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CMBS Special Topics

Russian Sanctions Impact: Lease Terminations and Forced Property Sales

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Russian Sanctions Direct CMBS Impact Appears Remote but Warrants Attention

A protracted Russia-Ukraine war and the attendant US-led economic sanctions on Russia could potentially pose a few unique implications for CMBS collateral:

- **Lease terminations.** US landlords may seek to terminate leases of Russian-owned corporations. Tellingly, British Land Co. is looking to terminate the lease of Gazprom Marketing & Trading LTD's office in London, according to press reports.
- **Forced property sales.** The US government may force Russian property owners to divest their holdings. Such forced sales happened in the past. For example, HNA Group, a China-based corporation, had to sell its stake in 850 Third Avenue (formerly in NCMS 2018-850T) back in 2019 following a directive of the Committee on Foreign Investment in the United States ("CFIUS"). CFIUS is an interagency committee that reviews transactions involving foreign investment in the US, and their effect on national security.

To be sure, these risks appear remote at this stage and perhaps will not be consequential even if they materialize. It seems there are very few (if any) large Russian corporations across the CMBS tenant universe. It is also unclear what legal provisions landlords can use to terminate long-term commercial leases of Russian tenants. In turn, there are likely only a handful of Russian owners of US commercial real estate. Russia does not show up in the list of top-25 countries originating capital inflows to US CRE in 2021, according to the National Association of Realtors. CRE data vendors have identified only six Russian-headquartered organizations and people with US CRE holdings, according to press reports.

All in all, the direct impact of the conflict in Europe on CMBS collateral likely pales in comparison to the implications for other securitized products segments, such as Aircraft ABS. Stranded aircrafts leased to Russia-based airlines could lead to cash flow interruption on ABS deals, according to KBRA.

But if US landlords do find a way to break the leases of their Russian tenants, or if the US cracks down on Russian property ownership, even a handful of situations can have a significant deal impact. In NCMS 2018-850T, the CFIUS directive to HNA created an event of default in the deal. Deal documents did not consider HNA's transfer as a permitted transfer, thereby triggering the default, according to servicer commentary.

No End in Sight

The Russia-Ukraine war is likely to get worse before it gets better, and to last longer rather than shorter, according to Academy's Geopolitical Intelligence Group ("GIG"). GIG is comprised of 15 senior Admirals and Generals. The group has been closely tracking the conflict in Europe, publishing on it extensively.[1] GIG's Head is Major General (ret.) James A. "Spider" Marks, a former Commanding General of the US Army Intelligence Center and School at Fort Huachuca, Arizona, and a national security contributor to CNN. Academy's recent Macro Strategy report summarized some of the GIG's views[2]:

- **The initial attack was flawed in many ways.** Ultimately, as General (ret.) Marks stated, "if you attack everywhere, you win nowhere." This has slowed Russia's progress and calls into question its ability to control regions that were once part of the former Soviet Union. In addition, the number of troops being used in this invasion force is not enough, and there are questions about their effectiveness.
- General (ret.) Marks also pointed out that "tactics are for amateurs and logistics are for professionals," which dovetails with Major General (Ret.) Mastin Robeson's comments "that there is a big difference between trained vs. seasoned troops." Both those statements go towards explaining the current status of the invasion.
- **Universally, the GIG expressed concern that this will only get worse before it gets better.** The devastating tactics typically used by the Russian army are likely to be employed in Ukraine. Such tactics include indiscriminate attacks on civilians and shutting off access to food and energy. Russia will also move to a plan designed to destroy the morale, the ability, and the willingness to fight back.
- **The likelihood of a coup or some internal action within Russia to remove Putin remains low.** While there is hope that something will happen within Russia to stop this invasion, the consensus is that it remains unlikely at this stage.
- **Sanctions are stronger than expected but potentially slow-moving and may ultimately prove ineffective.** The US has sanctions in place with Russia, Iran, North Korea, and Venezuela, to name a few, yet leaders in those countries remain in power. One notable difference in the current situation is the willingness of private companies to impose their own forms of sanctions.

Track Lease "Break Clauses"

A concerted effort of US landlords to terminate leases of Russian-related tenants should sharpen the focus on "break clauses." Under certain conditions, these provisions give parties the option to terminate leases during the term. Tenants have clearly taken advantage of early termination options throughout the pandemic. A notable example is United Airlines' decision to exercise its early termination option at The Willis Tower in Chicago ($1.32 billion, BBCMS 2018-TALL).

1 See "Russian Invasion of Ukraine," *Around the World with Academy Securities*, February 28, 2022; "Russian Attack On Ukrainian Nuclear Facility," *Geopolitical Insights*, Academy Securities, March 4, 2022

2 "Що Далі? (What's Next?)," Macro Strategy Insights, Academy Securities, March 6, 2022

Deal documents usually spell out tenant early termination options. In contrast, we have not found references to landlord termination options as we scanned a sample of asset writeups. Standard lease agreements almost certainly should allow landlords to terminate leases if the tenant is not paying their rent. But it is not clear what, if any, termination options landlords have following economic sanctions on the tenant's home country, absent actual breaches of the lease terms. Anecdotally, the lease of Gazprom's office at 20 Triton Street in London that the British landlord is looking to terminate expires in 2025, according to press reports. The reports did not mention how the landlord practically plans to terminate the lease before that time.

Landlords may also need to secure servicer or lender consent if they look to terminate "major leases." The precise definition of major leases can vary across different deals. But the standard provision would require servicer or lender consent on the execution, termination, or renewal of certain leases on the property.

In turn, we did not find large Russian tenants across the CMBS universe as we casually searched for the twenty largest Russian corporations. One tenant we did find – Lukoil International Upstream West Inc., a subsidiary of Lukoil Group, the second largest Russian corporation by revenue – appears to have moved from a CMBS property, Three Greenway Plaza (in GSMS 2017-GPTX), to another non-CMBS property in Houston.

US May Look to Crack Down on Russian CRE Ownership

Forfeiture of assets by the US government is a contingency that deal documents mention. The US can seize assets following violations of laws such as the Racketeer Influenced and Corrupt Organizations Act, the Bank Secrecy Act, or anti-money laundering rules, as the PRKAV 2017-245P prospectus notes, for example. The PRKAV 2017-245P borrower is HNA, the Chinese firm that also owned 850 Third Avenue. Notably, the list of events that can trigger seizure and forfeiture also includes "economic sanctions." If forfeiture proceedings do kick off, the deal documents state that the lender may establish its interest in the property under various conditions.

CFIUS directives to sell assets is another potential development. In 850 Third Avenue, HNA mentioned that the CFIUS directive did not result in a "fire sale." The Chinese landlord ended up selling the 604K sf office property in Manhattan to an entity controlled by Jacob Chetrit in 2019. The deal's event of default was reversed following the sale. But the uncertainty around the property marketing period highlighted the potential deal impact.

Russian capital has not played a significant role in the US CRE market, as we mentioned at the outset (Russian capital has been much more prevalent in the high-end condo segment). For context, cross-border flows from China totaled $5.8 billion in 2018, according to NAR (Chinese flows have significantly declined since then). As such, it was not unusual to find China-based sponsors of CMBS loans in recent years. But we cannot rule out a scenario where the US government does track down Russian owners of CMBS properties and moves to void their ownership.

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