CADWALADER

REF news and views

# COVID-19 Update: Three Months into Lockdown


By **Duncan Hubbard**
Partner | Real Estate

By **Livia Li**
Associate | Real Estate


In this market update, we discuss below some of the developments we have seen in the real estate financing sector for the last three months, and what's likely to come.

***What's happened to date***

With the lockdown officially happening on 23 March, all businesses faced a hard disruption and sudden drop of business and revenue. This led to a series of discussions/negotiations between tenants and landlords regarding rent reduction or, in some cases, suspension of payment of rent and service charges.

For borrowers who had their first quarter interest payment date falling end of March or mid-April, as the lockdown occurred towards the end of March, many had sufficient headroom to wear the decrease in income and still remain in compliance with the financial covenants for that quarter and so didn't need to seek waivers from lenders. This may be a result from recent lending policies in the REF market which, of late, has leaned slightly more towards the conservative side. Additionally, whilst negotiations were commencing through April and May with many tenants having little prospect of paying rent, the forward-looking financial covenant projections in many loan agreements (being generally drafted such that a tenant's rental income for assessment purposes is not deemed to be in arrears unless the rent remains unpaid for at least three months) meant that financial covenants remained largely in compliance.

Many borrowers sought consent from lenders to permit temporary changes to lease arrangement/rent collection, and deferral of amortisation (if applicable) to preserve cash throughout this period of uncertainty. Lenders have generally been accommodating on these requests to assist the borrowers during this time until there is further clarity.

For some hard-hit industries, such as hotel and retail, the discussions have generally been a little more forward-looking. Even where the financial covenants are still being maintained, there have been many discussions with lenders revolving around unlocking cash reserves, and banks also asking for cash sweep to be turned on, or surplus cash to be left in the structure, in preparation for further suspension of activity/downturn. In some instances, borrowers and lenders have entered into standstill arrangements to disable financial covenants for an agreed period.

We have also received numerous enquiries from private equity funds setting up new opportunity funds to take advantage of buying up distressed assets once the dust settles. Some of the enquiries we have been receiving are funds looking to buy up retail assets and repurposed for other uses such as for logistics, warehouses or other types of accommodation.

***What hasn't (yet) but may happen next***

As the July interest payment date quarter looms and there is no end in sight for the lockdown, no doubt there will be some financial covenant defaults starting to come through from the reduced rents/reduced income. This will start off with yield to debt and interest cover covenants.

The temporary waiver/consents sought back in April will now lead to more permanent discussions with lenders, possibly leading to standstill arrangements or, in some cases depending on the outlook, restructuring the facility.

We are also of the view that, in these discussions, it wouldn't be surprising to introduce liquidity covenants as part of the amendment/restructure of the facility in order to ensure there's sufficient cash to maintain the property for a specific period of time.