Q&A with Goulston & Storrs Attorneys Zev Gewurz and Elizabeth Lintz on "Reimagining Real Estate"

3/2/21

Zev Gewurz and Elizabeth Lintz

In this Q&A series, "Reimagining Real Estate," ***Brian Carrozza****, Senior Manager of Strategic Growth at Goulston & Storrs PC, sits down with attorneys from the firm's market-leading real estate practice to talk about how they see the pandemic reshaping commercial real estate in 2021 and beyond. This week, he spoke with* ***Zev Gewurz*** *and* ***Elizabeth Lintz****, both real estate partners in the firm's Boston office, about what investors, developers, financiers, and managers should know regarding the current and future state of capital markets, liquidity and value.*

Q. In what ways have the impacts of the Coronavirus Recession on capital markets differed from the effects of the Global Financial Crisis (2007-09)?

Gewurz: There are at least two differences. First, the Global Financial Crisis of 2007-2009 was a crisis of liquidity, driven by markets. This is a health crisis, driven by a virus, that also affects markets. Second, the Global Financial Crisis followed a period of unrestrained investment and lending. This crisis follows a period of sustained growth that has been far more disciplined and even restrained. This time, most properties are sitting with more stable capitalization, and many banks and investors continue to be well-capitalized and are sitting on the sidelines waiting for the right opportunities. The question remains, how much longer can owners, especially in certain asset classes, hold on, and how fast will our economy rebound once the pandemic subsides and we start to slowly return to more "normal" interactions.

Q. Which capital sources are still lending? What types of deals are being funded?

Lintz: Most capital sources are lending again, but many fewer deals are being funded. In the early days of the pandemic, virtually no one was lending. Eventually, the debt funds and local banks reopened, followed by the CMBS lenders, insurance companies, and national banks, and, finally, some foreign lenders and investors began coming back as well. Still, across nearly all lending sources, the focus is on relationships with strong borrowers and stabilized assets. Some newer borrowers with stabilized deals are having trouble obtaining financing in this market, and some strong sponsors with speculative construction projects are finding it more difficult than before.

Q. How have terms changed for getting these deals done?

Gewurz: This has been a bit of a journey. From the end of March through most of April, there were virtually no terms. When lending started coming back online in May and June, it was at lower leverage, somewhat higher rates, and usually combined with more flexibility for prepayment and rights to obtain additional capital, whether from affiliated or third-party mezzanine or preferred equity. Some deals also saw a slight tightening of cash management, and some also saw increased recourse. At this point, however, either deals are getting done or not, and the terms for the deals that are getting done have not changed all that much. We have seen record-low interest rates, including in recent deals our firm has closed for clients, such as a securitization for a portfolio of single-family rental homes with an interest rate in the high ones, and a CMBS execution on a stabilized office building with a 10-year term and a rate in the low twos.

Q. Are we going to see substantial distress in the market? When and where are we likely to see it?

Lintz: We saw immediate distress in hospitality, which was hit the fastest and hardest early on in the pandemic. Outside of that, we have yet not seen much distress, and even in hospitality, we saw rescue capital and bridge loans more than forced sales. Most people, however, believe that distress is coming soon, at least in certain property types and locations. Many lenders entered into loan modifications early on that avoided distress across most property types. While there is much hope with the recent approval and distribution of a vaccine, it is hard to believe that certain retail and hotel—and even office—owners will be able to hold on through what could be an extended recovery period. A number of our clients have raised distressed asset funds with the expectation that, at some point, the flood gates of distress will open.

Q. Which asset classes and geographies are in favor right now?

Gewurz: People have been talking about industrial and multifamily for a long time, and the outlook for these property types generally remains strong. In my opinion, the hottest emerging asset class in an increasing number of markets is life sciences real estate. These properties can range from labs to greenhouses and include manufacturing facilities for medical devices, and storage for biomaterials and biomolecules, including vaccines. In terms of geography, we have seen a pause on central business districts in some of the country's largest cities, including New York City, which may present an opportunity. One looming question is what will happen to suburban office, which was clearly out of favor before the pandemic began but has experienced a modest boost from businesses adopting a "hub and spoke" model whereby they may keep the main office (the "hub") and add a constellation of smaller branch offices (the "spokes"), which are often strategically located in closer proximity to employees' homes. It seems that growth markets like Austin, Nashville, and Raleigh-Durham—and even some markets in the Midwest— may continue to be attractive, as will life sciences clusters such as Boston-Cambridge, San Diego, and Washington, D.C.-Baltimore.

Q. What can/should the government be doing to ensure the industry's ongoing economic vitality?

Lintz: There is a strong push for the government to continue bridging the gap between tenants and landlords in the multifamily space to prevent evictions while preserving economic value for owners. The U.S. government will also need to do more for retail, restaurant, hospitality, and other CRE sectors that rely on social environments and in-person interaction.

Q. What are some of the challenges you've faced while working on complicated, multifaceted deals during a global pandemic?

Gewurz: The challenges have been wide-ranging through this period, from trying to understand macroeconomic trends to translating these trends into new market terms for legal documents. Early on, we spent a lot of time analyzing force majeure clauses (and when and how COVID-19 might trigger such provisions), especially in the context of construction contracts and construction loan agreements, to determine and preserve rights. This is an area that will forever be changed by the pandemic, at least in terms of the level of scrutiny these provisions receive going forward. We also had to deal with several very practical constraints, like finding a notary to go to a tenant's home in San Francisco when the city was partially locked down to get an SNDA notarized and sent by overnight mail for a closing in Boston the next day, and making sure that registries would not be shut down on transaction closing days due to COVID-19 infections.

Q. Which changes do you believe will outlive the crisis?

Lintz: Remote work is here to stay in some form or another. As we said above, one of the big questions that will be answered in the longer term is to what extent the pandemic will spur lasting changes in the office market and office properties themselves, including with respect to design requirements for building HVAC systems (think enhanced air filtration), the configuration of interior spaces, the criteria for what is considered a desirable location, overall demand for space and more. I also think business travel won't be the same for a long time. Many people I've spoken with seem to share the feeling that business travel will be forever transformed, and the days of flying across the country for a 90-minute meeting may be over. It will be interesting to see how long it will take for large conferences to come back and, when they do, what form they take. All of these factors will continue to affect the country's travel, tourism, and hospitality industries. Retail has been strongly impacted as well, but like many other areas, some of the underlying trends that worsened during the COVID-19pandemic started long ago. I don't think we have seen many changes that are truly new in the retail space—what we're seeing is existing trends accelerated, disrupted, slowed, and/or reversed.

Zev Gewurz *represents institutional and private equity lenders, and foreign and U.S.-based investors, as well as owners and real estate developers, across the United States and abroad. He is Co-Chair of Goulston & Storrs' Real Estate Group and International Investors Group. Elizabeth Lintz represents sophisticated developers, investors, and lenders in real estate financing, acquisitions and dispositions involving a range of asset classes, including retail, multifamily, mixed-use, and office. They can be reached at* ***zgewurz@goulstonstorrs.com*** *and* ***elintz@goulstonstorrs.com****.*