

Congress Introduces HOPE-ful Solution for Distressed CRE Borrowers

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U.S. Representatives Van Taylor (R-TX) and Al Lawson (D-FL) introduced a bipartisan bill in Congress on July 29, designed to provide economic relief to commercial real estate borrowers hurt by the coronavirus pandemic with low-cost financing to support their properties.

The legislation, titled the Helping Open Properties Act of 2020 and referred to as the HOPE Act (the Act), would direct the Department of the Treasury (the Treasury) to establish and administer a program under which it would guarantee preferred equity investments by financial institutions in borrowers that were in good standing before the COVID-19 pandemic but are now struggling to access reasonably priced liquidity to pay debt service, taxes and other expenses. The Act would be funded by utilizing amounts already appropriated for providing capital to eligible businesses under Section 4003(b)(4) of the Coronavirus Aid, Relief, and Economic Security Act (CARES Act).

Why Offer Preferred Equity?

The Act's preferred equity structure avoids layering on additional debt at the property level, which is prohibited under many mortgage loan documents, especially in commercial mortgage backed security (CMBS) loans. Further, because bondholders of CMBS trusts expect timely principal and interest payments, servicers have little or no flexibility to modify these loans to allow for additional debt. Given these limitations, a better alternative to loan facilities for certain borrowers is preferred equity, which does not add to the debt burden at the property level or reduce a property's cash flow.

Who is Eligible?

Borrowers with no uncured monetary defaults prior to March 1, 2020 could receive infusions of up to 10% of their existing debt in the form of preferred equity sold to financial institutions such as national banking associations, who automatically qualify as eligible lenders under the Act. The term financial institution also includes such other entities as the Secretary determines to be appropriate. A borrower must be able to establish that it has been adversely effected by the pandemic by proving the subject property has experienced at least a 25% drop in revenue during any consecutive three-month period between March 1, 2020 and February 28, 2021 as compared to the same period in the previous year. The Act also requires the borrower to have a debt service coverage ratio (DSCR) of at least 1.3 times on an annual basis in 2019 or at least 1.3 times DSCR on an annual basis in 2017 and 2018. Finally, the subject property cannot be owner-occupied (with an exception for management offices or other *de minimis* space at the property).

Terms of the Preferred Equity Instrument

The Act incentivizes preferred equity investments by having the Treasury guaranty against losses and pay for origination and servicing fees. The investments would accrue at an interest rate of three percent over a 10-year term, at which time the financial institution would have the right to sell the instrument to the Treasury at par, plus unpaid interest, less the origination fee. Borrowers would have one year to draw down the amount, and must begin payment within two years of the draw down. The instrument would amortize over a

seven-year period beginning on the date of first payment. The Secretary would have the right, at his/her discretion, to purchase the preferred equity instrument from the financial institution at any time after the end of the seven-year period. Borrowers would have the right to prepay at any time without penalty.

The instrument would have no voting rights and no right of foreclosure. It could not be secured by the mortgaged property or by placing a lien on it. However, the Act expressly permits a financial institution to require additional collateral from the borrower, including personal recourse, corporate recourse, a first lien on another property or a claim on business assets. The instrument must be redeemed if there is more than a 50% change in ownership of the borrower.

Conclusion

The Act's introduction is a positive step in the direction of providing additional needed liquidity to commercial real estate borrowers in the current economic climate. However, we are still a long distance away from the bill's enactment and the creation of a viable preferred equity facility, as it remains to be seen what changes might be made to the Act as it makes its way through Congress. We will continue to provide updates on any legislative developments related to the Act.

If you have questions relating to a specific loan, please contact Timothy E. Davis (davist@whiteandwilliams.com; 215.864.6829), Marissa Levy (levymp@whiteandwilliams.com; 646.837.5753) or another member of our Real Estate and Finance Groups.

As we continue to monitor the novel coronavirus (COVID-19), White and Williams lawyers are working collaboratively to stay current on developments and counsel clients through the various legal and business issues that may arise across a variety of sectors. Read all of the updates [here](#).

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