

July 21, 2020

The Honorable Mike Crapo
Chair, Senate Banking Committee
534 Dirksen Senate Office Building
Washington, DC 20510

The Honorable Sherrod Brown
Ranking Member, Senate Banking Committee
534 Dirksen Senate Office Building
Washington, DC 20510

Dear Chairman Crapo and Ranking Member Brown:

On behalf of commercial real estate (CRE) investors, owners, developers, lenders, builders, hospitality providers and other stakeholders in the \$16 trillion U.S. CRE sector that we collectively represent, thank you for the opportunity to share urgent recommendations to improve the effectiveness of the Main Street Lending Program (MSLP) for commercial real estate owners and tenants. Important public safety measures and mandated closures have devastated many of our members' businesses across the country and much of our industry is under severe financial distress.

Commercial properties across asset classes – hotels, shopping centers, apartments and office buildings – are a major part of the economy, directly and indirectly comprising 18% of US GDP.¹ These properties are financed by \$11.4 trillion in equity² and \$4.6 trillion in debt,³ mostly provided by commercial banks, life companies, government-sponsored enterprises and commercial mortgage backed securities (CMBS). As we approach mid-year, overall loan delinquencies have increased 500% year-to-date;⁴ hotel and retail delinquencies have reached record highs. These rates already exceed those experienced during the height of the Great Financial Crisis a dozen years ago.

One quarter of jobs in the U.S. are located in commercial properties, with 29.1 million jobs located in stores, hotels, and restaurants.⁵ More than three million establishments in these industries alone paid nearly \$700 billion in wages. Fewer than half of hotel employees are currently working and according to the Bureau of Labor Statistics (BLS), the leisure and hospitality sector has lost 4.8 million jobs since February. Shopping centers have lost 8 million jobs.

Revenue lost due to COVID-19 is expected to exceed \$120 billion, a loss of more than fifty percent of the hotel industry's total revenue in 2019, according to CBRE and STR.⁶ Shopping centers report \$188 billion in lost sales and \$46 billion in lost rent from tenants. State

¹ <https://www.naiop.org/Research-and-Publications/Economic-Impacts-of-CRE/Economic-Impacts-of-Commercial-Real-Estate-2020-US-Edition>

² <https://www.reit.com/data-research/research/nareit-research/estimating-size-commercial-real-estate-market-us>

³ <https://www.federalreserve.gov/apps/fof/FOFTables.aspx>

⁴ Source: Intex Solutions, Inc

⁵ <https://static1.squarespace.com/static/52850a5ce4b068394a270176/t/5f132dd8e28e0f1e88194e90/1595092440548/Economic+Activities+of+Selected+Industries+July+2020.pdf>

⁶ <https://str.com/press-release/us-hotel-demand-not-expected-fully-recover-until-2023>

and local taxes are hurt as a result of this lost revenue. The pandemic is projected to reduce hotel-specific state and local tax revenues by nearly \$17 billion this year – with an additional \$9 billion in hotel real estate taxes at risk.⁷ Also in jeopardy is the approximately \$400 billion of state and local taxes generated by the shopping center industry that goes to support local communities, public safety resources and infrastructure.

Before COVID-19, many of the various real estate assets held by our members were performing well and even thriving and will likely do so again in the future; today a number of these income and job-producing properties are shut down or operating at very limited capacities, impacting their ability to meet contractual debt obligations. The economic crisis created by the pandemic has created temporary market distortion for CRE that should be minimized in order to preserve some of the value of the underlying assets to investors and the communities we serve. A mechanism offering liquidity could be the bridge they need to help restore the jobs and tax revenue they support until they can prosper again.

We believe that the MSLP could properly be used to provide much-needed relief for commercial properties. Unfortunately, current eligibility rules of the Paycheck Protection Program, MSLP and the Primary Market and Secondary Market Corporate Credit Facilities have effectively excluded owners of property from applying for these loans even if they suffered economic hardship from the pandemic, their tenants have not met rent obligations and they are unable to meet their ordinary business expenses. Congress provided the Federal Reserve and the Treasury Department with minimal MSLP guidance in the CARES Act. For MSLP to be utilized by our members we believe it is necessary for Congress to now provide direction. Accordingly, we propose that Congress take action to provide relief for CRE by making the following changes to the MSLP:

Expand Eligibility

Congress should make clear that all businesses of a certain size can qualify for MSLP. Currently, MSLP uses the Small Business Administration's (SBA) 7(a) loan eligibility standards, even though this is not an SBA program. The SBA eligibility standards are problematic as they exclude business entities holding passive real estate.

Extend the MSLP

Given the mid-June start of the program, we recommend extending the MSLP application period until at least December 31, 2020 from the current September 30, 2020 deadline.

Modify Asset-Backed Underwriting Methodology

Lenders need flexibility to adjust the underwriting methodology based on the types of assets involved. Currently, MSLP limits a borrower's maximum loan size to a multiple of its earnings before interest, taxes, depreciation, and amortization (EBITDA). As the Federal Reserve has acknowledged, EBITDA is not a standard underwriting metric for real estate or

⁷ <https://www.ahla.com/sites/default/files/AHLA%20State%20%20Local%20Tax%20Revenue%20Loss%206-12-20.pdf>

other asset-based businesses. If the EBITDA multiple test remains, the number should be increased substantially. We recommend that the Federal Reserve allow lenders to use conventional metrics of the real estate industry:

- For construction, development projects and hotels, a 75% maximum loan to cost (LTC);
- For other assets, an 80% maximum loan to value (LTV) or a 1.2x minimum debt service coverage ratio based on 2019 operating income.
- In addition, we believe Net Operating Income is a better metric to reflect the long construction and lease-up times in commercial and residential property. MSLP should allow the maximum loan size for CRE borrowers whose buildings were placed into service after January 2019 to be based on the projected stabilized NOI.

Additional Debt

Many CRE loans prohibit borrowers from taking additional debt, which increases risk for the borrower, property and lender. Additional debt reduces a commercial property's cash flow and has a negative impact on the credit underwriting profile of the property. A better alternative to loan facilities for commercial property is preferred equity, which does not add to a property's debt burden and keeps cash available to operate.

Congress should allocate unused Title IV CARES Act funds and direct the Federal Reserve and Treasury to create a preferred equity program for CRE borrowers, as part of MSLP or as a separate facility. The purpose of the new facility or program would be to purchase such positions and to provide full or partial guarantees to insured financial institutions to make such purchases, providing a temporary liquidity bridge to combat the temporary market distortion in certain commercial real estate sectors. This could be accomplished with the following technical amendment to Section 4003(b)(4)(A) of the CARES Act:

(a) TECHNICAL AMENDMENT. Clarify that "obligations or other interests directly from issuers of such obligations" is intended to encompass both the direct purchase of and the provision of full or partial guarantees to insured financial institutions to enable them to purchase preferred equity positions in commercial real estate firms that require the capital to satisfy outstanding debt obligations.

(b) REGULATORY CAPITAL REQUIREMENTS RISK WEIGHT. With respect to the appropriate Federal banking agencies or the National Credit Union Administration Board applying capital requirements under their respective risk-based capital requirements, a preferred equity investment in a commercial real estate firm that receives a full or partial guarantee in accordance with subparagraph (a) shall receive a risk weight of zero percent.

Affiliation Rules

Borrowers should have flexibility within affiliated companies to ensure businesses are able to use the funds where they are needed, while at the same time being prohibited from making distributions to unfairly enrich themselves.

Statutory Distributions

The Internal Revenue Code requires Real Estate Investment Trusts (REITS) to pay dividends to their investors. MSLP guidance should not conflict with existing Internal Revenue Code requirements for these distributions. Currently the MSL program permits other similar kinds of tax distribution.

The impact of COVID-19 has been especially devastating to commercial real estate tenants, borrowers and lenders. As our members attempt to navigate the fall-out from this crisis, there is a deficiency of reasonably priced capital sources to address temporary liquidity deficits. Again, unfortunately, federal assistance has been out of reach. Should impacted assets go into foreclosure, a downward spiral follows, affecting jobs, property values, investors at all levels (including pension funds), and state and local tax revenues. The repercussions on communities will be profound and take years from which to recover. We appreciate the chance to share our views and look forward to working with you to craft relief that will enable our members to weather the current predicament and position the economy for a recovery when the pandemic subsides.

Sincerely,

American Hotel and Lodging Association

Asian American Hotel Owners Association

Commercial Real Estate Finance Council

International Council of Shopping Centers

Latino Hotel Association

Mortgage Bankers Association

NAIOP, the Commercial Real Estate Development Association

National Association of Black Hotel Owners, Operators & Developers

The Real Estate Roundtable