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Commercial Real Estate

South Florida's commercial real estate market heading toward crisis as Covid-19 relief runs out

The commercial real estate market in South Florida could experience a wave of evictions and foreclosures later this year as relief measures expire amid the surge of Covid-19 cases, experts say.

When the pandemic started in March, many people in the industry hoped the sudden shutdown would give way to an economic rebound by late summer or fall.

But many of the relief measures reached in those initial months were short-term band aids for businesses — three months of rent deferrals, three to six months of interest-only loan payments and eight weeks of the Payroll Protection Act covering labor and rent costs.

Meanwhile, the surge of the coronavirus in South Florida has caused local governments to enact more restrictions. For many companies, especially restaurants, bars, entertainment, retail, hospitality, and travel, business remains so low that owners struggle to pay full rent. That means big trouble for landlords when banks can no longer defer their mortgage payments.

“The tenants negotiated something they thought they would only need for a little while,” said Lyle Chariff, president of Miami-based commercial brokerage Chariff Realty Group. “They didn’t think it would keep going. People are falling like flies.”

Miguel Pilgram, CEO of the Pilgram Group, said he was forced to cancel plans to reopen indoor dining at the NYSW Jazz Lounge in Fort Lauderdale after cases spiked. (It still offers a grab-and-go menu.) A PPP loan covered expenses for eight weeks, but that time has expired and his restaurant is down from 27 workers to about five.

“Anybody open at 50% capacity is operating at a loss now,” Pilgram said. “You are just operating to keep your customer base engaged and hoping something can change soon so you can get back to even 75% and talk about making a profit.”

While Pilgram owns his real estate debt free, he’s concerned many local restaurant owners will face evictions.

Martin Bravo, a partner at Miami-based brokerage Apex Capital Realty, has seen more commercial tenants turn over keys to their landlords. The situation is especially tough for traditional retail and office space.

"It gets dicey for landlords that have loans on their property, especially at high loan-to-value [ratios]," Bravo said. "At the end of the day, the banks are in the business of making money. They can only work out deals with landlords for so long."

Early in the pandemic, lenders were willing to grant mortgage deferrals with no questions asked, but that will no longer be the case, said attorney Hal Lewis, a partner at Pathman Lewis in Miami. Banks will want to see financial statements and justify whether an extension of relief is warranted, he added.

"Through the summer, if they can show a reason to get additional time for a deferral, banks should be willing to grant it," Lewis said. "Come the fourth quarter, the game will change. Lenders will really start to evaluate ... whether or not these loans can be rehabilitated or whether they should turn them over for legal action."

Banks are bracing for when their three- and six-month forbearance agreements with commercial property owners end and must evaluate whether the borrower is still financially viable, said Frank Gonzalez, managing principal accounting firm MBAF in Miami.

In the first 90 days of the pandemic, regulators allowed banks to grant forbearance without classifying loans as "troubled debt restructuring" - a category that requires a review of the loan's true value and potentially a charge-off to the bank's books. The longer borrowers are unable to pay their full loan amounts, the greater the risk of banks labeling them as trouble debt.

Gonzalez said banks will start asking for personal guaranties to boost the value of their collateral.

"I am concerned [about more commercial foreclosures] and the banking institutions are concerned," he said.

Property owners with loans in the commercial mortgage-backed securities (CMBS) market face the biggest challenge because servicers of those loans rarely have relationships with the borrowers, so the priority is to secure repayment, Lewis said. Data obtained by the *Business Journal* showed an increasing delinquency rate of CMBS loans to South Florida commercial properties, and many three-month forbearance agreements that are set to expire in July and August.

"The CMBS market will be a bloodbath," said Jeremy Larkin, co-chairman of NAI Miami Commercial Real Estate.

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Larkin expects an increase in tenant bankruptcies, commercial foreclosures and distressed property sales in the fourth quarter. Restaurants without strong drive-thru and delivery operations, personal service businesses, and any tourist-related business will suffer.

Landlords will often work with tenants that were strong performers before the pandemic, but they will require them to pay some rent, Larkin said. The forbearance agreement may have included "golden handcuffs" provision to keep them in the property longer, such as making the deferred rent forgivable only if the tenant renews its lease.

John Ebenger, director of real estate tax services at Fort Lauderdale-based Berkowitz Pollack Brant Advisors and Accountants, said some of his landlord clients are tying restaurants' rent to a percentage of their revenue. Still, he expects rents to fall due to a large supply of available space as many tenants permanently close.

Many downtown office buildings have issues with tenants seeking relief because they no longer need as much space as staffers work remotely, said attorney Steve Silverman, a shareholder at Kluger, Kaplan, Silverman, Katzen & Levine. Office owners are often reluctant to file eviction lawsuits, but they may have no other choice, he added.

"It could get very ugly," Silverman said. "This could spawn a tremendous amount of litigation."

Commercial landlords would prefer to work out deals with tenants because they don't want empty spaces when they're especially difficult to fill, said Jeffrey Snyder, a Bilzin Sumberg attorney. However, it's been hard to ink long-term restructuring deals due to the uncertainty of future revenues and an ailing economy.

"A day of reckoning has to happen," Snyder said. "This isn't sustainable."