



# Commercial Real Estate Risks and Liabilities in an Uncertain Economy

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# The State of Affairs

## Business:

- A scary time – the winds of change are blowing in
  - Forecasting costs and returns
  - Capital markets
  - Deal flow

## Litigation:

- Pipeline of disputes increasing
- Interest in resolving matters waning
- Tempers are flaring



# The Capital Stack

## Loans & Guarantees

- Negotiating guarantees “heavily” at the term sheet stage
- Non-recourse provisions
- Considering impairment of collateral waivers



# Loan “War Stories”

- Pledge requirements
- Payoff letters with releases



# Joint Ventures (“JV”) – Marriage and Divorce

## Numerous considerations that are featured in a cooling economy:

- Management control
- Major decision provisions
- Management removal
- Capital calls
- Put/Call options
- Drag to market
- Guaranteed internal rate of return (“IRR”)
- Removal from guarantees
- Removal of members

# Management Control

“Management” is a reference to the person or persons vested with the authority to manage the Company’s affairs. The Company is a “manager-managed” limited liability company. However, the term “Management” (i) *includes* Investor whenever Investor’s consent or approval is required and (ii) means Investor alone if Operator has been removed as Manager.

- a) *Exclusive Right to Manage.* Subject to paragraph (c), Manager shall have the authority to operate, manage and conduct the affairs of the Company.

## Management Control (cont.)

- b) *Power and Authority.* Without limiting the generality of the foregoing, and consistent with the purposes of the Company, but subject to paragraph (c), Management shall have all of the rights, powers and authority under the Act and otherwise as provided by law, including the right, power and authority to acquire assets; purchase goods and services; sell, exchange, lease, license or otherwise deal in or with any and all assets of the Company; merge or consolidate the Company into or with one or more other companies; open and maintain one or more bank accounts and designate (and change the designation of) signatories thereon; borrow funds to finance the Company's activities and in connection with such borrowing, mortgage, hypothecate, pledge, lien or otherwise encumber the revenues and assets of the Company; guaranty the debts of affiliates and others when Management believes it will benefit the Company to do so; confess, settle, compromise or otherwise satisfy debts, claims, judgments and other obligations, including by way of a deed in lieu of foreclosure or similar transaction; enter into any contract or agreement or amend or cancel the same; and invest and reinvest any funds or other assets of the Company – all as incident to or necessary for the operations of the Company. Without limitation of the foregoing, but subject to paragraph (c) and Section 11.2, Management has the right, power and authority to sell, exchange or otherwise dispose of all or substantially all of the Company's assets, irrespective of whether such a transaction is not in the ordinary course of the Company's business.



# Major Decision

*Major Actions.* Notwithstanding any other clause in this paragraph, Operator shall not be authorized to take (and shall not take) any of the actions that are set out in EXHIBIT 8.2(c)(v) (each a “Major Action”) without the approval of Investor.

## Possible Types of Major Decisions:

- Sale or transfer of JV assets outside ordinary course
- Operating Budgets and Business plans
  - Increase in line items by more than \_\_\_\_% or \$\_\_\_\_\_
  - Increase in aggregate budget by more than \$\_\_\_\_\_
- Merger, reorganization, dissolution, creation of subsidiaries
- Admission of new members (other than permitted transferees)
- Removal and replacement of Manager
- Major Contracts and Major Leases
- Affiliate Contracts
- Major Capital expenditures
- Amend JV Operating Agreement
- Engage in litigation or settle any claim over \$\_\_\_\_\_
- Making assignment for benefit of creditors, commencing BK proceeding or applying for receiver



# Management Removal

Investor shall have the right to remove Manager as Manager for Cause (as defined below) at any time upon written notice to Manager specifying the grounds for such removal (the “For Cause Removal Notice”). Manager shall be deemed to be removed as Manager hereunder upon Manager’s receipt of the For Cause Removal Notice, but Manager shall have the right to dispute Investor’s determination of Cause pursuant to the dispute resolution procedures set forth in Section 17.8, and if Manager prevails in such dispute resolution procedure, then Manager will be reinstated as Manager. As used herein, “Cause” shall mean the occurrence of any one or more of the following:

- (i) Fraud, Gross Negligence, Recklessness or Willful Wrongdoing.**
- (ii) Material Breach of this Agreement.**
- (iii) Material Breach of Affiliate Agreement.**

## Management Removal (cont.)

### **(iv) Loan Default Caused by Operator.**

(A) Any of Manager, Operator or Promote Interest Holder are no longer controlled, directly or indirectly, by the Key Person. As used in this clause, “controlled” shall have the meaning given to it in Section 1.2(c).

(B) Any of Manager, Operator or Promote Interest Holder are no longer owned, directly or indirectly, by Key Person. As used in this clause, “owned” shall mean ownership of at least 80 percent of the capital interests and profits interests in the entity.

(C) Key Person is not actively involved in the oversight and administration of Manager and the Property.

## Management Removal (cont.)

**(v) Target Financing Not Achieved.** If by \_\_\_\_\_, 201\_\_\_, the financing described in Section 7.3(c)(ii) has not been completed.

**(vii) Failure to Meet Performance Threshold.** The Property does not meet the Performance Threshold for two consecutive calendar quarters, commencing with the calendar quarter ending \_\_\_\_\_, 201\_\_\_. For purposes of this clause, “Performance Threshold” shall mean, for any applicable period, that the average occupancy for the Property for any such period is less than 90 percent of the average occupancy for other multi-family apartment properties located in the \_\_\_\_\_ submarket for multi-family apartment properties, as published by Reis, Inc. (or, if Reis, Inc. ceases to exist, a similar nationally recognized real estate market information company).

# Capital Calls

## When can it be required?

- With unanimous agreement of members
- If approved as a major decision (lesser standard than unanimous approval?)
- If necessary for operation of project, preservation of project, safety, or some other emergency (required by either member?)
- Operating Agreement itself can require additional capital in certain pre-negotiated circumstances

# Put/Call Options/Drag to Market

Either member may have right to buy or right to sell membership interests

— Be careful about Trigger Events

## Right of Sale (Drag to Market) Subject to Right of First Offer

- a) If at any time after the relevant date that a Member who is eligible to send a Sale Notice (as defined herein) wishes to invoke this section, such Member (the “Initiating Member”) shall first give written notice (the “Sale Notice”) to the other Member (the “ROFO Member”) of the Initiating Member’s desire to pursue such a sale (it being understood and agreed that no offer or proposal to purchase need be pending at the time the Sale Notice is given). The Sale Notice shall state the minimum price (the “Minimum Price”) at which the Property would be sold. A Sale Notice may be issued:
- i. By either Investor or Operator at any time after the \_\_\_th anniversary of the date of this Agreement.
  - ii. By Investor, if Operator has issued a For Cause Removal Notice under Section 8.1(c).
  - iii. By Investor, if there is an impasse in respect of any Major Action proposed by Investor and not agreed by Operator.



# Guaranteed return for IRR

- Not market
- Turning partner into lender/disguised loan

# Resolving Disputes

## Litigation (What jurisdiction? Does prevailing party get reimbursed?)

- Arbitration (by panel, single arbitrator, expert in a field?)



# JV “War Stories”

- DIVORCE – in every respect
- This is where the formalities and boilerplate matter (not just having the terms but following them)





# Landlord-Tenant

- Tenant needs – space shrinking
- Tenant financials
- Tenant guarantees
- Net worth/liquidity covenants
- There is not much to say here, other than matter after matter sees tenants who are simply unable to pay.
- Crime impacting habitability
- Office vs. Retail vs. Multifamily vs. Industrial



# Purchase and Sale Agreements

- Material Adverse Change
- Defeasance



# Any questions?

Ask us anything. We're happy to answer now,  
or connect with us later if you prefer.

## Connect with us



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# Purpose in practice

We cultivate deep business relationships that last and have seen our clients thrive beyond their expectations.

## Our services

We've structured our team to offer knowledge, experience, and creative thinking that put our clients' goals in reach.

### **REAL ESTATE**

We act as business partners and deal managers through the acquisition of commercial properties.

### **CORPORATE**

We work to understand and anticipate your needs through complex legal, tax, and business issues.

### **TRUSTS AND ESTATES**

We help clients achieve their business and personal goals through gift, charitable, and estate planning.

### **LABOR AND EMPLOYMENT**

We help clients achieve their business and personal goals through gift, charitable, and estate planning.

### **INTELLECTUAL PROPERTY**

We work diligently to protect our clients' ideas and products.

### **FINANCIAL SERVICES AND RESTRUCTURING**

We assess opportunity and risk to guide commercial lenders and borrowers.

### **COMMUNITY ASSOCIATION**

We are a one-stop shop to help navigate contract review, collections, governance, and more.

### **TAX PLANNING AND LITIGATION**

Our attorneys bring creativity, intellect, and pragmatism to the full range of tax matters.

### **LITIGATION**

We work to protect your assets: products, intellectual capital, human resources, and time.

