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HOPE Act Aims to Provide Assistance to Commercial Real Estate Market

On July 29, 2020, Texas Congressman Van Taylor introduced the Helping Open Properties Endeavor Act of 2020 (the "HOPE Act") into Congress. The bi-partisan bill is co-sponsored by Kentucky Congressman Andy Barr, Florida Congressman Al Lawson, Minnesota Congressman Jim Hagedorn and Tennessee Congressman David Kustoff. The HOPE Act is intended to provide additional relief to the commercial real estate ("CRE") market in the form of a preferred equity facility. The "HOPE Preferred Equity Facility" will guarantee a financial institution's purchase of a preferred equity investment in a CRE borrower.

Borrowers in the commercial mortgage-backed securities ("CMBS") market and other structured debt markets have generally faced greater structural obstacles in attempting to obtain relief from federal or state aid facilities during the COVID-19 pandemic due to loan document restrictions prohibiting the incurrence of additional debt. By structuring aid in the form of preferred equity, these borrowers will hopefully be able to access additional capital needed to continue to pay operating expenses and make debt service and reserve payments. As COVID-19 related governmental orders continue to restrict the operation of commercial properties and impact revenues, CMBS borrowers and other CRE borrowers are hopeful they will be able to obtain much-needed relief under the HOPE Act.

This article will provide a summary of the proposed terms of the bill. Within thirty days of enacting the bill, the Secretary of Treasury would be required to issue additional rules and guidance on the HOPE Act.

Eligibility Requirements

- Eligible borrowers are subject to the conflicts of interest rules under the CARES Act.[1]

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- An eligible borrower cannot have received notice of a monetary default within the prior year and failed to cure the default as of March 1, 2020.
- Revenue during a three consecutive month period between March 1, 2020 and February 28, 2021 must be at least 25% less than revenue during the same period in the prior year.
- The property must have had a debt service coverage ratio of at least 1.30 to 1.00 in 2019 or 1.30 to 1.00 in 2017 and 2018.
- The borrower or a parent entity cannot have acquired the property after March 1, 2020 through a foreclosure proceeding and the property cannot be owner occupied, except for de minimis occupancy permitted by the Secretary of Treasury.
- A guarantor approved by the financial institution must provide a "bad boy" guaranty to the financial institution and Secretary of Treasury. The guaranty must include indemnification if the borrower, its parent entity or any affiliate commits fraud, misappropriates or misapplies any amounts received, fails to apply any amounts received in accordance with the HOPE Act, commits intentional waste or fails to comply with requirements related to the Secretary of Treasury's redemption of a preferred equity instrument.
- Borrowers receiving assistance must immediately issue a public statement announcing receipt of funds under the HOPE Act.

Preferred Equity Instrument Requirements

- The preferred equity investment will be made by financial institutions and guaranteed by the federal government.
- The amount of the preferred equity investment will be up to 10% of the outstanding debt.
- The preferred equity instrument will be unsecured, subordinate to any existing perfected loans and unsecured debt and provide for no management/approval rights or right of foreclosure.

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- Borrowers must begin repayment two years after the earlier of the date all funds have been drawn and one year after the date of the preferred equity investment. There is a 7-year amortization period beginning on the date payments are first due.
- The interest rate is 3%. The interest rate will be increased to at least 3.5% and no more than 13% if the Borrower fails to make any required payments. The increase will be dependent upon when the Borrower defaults in the repayment schedule. Any interest over 2.5%, including any increase in the interest rate due to failure to make payments, will be payable to the Secretary of Treasury.
- Borrowers can redeem (i.e. pay off) the preferred equity at any time without penalty, subject to certain mandatory redemptions upon transfers of 50% or more of the ownership in the property.
- Borrowers must redeem (i.e. pay off) the preferred equity before any distributions or loans can be made to other equity holders or affiliates and before any management fees to affiliates may be increased.

Financial Institution Requirements

- Eligible financial institutions include any institution authorized to make and approve Paycheck Protection Program loans or otherwise authorized under Section 1109 of the CARES Act, any national banking association and any other institution deemed appropriate by the Secretary of Treasury.
- Financial institutions must make funds available within 14 days of approval of the preferred equity instrument by the Secretary of Treasury. The funds will be made available in a reserve for the borrower to be used for any expenses that will benefit the operation of the property, including but not limited to, payments of the preferred equity interest, principal, interest, insurance, taxes, utilities, fees, operating expenses, payroll expenses and lender required reserves.

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- Financial institutions will receive an annual servicing fee equal to 1% of the outstanding preferred equity amount.
- Financial institutions must provide notice of a payment default to borrowers within 5 days after a missed payment and the borrower will have 30 days to cure before the interest rate is increased. If the financial institution fails to assess increased interest or fails to notify the borrower for a period of 3 months or more, the financial institution will only receive 50% of the servicing fee.
- Financial institutions are eligible for reimbursement of a portion of the preferred equity amount by the federal government. If a borrower defaults on 90% or more of the amount drawn down, the financial institution would be required to repay the reimbursement amount.
- Financial institutions may charge additional fees and may require additional collateral, including but not limited to, personal recourse or a first lien on other encumbered property.

Structured debt loans, such as CMBS, CLO, debt funds, mortgage REITs and life insurance company lenders, have unique constraints that will need to be addressed for these borrowers to be able to obtain much needed relief under the HOPE Act while complying with their underlying loan documents. Generally, structured debt loan documents prohibit borrowers from incurring additional debt. Some existing loan transactions will need lender approval, while others may be structured in a way that avoids that requirement. It will be a case-by-case determination. In any event, the preferred equity instruments will need to be drafted in a manner that ensures they are categorized as additional equity investments and not additional indebtedness.

While the bill will need to address structured debt loan restrictions, CRE market advocates continue to be optimistic that the HOPE Act will provide relief to portions of the CRE market previously unable to obtain relief from federal and state aid facilities, particularly the hospitality and retail markets which have been hit the hardest by the COVID-19 pandemic and related government restrictions.

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Frost Brown Todd will be continually monitoring the Helping Open Properties Endeavor Act of 2020 and will provide additional information as it becomes available. For more information on the Helping Open Properties Endeavor Act of 2020, please contact John Gragg, Geoff White, Chandler Hodge and Devon Callaghan or any attorney in Frost Brown Todd's Financial Services Industry Team .

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[1] Section 4019(b) prohibits any entity "controlled" by the President, Vice President, head of an Executive Department, or Member of Congress or by any of their immediate family (including son or daughter-in-law) from being eligible as a borrower or lender under the HOPE Act.

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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