Marcus & Millichap
Capital Corporation

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LATEST DEBT MARKET INFORMATION

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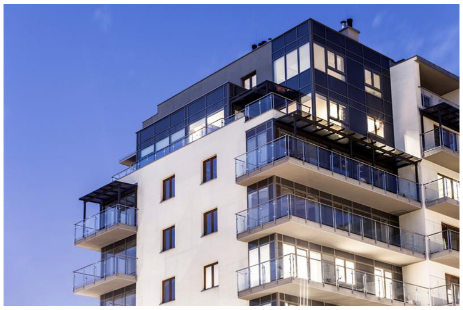
The Unintended Consequences and Risks of Forbearance

To stop the spread of Covid-19, communities are coming together, staying home, washing hands and social distancing to protect the most vulnerable. A similar level of cooperation is needed in the commercial real estate industry among tenants, owners, lenders and the government to prevent a cascade of bankruptcies. In the words of one commentator, we are “too connected to fail.”

For example, the $2 trillion Coronavirus Aid, Relief, and Economic Security Act (CARES) allows multifamily property owners who hold federally backed mortgages to request forbearance on their loans. The policy is intended to prevent a wave of multifamily loan defaults and potential foreclosures by giving owners some relief in the event tenants fail to pay rent. Though the forbearance provision is well-intentioned, many believe adjustments need to be made to better align the interests of tenants, property owners and lenders, and avoid dire consequences for the entire system. For example:

Landlords who seek forbearance can’t evict tenants, charge late fees or issue negative credit reports for those who fail to pay rent. While this is appropriate for people who have lost their jobs due to Covid-19, the policy covers all tenants, even those whose incomes have not be affected.

Many believe the Agencies should require tenant relief to be predicated on direct impact from Covid-19. Those whose employment can be documented should be subject to business as usual. This is particularly important as unemployment rises over time. A Wall Street Journal survey of 57 economists suggests that 14.4 million jobs will be lost in the coming months, and the unemployment rate will rise to a record 13 percent in June.



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Servicers are working on a case-by-case basis to help property owners, but since major modifications require Special Servicer sign off, we expect the bigger deals to be subject to significant fees. Meanwhile the Special Servicers may not have the bandwidth to address smaller deals, which may be ignored.

The good news is that we see evidence of owners, tenants and lenders across the commercial real estate spectrum coming together to avoid irreparable damage to the system. Most apartment residents understand that their rent payments are crucial to running a safe and livable property. The National Multifamily Housing Council (NMHC) found that 84 percent of apartment households made a full or partial rent payment by April 12, up 15 percentage points from April 5, based on a survey of 11.5 million units of professionally managed apartments across the U.S.

In addition, many landlords are being compassionate and flexible, offering modifications that can be paid back incrementally over the life of the lease when the crisis abates. Owners tell us they are communicating with tenants to find out who is facing hardship, and reaching out to elderly residents in particular who may lack a support system. Others say they are focused on maintaining staff and operations, as supporting tenants is the right thing to do and will have significant upside for the property's reputation over time.

Finally, in this uncertain economic landscape, lenders are like doctors. They need to manage borrowers like a physician working to help cure a patient. To that end, we are seeing many banks, and some life companies, allowing shortfalls to be tacked on to the back-end balloon payment. Lenders also need to make allowances for this unprecedented situation and recognize that even the most stable borrowers may require forbearance and remain excellent candidates for future financing.

RECENT TRANSACTIONS

MULTIFAMILY
Longmont, CO
$16,800,000
2.98% Fixed
3 yrs I.O.
10-yr term/30-yr amort.
Non-Recourse

HOSPITALITY
Cary, NC
$5,100,000
4.15% Fixed
10-yr term/25-yr amort.
Recourse

INDUSTRIAL
Novi, MI
$4,970,000
4.16% Fixed
5-yr term/25-yr amort.
Borrower cashed out $2 million