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CMBS Credit Focus

PILOT: Check Another Wrinkle of Ground Leases

NYT Building and One Bryant Park Show Ground Lease Nuances

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As the market increasingly focuses on ground lease complications, especially on distressed office loans, situations such as One Bryant Park ($950 million, OBP 2019-OBP) and New York Times Building ($515 million, NYT 2019-NYT) spotlight a unique category of ground leases. Both CMBS properties are labeled as "ground leases" in deal documents. The collateral is the leasehold interest of the borrowers. But the key credit drivers on NYT and OBP are not the typical ground lease minefields such as ground rent resets (especially market-value ones), relatively short leasehold periods (such as in 1407 Broadway), or potential friction between the leaseholder and the ground owner.[1]

Rather, the ground leases on the two Midtown Manhattan office buildings are structured to effectuate tax breaks to the sponsors in the form of payment in lieu of taxes (PILOT). As such, the ground rent the leaseholder pays is actually PILOT payments. The milestones and projections CMBS investors should track on such loans are PILOT program expirations, and switches to payments of full taxes. In fact, in both NYT and OBP the leaseholders can take over the ground for a nominal fee a few years down the road, thereby effectively collapsing the fee/leasehold structure.

Figure 1. New York Times Building and One Bryant Park Loan and Property Parameters

Asset	New York Times Building	One Bryant Park
Deal	NYT 2019-NYT	OBP 2019-OBP
Loan Balance ($MM)	$515.0 ($697 psf)	$950.0 ($403 psf)
Maturity	December 2024 with a one-year extension through December 2025	September 2029 (ARD) and September 2049 (Maturity)
Coupon / Amortization	TSFR1M + 2.1538% floating / Interest-only	3.25% fixed / Interest-only
Loan Status	Current	Current
Property Type	Office (95.4%) and retail/other (4.6%)	Office (89.9%) and retail/other (10.1%)
Property Size / Occupancy	738,385 sq. ft. / 98% occ. (Dec 2023)	2,356,834 sq. ft. / 99% occ. (Mar 2024)
Location	Eighth Ave./41st St., New York, NY	Sixth Ave./42nd St., New York, NY
Borrower Sponsor	Forest City Enterprises (Brookfield)	The Durst Company (50.01%) and Bank of America
Largest Tenant	Datadog Inc (30.8%)	Bank of America (80.9%)
Other	The property benefits from a payment in lieu of taxes ("PILOT") program that expires December 2032	The property benefits from a payment in lieu of taxes ("PILOT") program that expires June 2029

Source: Morningstar Credit and Academy Securities

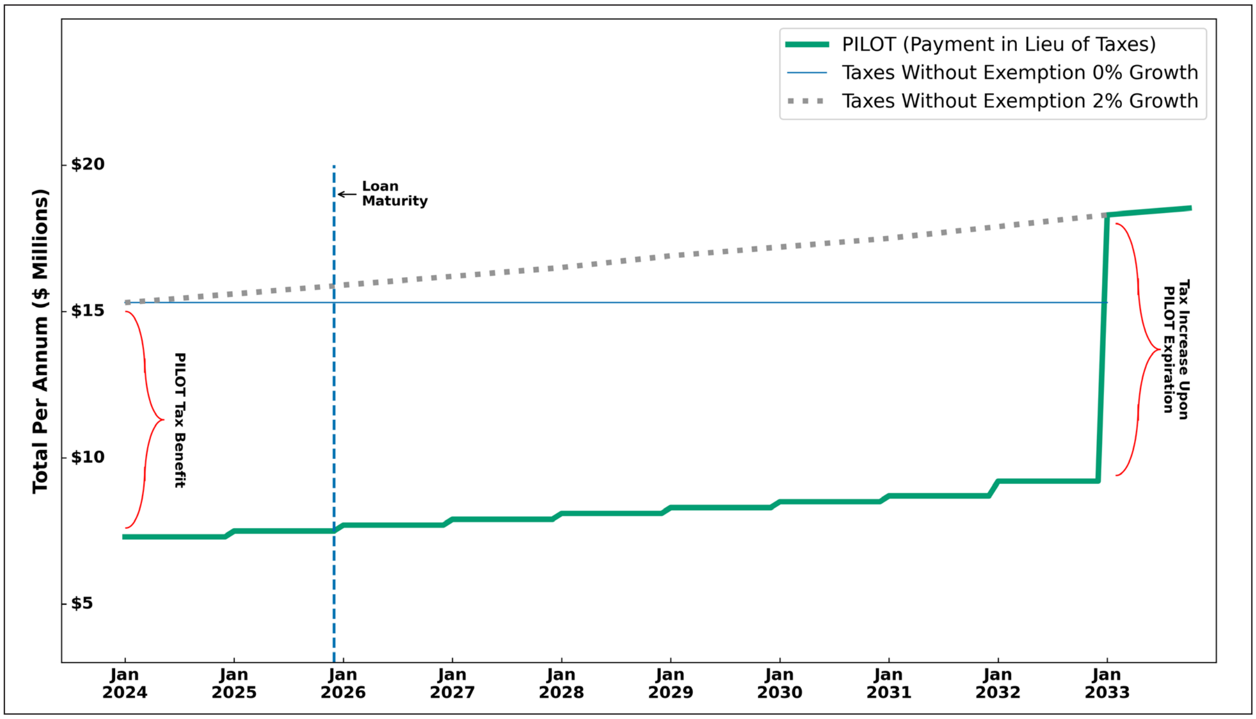
1 See "The Road to Conversion: Consider Ground Leases and ARD Loans in Office Analysis," CMBS Credit Focus, Academy Securities, January 5, 2023

Track PILOT Benefits and Terminations

PILOT benefits can represent significant savings on CMBS property expenses. Property taxes typically comprise the largest expense item across properties. The termination of a PILOT program during the CMBS term, or even after loan maturity, can dramatically impact financials, as well as the loan's refinancing scenarios. For a variety of reasons, it is quite challenging to come across official data of precise PILOT discounts for specific properties. But we estimate, for example, the tax savings on New York Time Building to be 52.3% compared to non-exempt tax payments, based on the property's published tax assessment.

The NYT borrower currently pays about $8.2 million PILOT annually (again, in the form of "ground rent"), until December 2032 (Figure 2). The PILOT payment comprised ~45% of the property's overall expenses, as of YE 2022, attesting to the PILOT significant impact on property financials. In 2032, the borrower can purchase the fee interest (ground) for $10 (the dollar amount is not a typo, but the purchase option is subject to a few other conditions). The NYT ground owner is the City of New York. As such, after 2032 the borrower would pay full property taxes as the fee/ground owner, or pay full taxes in the form of ground rent if it chooses not to exercise the ground purchase option. Either way, the relevant metric to assess the 2032 "reset" impact on the NYT CMBS loan is the PILOT-to-full taxes switch, rather than any ground lease subtleties.

Figure 2. New York Times Building PILOT and Full Taxes



Source: Deal Documents, New York City Department of Finance, and Academy Securities

Sleuthing for PILOT CMBS Loans

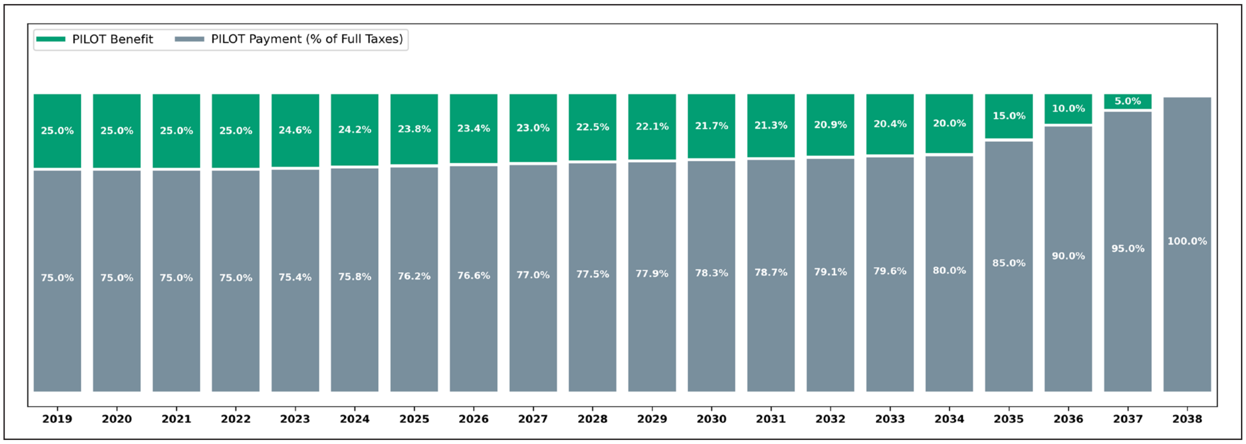
PILOT terminations that would saddle CMBS properties with much higher property tax expenses are also relevant in situations that do not involve a ground lease structure of the kind NYT and OBP feature. Loans such as One Manhattan West ($1.5 billion, OMW 2020-1MW and BBCMS 2020-C8) and 10 Hudson Yards ($900 million, HY 2016-10HY and four 2016-vintage conduit deals) have complicated PILOT schedules but are not structured as ground leases. Interestingly, in 10 Hudson Yards it appears that the borrower collapsed an existing Metropolitan Transportation Authority (MTA) ground lease around the time of the CMBS issuance.

Despite the critical impact PILOT programs can have on property financials, consistently identifying CMBS loans with a PILOT component appears to be a challenge. We do not see a specific IRP field identifying such situations. Cashflow systems also do not offer clear identification. Compiling all PILOT properties from third-party sources and mapping them to CMBS loans looks far from straightforward.

In New York City, for example, there are two agencies that issue PILOT agreements: (1) NYC Industrial Development Agency (IDA) and (2) NYC Economic Development Corporation (EDC). Both agencies disclose an abundance of public reports, including lists of all their projects. We see hundreds of projects on annual reports and spreadsheets. EDC appears to handle 231 projects with some PILOT benefit. IDA had over 310 entities with PILOT agreements as of late 2022, totaling $521 million in effective tax exemptions, according to press reports citing the agency data. But the project or entity listings do not lend themselves to specific properties.

Beyond New York City many other local governments and states offer PILOT benefits, further complicating PILOT sleuthing for CMBS investors. All told, the market may be left to manually scrub deal documents for PILOT situations. Anecdotally, loans such as NYT, OBP, OMW, and HY, show the relevance of going through the exercise. For example, in One Manhattan West, the PILOT discount represented 25% of full taxes from 2019 through 2023, based on deal documents (Figure 3). The discount then decreases by 3% per year in the next 10 years (which extends beyond the CMBS loan 2027 maturity), and fully abates in 2038.

Figure 3. One Manhattan West PILOT Schedule



Source: Deal Documents and Academy Securities

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