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Mid-Atlantic Bankruptcy Workshop

The Coming Tsunami of Commercial Real Estate Restructurings: Part II

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2023

Current State of Bank & Non-Bank Financing

Subdividing office space to subleasing arrangements, helping to offload the investment

Shortage of warehouse space, is forcing 3 PL's utilizing e-commerce fulfillment, and shelf space as well as logistics addressing the problem in the lack of drivers.

Banks are holding on to the accounts, due to the interest rate increase and the fear of re appraising the real estate assets (as they have increased in value!), putting them out of formula/convenance. CBRE is now taking 2 weeks to do appraisals as the banks are not calling.

Data centers next to fail. Crypto space.

The Coming Tsunami of Commercial Real Estate Restructurings: PART II

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THE COMING TSUNAMI OF COMMERCIAL REAL ESTATE RESTRUCTURINGS: PART II

August 8, 2023

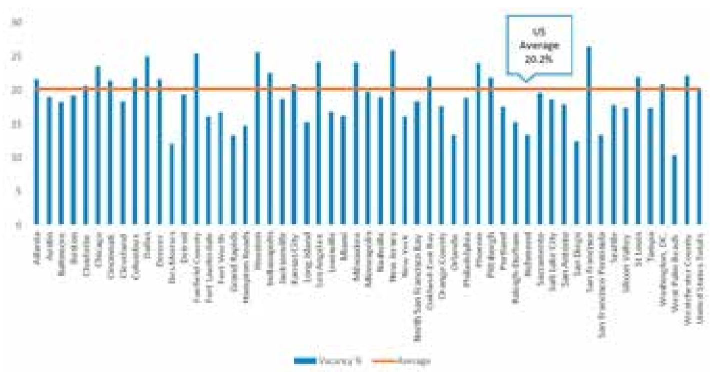
Market Overview

Office

The office sector remains under pressure with above average vacancies in major markets on the rise

- While hybrid work policies are still evolving, there is a slow and steady return to the office.
  - As of March 2023, average office occupancy is 50% of pre-pandemic levels.
  - Tenants still seek to reduce footprints and improve efficiency.
  - Employer/employee preferences have created demand for new, innovative office space, while older properties see increases in vacancies.
  - 21 major markets are above the U.S. vacancy average.
- NY Metro vacancy rates show pockets of resilience.
  - Long Island 15.2%, New York 16.1%.
  - New Jersey 25.8%, Fairfield County 25.4%, Westchester 22.1%.

Vacancy rates above national average in 21 markets



Source: JLL Research Q1 2023

Office (cont'd)

Q1 2023 recession fears continued to decrease office space demand

- Continued softening of office space demand in Q1 2023.
  - Inflation is easing, but employers were defensive and commenced cost cutting initiatives.
  - Layoffs contributed to a tightening of office space portfolios.
  - Bank defaults limited lending to preserve liquidity .
- Office attendance has stabilized at 30% below pre-pandemic levels. [1]
  - Finance & Tech rank among the lowest industries in avg. days per week worked in the office.[1]
- Q1 2023 saw the largest decline in net absorption since Q1 2021.
  - Net Absorption= total new square footage leased by tenants, minus the square footage no longer occupied over a specific period.

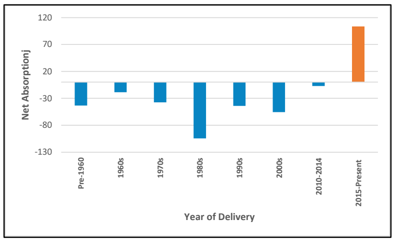
Source(s): (1) McKinsey Global Institute; Graph Source: CBRE Econometric Advisors Q1 2023

Office (cont'd)

Flight to Quality in Office continues to pose challenges for older buildings

- While vacancies are increasing for buildings delivered before 2015, there continues to be strong demand for newer office product.
  - Even as companies have become more defensive over the past six months, a sizable share of tenants have opted to expand or relocate into newer, higher-quality office assets.
  - 6.6 msf added in Q1 2023 with net absorption reaching more than 100 msf for building delivered after 2015.
- The divergence is expected to become even more pronounced in primary markets, due to significantly older inventories than midsized metro areas.
  - >70% of existing office space in NYC, San Francisco, LA, Boston, Chicago and Philadelphia is more than 30 years old.

Flight to Quality (Net Absorption)



Primary Market Vacancy Rates (sf in millions)

Primary Market	Inventory (sf)	Vacancy (sf)	Vacancy Rate
Chicago	269.2	63.2	23.50
Los Angeles	195.9	47.1	24.10
San Francisco	86.3	22.8	26.40
Philadelphia	148.4	27.8	18.80
Boston	166.9	31.8	19.10
New York City	469.6	75.8	16.10
	1,336.3	268.5	21.33
United States	4,773.6	962.5	20.20
Primary Market as Percentage of Total	**27.99%**	**27.90%**	

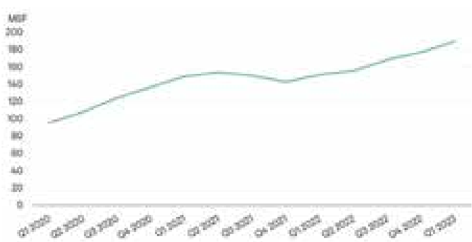
Source: JLL Research Q1 2023

Office (cont'd)

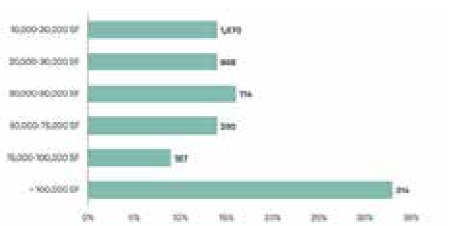
Sublease additions continues to drive availability to new record levels

- A reacceleration of space added to the sublease market created a new record high of 189 million square feet in Q1 2023.
- Sublease space in Q1 2023 accounted for 19% of total office space availability.
  - Up from 13% in Q1 2020.
  - Roughly half of sublease space is reported as vacant, adding to the overall office vacancy rate of 20.2% in Q1 2023.
- Mirroring trends of the overall market, sublease space is similarly concentrated in older-vintage and lower-quality office assets.
- Small spaces contributed the most to sublease availability.
  - Nearly 40% of sublease space blocks were between 10,000 and 20,000 sq. ft.

Sublease space (Net Absorption)

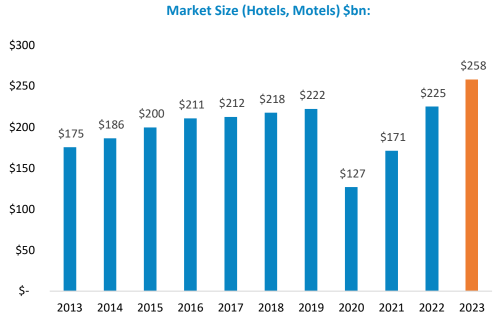


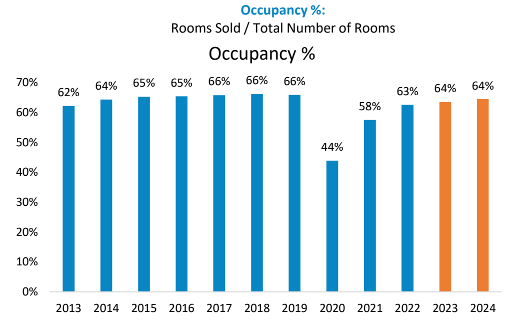
Share of sublease space availability by size

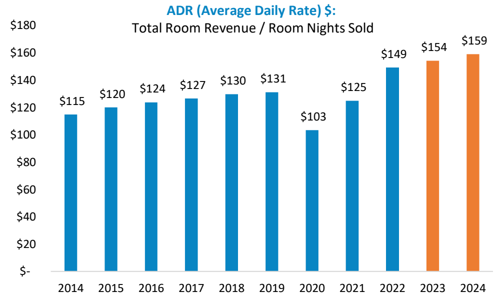


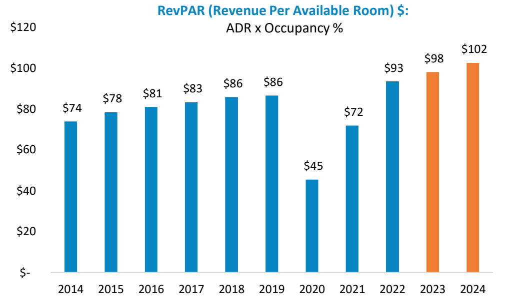
Source: CBRE Research Q1 2023

Hospitality Industry









Sources: IBIS World, AHLA, STR, Hotel Tech Report, News
Note: Data as of July 2023

Hospitality Industry (cont'd)

Trends:

- Macro:
  - Market expectations for a recession have cooled
  - Hotel demand improved in 1H 2023 and the industry remains optimistic about top-line performance for the rest of the year
  - With the overall outlook for economic expansion muted, growth in fundamentals are expected to substantially slow in 2023 and 2024.

- Segmentation:
  - Hotel demand improved in 1Q 2023 with most of the gain concentrated in the upper upscale and upscale chain segments. These two segments, which are most associated with business and group travel are expected to lead industry demand growth for the balance of 2023
  - Group and business activity, international travel, and consumers' desire for travel are expected to sustain modest growth in room nights
  - Corporate recovery will be somewhat dependent on return to the office, which is expected to continue to gradually progress through 2023
  - Limited service and extended stay have been strong performers since the pandemic. Hyatt and Hilton recently launched new extended stay brands and more are in the works.

- Importance of technology:
  - Properties invest in new in-house and guest-facing tech solutions to satisfy the changing needs and preferences of today's consumers and reduce labor costs
  - CRM and CEM use big data to create one-to-one interactions between the guest and the host at scale. AI-powered chatbots have proven to be a customer service asset during the booking process and in responding to recurring questions
  - Rising importance of integrated messaging, predictive analytics, customer profiling and middleware (to connect disparate systems)

- Globalization and international travel:
  - Growing global middle class: travelers seeking experiences rather than material possessions, leading to greater international travel
  - In the U.S., outbound international leisure travel outpacing inbound, given the relative strength of the dollar

Headwinds:

- Higher interest rates have led to lower higher cap rates and lower purchase prices, slowing transaction sale and refinancing activity significantly
- Lenders have tightened credit standards, including higher interest rates, lower LTV, and more stringent underwriting
- The inflationary environment, including significantly higher labor costs, has led to higher operating expenses, putting pressure on margins
- The hospitality industry has been able to tap a growing supply of labor to fill open positions, but many properties remain understaffed, leading to service and customer satisfaction issues

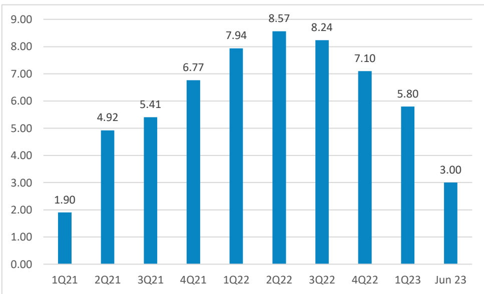
Sources: IBIS World, AHLA, STR, Hotel Tech Report, News

Retail

Retail is slowing its growth, yet consumer spending remains resilient

- June retail sales grew 0.2%, but below expectations with mixed results.
  - In June, clothing stores saw a 0.6% increase, while department store sales fell 2.4% and food & beverage store sales were negative 0.7% for the month.
- Bankruptcy related closures drag down net absorption.
  - Absorption in smaller shopping centers fell 75% to a modest 2.1 million, with much of that decline taking place within community centers.
- People still seek the "shopping experience".

US Consumer Price Index Q1 2021 - Current



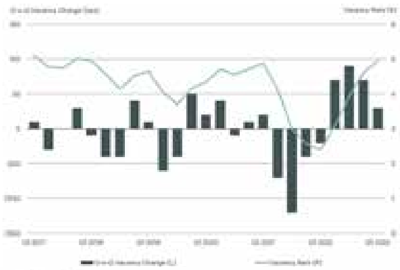
- **Consumer spending remains resilient, despite higher interest rates, supported by a strong jobs market and declining inflation.**
  - **Inflation:** Inflation is trending down: however, consumers have responded to persistent inflation by shifting money away from discretionary goods purchases in favor of groceries and other key necessities.
  - **Interest Rates:** Given inflationary pressure, the Fed has increased interest rates three times in 2023 and the Fed Chairman indicated that rates may rise again.
  - **Supply Chain:** Supply chain issues have moderated as evidenced by container prices, which are now below pre-pandemic levels
  - **Oil Prices:** Prices are down 20%, freeing up funds for discretionary consumer spending

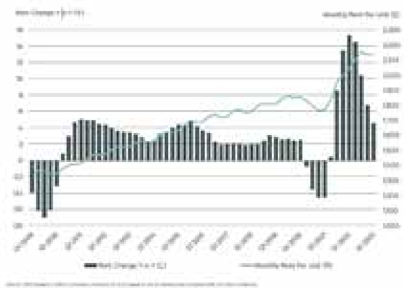
Source: Bureau of Labor Statistics

Other Asset Classes

Multifamily: New household formation is boosting demand for rentals

- Multifamily properties in NYC, LA and other coastal cities largely returned to pre-pandemic vacancy levels by Q3 2021.
- Multifamily occupancy levels are approximately 95%.
- Projected Vacancy Rate of 4.9% has returned to the long-term average
  - There was less than a 70 bp increase from Q4 2022 suggesting supply and demand dynamics are beginning to stabilize.
  - New York remained the largest market with the lowest vacancy rate at just 2.9%.
  - However, 66 markets had vacancy rates above 3.0% with 57 of them above 4.0%.
- Average monthly multifamily rent fell by 10 bps quarter-over-quarter to $2,134
  - Y-O-Y average monthly rent increased by 4.5%, down significantly from the record in Q1 2022 but above the pre-pandemic average of 2.7%.
- The Northeast and Midwest lead in annual rent growth.
  - The Northeast / Mid-Atlantic lead with 5.7% growth in Q1 followed by the Midwest with 5.4%. (Newark with 7.1% rent growth; New York trailing behind with 6.4%).





Source: CBRE Research Q1 2023

Other Asset Classes (cont'd)

Certain CRE asset classes are responding well to an evolving U.S. economic landscape

- **Industrial & Logistics (Warehouses):** Demand will primarily be driven by growing e-commerce sales, the improving economy and population migration.
  - E-Commerce sales in 2022 set a record of $1 trillion, a 26.8% increase from the record set in 2020
  - Supply chain volatility will also drive demand as the need to onshore "safety stock" inventory to avoid the supply chain disruptions increases.
- **Data Centers:** Demand for space will increase to meet the needs of growth in cloud service providers, social media and content streaming companies.
  - 5G, AI and edge computing continue to gain traction, spurring development of additional capacity nationwide.
- **Mall Redevelopment:** Malls across the country are being redeveloped into sports-related, multifamily and other asset classes.
  - Ex: Southland Mall in Cutler Bay, Miami will be the location of a $1 billion redevelopment, adding over 4,300 apartments, medical office space, and additional retail and restaurant locations.

Source(s): CBRE Research Q1 2023; JLL Research

Real challenges.
Real solutions.

Faculty

Dion W. Hayes is a partner with McGuireWoods LLP in Richmond, Va. He served from 2017-22 as the firm's deputy managing partner for Litigation and chaired the firm's Restructuring and Insolvency Department from 2012-17. Since 1992, Mr. Hayes has focused his practice on insolvency law and financial restructuring, including bankruptcy, out-of-court restructurings, distressed-asset acquisitions and recapitalizations, and related litigation. He has particular experience in the coal, mining, insurance, banking, retail and health care industries. He also has experience with the insolvencies in the U.S. and elsewhere of regulated entities, such as insurance companies and banks. Mr. Hayes has appeared in bankruptcy courts and other federal courts in Delaware, Florida, New York, Texas and Virginia. He is a Fellow in the American College of Bankruptcy and has been selected for inclusion in *Chambers USA* (Tier 1) for Bankruptcy, *The Best Lawyers in America* for Bankruptcy and Creditor/Debtor Rights, *Super Lawyers* for Bankruptcy & Creditor/Debtor Rights, Banking, and Business Litigation, the *Legal Elite* for Bankruptcy, and the *Irish Legal 100*. He is admitted to practice in D.C., Maryland, New York and Virginia, and he teaches bankruptcy as an adjunct professor at William & Mary Law School. Mr. Hayes received his B.A. from the University of Virginia in 1989 and his J.D. from William & Mary Law School in 1992.

Jill Kirshenbaum is a senior vice president of Business Development at Briar Capital Real Estate Fund in Highland Park, Ill., and is experienced in accounts receivable, commercial real estate, purchase-order facilities and other alternative financing for commercial business needs. Previously, she was responsible for creating collaborative alliances and new opportunities with the finance world. Ms. Kirshenbaum works with nonbank, bank, fiduciary, accounting and turnaround professionals on improving the outcome with liquidity for the businesses they serve. She also serves on the Turnaround Management Association's global board of directors as a trustee and board member of its Global women's board (the TMAnow). She has a wide network of individuals in finance, and is seen as a mentor who is willing to assist in collaboration, introduction and advocacy. Ms. Kirshenbaum received her B.S. in education from the University of Maine.

Mark D. Podgainy, CTP is a managing director with Getzler Henrich & Associates LLC in New York and has more than 25 years of experience in operational roles and turnaround consulting in a variety of industries. His expertise includes operations restructuring, business plan analysis, performance improvement, cash and vendor management, bankruptcy consulting and interim-management services. Mr. Podgainy's clients include companies, secured lenders, boards of directors and creditors' committees, and he also works with law firms on forensic, litigation support and expert witness assignments. His client focus has been in the real estate, hospitality, consumer products, apparel and textile, food, retail and building products sectors. Mr. Podgainy leads the firm's commercial real estate and hospitality practice, where he advises owners, sponsors and their creditor constituents in a variety of asset classes, including hotel, multifamily, office and industrial, among others. He has experience guiding clients through complicated and contentious workout and restructuring processes both in and out of court throughout the country. Mr. Podgainy has significant experience in the hospitality industry, including line and management positions at Harvey Hotels, Winegardner & Hammons (Holiday Inn concepts) and Howard Johnson's Restaurants. His hotel clients are major flag franchisees and independent hotels, and his restaurant clients have included KFC, Big Boy Restaurants, Roadhouse

Grill, Eateries (Garcia's, Garfield's and Pepperoni Grill concepts) and Toojay's, among others. He is currently the CRO of Urban Commons 2 West LLC, *et al.*, and financial advisor to a flagged hotel going through a workout process with its senior lender. Mr. Podgainy is a board member of the NYC chapter of the Turnaround Management Association; of Neighborhood Housing Services of New York City, Inc., a nonprofit empowering disadvantaged low- and moderate-income New Yorkers to purchase and preserve affordable housing; and of the 520 West 19th Street Condo Association. He is a member of ABI and the Cornell Hotel Society. Mr. Podgainy has authored thought leadership articles on distressed mergers and acquisitions, real estate, hospitality, education and related topics for numerous industry trade publications. He received his Bachelor's degree from Cornell University's School of Hotel Administration and his M.B.A. from Columbia University.

Stephanie Shack is a general counsel and senior vice president with Continental Realty Corporation in Baltimore, a privately owned and operated real estate investor that acquires and manages multifamily communities and high-quality retail and office space in 10 states across the country. She honed her real estate transactional skills as senior vice president and general counsel for a national nonprofit specializing in affordable housing and as senior vice president and associate general counsel at a publicly traded REIT. After moving to Baltimore to start her career as an attorney for a global law firm, she made the move to become an in-house attorney, allowing her to develop her expertise in portfolio strategy and risk, investment and asset management, as well as real estate and private-equity funds. Having spent most of her career representing landlords in office, multifamily and retail leasing, Ms. Shack brings a unique perspective on how market conditions impact commercial real estate. She received her undergraduate degree in psychology from Washington University in St. Louis and her J.D. from Emory University School of Law.

Hon. John K. Sherwood is a U.S. Bankruptcy Judge for the District of New Jersey in Newark, appointed in June 2015. In private practice, he had more than 25 years of experience in bankruptcy and debtor/creditor matters, including related litigation. Some of his noteworthy engagements were Ocean Place Development Resort (counsel to debtor), MagnaChip Semiconductor Finance Co. (counsel to creditors' committee), Quebecor World (USA) Inc. (litigation counsel), Le Nature's Inc. (counsel to creditors' committee) and the City of Detroit (counsel to union). Judge Sherwood was president of the New Jersey Bankruptcy Lawyers Foundation from 2008-13 and an active member of ABI and the Turnaround Management Association. He was selected by *Chambers USA* from 2013-14 as one of America's Leading Lawyers for Business, and he was recognized in *The Best Lawyers in America* (2012-15) for his work in bankruptcy and in *Super Lawyers* (2006, 2009-14), where he was featured in the bankruptcy section and corporate counsel edition. Judge Sherwood received his undergraduate degree from James Madison University in 1983 and his J.D. in 1986 from Seton Hall University School of Law.

Brent C. Strickland is a partner with Whiteford Taylor Preston LLP in Rockville, Md., where he advises on legal strategies for managing financial and other issues that can otherwise hinder, or threaten, business growth and success. He has decades of experience with the rescue, restructuring and revitalization of companies at risk of financial distress, including through out-of-court financial restructurings, bankruptcy or insolvency proceedings, and other essential strategies for corporate survival and renewal. Mr. Strickland has worked with numerous industries, including commercial real estate, retail operations, energy, golf courses and manufacturing. In addition, he is often asked to assist corporate and individual debtors, buyers and sellers of distressed assets, and individual creditors in protecting their interests and maximizing recoveries. Mr. Strickland is an experienced litigator in matters related to bankruptcy and creditor issues in both state and federal courts, and has significant in-court trial experience. He has been listed in *Benchmark Litigation* as a Maryland and Delaware Bankruptcy "Future Star" from 2009-10, in *The Best Lawyers in America* for Bankruptcy and Creditor/Debtor Rights/Insolvency and Reorganization Law, and Litigation - Bankruptcy every year since 2012, and in *Maryland Super Lawyers* for Bankruptcy from 2007-20. In addition, he is a member of ABI and the Maryland Bankruptcy, Maryland State, Virginia State, New York State, District of Columbia and American Bar Associations. Mr. Strickland received his B.A. *cum laude* in 1990 from State University of New York (SUNY) Buffalo, and his J.D. *magna cum laude* in 1993 from American University Washington College of Law.