



Retail and Shopping Center Landlords: Commercial Real Estate Finance COVID-19 Impact Series

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The ongoing COVID-19 pandemic continues to impact all areas of the economy, but retail shopping center owners (often referred to below as “landlords” for simplicity) are disproportionately feeling the impact. This article, which examines the pandemic’s impact through the lens of retail and shopping center landlords, is one of a series of publications that aim to provide informed and real-time guidance tailored to various sectors of commercial real estate owners. View more resources about the COVID impact on [multifamily properties subject to loans backed by Fannie Mae and Freddie Mac](#), analysis focused on [HUD-insured loans](#), or analysis directed to [hospitality property owners](#).

Many non-essential businesses have been forced to close their doors to the public or to severely limit their operations with jurisdictions nationwide imposing “shelter in place” or “stay at home” orders. Even stores permitted to stay open are facing significantly decreased foot traffic due to other tenants’ closures and shoppers staying home to adhere to social distancing guidance. To see what mandates are in effect in your state, visit the [International Council of Shopping Center’s \(“ICSC”\) fifty-state survey](#).

In this environment, many tenants are generating no, or significantly reduced income. Retail landlords are already hearing from tenants who do not expect to be able to pay all or some of May rent, and who may not have paid full April rent, impacting landlords’ ability to make debt service payments and creating other significant economic and operational issues. While most landlords will have business interruption insurance, many policies will probably not cover this disruption – but note some jurisdictions are considering mandating that carriers cover it. Moreover, the Small Business Administration’s popular (and forgivable, if certain conditions are met) Paycheck Protection Program (“PPP”) loans are generally unavailable to retail shopping center owners currently even though

some mortgage lenders may permit PPP loans under certain conditions. Though the ICSC and other industry trade organizations are lobbying to have this exclusion lifted, no relief is currently in sight. Landlords can, however, encourage tenants that might qualify to obtain such loans since up to 25% of the forgivable loan proceeds may be used for rent and other non-payroll expenses (note, the ICSC also is lobbying to have this limitation increased or removed). While the initial \$349 billion in federal funding for PPP loans were committed to borrowers within weeks of passage of the CARES Act, Congress authorized an additional \$320 billion for the program on April 23, 2020.

Landlords must consider several key issues while navigating these unprecedented events as it is becoming clearer that a rapid recovery will not occur. Scientists, public health officials and political leaders begin to publish guidance on how and when to safely reopen parts of the economy, and with the explicit warning that broader stay at home orders may resume in communities that see significant outbreaks. Compounding the matter, there is no guarantee that shoppers will return to pre-COVID-19 levels before safe and effective treatments or a vaccine are developed.

Avoiding Recourse and Events of Default under Loan Documents

If they have not already, now is the time for landlords to develop a keen understanding of the requirements of their loan documents by having their loan documents carefully reviewed. Moreover, correspondence with tenants and lenders should be carefully considered and reviewed as the pandemic unfolds. Below are several of the most common, and consequential, mortgage loan document requirements that will be implicated in the coming months. Breaches of some covenants trigger an immediate event of default, and some breaches may activate springing recourse to the guarantor (either for losses incurred by the lender as a result of the breach or for the full amount of the debt) in an otherwise non-recourse loan to the sponsors. Note, the summaries below apply to common loan document provisions and each individual set of loan documents should be carefully reviewed to see where and when

any of the following apply, or for any other “trap doors” that may exist in the loan documents.

Leasing:

- Landlords are receiving requests for rent deferrals and other lease modifications to provide temporary relief for tenants. Loan documents, however, very often prohibit most new leases and amendments or modifications to existing leases without lender consent or permit modification without lender consent only in strict accordance with clearly delineated standards. Breach of those prohibitions can have severe consequences – often an immediate event of default and spring in full recourse as a “prohibited transfer” of an interest in the property. Seemingly benign actions in good faith to help tenants, such as an e-mail deferring rent for a month, or permitting reduced rent for a short period, can be construed as a modification. While landlords will need to work with tenants where possible in order to maximize cashflows and limit rollover in a difficult environment, landlords should be vigilant not to engage in any leasing activity that would trigger recourse or an event default.
- Some landlords may find comfort if their loan documents’ leasing provisions a concept of lender’s “deemed approval”. Deemed approval provides that if notices are sent to the lender with proposed lease modifications, or new leases but the lender fails to respond after a certain period of time the request is deemed approved. Lenders and servicers are overwhelmed with requests currently and are triaging the most at-risk properties. The current servicing request tidal wave may play to landlords’ advantage if deemed approval is available in loan documents. Note that deemed approval may not be available during an event of default, and if so a determination should be made that there are not grounds for an event of default to avoid adding recourse on top of the event of default.

Additional Indebtedness and Use of Cash Flow:

- Most mortgage loan documents, particularly if the loan is destined for the commercial mortgage backed securities (“CMBS”) market or is otherwise non-recourse in nature, prohibit any additional indebtedness at the borrower level except (i) the mortgage loan and (ii) unsecured trade payable debt that is (a) paid within a short period of time after it was incurred and prior to delinquency, and (b) not in excess of a low percentage of the loan amount (e.g., 1% or 2%). Regardless of the landlord’s cash flow, in such a scenario the landlord will want to ensure the trade payable threshold is not exceeded since the consequences for breaching the covenant will be an event of default and recourse, typically full recourse.
- Landlords should also be careful with the use of cash flow generated from the property. Many are facing competing cash flow needs elsewhere in their portfolios, but many CMBS and other non-recourse loan documents have carveouts if rents from the subject property are not used to pay certain items at that property. Some of the most common carveouts (typically losses) are for failure to maintain and repair the property, failure to pay taxes and insurance premiums, permitting mechanic’s liens to be filed against the property, misappropriating rents (such as distributions to investors when operating expenses, debt service and reserves are not paid or while in a cash trap) and failure to comply with the cash management provisions (typically for establishing any accounts and depositing rents therein).

Other Loan Document Considerations:

- One very common, but sometimes hidden, trigger in nearly all CMBS and other non-recourse loan documents is for “admitting in writing the Borrower’s inability to pay its debts as they become due.” Common advice, which can be good advice, is to deal with your lender straightforwardly and keep the lender informed on the property’s performance in order to obtain a forbearance or an acceptable workout (more on that below). But a well intentioned e-mail to your lender could just wind up triggering not just an event of default but full recourse if the e-mail is not carefully crafted.

- The “special purpose entity” (“SPE”) covenants of the borrower, meant to silo off the subject property from risks at other unrelated properties owned by investors, must also be carefully reviewed. Breach of these covenants trigger an event of default and recourse (often full recourse), and some may pose additional risk during a low cash flow period. Commonly SPE provisions include, among others things, that the borrower may not fail to maintain adequate capital for normal operations and must maintain solvency. Courts can interpret provisions such as these and others in unexpected ways. In one well known instance in the wake of the last economic downturn, the “Cherryland Mall” decision, a property owner sought to “turn in the keys” from a property subject to a non-recourse loan that was no longer generating sufficient cash flow to satisfy the loan obligations. A court then interpreted these provisions to trigger full recourse to the guarantors for borrower’s breach of these covenants. This decision came over strong objections of industry stakeholders – including CMBS and other non-recourse lenders – since the decision effectively undid the non-recourse nature of the loan. Search “Cherryland Mall decision” for more information. Some states, like Ohio and Michigan, have “fixed” this issue by statute, and relevant SPE provisions are also now commonly modified to better tailor them to the underlying nature of the loan, such as qualifying them as “subject to available cash flow” or “*intending to remain solvent*”, but this example underscores the need to identify and understand risks in loan documents, then strictly follow best practices to mitigate those risks.
- After the biggest risks in the loan documents are understood and planned for, several other provisions may need to be considered. For instance, assuming the property is not yet in a cash trap for loans with cash management, if a major tenant “goes dark” or ceases operations is cash management triggered? Would this be waived by the lender if the failure to operate was the sole triggering event and only due to a government order? What if a tenant fails to pay rent for several months? How far must a landlord go toward enforcing that obligation in order to comply with a covenant in the loan

documents to enforce the terms of the lease? Fortunately for landlords, breach of this particular covenant is often not an immediate event of default or recourse obligation but again it highlights how carefully landlords need to understand their loan documents to avoid dire consequences.

Negotiating with the Lender and Servicer

The longer the pandemic continues, more and more landlords will struggle to make payments required under their loans as cash reserves are depleted and investors grow leery of capital infusions. A forbearance or workout may eventually be necessary for many landlords. When a landlord determines it will not be able to make upcoming debt service payments the landlord will have to determine whether and how to notify the servicer or lender, and getting their attention may be difficult, as discussed above. So, the right first step may be calling the relationship manager at the lender to ensure your request is heard. If such a contact does not exist, or when following up after such a phone call, a notice e-mail or letter may be appropriate. Such correspondence should be limited to a short, matter-of-fact statement that is carefully drafted, as caution must be used to avoid admitting an inability to make payments since, as discussed above, doing so may trigger personal recourse.

In these initial communications with the lender, there are certain common requests that we are currently seeing:

- deferral of monthly payments – some lenders and servicers are granting short deferrals, but the deferred payments will ultimately need to be paid, and there is no uniform approach by lenders as to how to handle such deferred payments;
- waiver of additional deposits into capital expenditure or rollover reserves for a certain period of time;
- using funds on deposit in existing reserves, particularly capital expenditure or rollover reserves, for other purposes, including (1) funding of tax and insurance reserves, (2) application to debt service payments and (3) using such amounts for basic operating expenses, although catch-up payments may be required at a later date; and

- requests for rent concessions to tenants and other lease modifications, to the extent lender consent is required by the loan documents.

Once these requests have been made, it is likely that the lender or servicer will ask to enter into a pre-negotiation agreement (“PNA”) before granting or further considering such requests. In their basic form, PNAs protect the borrower and the lender by providing that statements and information disclosed during negotiations cannot be used against the other party. While there is generally little room for negotiating a PNA, an experienced attorney should review the PNA to ensure that it covers standard matters.

If the loan is a CMBS loan, any request for concessions from a master servicer can potentially result in a transfer to special servicing. Typically, such a transfer would be necessary to obtain concessions, as master servicers generally have limited ability to provide such relief. However, many master servicers appear to have been granted expanded powers in these unprecedented circumstances. Since a transfer to special servicing will result in additional fees, it would appear that the current best practice is to avoid such a transfer if possible, understanding that it will be more important to make the necessary requests. Avoiding special servicing may not be possible for every property, but it is something to be considered when developing a plan to deal with the COVID-19 pandemic.

Conclusion

In summary, landlords are faced with varied and sometimes competing considerations to navigate. They must work through tenant relationships and lease issues while being mindful of loan document obligations and any “landmines” the loan documents may contain since courts can come to unexpected decisions. If the property starts to go underwater, then the landlord must consider cautiously and thoughtfully approach the lender or servicer to initiate discussions on how to manage the property through these rapidly changing times.

For more information, please contact [Geoff White](#), [Doug Walter](#) or any attorney in Frost Brown Todd's [Real Estate](#) practice group.

To provide guidance and support to clients as this global public-health crisis unfolds, Frost Brown Todd has created a [Coronavirus Response Team](#). Our attorneys are on hand to answer your questions and provide guidance on how to proactively prepare for and manage any coronavirus-related threats to your business operations and workforce.

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