COVID-19 AND ITS IMPACT ON U.S. REAL ESTATE

JANOVER LLC

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We are surely in unprecedented, uncertain times. The COVID-19 pandemic has impacted nearly every industry on the planet, including the real estate industry. Our Real Estate team here at Janover has compiled our thoughts on the outlook of the market and key ideas you should be thinking about.

Our analysis includes both the commercial and residential markets and we provide some key implications related to the CARES Act.

Our Overall Thoughts

- Much uncertainty around how many businesses will pay rent and how many furloughed workers will pay their rent
- There appears to be a “Wait and See” approach – markets are essentially frozen right now
- The number of homes on the market are at an all time high, and, once life returns to normal, there could be even more of an uptick in inventory.
- Mortgage rates have fallen to all time lows – the 30-year fixed-rate mortgage dropped to 3.29% during the week of March 5th. The previous all-time low was in 2012 when the average rate hit 3.31%
    - FED rate cuts don’t necessarily lead to lower mortgage rates

Residential Real Estate

Tenant protections have been increasing since 2019

Advocates have been calling for the following:

- Suspension of rent, mortgage, and utility payments
- Full eviction moratorium
- State investment in affordable housing

Government is looking to assist tenants, not owners

Our view: We expect tenant protections to increase in the short-term and we patiently await governmental assistance for owners.

Unemployment numbers could be a strong indicator of the number of residential tenants that might default on upcoming and future rent payments.

- Possibility of between 45-55 million Americans will be laid off during this epidemic
- With a constant labor force, this can result in a 32.1% unemployment rate
- Unemployment rate in February 2020 was 3.5%
- Estimated layoffs in the second quarter 2020 are 45 million

“At Risk” Metro Areas

The metropolitan areas hardest hit by the coronavirus-driven economic downturn are those with jobs heavily concentrated in transportation, employment services, travel arrangements, leisure and hospitality and mining/oil and gas, according to an analysis by Brookings. The study finds that more than 24.2 million Americans work in those high-risk sectors, which might suffer “significant work disruptions, furloughs, and other uncertainties in the coming months” as the country’s population curtails travel, entertainment and other non-essential spending.

Residential Real Estate

Uncertainty and government assistance is likely to drive the short term. These are just some of the many unanswered questions at this time:

- How many months will tenants get to live rent free?
- Will the government give mortgage assistance for building owners?
- How many tenants in each market will be able to make payments?
- Will government assistance trickle down to the building owner and the banks holding mortgages?

Home Prices are likely to re-adjust…

- Foreign investment is likely to change after COVID-19
  - In the prior 12 months there was already a 53% decrease in Chinese buyers.
  - Travel restrictions are likely to remain in place for an extended period
- Mortgage rates are falling for investment properties but they still seem to be bottoming out at rates which have not been seen in the past 5 years. We don't expect rates to go much lower than that.
- We would not be surprised to see large groups of city residents leaving the city permanently.
- Many people are pulling their personal residence from listing

The construction industry is also likely to be affected…

Our view: At the start of this year, we expected new construction apartments to continue to boom through 2020 and 2021. We now find it unlikely this will be the case.

Questions that you, as a residential building owner, may be asking:

- Should I be paying my mortgage?
- Can I pursue tenants for non-payment?
- Should I use the security deposits from tenants to offset loss of rent? Is this even allowed in my State or City?
- What bills should I be holding off on paying during this time?

Commercial Real Estate

The most affected areas of commercial real estate will be in retail and office rentals:

Short-Term effects:

- Will companies that shuttered, or were forced to go remote, still continue to pay full rent?
- People are not going our or ordering food as much. Those affected businesses may not be able to pay rent or upcoming escalations.
- Will banks allow for the deferment of mortgage interest, principal or escrow payments?
- Will State and local officials defer payments of real estate taxes?
- With governmental offices closed, any in-progress deals that required construction will likely be put on hold.

Long-Term effects:

- More Americans than ever are working from home. As businesses begin to see this working, and if this continues post-pandemic, Companies may try to renegotiate rental rates as space becomes available.

Key CARES Act Implications

Temporary Modification of the Business Interest Expense Limitation

For taxable years beginning in either 2019 or 2020, the taxable income limitation for purposes of applying the business interest expense limitation has been raised to 50% up from the 30% limitation created by the Tax Cuts and Jobs Act.

Additionally, a new provision allows for taxpayers to choose between 2019 and 2020 taxable income for purposes of the 2020 interest expense limitation calculation. For 2019, Partnerships have special rules which require a special election.

Technical Correction for Qualified Improvement Property

The CARES Act has corrected an error in drafting the Tax Cuts and Jobs Act which resulted in qualified improvement property (QIP) being disallowed from using bonus depreciation for those improvements. As a result of the CARES Act, the QIP drafting error has been corrected retroactively, allowing for bonus depreciation for these expenditures.

Taxpayers may have an opportunity to amend their 2018 tax filing to claim bonus on these assets and receive a refund of taxes paid.

Delayed Payment of Employer Portion of Social Security Tax

Employers will be able to defer the employer portion of social security tax beginning with the enactment date of the law through the end of 2020. Fifty percent of the deferred taxes become payable on December 31, 2021 with the balance payable on December 31, 2022. Note that this deferral is <u>not</u> available to those who receive benefit from forgivable loans.

Key CARES Act Implications

Employee Retention Tax Credit

To encourage employers to retain and continue to pay employees who are unable to work during the current pandemic, a new tax credit has been created. Eligible employers are those who were in business during 2020 where their operations were either fully or partially suspended due to orders from a government authority or suffered a significant reduction in gross receipts due to COVID-19.

The tax credit is 50% of a qualifying employees wages for wages paid up to $10,000. Employers who receive a small business interruption loan will not qualify for this credit.

Forgivable Loans for Businesses

Qualified businesses can obtain small business loans to encourage keeping employees. While the loans are designed to keep employees, other qualifying costs that can be paid include rent, mortgage interest and utilities, in additional to payroll costs.

This could benefit your business even if you are unable to qualify, as it provides tenants who receive these loans incentive to continue to pay their rents during this difficult economic climate. Stay tuned for a future alert on this topic which will take a deeper dive into the eligibility and forgiveness requirements

Key CARES Act Implications

Expansion of Net Operating Loss Rules

For any net operating losses (NOLs) incurred by a taxpayer during a taxable year beginning after December 31, 2017 and before January 1, 2021 (2018, 2019 and 2020 for calendar year taxpayers), the rules have been modified to enable receiving a quicker benefit from these losses.

Losses incurred during this time frame may be carried back up to the previous 5 tax years. This will allow for taxpayers who incurred NOLs during these years to carry them back to earlier tax years where they paid tax to receive an immediate refund. Additionally, the 80% income limitation on use of NOL carryovers has been retroactively suspended.

Multifamily borrowers with a federally backed mortgage loan

Fannie, Freddie, or HUD borrowers who have experienced a financial hardship may request up to 90 days of forbearance. Borrowers receiving forbearance may not evict or charge late fees to tenants for the duration of the forbearance.

...and, if forbearance is not sought

Landlords with federally backed mortgage loans are prohibited from initiating eviction proceedings or charging late fees for 120 days after the enactment of this legislation. This will not only preclude new eviction proceedings, but also may impact ongoing proceedings

Real estate can and should be one of your most powerful assets. Even in these uncertain times, Janover can help you leverage real estate in strategic and practical ways that move you closer to your ultimate financial goals.

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About Janover LLC

Janover is a full service accounting firm, with offices in Long Island and Manhattan. We are one of the larger regional accounting firms in the Metropolitan area. We service more than 2,000 U.S. and international business clients in a wide range of industries including professional service companies, financial services, real estate, construction, retail, entertainment, manufacturers and distributors. Janover is committed to helping our clients at all stages.

The **Janover Real Estate team**, with its decades of collective experience, fully understands the ever-changing real estate landscape. We can anticipate and address complex tax and financing challenges while working to maximize the value of your holdings and your operational efficiency. Whether you are an owner, developer, investor or manager, you can trust our knowledge and practical know-how to help you successfully navigate through the intricate regulations and laws that are inherent to this industry.

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