

Commercial Real Estate Loans and the COVID-19 Crisis: Sitting on the Sidelines

March 31, 2020

[VISIT THE CARLTON FIELDS CORONAVIRUS RESOURCE CENTER](#) 

It is an article of faith that each commercial real estate downturn is different in some way, invariably prompting a unique response from the private and public sectors.

The savings and loan crisis of the 1980s and 1990s saw the failure of more than 700 savings and loan associations. The S&L crisis gave rise to the Resolution Trust Corp., which fashioned the sale of nonperforming loans both as whole loans and, for the first time, through a series of commercial mortgage securitizations, creating the secondary market for commercial loans we know today.

The comparative blip in the capital markets in 1998 incited by the failure of Long-Term Capital Management and the Russian ruble crisis was met with a wait-and-see approach before markets largely normalized within a few short months.

On the whole, the Great Recession saw a patient response to the calamity by the federal government and many financial institutions. Through TARP, TALF, HAMP, and a range of other initiatives, financial markets and institutions were flooded with liquidity in a host of ways, providing time for markets to normalize and values to stabilize. Rather than taking the “mark-it-down-and-move-it-out” approach prevalent during the S&L crisis, “extend and pretend” became the mantra by many, and it largely worked.

While the government was fostering extend and pretend on a macro level during the Great Recession, the approach in the workout trenches was largely traditional, especially for defaulted loans managed by special servicers and nonperforming loans purchased by debt funds. Generally, if a borrower was prepared to infuse additional capital into an asset, the lender would often be inclined

to fashion a tolerable solution. This meet-me-halfway approach was sensible in the prevailing environment.

With the hard reality of COVID-19 manifesting, we are reminded yet again that each downturn is different in important aspects. Under the prevailing circumstances, the pandemic impacts the business and financial communities in extraordinarily deep, wide, and immediate ways. The initial response by many lenders has been measured and tolerant, recognizing that every aspect of the economy is under assault. By way of example, with America essentially locked down, the outlook for the hotel and restaurant industries is bleak. In cities and states where shelter in place has been mandated, the only meaningful revenue stream may come from alternate uses such as housing for medical staff, international students stranded in the states and, in some cases, as interim medical facilities. Even in communities not yet under lockdown, hospitality properties struggle to remain operational. Adding to the difficulty in assessing property prospects, the duration of these shutdowns is unknowable. Answers to these questions are informed more by epidemiological analysis than ARGUS runs.

The events of late have accelerated more rapidly than anyone could have imagined just a few short weeks ago, prompting a host of responses from federal and state governments, agencies, and regulators. Congress has enacted the \$2 trillion Coronavirus Aid, Relief, and Economic Security Act providing an array of programs designed to provide relief to businesses and individuals. The Federal Reserve, the FDIC, and other major federal and state regulators have issued an interagency statement encouraging financial institutions to work prudently with borrowers under strain as a result of COVID-19, providing assurances that the regulators will not automatically categorize all COVID-19-related loan modifications as troubled debt restructurings. The Federal Reserve has established the Term Asset-Backed Securities Loan Facility in order to provide a source of liquidity for consumer and business loans. Fannie and Freddie have imposed moratoria on foreclosures, extended favorable forbearance arrangements, and waived penalties and late charges. HUD has announced a 60-day moratorium on FHA while other large banks are rolling out similar programs. And so on.

As for the commercial real estate sector, the response by financial institutions to the flood of borrower requests for accommodations has dimensions that parallel today's unique circumstances. Yes, by definition, all real estate is unique requiring an approach that fits the specifics of each asset. This will always be the case, particularly as problem credits resolve. But for the here and now, the initial response from the lending community has been measured and temperate.

Setting aside borrowers who were already in the workout pipeline with challenges unrelated to the crisis, financial institutions appear inclined to call a timeout for some period, favorably disposed to a short-term forbearance that will bridge to a time when the severity and public policy response to the pandemic offers some clarity. This measured, sensible approach not only takes into account the

source of the strain on most every asset class, but is colored by the prevailing sense that we are all in this together. While global infections have shut down income sources temporarily, this doesn't reflect on a property's operational quality, the durability of a capital structure, or the competency of the property's ownership and management. The source of impairment distinguishes this crisis from others of the recent past.

Hope may not be a strategy, but history suggests that betting against innovation in science and medicine can be a sucker's bet. As human ingenuity finds a way to abate, treat, and eventually conquer the virus, borrowers and lenders will return to their traditional roles, grappling to find solutions for recapitalizing unique assets with broad geographic diversity and a range of considerations. While we wait and cheer on the medical response, a pause to catch our collective breath seems both appropriate on a human level and NPV-maximizing on a technical level.

While Kenneth Rogoff and Carmen Reinhart's instant classic *This Time Is Different: Eight Centuries of Financial Folly* illustrates how naive it can be to describe a financial crisis as truly different, the fact remains that this downturn has a least one distinguishing feature. In previous cycles, solutions were largely in the hands of real estate and finance professionals. This time around, lenders and borrowers are spectators in many ways, relegated to rooting for the medical community to break the fever.

Authored By



W. Gregory Null

Related Practices

[Real Estate](#)

[Institutional Investment and Finance](#)

Related Industries

[Real Estate](#)

publication may not be quoted or referred to in any other publication or proceeding without the prior written consent of the firm, to be given or withheld at our discretion. To request reprint permission for any of our publications, please use our Contact Us form via the link below. The views set forth herein are the personal views of the author and do not necessarily reflect those of the firm. This site may contain hypertext links to information created and maintained by other entities. Carlton Fields does not control or guarantee the accuracy or completeness of this outside information, nor is the inclusion of a link to be intended as an endorsement of those outside sites.