



Tenant in Common Workouts

Negotiating the Real Estate, Tax, Finance and Securities Issues When Exiting TIC Deals

A Live 90-Minute Teleconference/Webinar with Interactive Q&A

Today's panel features:

Edward J. Hannon, Partner, **Freeborn & Peters**, Chicago
Coni S. Rathbone, Partner, **Davis Wright Tremaine**, Portland, Ore.
Michael A. Moynihan, Partner, **Freeborn & Peters**, Chicago

Thursday, October 22, 2009

The conference begins at:

1 pm Eastern
12 pm Central
11 am Mountain
10 am Pacific

The audio portion of this conference will be accessible by telephone only. Please refer to the dial in instructions emailed to registrants to access the audio portion of the conference.

Negotiating Tenant in Common Workouts: Navigating the Real Estate, Tax, Finance and Securities Issues When Exiting TIC Transactions

Presented by:

Edward J. Hannon
Michael A. Moynihan
Coni S. Rathbone

Freeborn & Peters LLP
Attorneys at Law

 Davis Wright
Tremain LLP
DEFINING SUCCESS TOGETHER

Meet the Presenters



Edward J. Hannon

Mr. Hannon provides tax and structural advice to developers and owners of real estate. He has been involved in a number of real estate oriented lender workouts, including several transactions involving the restructuring of co-ownership structures using both Delaware Statutory Trusts and the tenant in common structure.



Michael A. Moynihan

Mr. Moynihan focuses on a broad range of commercial real estate and financing transactions. A significant portion of his practice involves representing developers of large-scale commercial, residential and mixed use developments, principally in major metropolitan areas. He represents clients in the acquisition, financing and leasing of office properties, retail centers and other real property assets.



Coni S. Rathbone

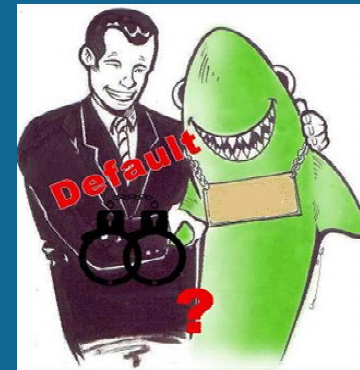
Ms. Rathbone focuses on real estate, corporate and securities law, mergers and acquisitions, and general business transactions. She regularly helps clients in the purchase, development and sale of commercial property. She has significant expertise in representing tenant-in-common (TIC) sponsors and investors. She also serves as General Counsel for several Oregon corporations.

Impact Of Real Estate Slowdown On TICs

- Volume of sales of TIC interests has declined significantly
- Bankruptcy or insolvency of key tenants
- Lack of refinancing options for TIC structures

Workouts Defined

- Reserves depleted – capital call needed
- Poor property performance – close to loan default
- Loan maturing within 1 year
- Master lease default
- Sponsor non responsive, insolvent or bankrupt
- Property in receivership



Participant Roles

- TIC Owners
- TIC Sponsor
 - Asset Manager
 - Master Lessee
- Lender
 - Special Servicer
 - Master Servicer
- Tenants
- Registered Representatives



Impact Of The Involvement Of Special Servicers In TIC Loan Workouts

- Role of special servicer
- Lender objectives – special servicer vs. portfolio lender
 - Discussion with the special servicer
 - Discussion with the lender's counsel
- Duel track negotiations
- Principal Reductions or Additional Lender Advances

Impact Of Troubled TIC Sponsor Situations

- Underperforming sponsor
 - Communication among TIC owners
 - Communication with lender
 - Financial / performance information
- Underperforming property
 - Tenant issue
 - Geographic issue
 - Operational issue

Overview Of The Tenant In Common Structure

- **Master Lease Structure** – the investors, through single member limited liability companies, become co-owners of real estate as tenants in common and enter into a master lease with an affiliate of the sponsor (“Leaseco”). Under the master lease, Leaseco has the power to “sublease” the property to tenants.

Overview Of The Tenant In Common Structure, *contd.*

- **Asset Management Structure** – the investors, through single member limited liability companies, become co-owners of real estate as tenants in common and enter into an asset management agreement within affiliate of the sponsor (the “AM”). Under the asset management agreement, the AM is required to obtain the consent of the investors to approve leases.

Comparison Of The Asset Management Structure And The Master Lease Structure

Asset Management Structure

- Asset Manager collects rents as agent of the co-owners
- Return received by co-owners based on performance of the property
- Lender consent is required for removal of asset manager

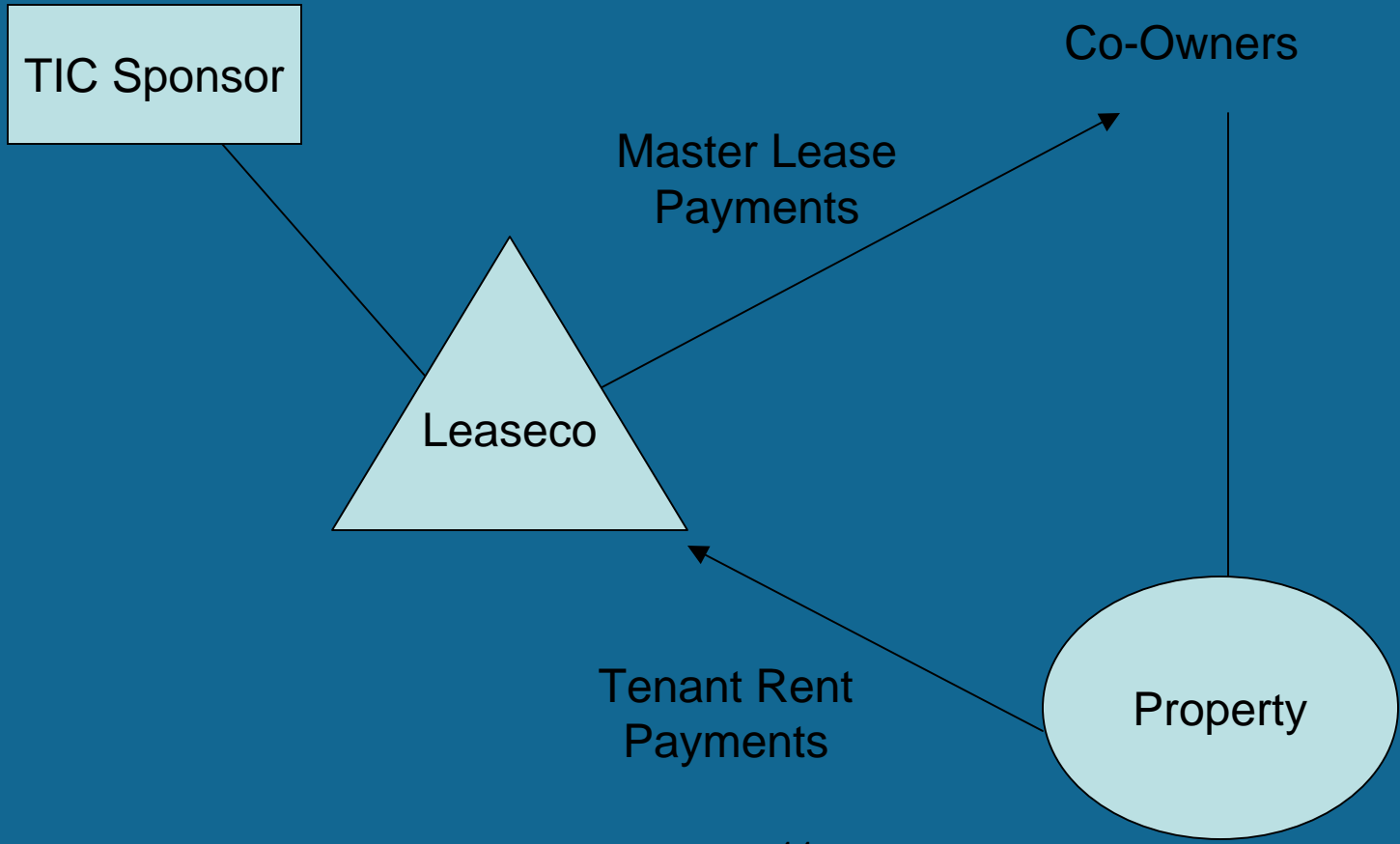
Master Lease Structure

- Leaseco is a sub-landlord
- Return received by co-owners based on terms of master lease
- Lender consent is required for termination of the master lease

It Looked Like a Good Idea at the Time – Master Lease Structure

- Master Lease Entity was typically formed as a newly formed single member limited liability company
- Typically, the sole line of communication among co-owners was through the sponsor
- Bankruptcy of the Leases could jeopardize underlying tenant leases
- Lenders can be non-responsive to requests for master lease termination

The Master Lease Structure



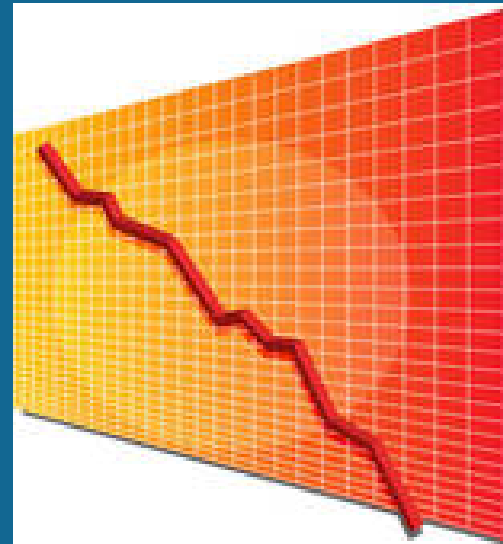
Sponsor Related

- Poor asset and / or property management
- Poor investor communication
- No new TIC properties / small portfolio
- Insolvency (insolvency desperation)
 - Attempt to move the property to another sponsor before a potential bankruptcy occurs



Sponsor Failure Defined

- Bankruptcy
- Cease business
- Performance issues
 - Sponsor level
 - Property level



Causes of Sponsor Failure

- Severe Real Estate Recession
- Business Model, i.e. Master Lease
- Fraud / Unethical Practices
- Violating Securities Regulations
- TIC Ownership Disagreements

Causes of Sponsor Failure, *contd.*

- Poor Acquisitions Selection / Due Diligence
- Poor management
- Loan / Issues
 - Refinancing
- The 2 “Gs” – Growth & Greed

Poor Sponsor Performance

- “Counsel” Sponsor into action
 1. BD, Reps, Investors
- Replace sponsor
 1. Management Contract Termination / assignment / amendment
 - Unanimous consent
 - Possible new sponsor assumption of loan carve-outs
 - Majority consent

Poor Sponsor Performance, *contd.*

- Replace sponsor, *contd.*
 2. DST restrictions
 3. Sub Management Agreement with Originating Sponsor
 - Requires cooperation between sponsors
 - Lender consent required
 4. Loan non recourse carve-out issues

Property Related

- Large tenant vacancy / Uninsured property damage / Property vacancy / Market vacancy
 - Loan Default
 - Suspended Cash Flow
- Reserves depleted



Property Related, *contd.*

- Loan Matures
 - Difficult to Refinance
 - General unavailability of funds
 - Lenders don't like TICs
 - Loan Sizing
 - Loan Sizing
 - Number of TICs
- Loan to Value requires additional equity – capital call, contribute to LLC or sell



Poorly Managed Property

- Inadequate supervision of third party property manager
- Failure to actively manage property
- Cost cutting
- Failure to actively find replacement tenants

Situations Involving Fraud

- Co-mingling of property funds
- “Sponsor loans” from the TICs using the reserves
- Misapplication of reserves



Structure Related Issues

- Management contract
 - Unanimous consent
 - Leasing parameters
 - Loan non-recourse carve-outs



Structural Limitations Under Existing Tax Rules

- Preserve like kind exchange treatment
 - Proposed rollups / crucified by owners
- Limitations under the TIC Structure
 - Pro rata distributions
 - No back-end participation
- Limitations under the DST Structure
- Tax consequences on loss of co-ownership status



From Bad to Worse – Unwinding the Master Lease Structure

- In many cases, termination of master lease without lender consent triggers the co-owner's non-recourse carve-out guarantees
- Many co-owners are unfamiliar with the complexities of the structure
- Conversion to “flow-through” master lease structure raises significant tax issues
- The TIC Structure does not facilitate unified actions by the owners

Bankruptcy

- Do everything possible to escape sponsor prior to bankruptcy
- Be prepared for legal fees and to pay the bankruptcy estate to get the master lease out
- Management contract usually has a termination right if there is a bankruptcy
- Sponsor bankruptcy is almost always a loan default
- Lender needs to approve new sponsor / asset manager

Conflicts of Interest in Selecting Counsel

- Multiple Owner Disagreements
- TIC Agreement Call Provisions
- Transactional Solutions vs. Litigation

Replacing The Existing TIC Sponsor

- Sponsor / Default Issues
- Unanimous Approval Requirements
- Privacy of Contract
- Lender Consent

Lender Reaction To TIC Workouts

- Changing Structure
- Concerns re New Sponsor
- Distain for TIC Structure
- Guarantees

Capital Structure Issues / Solutions

- Capital call to replenish reserves / obtain loan mod / obtain new loan
- Sell - Contribute TIC interests into REIT
- Contribute TIC interests into LLC (TIC > LLC or DST > LLC) to recapitalize the equity or refinance (DST)
- Mezzanine loan to replenish reserves (not likely in this market and will be joint and several recourse)



Loan Defaults

- Monetary Default – if not cured immediately, lender will likely seek appointment of receiver
 1. Loan goes to special servicing
 2. Default interest and other fees are assessed
 3. Lender inserts Receiver
 4. Pre-negotiation agreement needs to be signed by TICs
 5. Negotiate a forbearance agreement (loan modification)
 6. Capital call will be required to get any concessions from lender
 7. If owners will not contribute or it is not recommended – Deed in Lieu of Foreclosure is better than lender foreclosure.

Loan Defaults, *contd.*

- Non-monetary loan defaults
- Capital Gains Tax Issues with Deed in Lieu of Foreclosure or Foreclosure

Loan Modification Agreements

- Owner capital call – partial cure
- Interest only
- Lower interest rate
- Defer principal
- Defer / waive default interest
- Release reserves
- Eliminate non recourse guarantees
- Return to regular servicing
- Release property from Receivership

Tax And Securities Law Issues

- Can the ability to engage in a subsequent like kind exchange be preserved
- Tax consequences of conversion to a multi-member LLC
- Securities law concerns

The End!

Edward J. Hannon
Michael A. Moynihan
Freeborn & Peters LLP
311 S. Wacker Drive
Suite 3000
Chicago, Illinois 60606

ehannon@freebornpeters.com

mmoynihan@freebornpeters.com

Coni S. Rathbone
Davis Wright Tremaine LLP
1300 SW Fifth Avenue
Suite 2300
Portland, Oregon 97201

conirathbone@dwt.com