

Top 10 Legal Issues to Watch for in 2021

2020 brought real estate professionals scrambling to the boilerplate at the back of each of their leases and contracts. Provisions relating to force majeure, time is of the essence and business interruption suddenly became hot topics for discussion, as parties looked for ways to obtain relief from or to strictly enforce the obligations of an agreement. Every day vocabulary expanded to include terms such as “essential business” and “social distance.” While lawyers took to their law school textbooks to review common law theories of impossibility and frustration of purpose, business people rolled up their sleeves and started negotiating.

With a rocky start to 2021, we all hope that the year will return to “normal” as vaccines are rolled out, small businesses are infused with a second round of PPP funds and states begin to loosen restrictions. In the real estate market, new leasing provisions (such as operating covenants for office leases) gain momentum, loan defaults and workouts begin to rise and construction projects forge ahead despite supply chain issues. We cannot predict with any certainty what the year will look like or what issues may come to the forefront, but here is our Top 10 List of Legal Issues to Watch for 2021:

1. **Force Majeure.** The provisions relating to force majeure will not go back into hibernation. With the lessons learned from 2020, the catastrophic events that these provisions are intended to capture are more real than ever. These all but forgotten provisions will now become major negotiating points in every lease or agreement. Depending on the industry, each party now has a different idea of what should constitute a force majeure event, which can be further tailored to whether the business is an essential service, a restaurant, a gathering or meeting place or some other type of operation. The standard carve out that an incident of force majeure will not affect the monetary obligations of the parties under the agreement is also being modified to allow for immediate (and certain) relief for a fixed period of time. While these provisions are not ideal and will likely add another cause for rent abatement, deferral or termination that give owners and lenders heartburn, they can be used as an opportunity to build in more certainty as to what will happen if another event occurs during the term of the agreement that is out of the reasonable control of the parties.
2. **Business Interruption vs. Rent Loss Insurance.** The jury is still out on the ability of businesses to claim under a business interruption policy for certain losses caused by the COVID-19 virus and, in some cases, looting. Business interruption and rent loss insurance operate hand in hand under essentially the same parameters. Rent guarantee insurance is a little known product that may offer the needed coverage, but at a cost that may be prohibitive in most instances. We will continue to watch the cases to see how more courts interpret the current policies and suggest watching for new insurance products to hit the market to provide for these products (and their payment) to be incorporated into future agreements.
3. **Remedies.** The lack of any swift resolution of a dispute through the court system was a disappointment for 2020 and provided additional time to those parties looking for

relief. Many jurisdictions imposed moratoriums on certain types of eviction cases and court systems slowed down generally due to the work from home arrangements and transfer to a virtual platform. Remedies are now divided into categories of “practical” remedies and “legal” remedies for discussion. We would expect that new agreements will try to better define the remedies available for the parties going forward to discourage the need for a long court battle. While this may not speed up the court system in the event of a dispute, creating more certainty around the potential outcome may facilitate settlement negotiations earlier.

4. **LIBOR.** Financial institutions have been preparing for the end of LIBOR for many years, but it is expected to officially phase out by the end of 2021. The Secured Overnight Finance Rate (“SOFR”) is expected to take its place. This SOFR rate is based on actual overnight transactions secured by U.S. treasury securities (rather than the hypothetical rates that comprised LIBOR). This change is being overseen by the Alternative Reference Rates Committee of the Federal Reserve Board. Financing documents that have not already incorporated alternative provisions for LIBOR will need to be addressed and borrowers will need to get used to new loans being quoted at rates such as SOFR or Prime.
5. **PPP.** The second draw of the Paycheck Protection Program Loans (“PPP”) is aimed to provide another boost to small businesses (and some not so small businesses) in 2021. This program is open until March 31, 2021 and provides additional assistance to those in the Accommodation and Food Services Sector. A portion of the funds obtained through a PPP loan can be used to pay rent, utilities and cover uninsured property damage caused by looting or vandalism. We can expect transactions to require further scrutiny into the credit of any party that qualified for a PPP loan and for parties to normalize financials for these additional funds. If you are a business owner looking to sell a business that received a PPP loan, take note that you may need approval from the SBA for the transaction depending on the structure, if such transaction will close prior to forgiveness.
6. **Sublease.** Although we expect to see more and more offices reopen and increase on-site staff, reduced space needs are top of mind for many firms that have moved to a remote working platform for the past 9 months. The lessons learned from this period will inevitably translate into some firms reducing space and creating more attractive sublease opportunities. These transactions seem very simple on their face, but keep in mind that the sublease falls under that of the prime lease. Additional protections need to be taken by a subtenant to ensure that it can continue the sublease even if the prime tenant defaults on the prime lease or files bankruptcy and landlords should also negotiate clear consent agreements to reflect their rights and obligations as to the subtenant.
7. **4% Floor on LIHTC.** At the end of 2020, the Consolidated Appropriations Act, 2021 (“CAA”) COVID-19 relief bill reformed the Low-Income Housing Tax Credit program to include a permanent minimum floor rate of 4%. The new floor rate applies to projects that receive tax credits after December 31, 2020. This change is thought to free up subsidies for projects, as it will allow developers to raise more equity through tax credit sales. Previously, the 4% credit value depended on an average of annual applicable Federal mid-term and long-term rates. With those rates being very low, the low-income housing projects were realizing much less capital. This change is intended to add more predictability to the marketplace and increase the attractiveness to corporate investors.
8. **Bankruptcy.** The CCA also made revisions to the bankruptcy code affecting commercial landlords and tenants. Most notable is an extension of the time by which the debtor under a lease for an unexpired, nonresidential lease must assume or reject the lease. This time period was extended from 120 days to 210 days, leaving in place the additional 90 day extension that is available upon showing cause. In addition, the CCA also amended the Bankruptcy Code to exempt “covered payment of rental arrearages” made to a creditor within the 90 day period preceding the bankruptcy filing and that might have otherwise been recoverable as preferential transfers outside the ordinary course of business. **This is intended to encourage landlords to enter into rent deferral arrangements without fear**

of a claw back in bankruptcy. To qualify for this exemption, such payments must have been made on account of (i) a lease that was entered into before the bankruptcy filing, (ii) a lease that was amended *after* March 13, 2020, and (iii) a lease amendment that deferred or postponed payments otherwise due under the lease. These provisions are in effect for a 2 year period and, therefore, will sunset on December 27, 2022.

9. **1031 Regulations.** The IRS issued regulations at the end of November, 2020 to address the definition of real property and provide a rule addressing the receipt of personal property incidental to real property received in a like kind exchange. The 2017 Tax Cuts and Jobs Act ("TCJA") limited like kind exchanges to real property held in a trade or business or for investment. The new regulations clarify that real property includes land and generally anything built or attached to the land. This includes improvements, as well as certain intangibles, such as leaseholds or easements, and property characterized as real property under applicable state and local law.
10. **Carried Interest Regulations.** The IRS posted final regulations on the tax treatment of carried interests under Section 1061 of the Internal Revenue Code. The TCJA closed a loophole and now generally imposes a 3-year holding period requirement in order for gains arising with respect to a "carried interest" in an applicable partnership interest to qualify as long-term capital gain instead of ordinary income. This change in the carried interest rules, generally known as the "promote" or "profits interest", now creates a conflict between investors and developers, in that the rules require a longer holding period which may not be in the best interest of a project if an opportunity comes along to sell it sooner. The specifics of the regulations issued in 2020 are too lengthy for this article, but we wanted to make mention of this in our list.

The above items are intended to be a snapshot of what we believe will be key legal issues for 2021 or law changes affecting the commercial real estate industry for 2021. Of course, only time will tell.

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