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Real Estate

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State of the Market

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State of the Market

- Current market turbulence and uncertainty
 - Interest rates
 - Recent bank failures
 - Recession worries
- Uninvested capital abounds
 - Investors are staying on the sidelines
 - Waiting for normalization
- Flight to quality
 - High-quality assets
 - Prime locations
 - Sustainability

State of the Market (continued)

- Increases in cost of capital and decreases in asset values
 - Refinancing challenges
- Active property sectors
 - Value-add and conversions
 - Life sciences and healthcare
 - Multifamily and SFR
 - Urban logistics and last-mile

Joint Venture Considerations

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Joint Venture Considerations

- **Formation and structure**
 - Limited partnership/limited liability company
 - State tax considerations
 - Real estate investment trusts
 - Financing goals and potential additional investors
- **Operating partners**
 - Experience
 - History of success
 - Vertically integrated
 - Programmatic relationships
- **Capital contributions**
 - Amount and frequency
 - Capital commitment
 - Remedies for failure to contribute

Joint Venture Considerations (continued)

- **Management and control**
 - Major decisions
 - Budgets and permitted variances
 - Fiduciary duties
 - Removal of manager
- **Exit mechanisms**
 - Permitted transfers
 - Drag-along and tag-along
 - Buy/sell
 - Forced sale
 - Put/call
 - Rights of first offer and first refusal

Preferred Equity Considerations

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Filling the Gap Between Debt and Common Equity

- Lower LTVs require alternative financing solutions
- Subordinate to debt
 - Mortgage lender recognition
 - Potential for loss
- Senior to common equity
 - Payment priority over common equity
 - Lower risk exposure than common equity
- Fannie/Freddie
 - Prohibition on subordinate debt; preferred equity permitted

Flexibility

- **Characteristics of debt**

- Specified fixed rate of return (“nonparticipating”)
- Obligation to make scheduled payments (“hard pay”)
- Maturity date
- Extension options
- Preferred equity reserve
- Carveout guarantee, completion guarantee, and environmental indemnity from principal
- From a federal tax perspective, can be considered debt

- **Characteristics of equity**

- Participation in profits (“participating”)
- No obligation to make scheduled payment; payments based on performance (“soft pay”)
- Negative control rights
- Right to remove manager
- Forced sale right

- **Distributions**

- Current return
- Accrued return

Broken Deals, Distressed Assets, and Workouts

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Broken Deals, Distressed Assets, and Workouts

- Currently, the real estate market is adapting to the new post-COVID “normal.” As such, certain asset classes are struggling, such as office, retail, and business hotel properties, and investors may have an interest to exit the investment or seek to “turn around” the investment
- Additionally, a partner may “fall out of love” with the asset over the term of the joint venture. For instance, a large institutional investor that is continually acquiring assets may determine that other assets in the relevant market are more attractive and thus seek to sell the property. An operating partner that is unlikely to achieve its promotion may not be willing to invest additional capital, whether financial or emotional, and may want to turn its attention to other investment opportunities.
- In a failed development project, the capital partner will probably want to get rid of the operating partner as soon as possible, but may also want to pull the plug on the entire project. The operating partner, on the other hand, even if behind in its “promote,” may want more time to complete the development and stabilization of the asset.

Broken Deals, Distressed Assets, and Workouts (continued)

- **Remedies/exit strategies**

- Drag-along and tag-along
- Buy/sell
- Forced sale
- Put/call
- Permitted transfers

- **Control mechanisms**

- Removal and replacement of manager of venture
- Removal and replacement of asset manager/property manager

Broken Deals, Distressed Assets, and Workouts (continued)

- **Third-Party Considerations:**

- Rights of Third-Party Contractors/Vendors upon a Change of Control
- Rights of Lenders upon a Change of Control – Mortgages Lenders / Mezzanine Lenders / Unsecured Lenders
- Releases of Transferring Venturers

- **Tax Considerations:**

- Treatment of Gains
- Step-Up in Basis
- Transfer Taxes
- Property Tax Reassessments

Investment Opportunities

- ❖ “Distressed-to-control” (or loan-to-own)
- ❖ Distressed Buyout Fund Investments

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Fred's practice covers all aspects of real estate investment, acquisition and disposition, development, and financing. He regularly represents institutional investors and owners in all aspects of project development, including land acquisition, parcel assemblage, formation, and capitalization of real estate investment joint ventures. His experience includes negotiation and documentation of construction contracts and design and development agreements for all real estate asset classes throughout the United States and the Caribbean. He also handles fund formation, fund investment, and investment management matters.

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Jarrold advises clients on forming and operating private investment funds, joint ventures, and other alternative investments. Fund sponsors and institutional investors turn to him for advice in connection with the formation and operation of private investment funds, complex joint ventures, co-investments, and managed accounts. Jarrod also advises his clients on federal income tax matters related to the formation and operation of private investment funds and joint ventures. He frequently counsels institutional investors in connection with their alternative investments.

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Eric advises clients on issues related to their ownership, use, and financing of real estate. Companies, large and small, including real estate investment trusts (REITS), Fortune 500 companies, privately held estate companies, and energy and utility companies, turn to Eric to help negotiate the real estate transactions most important to their business success. He also represents institutional investors in multimillion dollar real estate joint venture transactions.

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