, but the numbers got under control early. And so I think that there was a pretty measured approach by the governor and by local governments to open in a phased way. In a way that made sense. Really, most things are open now. You don't see a lot of entertainment and large venues open, but general businesses have been open. Retail is open. Restaurants are open with limits on capacity.

And I think you've seen the typical kind of growing pains that you would see where some bars and restaurants got excited at too many people. That required some enforcement action by local governments, which occurred. I think by and large, the ability to stay open is so critical to that sector that you've seen people being very careful for the most part. And I think that the governor's imposing some further restrictions and limitations has been helpful. Ohio's [COVID-19] numbers have gone up to some degree since the reopening but not as you've seen in other places and [the government has been] working actively to try to keep it under control.

What's your take on the response to the pandemic by the city of Cleveland and by lawmakers in the state of Ohio?

I think they've done a fantastic job. You don't hear a ton in terms of the policies that have been established by the city of Cleveland. But they follow fairly closely, I feel like, the guidelines that have been established by the state government. And again, they've been careful. I think they've been very communicative. They did a great job. Some people really want everything to be open quickly. Some people want nothing to be open and are very careful. And so, I think the governments have done a very good job of balancing those competing interests and keeping people safe.

I know you do a lot of work in the retail sector. I'm curious to hear your take on how conversations are going between owners of retail properties and lenders. It's an interesting time. A lot of these 90-day forbearance periods are ending, and so I'm curious to hear how those conversations now are playing out to the extent that owners of retail properties are having trouble making their debt payments.

Early on, most lenders were on board with sort of a 60- to 90-day extension without moving it toward sort of like a true workout scenario. They just understood the situation, wanting to get through that, recognizing the retail landlords we're dealing with have very complex issues with their tenants, right? So it was kind of status quo. There was action more on the tenant side and less on the loan side for a while. I've seen recently, [while] the lenders are not aggressively pushing things into default, I've seen several real workouts start in earnest. And you're going to see more, because the lenders are running out of rope a little bit without having some true discussions. I think they're also trying to figure out what's best for their portfolios. It depends on the type of lender, whether it's a balance sheet lender or whether it's a private lender, CMBS lender, insurance company. So people have different tolerances, different abilities to do things. But you have to take into consideration, kind of like in the Great Recession, [that] it's not going to be good for the lenders if they just push everything straight in to work out, or to try to exercise default rights. They don't really want to own the retail, and they recognize that for retail that's owned by sophisticated institutional investors, you're not really going to be better off putting it with the receiver. I think you're going to see more measured workouts. There could be some pain related to putting more equity in. But I haven't seen yet anybody take really aggressive positions.

To the extent that your clients are in discussions with special servicers, what are the key questions you're getting from clients right now on that point?

I think some of the key questions are: What's the ability to actually create a loan modification that actually works? How much time can I get? And then, probably most importantly on that, what kind of flexibility can I kind of get with respect to the ability to negotiate with dependents, right? So if you look at loan documents, a lot of them have covenants, especially with respect to major tenants, as to what you're allowed to do, and all the amendments that are occurring, and we're negotiating hundreds and hundreds of them. They're all rent deferrals or rent abatements of some combination of that. And so what kind of flexibility can I expect from my special servicer on the ability to do that? And unfortunately, the answer is not a lot. And so that's been a big hurdle. There have been scenarios where we've seen people request and get the ability to use some sort of [Capital Expenditures] reserve and things like that to fund payments, or reserves if there's not enough capital in the property.

You mentioned earlier that you don't think special servicers are

really terribly interested in owning these assets, so does that suggest that there's opportunity for discussion and negotiation and for deals to be worked out rather than special servicers just taking these assets?

I think I would say on the CMBS side, there definitely is. Special servicers are not paid to take risk. They generally don't have the ability, under the [Real Estate Mortgage Investment Conduit] Rules to make significant modifications to the loan documents. Through negotiated adjustments they're bound by those other rules. So that's probably the biggest thing that's inhibiting [special servicers]. It has always inhibited the ability to do workouts in the CMBS world. It's the limitations on the REMIC rules. And then under the special servicing, for the pooling and servicing agreements, because of the different tranches of ownership, [special servicers] have to protect all classes, and different modifications may be used to protect the lowest tranche or the highest tranche. So that's where I see little flexibility.

So staying on CMBS for a moment, what are you seeing in terms of new issuance of CMBS debt? Are our lenders starting to go out there and make large loans again?

I have not seen new large issuance recently. I have seen debt become slightly more available, generally for really good projects at lower leverage. But I haven't seen large CMBS issuances. If it's a triple net lease with a credit tenant that is not particularly harmed by both COVID or the evolution of retail, so grocery anchor stuff, [those properties are] favored.

We're starting to see some new construction loan availability for multifamily, which is a good sign, in my opinion, for the credit markets taking risk on the development side of things. And on good multifamily assets you're seeing a little bit lower leverage.

What's your sense of the construction market right now in Cleveland? Have projects started back up now?

In terms of cranes in the air, I think the projects that were funded and [had the] ability to move forward, I think that those have started. During the worst part of COVID, there was debate whether or not disruption was essential. There was a lag. That ended in the reopening of the economy. So projects like that, you're starting to see move forward. There are large development projects that we are in the process of negotiating the construction lending for, which is good. Those will start relatively on time, when we're able to close the loans. From a pure construction perspective I just see less spec development. Things that were teetering in terms of whether or not they would have been a great deal pre-COVID, those might have been delayed. In Cleveland, multifamily development has been relatively strong. You see some new projects have come online in 2020 and others are still working through construction, but you see those still happening.

We talked earlier about questions your clients are asking on the topic of lender-borrower discussions, but I want to broaden that and just ask you more generally what are some of the other questions you're getting from your clients?

I'll focus on retail for a second, because I think the questions there are very interesting in terms of what we're dealing with. So if you look at the evolution of COVID, in the early days, we analyzed thousands of claims. Do tenants have the right to not pay rent because of force majeure clauses and the like, or do they have other arguments under leases. So we analyzed that. The answer, generally speaking, was no, because of the way that the force majeure clauses worked. They didn't carve out an ability to pay rent. And so we kind of moved on from that phase, right? So then it was a combination of, as we talked about a little bit before, do I have the ability to negotiate with my tenant? And do I have the ability to negotiate with my lenders, right? And so, for the most part, if they had loans on the properties, lenders gave those short-term extensions that we talked about.

The evolution of dealing with the retailers on the tenant side of things has been interesting and has continued to evolve. I think that early on, the retailers reached out and said we're going to need help. We're closed down. And there was kind of a longer than I expected wait-and-see period of: What's going to happen? How is this shaking out? Different types of retail had factors. I saw open-air centers, community centers, power centers, move faster through getting a workout amendment done with the retailers. And then I saw the mall landlords hang on longer to see how is this shaping up. What is [the pandemic] going to do? It takes longer to open an interior mall than it takes to open an open-air center. So that logjam [recently] broke, and you see now tons and tons of negotiations of amendments being done, and that ranges.

Initially, I think folks were amenable to short-term deferral. It wasn't even real abatement of rent. It was just like, we'll let you not pay for April, May and June. So some negotiations happened around that. In return for that, the landlord got certain things. They got some lightening of exclusive uses, they got things that were beneficial for their potential redevelopment of the property. Extensions of terms. It was kind of like a quid pro quo, and it was working. And then, I think there's been a recent evolution where you start to see a little bit more of a true splitting of the pain where there's an actual abatement, where some of the rent is is paid and some of it is deferred. You're starting to see situations now where, in certain markets, they've had to close retail again, given outbreaks and things like that.

And I think there's a lot of fear, or concern, among the landlords that, if they do these things that are in the hundreds of thousands of amendments to help the tenants out, if there is a second wave of COVID, are you just back to the same place you were before? And what does that do to your relationships with both the tenants and the lenders?

And to the extent that that retailers are closing for a second time, how are those conversations and issues different from the conversations and issues during the first wave of closings? Are there different legal questions, different things that are being looked at as retailers close for a second time?

I think it's a little expedited in the sense that people have already analyzed what their rights are under the leases, and they know for the most part that works in the favor of the landlord. I mentioned that lenders don't want to be in a position of owning all these properties that are owned by their borrowers at the moment, right? But then there's also the fact that you have retail bankruptcies happening. It's almost one a day. And so, I think the landlords are focused on how do you do this in a way that actually gets the retailer back to a position of health, not that you can completely fix all their problems, but that allows you to maximize your rent, right? And so those are the kind of things that I think people are wrestling with as people reclose.

One of the things I think is very frustrating is the process has been kind of arduous, and it's taken longer than people want. But it's because people are so busy and every single retailer is going through this, and most landlords are going through this. And so, the thing that's tough is when you thought you were there, and something changed related to a reclosure that kind of reset the process, and that's been challenging for everybody.

--Editing by Rebecca Flanagan.

*Check out Law360's **previous installments** of Coronavirus Q&A.*
