South Bay Cities Council of Governments

October 12, 2020

TO: SBCCOG Steering Committee

FROM: Jacki Bacharach, SBCCOG Executive Director

SUBJECT: H.R. 7809 – HOPE Act of 2020

Adherence to Strategic Plan:
Goal B: Regional Advocacy. Advocate for the interests of the South Bay.

BACKGROUND

At their August meeting, the SBCCOG Steering Committee considered taking a position on H.R. 7809 – HOPE Act of 2020. Committee members felt they needed additional information before a position could be recommended to the Board of Directors. Staff prepared the information below accordingly.

Rep. Van Taylor (R-TX) introduced the bill in response to the COVID-19 pandemic. The "Helping Open Properties Endeavor Act of 2020" or "HOPE Act of 2020" would establish an equity facility in the Treasury Department to assist commercial mortgage borrowers. The bill would set aside $454B in funding for distressed businesses from the CARES Act and would make that money available to commercial mortgage-backed securities (CMBS) borrowers in the form of equity instruments. The Treasury must guarantee the purchase of these equity instruments to CMBS borrowers by lending institutions, leaving taxpayers on the hook for funds that do not get repaid.

This bill would help provide cash to CMBS borrowers, mainly hotels and shopping centers, that meet certain requirements and have been unable to pause mortgage payments during the pandemic. The economic downturn caused by the pandemic has reportedly accelerated the rate of potential CMBS foreclosures. CMBS borrowers, particularly hotels, report having little luck getting relief on their loans. Typically, they must work with special servicers, which are hired by bond holders to negotiate on their behalf and abide by rigid loan provisions. These have been much slower and less generous than traditional bank lenders according to those borrowers. The loan servicers say the relief process is complex and that they won't foreclose on properties without having had conversations with the borrowers first.

Most CMBS loans have provisions that forbid borrowers from taking on more debt without additional approval from the servicers. Because of the complicated nature of these mortgages, borrowers aren't allowed to take out loans during these times. The bill would structure the cash infusions as "preferred equity" which isn't subject to the same restrictions and is considered junior to other debt. This preferred equity must be paid back with interest before the property owner can pull money out of the business.

The University of Texas at Austin recently studied these loans and found they were largely overstated and created with fraudulent information in order to increase returns. The loans were aggressively appraised with super low cap rates and shaky underwriting practices that would collapse if rents did not continue to rise and vacancy rates continued to fall. This is similar to the mortgage crisis leading up to the Great Recession.

Supporters of the legislation, including the American Hotel and Lodging Association, claim that without relief, hundreds of thousands of jobs would be destroyed by an impending wave of foreclosures. Currently about 1/4 of hotels and 1/6 of retail centers with CMBS loans are in trouble.

Opponents of the legislation argue that a bailout of CMBS borrowers would mainly benefit a small group of politically connected large private equity companies and real estate investment trusts, and would have absolutely no effect on employment levels. Unite Here, the North American hotel union, reported that following the 2008 financial crisis, hotel owners who had taken out risk loans walked away from their investments, leaving properties in the hands of new lenders and/or investors, but continued to operate throughout. They noted there was no loss of hotel jobs or local tax revenue in their experience, and that new investors actually brought new capital to reinvest in many of those hotels. Opponents also claim that a bailout would not benefit workers. The enormous job losses in the hotel industry resulted from the collapse in global demand for travel/tourism. 70% of hotel employees had already been laid-off or furloughed by the end of March. Without demand for travel returning, the impacted employees will continue to be without work and the temporary relief the bill would likely only benefit CMBS borrowers.

As opposed to passing the HOPE Act, Unite Here recommends Congress pass the HEROES Act, which contains provisions that directly support hotel workers and those in other affected industries. The HEROES Act would extend pandemic unemployment benefits at the $600 level; keep workers on payroll; keep state and local governments, public schools, and the U.S. Postal Service solvent; build infrastructure; and more.

RECOMMENDATION

Due to the complex nature of these CMBS investments and no guarantees of job loss prevention, as well as the fact that this is a bill that deals with the private sector and not government, staff recommends the Board take no position.

Prepared by:
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