Strafford

Presenting a live 90-minute webinar with interactive Q&A

Tenant-In-Common Workouts: Latest Developments

Strategies for Owners, Sponsors, Brokers and Lenders Evaluating TIC Workout Options

MONDAY, JUNE 17, 2013

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

Today's faculty features:

Coni S. Rathbone, JD, CRE, Shareholder, **Zupancic Rathbone Law Group**, Lake Oswego, Ore.

William M. Levinson, Co-Chair Financial Services Industry Practice Group, **Fox Rothschild**, Los Angeles

Gary W. Marsh, Partner, **McKenna Long & Aldridge**, Atlanta

The audio portion of the conference may be accessed via the telephone or by using your computer's speakers. Please refer to the instructions emailed to registrants for additional information. If you have any questions, please contact **Customer Service at 1-800-926-7926 ext. 10**.

Tips for Optimal Quality

Sound Quality

If you are listening via your computer speakers, please note that the quality of your sound will vary depending on the speed and quality of your internet connection.

If the sound quality is not satisfactory and you are listening via your computer speakers, you may listen via the phone: dial **1-866-871-8924** and enter your PIN when prompted. Otherwise, please **send us a chat** or e-mail **sound@straffordpub.com** immediately so we can address the problem.

If you dialed in and have any difficulties during the call, press *0 for assistance.

Viewing Quality

To maximize your screen, press the F11 key on your keyboard. To exit full screen, press the F11 key again.

Continuing Education Credits

FOR LIVE EVENT ONLY

For CLE purposes, please let us know how many people are listening at your location by completing each of the following steps:

- In the chat box, type (1) your **company name** and (2) the **number of attendees at your location**
- Click the SEND button beside the box

If you have purchased Strafford CLE processing services, you must confirm your participation by completing and submitting an Official Record of Attendance (CLE Form).

You may obtain your CLE form by going to the program page and selecting the appropriate form in the PROGRAM MATERIALS box at the top right corner.

If you'd like to purchase CLE credit processing, it is available for a fee. For additional information about CLE credit processing, go to our website or call us at 1-800-926-7926 ext. 35.

Program Materials

If you have not printed the conference materials for this program, please complete the following steps:

- Click on the + sign next to “Conference Materials” in the middle of the left-hand column on your screen.
- Click on the tab labeled “Handouts” that appears, and there you will see a PDF of the slides for today's program.
- Double click on the PDF and a separate page will open.
- Print the slides by clicking on the printer icon.

Tenant-In-Common Workouts: Latest Developments

Coni S. Rathbone, J.D., CRE

Coni@zupgroup.com

ZUPANCIC RATHBONE
LAW GROUP, P.C.

(503) 941-9621 direct ~ (503) 704-2795 cell

4949 Meadows Road, Suite 600, Lake Oswego, OR 97035

ZUPANCIC RATHBONE LAW GROUP, P.C.

Current State of TIC Deals

1. CMBS Loans Maturing through 2017
   - Limited Refinancing Available in TIC Structure, Must do 721 Roll-Up
2. Servicers Becoming More Inflexible:
   - Few, if any, DPOs
   - Some AB Structures
   - PNAs Advance Waivers are Back
3. More TIC Sponsors Going Under
4. New Equity Available

TENANT-IN-COMMON WORKOUTS: LATEST DEVELOPMENTS

Mark Levinson, Partner,
Co-chair of Financial Services Industry Practice Group

Fox Rothschild, LLP, Attorneys
1800 Century Park East
Suite 300
Los Angeles, CA 90017
310.228.2133
MLevinson@foxrothschild.com

Fox Rothschild LLP
ATTORNEYS AT LAW

Legal Disclaimer

The information contained in this PowerPoint is for information purposes only and not for the purpose of providing legal advice. Nothing contained in this outline is to be construed as the rendering of legal advice. Readers are responsible for obtaining any legal advice with respect to the matters discussed in this outline from their legal counsel.

We are not responsible for any errors or omissions, or for the results obtained from the use of this information. All information in this site is provided "as is", with no guarantee of completeness, accuracy, timeliness or of the results obtained from the use of this information, and without warranty of any kind, express or implied, including, but not limited to warranties of performance, merchantability and fitness for a particular purpose. In no event will the authors of the information contained herein, their respective related partnerships or corporations, or the partners, agents, employees, trustees thereof be liable to you or anyone else for any decision made or action taken in reliance on the information in this outline or for any consequential, special or similar damages, even if advised of the possibility of such damages.

Introduction: TIC Workouts

General

- Most TIC loans are structured as non-recourse.
- Most TIC loans contain a non-recourse carve-out allowing the lender/servicer to accelerate the entire amount of the TICs allocable share of the loan.
- Most TIC loans provide the lender/servicer the right to replace the TIC investment program sponsor/property manager under the TIC Agreement.

Introduction: TIC Workouts

General

- Rev. Proc. 2002-22 tax ruling plus rapid rise in real estate values in the 2000s created "perfect storm" of opportunity for real estate investors rolling out of income producing property to jump on pooled TIC investment structure to own bigger and better professionally managed income producing real estate assets and defer tax on the gain from their real estate sold.

- 2008 real estate recession adversely impacted TIC owned real estate in the same fashion as any other investor owned real estate project.

- TIC owned real estate investors must make many strategic decisions that are handled differently than the single borrower structure.

Introduction: TIC Workouts

From the Borrower's Perspective

▪A TIC workout involves control issues among multiple borrower/investors and securities, tax and bankruptcy law issues because

- the property ownership and decision making is divided among many owners who cannot individually control the real estate asset (100% consent of TICS necessary to recast loan);
- the property ownership and decision making is effected through a somewhat cumbersome “tenant in common agreement” to direct a manager as to how to handle significant property related issues;
- the limited financial wherewithal of some TIC owners to fund capital calls to mitigate the impact of project revenue shortfalls (term limited under IRC to 31 days);
- Lenders/Servicer limitations on their powers.

Introduction: TIC Workouts

Lender/Servicer Perspective - unique complexities of TIC workouts

▪seeks control over workout process and borrower (cooperation among borrowers).

▪Seeks to avoid dealing with multiple borrowers.

▪may need to deal with borrowers with limited liquidity.

▪may need to deal with unsophisticated investor/borrowers.

▪Sponsor/manager viability as TICs may know nothing about the kind of asset they purchased (*i.e.*, apartments, office buildings, multiplexes, single family or condo rentals, raw land, farms, ranches, commercial and industrial properties).

Introduction: TIC Workouts
(COLLATERAL ISSUES)

Overview of collateral issues considered in a TIC workout

- **Documents.** How broad are provisions? Covenant defaults? Triggers of non-recourse carveouts? Sufficient to create a valid first priority enforceable lien? guarantees? transferability of interest provisions.
- **Structure**. Does TIC structure comply with federal and state securities laws?
- **Capital requirements?** If so, likelihood of TIC bankruptcy (automatic stay on filing shield filing TIC from performance under TIC Agreement)?
- **Tax status** of each TIC? SPE?
- **Subordination** of TIC Agreement to mortgage/deed of trust.
- **Tax Structure**. Rev. Proc. 2002-22 - avoid taking action that will disqualify the transaction for tax deferral.
- Consider fees to be paid to Sponsors or their affiliates (to be sure the fees are FMV)
- **Manager**. Consider the manager and other operators (determine capability and viability). Do documents provide efficient mechanism for removal of the manager of the TIC? Requirements to replace the old manager with a new one? (scope of indemnifications required by new manager?).
- **Securities**. Any claims against sponsor/broker-dealer/other?

Introduction: TIC Workouts

▪Loan workouts often rise or fall on the borrower's ability to bring the loan into "balance". Balance often depends upon equity in the asset or additional capital being injected into the transaction to facilitate a modification or cure. Lenders/servicers have little room to negotiate where

- the high loan-to-value ratio structures of some TIC investment programs limit owner equity availability, or
- Sponsor/manager's financial problems (or existence) limit efficient property management of a property and often impact project revenues, complicating cash availability.

▪Result has been foreclosure and severe losses to both TIC owners and sponsors who have filed for bankruptcy.

Introduction: TIC Workouts

Tax consequences of a workout or the effect of foreclosure/ loss of property to the TIC investor include:

- economic loss
- tax recapture
  - based on the initial gain plus interest on that amount; and
  - tax penalty - 25% penalty on tax owed

Multi-party Structure of TICs
(UNIQUENESS OF A TIC INVESTMENT)

Overview of tax and securities law issues relating to TIC investment structures:

•**Federal securities law definitions of "interests in a partnership" does not control interpretation of the tax laws.** The fact that TIC interests are typically investment contracts under securities laws does not inherently disqualify them as property that may be exchanged under Section 1031.

•**State law and federal law differ** and characterization of an arrangement as not a security under state law does not mean that the transaction as structured would not be a security under federal law.

Multi-party Structure of TICs (UNIQUENESS (cont'd))

Securities Laws

•TIC interests offered and sold together are considered investment contracts and therefore considered securities under the federal securities laws.

•An "investment contract" is any contract, transaction or scheme where persons invest money in a common enterprise with the expectation of profits to be derived predominantly from the efforts of others through leasing contracts, management and operation of the acquired property.

•TIC interests are generally investment contracts because the TICS invest in an undivided fractional interest in the rental real property by pooling their assets and sharing in the risks and benefits of the enterprise, while obtaining profits.

Multi-party structure of TICs (Rev. Proc. 2002-22)

Tax considerations

- Section 1031 rules prohibit title to real property to be exchanged for interests in legal entities that own real property.

- In March 2002, IRS issued Revenue Procedure 2002-22, 1C.B. 733 and changed that rule.

- Rev. Proc. 2002-22 established conditions under which IRS would consider a request for a ruling that a TIC interest in rental real estate was not an interest in a partnership.

Multi-party Structure of TICs

Basics:

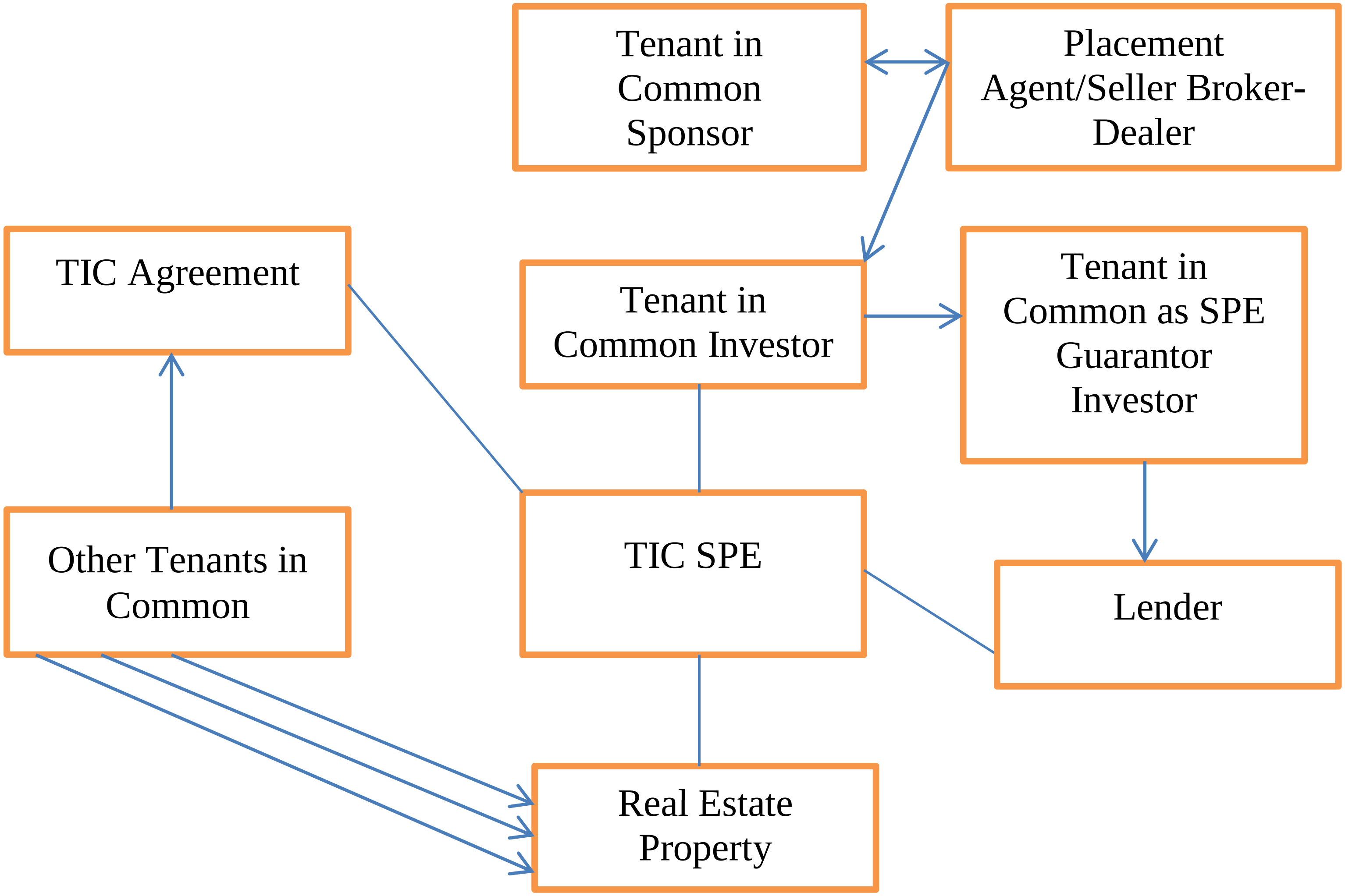
- Central elements of a tenancy in common
  - each owner is deemed to own individually a physically undivided part of the entire parcel of property.
  - each investor has a separate but undivided right in the economic benefits and burdens deriving from ownership of the property.
- This "separate but undivided" interest allows the TIC to sell, finance, bequeath and encumber without the consent of knowledge of the other TICs.
- Decisions affecting the property become challenging absent some agreement otherwise between the TICs.

Multi-party Structure of TICs

Basic Primary parties to a TIC syndication:

- Real estate promoter (often referred to as "**Sponsor**") who often act as manager, leasing agent, broker upon sale of the property.
- Investors/TICs.
- Lenders/Servicers.
- Broker-Dealers, Placement Agents, Financial Advisors/Registered Representatives (often, facilitators of the sale of the investment to the TIC).

Multi-party Structure of TICs Organization Chart



Multi-party structure of TICs

<u>Explanation of prior chart</u>

•investor owns the property in common with the other tenant-in-common investors.

•Each investor enters into a control agreement among the TICs known as “Tenant in Common Agreement” (“**TIC Agreement**”).

– controls relationship between the TICS; and

– controls relationship between the “manager” and TICs relating to operation of property.

Multi-party structure of TICs
(LOAN DOCUMENT REQUIREMENTS)

Checklist for Lender documents:

•Each TIC a single purpose, bankruptcy remote entity (SPE) to minimize bankruptcy exposure?

•TIC Agreement subordinated to the mortgage/deed of trust to limit title concerns.

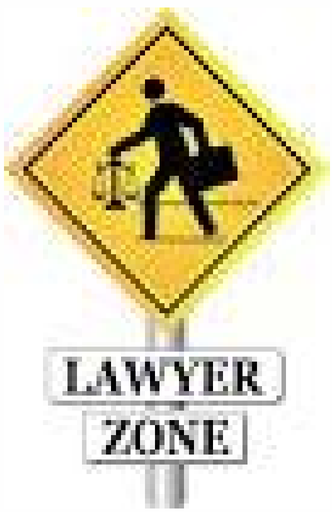
•all loan documents signed by each TIC to avoid foreclosure limitation on the interests actually pledged?.

•Limitations on transferability (consistent with Rev. Proc. 2002-22 that allows for restrictions that are customary in commercial lending)?

•In California, each TIC waived the right of partition (i.e., end the tenancy in common) so as to avoid a forced sale of the property and unwinding the loan transaction?

Conflicts of Interest in Selecting Legal Counsel

1. Borrowers Advocates vs. Legal Counsel
2. Experienced TIC Workout Counsel vs. Local Counsel
3. Sponsor Counsel / Owner Counsel
   - If Sponsor Selects Counsel, Whose Interest Does Counsel Represent
4. Representing multiple Groups with same Asset Manager
   - No Conflict
   - Economies of Scale



Sponsor Problems

1. Poor Asset/Property Management
2. Poor Communication
3. Small Portfolio of TIC properties / Small Company
4. Insolvency
5. Bankruptcy
6. Sponsors Fight to Keep Properties That Want to Leave
7. Sell Management Contracts Like Chattel

Methods to Terminate Sponsor

1. Annual Termination, if Asset Management
2. Termination for Cause
3. Cooperative Termination
4. TIC Ø Often Biggest Challenge

Goddard Cartoon ©PharmaVentures; all rights reserved

Transition Issues

- Replace Sponsor
  - Master Lease vs. Asset Management
  - Exit Fees
  - New Money
  - Lender Consent Required / Transfer of Loan
  - Loan Guarantors
  - Lender Fees

LENDER CONSENT/NON-RECOURSE CARVE-OUT GUARANTEES

Nonrecourse loan?

- **Expansion of Exposure:** Since 2008 real estate recession, we've seen surprise expansions of borrower and guarantor liability in nominally non-recourse loans up to full amount of loan.
- Case law is revealing a steady march to broaden that exposure to include obligations to properly maintain the property and preserve its value or violate financial covenants.

- **Exceptions to nonrecourse** commonly referred to as "bad boy" provisions.
- Document carveout exceptions to nonrecourse mortgage provisions have evolved from the traditional borrower "bad acts," such as fraud and material misrepresentation and the diversion of the loan proceeds.
- Exclusion from nonrecourse loans now includes matters of conduct (or inaction or misconduct) related to the economic performance of the property. For example, misapplication of rental income, environmental contamination of the property, and physical or economic waste of the property.

LENDER CONSENT/NON-RECOURSE CARVE-OUT GUARANTEES

"Non-recourse" does not mean "without recourse".

- Courts that have ruled on the validity and enforceability of carveouts to nonrecourse provisions have supported a trend to construe them in favor of lenders and rejected borrower's efforts to limit lenders taking advantage of overly broad terms in loan documents to accelerate foreclosure and recover the full amount of a loan.

- In the Bankruptcy context, Courts generally have construed non-recourse carveouts in favor of lenders, rejecting borrower and guarantor claims of ambiguity, merger, lack of harm, or invalidity.

LENDER CONSENT/NON-RECOURSE CARVE-OUT GUARANTEES

Example of expansion of scope of non-recourse carve-out :

- A special purpose entity borrower negotiated and closed a $33 million non-recourse mortgage loan with its lender.
- The SPE guarantors guaranteed the loan obligations of the SPE.
- The loan was secured by a first trust on the commercial property.
- The loan terms included typical carveouts from the non-recourse provisions, covering acts such as waste, fraud, environmental, transferability and other recourse triggers.
- The SPE negotiated a zoning settlement with its next door neighbor. The SPE didn't tell the lender that it received $2 million dollars. Neither did the guarantors tell the lender they split the $2 million dollars.
- The SPE later stopped making payments on the loan and asked the lender to make the missed payments from the loan reserve.
- The lender's reply was, without giving any notice or opportunity to cure, to accelerate the loan, foreclose on the property, and pursue a deficiency claim of over $10 million.
- The SPE defended and claimed that the lender breached the terms of the loan and wrongfully foreclosed.
- The lenders claimed that the SPE and its underlying guarantors, breached the loan agreement and some of the "bad boy" carveouts.

LENDER CONSENT/NON-RECOURSE CARVE-OUT GUARANTEES

NONRECOURSE CARVEOUT PROVISIONS ARE NOT UNENFORCEABLE LIQUIDATED DAMAGES PROVISIONS.

- Non-recourse carve-out clauses are not considered liquidated damages provisions because they operate principally to define the terms and conditions of personal liability, and not to affix probable damages.

- Non-recourse loans may create issues of a borrower's motivation to act in the best interest of the lender and the lender's collateral, “lenders identified defaults that posed special risks and carved them out of the general nonrecourse provision.

- The carve-out clause is not a liquidated damages provision for another reason: it provides for only actual damages. Unlike the typical stipulated damages provision which reasonably estimates an amount otherwise difficult to compute, the carve-out clause permits the lender to recover only damages actually sustained, namely the amount remaining on the loan at the time of breach. Such an amount is fixed by the terms of the loan and is therefore neither speculative nor incalculable.

LENDER CONSENT/NON-RECOURSE CARVE-OUT GUARANTEES (BANKRUPTCY LINE)

The Bankruptcy line "ipso facto" clauses:

What about bankruptcy-contingent liability unenforceable under § 365(e) of the Bankruptcy Code?

Section 365(e) prohibits the enforcement in bankruptcy of "ipso facto" clauses in executory contracts (*i.e.*, provisions that provide for the termination or modification of the contract conditioned solely on the insolvency or financial condition of the debtor or the commencement of a bankruptcy proceeding).

Courts have rejected this argument as the ipso facto prohibition applies only to executory contracts, not mortgages, and that once the bankruptcy case had been dismissed the enforceability of the carveout was a matter of state law rather than bankruptcy law. The federal bankruptcy policy of providing a debtor with a fresh start and an opportunity to reorganize were not present in a foreclosure proceeding.

LENDER CONSENT/NON-RECOURSE CARVE-OUT GUARANTEES (BREACH OF COVENANT)

MERE BREACH OF A COVENANT CREATES FULL RECOURSE LIABILITY NOT THE STANDARD OF BLAMEWORTHINESS (i.e., within borrower's control)

3rd party lien placed on property without knowledge of SPE?

The borrower typically will strongly resist the imposition of conditions or covenants that would <u>negate</u> the nonrecourse provision and result in full personal liability, and will attempt to limit the lender's remedies to ***foreclosure*** *and other rights solely related to the property (or, at most, quantifiable and limited damages).*

<u>The following are examples of the types of "bad acts" of most concern to lenders</u>, the breach of which many lenders believe should result in the imposition of full recourse liability against the borrower because they are within the <u>sole control</u> of the borrower:

- *violation of the due-on-sale-or-encumbrance clause;*
- *violation of the prepayment premium provision;*
- *the voluntary filing of a bankruptcy or reorganization proceeding;*
- *contesting the lender's foreclosure action or asserting a "lender liability" claim, affirmative defense, orcounterclaim;*
- *environmental contamination of the property; and*
- *fraud and material misrepresentations regarding the borrower, the loan, the rental income from the property, or the condition of the property.*

LENDER CONSENT/NON-RECOURSE CARVE-OUT GUARANTEES (BREACH OF COVENANT)

New Jersey – *CSFB 2001-CP-4 Princeton Park Corporate Center, LLC v. SB Rental I, LLC,* 980 A.2d 1 (N.J. App.Div. 2009) where the appellate court held that a bad boy/carve-out provision was enforceable.

Case involved a $13 million non-recourse loan where the borrower cured a default. The court held that curing a bad boy default didn't **reset the clock** for the borrower and the borrower was liable for the entire loan amount.

In *Princeton*, the bad boy guarantee prohibited the borrower from future subordinate financing secured by the subject property **without the lender's consent**. The borrower obtained $400,000 in subordinate financing secured by a second lien on the property without the first mortgage holder's consent.

The borrower paid off the second loan but defaulted on the primary loan after the payoff. After foreclosing, the lender brought suit against the borrower and the borrower's principals (who had executed bad boy guaranties) for the deficiency. (con't)

LENDER CONSENT/NON-RECOURSE CARVE-OUT GUARANTEES (BREACH OF COVENANT)

- The borrower and its principals argued that the carve-out was unenforceable because the lender had suffered no harm, because the **second loan was paid off before the default** on the first lien.

- The court concluded the carve-outs were unambiguous and part of a commercial transaction negotiated by sophisticated parties. The court also concluded that the timing of the default (*i.e.,* that the prohibition against the second loan) was later cured because the loan was paid off did not change the fact that the borrower already blew the bad boy provisions which arguably adversely affecting the lender's security therein.

- Decision seemed to turn on (1) the **level of sophistication** of the parties and (2) the fact that the default was a **voluntary act**. Also, the damage, or potential damage, to the lender's interest was clear. On the other hand, the more recent laundry list of bad boy provisions often includes such acts as seeking bankruptcy protection or contesting the appointment of a receiver during a foreclosure – actions that are arguably statutory rights (federal or state) and may be looked at differently than a simple contract violation.

LENDER CONSENT/NON-RECOURSE CARVE-OUT GUARANTEES (BREACH OF COVENANT) ING REAL ESTATE FINANCE V. PARK AVENUE HOTEL

ING Real Estate Finance (USA) LLC v. Park Avenue Hotel (2010).

Court refused to enforce a non-recourse carveout provision in the loan documents that would make guarantors fully liable on a $90M loan.

Lender claimed borrower and guarantors violated the terms of a "Full Recourse Event" clause contained in the Credit Agreement because the borrower didn't pay about $300,000 of real estate taxes, which resulted in a **tax lien** against the property where the loan agreement explicitly provided for a **30-day grace period to cure** (the delinquent taxes were paid in full 6 days).

Lender argued that borrower breached the loan agreement because borrower incurred "Indebtedness" (as defined in the Credit Agreement to include "obligations secured by any Liens, whether or not the obligations have been assumed").

Lender asserted that the borrower's failure to timely pay the real-estate taxes was a Full Recourse Event under the Credit Agreement, and that the Guaranty Agreement executed by the guarantors concurrently with the loan agreement provided that the guarantors' full liability would be triggered in the event of the occurrence of such a Full Recourse Event.

LENDER CONSENT/NON-RECOURSE CARVE-OUT GUARANTEES
LIQUIDATED-DAMAGES ANALYSIS IN ING

The court reasoned that where a document contains conflicting or contradictory language, "specific provisions control over general provisions." The court deemed the provision providing the cure period to be the more specific provision because otherwise other provisions of the loan agreement would be read out of the loan agreement or rendered meaningless (such as the provision entitling the borrower to contest any tax lien).

The court also noted that under New York law, the terms of a guaranty are to be strictly construed in favor of the guarantor(s). The court in effect applied a liquidated-damages analysis to this issue, stating as follows:

▪Immediate liability for the entire debt is not a reasonable measure of any probable loss associated with the delinquent payment of a relatively small amount of taxes.

BAD FACTS in ING?

- The lender would end up having the borrower potentially liable for the entire debt of up to $145 million if the Borrower is just one day delinquent in paying a dollar in property taxes or any other debt for which a lien may be imposed.
- Such an unlikely outcome could not have been intended by the parties, sophisticated commercial borrowers and lenders aided by competent counsel at the time of the drafting.

Bad facts?

The court struggled to reconcile the conflicting non-recourse and carveout provisions in the loan agreement, and most likely favored the guarantors in this case because the events allegedly triggering full recourse liability were of little consequence, of short duration, and did not adversely affect the interests of the lender, whereas the consequences to the guarantors were extreme and not reasonably related to the lender's actual or anticipated damages under a liquidated-damages analysis.

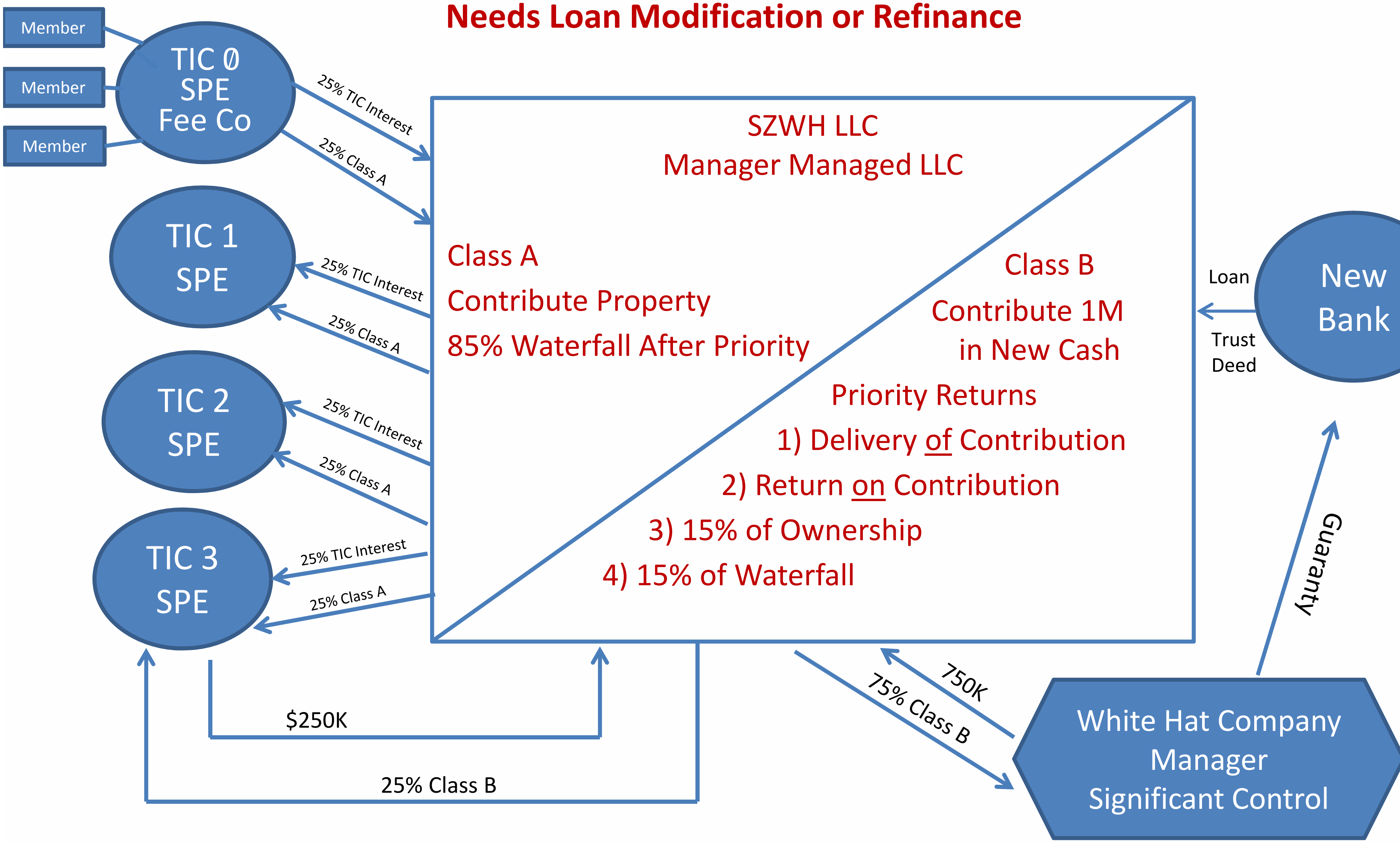
Change in Structure

- Amended Master Lease
- Master Lease to Asset Management
- Changing Asset Managers
- IRC 721 Roll Up
- New Money
- Exchange REIT or DST or Fund

Most Common Structure Change

- New Money
- 721 Roll Up Required into LLC
- Owners Contribute Ownership for Class A
- New Equity Providers Contribute New Money for Class B
- Priority Returns
- Ownership Percentage

New Structure for Sponsor Z Withering Heights Property
$1,000,000 New Money Needed for LC & TI
Needs Loan Modification or Refinance



ZUPANCIC RATHBONE
LAW GROUP, P.C.

Features

1) Opportunity for Original TIC Owners to Participate in New Capital and Not be Diluted

2) Manager wants significant control

   - Preserve for Owners Lock Out

   - Period for Sale

3) Negotiate Best Waterfall Possible

Capital Calls

No One Can be Forced to Participate, Except through Litigation

Before Contributing Identify Exit Strategy

Consider New Money

TIC Bankruptcies

Gary W. Marsh, Esq.
McKenna Long & Aldridge LLP
303 Peachtree Street, NE
Suite 5300
Atlanta, Georgia 30308
Phone: (404) 527-4150
Email: gmarsh@mckennalong.com

TIC BANKRUPTCIES

- Risk of TIC Bankruptcies in Numerous Venues
- Applicability of Section 362 Automatic Stay to Foreclosure Sale of TIC Property
- State Law and Ability to Foreclose Multiple Times

McKenna Long & Aldridge LLP

Defeating the First TIC Bankruptcy Case

- Cash Collateral Issues
- Ability to Keep Receiver in Possession

McKenna Long & Aldridge LLP

Defeating the First TIC Bankruptcy Case

- Motion for Relief for Bad Faith Filing
- Motion for Relief for No Equity and No Possibility of Plan
- Motion For Relief From Stay Based on Special Single Asset Real Estate Provisions
- Object to Motion to Extend Exclusivity and/or Motion to Terminate
- Object to Disclosure Statement
- Object to Confirmation Plan
  - Plan Objections: Failure to Satisfy 1129(a)(10) Requirements
  - Plan Objections: Violation of 524(e)

McKenna Long & Aldridge LLP

Defeating Subsequent TIC Bankruptcies

- Obtain In Rem Relief
- 362(d)(4) Intent to Hinder, Delay or Defraud Creditors

TIC Bankruptcies

<u>See</u> Marsh and Gordon, “Lender Strategies for Dealing with Commercial TIC Bankruptcies,” <u>American Bankruptcy Institute Journal</u>

Tax Issues - SALIENT ELEMENTS [IVB]

Under Rev. Proc 2002-22, failing to adhere to the 15 elements is not fatal to a structure but it tends to open the door to IRS challenge and loss of a 1031 exchange. Thus,

1. There can be no more than 35 TICS.
2. All of the TICs (100%) must retain the right to approve the hiring of the property manager and the property management contract, approve the sale or other disposition of the real property and all leases, loans and their modification.
3. All of the revenue from a property sale, after debt service, must be distributed to the TICs.
4. All leases must be at fair market value.
5. Compensation to Sponsors must be at fair market value and cannot be based on income or profits arising from the operation of the property.
6. TICs must share in all revenues and expenses of the property according to their ownership percentage.
7. Neither the TICs nor the Sponsor may loan money to other TICS for expenses unless the loan is recourse to the borrower and isn't longer than 31 days.
8. TIC may engage only in customary activities associated with maintenance or repair of the real property.

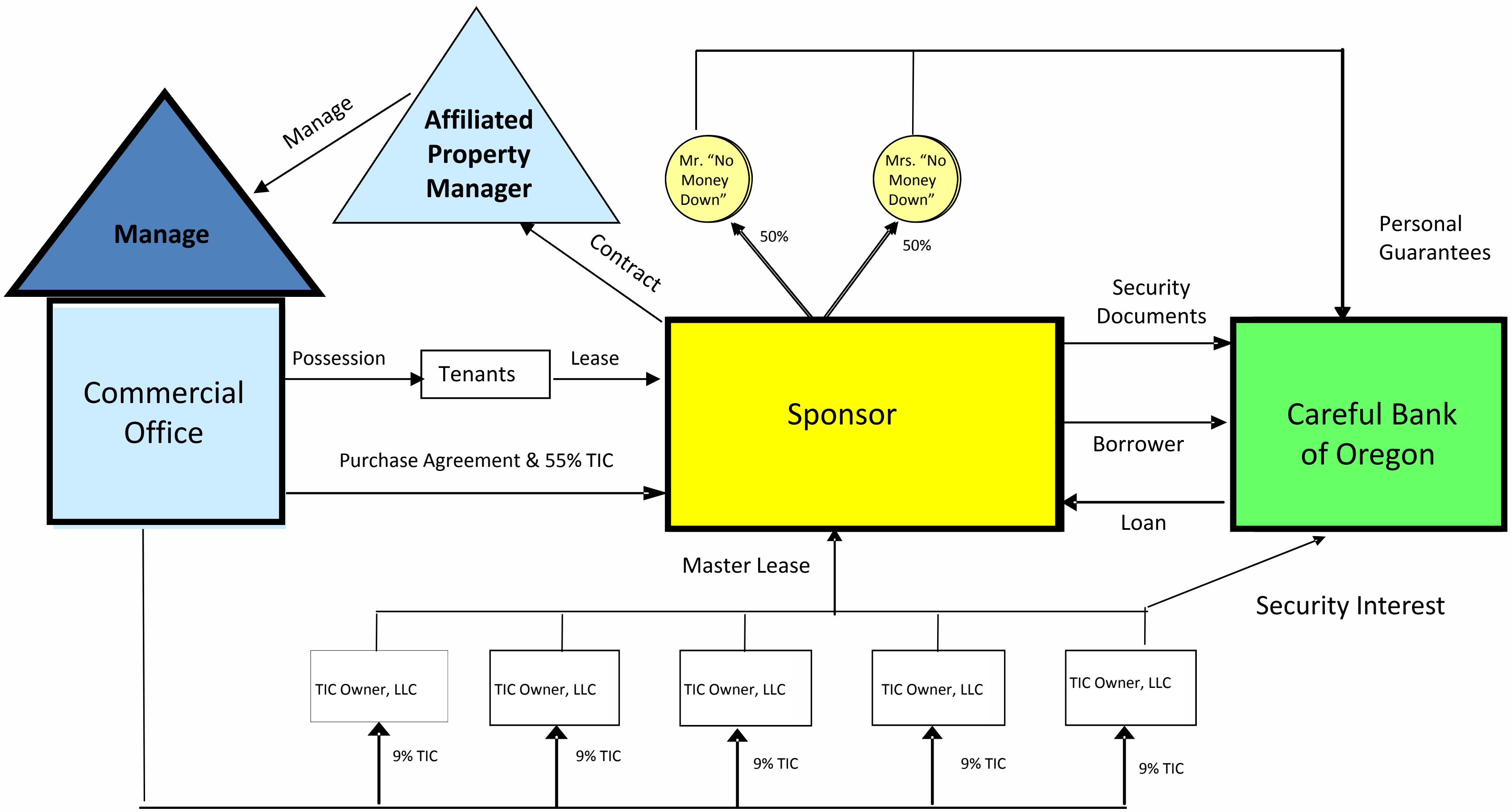
What is a Security?
The Howey Test & The Orange Grove

Scenario: A promoter sold rows of fruit trees to different investors and offered to sell them contracts with an affiliate to grow, tend and harvest the fruit.

1. Investment of Money;	1. Investors gave money to Promoter for the Trees and Investment Contract
2. In a Common Enterprise;	2. The Entire Grove of Oranges was a Common Enterprise, which Rose and Fell in Profit/Loss as a Unit
3. With Expectation of Profit, and	3. The Investors Expected Profit from the Sale of the Oranges
4. Based Solely or Primarily on the Efforts of Others (Promoter/Third Party)	4. The Primary Effort of Growing and Harvesting was Provided by Parties Other Than the Investors

Moral: Purchase of an interest in a physical asset (trees) does not avoid a security classification.

TIC Security



Sponsor Master leases Property No TIC owner approval of leases or form of lease.

Sponsor uses affiliated Property Manager.

Sponsors Borrower under loan

Sponsors principals guaranty loan

TIC Interests Were Securities on Structuring Are Likely Securities on Restructuring

- No Security if Master Lease to Asset Manager
- No Security if Change in Asset Manager
- Yes, Security if 721 Roll Up
- Yes, Yes, Security if Owners Contributing New Money
- Big Problem, Many Owners are No Longer Accredited