

Support for Right to Defer Policy

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The commercial real estate market involves many stakeholders (renters, property owners, developers, lenders, investors). When market conditions are favorable and stable, that ecosystem incents each of those stakeholders to enter into contractual relationships and accept risk based on an expected range of variation in household income, unit vacancy, market return, rental income, operating costs, and other variables. For those involved in development, those same market conditions incent the production of new market-demanded real estate products. In order for the market to deliver more property, developers finance nearly all stages of the real estate cycle, from development to operating a stabilized property. Financing (debt) also provides opportunities for institutions like retirement funds and insurance companies to directly invest in real estate, making PERS and pension holders among the key stakeholders in this complex ecosystem.

The foundation of this system is the monthly rent tenants pay. When many renters simultaneously fail to pay their rent, every participant in the real estate ecosystem is affected, in ways that can dramatically affect our national economy. In the global financial crisis of 2007-08, we saw a death spiral that began with non-payment of mortgages, and led to never-before-seen rates of short sales and foreclosures that had lasting effects that for many households still have not been remedied. We began to see COVID-induced under- or non-payment of rent in April, and expect an acceleration of that trend in May.

The State of Oregon has already taken important steps to prevent this chain of events from escalating through the entire commercial real estate sector of our economy. The eviction moratorium for residential and retail tenants gave compassionate and smart relief for Oregon's small businesses and renters, and also bought time for state and local governments to chart a more comprehensive course toward addressing economic development and affordable housing recovery needs to support those most directly affected by COVID-induced job losses.

A similar crisis-management action is needed for property owners. Unabated, non-payment of rent will lead to associated defaults, which will threaten to destabilize the commercial real estate and lending markets, accelerate the consolidation of property ownership, and deepen the state's housing shortage. Unlike residential mortgages, commercial defaults generally do not include a right to cure provision. If owners are not able to defer their payments, it could lead to a chain of events where the market unwinds completely, eliminating liquidity, and making the financing of future projects nearly impossible for a number of years until rents rise sufficiently to offset higher rates of return requirements.

Oregon went into this economic crisis with the availability of affordable housing as a top policy concern and most of its more urban markets under supplied for housing. The COVID shut- down is already slowing new construction starts; commercial property defaults threaten to upend the

market and bring new construction to a halt altogether. The consequences could take a decade to overcome, for the individuals affected and for the market as a whole, with particularly difficult consequences for those interested in advancing a long-term goal of housing affordability.

The Right to Defer policy is not a solution to these larger challenges, but it is a helpful first step to avoid further economic disintegration. A more comprehensive solution must ultimately focus on supporting the foundation of this system: small businesses and other commercial and residential tenants. Increased rent support, investments in affordable housing, and sustained and coordinated economic development activities that enable small business re-start activities will all be key to economic recovery. Like the eviction moratorium, the Right to Defer policy is a necessary stop-gap measure to slow the spread of this crisis into the commercial real estate market, to buy time to develop and implement a more comprehensive solution, and to thoughtfully position for speedy recovery.

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