



## Heading into Q4

September 30, 2020 | Issue No. 16

### Table of Contents:

- **New York State Legislature Considering Imposition of Mortgage Recording Tax on Mezzanine Loans and Preferred Equity**
- **Hotel Financing Series, Part 3: Use of OpCo/PropCo Structures**
- **COVID-19 Update: CDC Order Temporarily Halts Residential Evictions Nationwide until December 31, 2020**
- **Virtual 5th Annual Finance Forum Set for November 12**
- **Recent Transactions**

## New York State Legislature Considering Imposition of Mortgage Recording Tax on Mezzanine Loans and Preferred Equity



By **Loren R. Taub**  
Special Counsel | Real Estate

In January of this year a **bill** was proposed in the New York State legislature that would impose mortgage recording tax on mezzanine loans. The bill was recently amended to clarify that mortgage recording tax would also be imposed on preferred equity investments. In addition, in connection with either a mezzanine loan or a preferred equity investment, the mezzanine lender or preferred equity holder, as applicable, would be required to file a UCC-1 Financing Statement in the real property records to perfect its security interest in its collateral – certain membership interests or shares in the mortgage borrower.

The bill defines “mezzanine debt” and “preferred equity investments” as “debt carried by a borrower that may be subordinate to the primary lien and is senior to the common shares of an entity or the borrower’s equity and reported as assets for the purposes of financing such primary lien. This shall include non-traditional financing techniques such as a direct or indirect investment by a financing source in an entity that owns the [equity] interests of the underlying mortgage where the financing source has special rights or preferred rights such as: (i) the right to receive a special or preferred rate of return on its capital investment; and (ii) the right to an accelerated repayment of the investor[’]s capital contribution.” This bill may prove to be problematic for any joint venture that does not have a *pari passu* waterfall for distributions.

The bill specifically states that the same does not apply to a loan secured by cooperative shares in a cooperative apartment.

The purpose of the bill is (1) to raise additional tax money in the State of New York to fund capital expenditures related to public housing and (2) to require the disclosure of mezzanine loans and preferred equity in the public record so that a third party has a more accurate view of the debt stack with respect to a piece of real property.

The mortgage recording tax in New York City on commercial debt in excess of \$500,000 is 2.80% of the principal amount of the debt. To the extent that the proposed legislation is signed into law, the same will have a significant impact on the financing of large real estate projects in the State of New York, and we expect that, just as sophisticated real estate players have become savvy at assigning mortgage debt to save mortgage recording tax and structuring deals to limit the imposition of mortgage recording tax, they will do the same to the extent that mortgage recording tax is imposed on mezzanine loans and preferred equity investments.

## Hotel Financing Series, Part 3: Use of OpCo/PropCo Structures



By **Duncan Hubbard**  
Partner | Real Estate



By **Livia Li**  
Associate | Real Estate

In this part 3 of our hotel financing series, we discuss one of the most common structures – the “OpCo/PropCo” structure – and some of the issues surrounding security as a result of this structure.

The OpCo/PropCo structure comprises two special purpose vehicles, a PropCo (*i.e.*, property company), which holds the real estate interests of the hotel, and an OpCo (*i.e.*, operational company), which holds all other assets of the hotel, such as rights to key hotel contracts, licences, etc. and is essentially the trading company. PropCo leases the property to OpCo, and OpCo pays rent to PropCo under the lease and operates the property as a hotel. OpCo may undertake the hotel management duties, but often this is outsourced to a professional hotel operating manager. The hotel operating manager and OpCo deal with the franchisor with respect to the franchise agreement and hotel operating licence.

There are several reasons why this is a popular structure in hotel financings. Firstly, the separation of the real estate asset (held by PropCo) from the rest of the trading business (held by OpCo) segregates the ownership of the different types of assets and allows the owners to ring-fence the associated cashflows. This then makes it possible for the loan to be provided to PropCo as the principal borrower and secured against the real estate interest, relying on a fixed cashflow stream (being the rent from the operating lease), and therefore achieving more attractive commercial mortgage terms as opposed to leveraged finance.

That being said, with OpCo and PropCo in the same group, and the source of funds to pay the rent for the operating lease coming from the income of the hotel, lenders will (and should) look at underlying performance and management of the hotel. Lenders are likely to require OpCo to also be a guarantor and obligor and grant security.

There are also other benefits to this structure, not least the fact that exit is cleaner with separate companies holding the different assets, and certain structures may also be beneficial from a tax perspective. In a previous [article](#), we have discussed this in more detail. The cashflow structure is often tiered as a result of the split between PropCo and OpCo. A very common structure would involve the hotel manager (sometimes this could be OpCo, but often a designated professional manager) running the day-to-day accounts of the hotel, which collects all revenues and also attends to day-to-day expenses like suppliers, utilities and staffing costs. The gross profit (sometimes known as the “owner’s return”), usually after deducting management fees and sometimes any fees payable to the franchisor, is paid to OpCo. OpCo will need to allocate the gross profit across a few items, amongst them: 1) rent to PropCo for the lease of the hotel property, 2) capital

expenditure reserve for upcoming renovations and maintenance of the hotel and 3) payment of dividends and/or repayment of any equity injection to the Sponsor. Once the rent is paid to PropCo, PropCo then pays debt service/interest (as applicable) from its account. As mentioned above, although the rent is “fixed” under the lease, it is nevertheless dependent on the performance of the hotel (*i.e.*, if the business doesn’t perform, OpCo will not have the rent to pay PropCo) and therefore lenders often take security over every member within the group.

This will typically include share security over both OpCo and PropCo’s shares, security over bank accounts, mortgage over the real property, all the contracts (*i.e.*, ground lease, the operating lease between OpCo and PropCo, any occupational leases, the hotel management agreement, and the franchise agreement) and any intragroup debt, especially if there were any sale and leaseback arrangements in place. This is to ensure any intragroup debt can be expunged upon enforcement.

Furthermore, the cashflow structure and payments waterfall out of the various accounts is usually one of the most negotiated items. It is important to balance the lender’s requirement to have access and control over the cash to ensure all payments due under the facility is paid against the borrower’s need to retain sufficient flexibility to make payments required to run its business. This is discussed in more detail in a later part of this series, where we look into each of the cash items in more detail.

## COVID-19 Update: CDC Order Temporarily Halts Residential Evictions Nationwide until December 31, 2020



By **Steven M. Herman**  
Partner | Real Estate



By **Sulie Arias**  
Associate | Real Estate

In response to the coronavirus pandemic, the federal government, as well as many states, have enacted eviction and foreclosure moratoriums in an effort to keep homeowners and renters in their homes and slow the spread of COVID-19. One such moratorium was included by Congress in the Coronavirus Aid, Relief, and Economic Securities (CARES) Act, which was enacted earlier this year. The CARES Act provided, among other things, for a 120-day eviction moratorium for tenants who participated in federal housing assistance programs or who lived in a property that was federally related or financed. The CARES Act eviction moratorium, which expired on July 24, 2020, prohibited landlords from commencing new evictions proceedings or charging late fees, penalties and/or other charges against eligible tenants for non-payment of rent during the moratorium period.

On September 2, citing concerns with the continued spread of COVID-19, the Centers for Disease Control and Prevention (the “CDC”) issued a new order temporarily halting residential evictions nationwide through December 31, 2020 (unless extended). The order would prohibit landlords, owners of residential properties, or any other person with the right to pursue an eviction action from commencing eviction proceedings against any eligible non-paying tenant affected by the COVID-19 pandemic. The new CDC order does not, however, preclude evictions for reasons other than non-payment of rent or release qualifying tenants from their obligation to pay rent or to comply with the other terms of their rental agreement. In addition, the order does not preclude foreclosures of home mortgages.

Unlike the CARES Act, the protections provided in the CDC order are available to all qualifying residential tenants and not just those tenants who receive federal housing assistance or who lived in a federally related or financed property. In addition, the order does not prohibit landlords from imposing late fees, fines and/or from charging interest on unpaid rent while the moratorium is in effect.

In order to qualify, tenants must submit a “Declaration” to their landlord, the owner of the residential property, or any other person who has the right to commence an eviction action, claiming their eligibility under the new CDC order. The declaration must include the following statements from each adult tenant listed on the rental agreement: (1) that the tenant has used his/her best efforts to obtain all available governmental rental or housing assistance; (2) that the tenant either (i) expects to earn no more than \$99,000 (or \$198,000 for joint filers) during the 2020 calendar year, (ii) was not required to file an income tax return with the IRS for the year 2019, or (iii) received an Economic Impact Payment under the CARES Act; (3) that the tenant is unable to make rental or housing payments when

due as a result of a substantial loss of household income, loss of hours of work or wages, being a lay-off or due to “extraordinary” out-of-pocket medical expenses; (4) that the tenant is using his/her best efforts to make partial rental payments, taking into account such tenant’s other non-discretionary expenses; and (5) that the eviction of such tenant would likely result in such tenant being homeless or such tenant having to move into a “closed quarters” shared living space. Failure by any landlord to comply with the CDC order will result in criminal penalties.

The CDC order will only be applicable to those states, local, territorial, or tribal areas that do not already have an eviction moratorium in place that provides for the same or greater tenant protection than those provided in the CDC order.

We will continue to monitor these and other proposed legislation of interest and provide updates as needed.

## **Virtual 5th Annual Finance Forum Set for November 12**

Cadwalader's fifth annual Finance Forum will be held virtually this year on Thursday, Nov. 12.

The event will once again feature live panel sessions with leaders in U.S., UK, Europe and international commercial real estate, fund finance, middle market lending, distressed finance and securitization. Panelists will discuss the pressing issues and latest transactional and regulatory developments in their markets, providing key insights made more important by the uncertain environment.

Last year more than 500 industry leaders participated in the Finance Forum in Charlotte, and the numbers are expected to rise this year with the all-virtual format.

There is no charge to participate. Please contact [Cori Niemann](#) for more information.

## Recent Transactions

Here is a rundown of some of Cadwalader's recent work on behalf of clients.

- Representation of a lender in connection with a revolving credit facility of up to \$350M to finance the acquisition of class B or better self-storage facilities.
- Representation of agency lender in connection with the modification of a \$300 million (subject to increase up to \$400 million) revolving credit facility for the financing of senior living facilities.
- Representation of the lender in connection with a \$260 million mortgage loan secured by a 1.1 million square foot office property in Houston, Texas.