BCLP. Client Intelligent

Insights

U.S. COVID-19: TOIL AND TROUBLE – HOW THE PANDEMIC IS CHANGING THE COMMERCIAL MORTGAGE LANDSCAPE

Apr 29, 2020

As COVID-19 spreads throughout the world, institutional and private equity lenders are now confronted with novel and unanticipated obstacles in closing commercial real estate loans. The policies implemented by various state and local governments intended to minimize the spread of COVID-19 are central to these issues faced by real estate lenders, as even operations deemed essential have been severely limited, while others have almost ground to a complete halt. This article addresses several challenges, such as recording office closures and due diligence obstacles, among others, faced in closing new real estate loans, and lenders' approach to handling forbearance and modification of existing real estate loans, in the face of these exceptional circumstances.

Recording Challenges

In light of COVID-19 and shelter-in-place orders, many recording offices are closed. Nonetheless, recording a security instrument, such as a mortgage, deed of trust, or deed to secure debt, is a typical matter of course in real estate lending transactions. In addition to providing notice of the existence of the lender's lien and security interest in the property, recordation is critical to the exercise of a lender's remedies. An unrecorded security instrument is problematic because it may (i) call into question the validity or authenticity of such security instrument; (ii) present a hindrance to obtaining title insurance, or (iii) bar lender's exercise and enforcement of remedies. In Georgia, for instance, the failure to pay intangible recording tax within 90 days of the date the security instrument is executed will subject the security instrument to penalties and interest, and would constitute a bar to collection. Furthermore, in most jurisdictions, security instruments are required to bear an original signature and notarial acknowledgment verifying the identity of the signatory. With social distancing now the norm, notarization in the physical presence of a signatory is impractical. In response, some jurisdictions, such as New York, have suspended the "physical presence" requirement and now permit execution and identity verification through audio-visual technology.

Additionally, with widespread recording office closures, title insurance companies are struggling to issue lender's title insurance policies absent a valid recorded security instrument. If e-recording or recording by mail is not available in a particular jurisdiction, title insurance companies are sometimes willing to insure the gap period (period between closing and recording) conditioned upon the receipt of an indemnity from the seller, borrower, and/or guarantor(s). Based on our discussions with various title insurance company representatives, the title insurance company's willingness to insure the gap is on a case-by-case basis and is mainly determined based on their evaluation of the risk of potential liens by a seller or, as applicable, a refinancing borrower.

Due Diligence and Contingency Obstacles

Depending on the jurisdiction and the breadth of the applicable shelter-in-place order, property diligence (surveys, Phase One Environmental Reports, O&M Plans, etc.) is essentially impossible to complete. Without such reports, a complete picture of a property is challenging to obtain. As discussed above, recording office closures interfere with thorough title diligence. Lenders and buyers have no way of knowing what liens and security interests are recorded against a property if exhaustive title searches are not feasible.

Borrowers' ability to satisfy conditions precedent prior to closing, such as obtaining tenant estoppels and making property repairs, could make closing impractical. With many businesses shuttered, tenant estoppels and rent requirements become problematic. Many tenants are not willing to prioritize the negotiation of an estoppel when rent and employees' wages are left unpaid. Additionally, the receipt of estoppels where the tenant confirms that rent is not being paid and that the property is vacant will be viewed negatively by borrower's lender. Conditions precedent with respect to property repairs may also be unrealistic. Depending on the jurisdiction, commercial construction services do not qualify as "essential."

Loan Forbearance on the Rise

The practical obstacles discussed above have resulted in a decrease in the number of real estate loan closings during COVID-19. Many lenders remain preoccupied, however, with market threats that borrowers face under existing loans made prior to the pandemic. With respect to loans that have already closed, lenders should anticipate an exponential increase in the number of requests for loan payment assistance. In light of COVID-19, lenders appear to be most sympathetic to borrowers in the hospitality and retail sectors. Some lenders are willing to provide struggling borrowers with complete forbearances from payment for a period ranging from ninety days to six months. Lenders may either require the forbearance payments to be repaid within several months after the expiration of the forbearance period, or when the loan matures.

Payment forbearances are memorialized as both loan modifications and forbearances. Lenders tend to prefer documenting forbearance payments as a loan modification, which permits the modification of payment terms and does not trigger a default. Alternatively, some lenders prefer documenting such payment forbearances in a Forbearance Agreement, which acknowledges both that the loan is in default and that the lender shall refrain from exercising its remedies if the borrower makes payments in accordance with the Forbearance Agreement. Both regulators and lenders are working together to facilitate COVID-19-related loan modifications. According to the Revised Interagency Statement on Loan Modifications by Financial Institutions Working With Customers Affected by the Coronavirus, issued by the Board of Governors of the Federal Reserve System, et al., certain modifications relating to COVID-19 are not required to be reported as Troubled Debt Restructurings.

* * * * * *

While real estate services may be considered essential, acquiring property or closing a loan during the pandemic remains problematic as borrowers and lenders, and their counsel, struggle with the practical obstacles discussed above. Not surprisingly, current economic conditions are leading to an explosion in loan forbearance activities. For borrowers requesting payment forbearances, most lenders are providing relief provided the borrower can justify the request. We are working closely with our clients to address this new landscape in practical yet innovative ways.

RELATED CAPABILITIES

- Commercial Real Estate
- Real Estate
- Real Estate Finance

MEET THE TEAM

Mica A. Germain

Co-Author, Atlanta

mica.germain@bclplaw.com
+1 404 572 6764

Johnny D. Latzak Jr.

Co-Author, Atlanta

jay.latzak@bclplaw.com
+1 404 572 5939

Rebecca A. Zarett

Co-Author, New York

rebecca.zarett@bclplaw.com
+1 212 541 2023