CADWALADER

Updates, Changes and Cautions

February 25, 2020 | Issue No. 9

Table of Contents:

Negotiating Lender Approval Rights over Service Agreements for Hospitality and Other Properties

February 25, 2020 | Issue No. 9

By **Alan Lawrence**
Partner | Real Estate

Standard loan documentation for most commercial property classes typically includes lender approval rights over major commercial leases (subject to negotiated thresholds) and property management agreements.

Complex operating properties such as hotels, casinos, resorts and senior living facilities require extensive contractual relationships for services and goods that are important to the operation and financial success of these properties. These agreements may address somewhat standard services such as laundry service and waste removal for a domestic, city-center hotel but also may extend to somewhat exotic (but equally critical) services such as import services and water desalinization plant operations for a more remote destination resort. Agreements that are essential for the operation of these properties often include employment and union contracts, intellectual property and other licenses, online travel agency agreements, sports book and other gaming agreements, and contracts for headliner acts and other entertainment as well as major service contracts.

Lender's Concerns

A lender's diligence and underwriting typically will focus on the impact of major contracts on property cash flow and valuation. These contracts not only may represent significant expenses but, in the case of contracts with online travel agencies or entertainers, they may also provide significant revenue sources. Major contracts frequently cover services and amenities such as spa services and golf course maintenance that affect the property's value. A lender's concern that its real estate collateral becomes unduly burdened by costly service contracts that cannot be unwound easily must be balanced against the need for services and supplies that are essential to a property's continued operation and profitability.

Borrower's Concerns

In many ways, the interests of the property owner/operator and those of its lender are aligned with respect to major contracts. The property owner is concerned primarily with entering into agreements with suppliers and service providers that provide goods and services necessary for, and/or that enhance, the operations and revenue of its property on the best possible terms. However, the property owner and its property manager also need sufficient latitude to operate the property effectively, which may require making contract decisions quickly in order to obtain the best terms or the services of a contract party in high demand. In addition to its lender's requirements, the property owner and its manager must ensure compliance with standards imposed by franchisors, regulators and other third parties through service and supply contracts. Contracts satisfying the goals of all interested parties for an operating property such as a destination resort are not easily negotiated. For example, the lender's desire for relatively conservative contract terms with maximum flexibility may conflict with the terms necessary to secure licensing with a celebrity chef necessary to satisfy a franchise agreement standard for a flagged resort hotel. The owner/operator of a complex property will be focused on financing terms that allow it to act quickly and exercise its business judgement as to terms that are best for the operation and profitability of its property.

Loan Document Requirements

Lenders regularly seek to regulate the agreements to which its collateral property and borrower may become subject by imposing seemingly objective limitations on contract terms that do not require lender approval. Loan documents commonly require lender approval of service and supply contracts that (a) exceed a specified term, (b) cannot be terminated on limited prior written notice without payment of a penalty exceeding a specified amount, (c) require payments exceeding a specified amount, and/or (d) are not subordinate by their terms to a financing secured by the related property or equity interests in the property. This can be a rational approach for both the property owner/operator and the lender depending on the type of property involved. For a property requiring specialized services, such as operating a waste treatment plant or providing skilled nursing personnel, a term of only one or two years and the right to terminate the agreement on 30 days' notice with only a limited penalty may not be possible to obtain. A simple dollar threshold, such as all contracts providing for payments in excess of $1 million, may not adequately address contracts requiring variable payments based on use, consumption or a percentage of related revenue. Requiring a service

contract to include subordination language so that it may be terminated by a foreclosing lender may not correspond to the market standard or may be a concept that is completely unfamiliar to the supplier or service provider, depending on the jurisdiction and sophistication of the parties involved.

Further Considerations

When negotiating loan document provisions for service and supply contracts, the property owner/operator will want to involve its property management personnel familiar with the property's day-to-day operations to confirm that the criteria being imposed make sense in the context of the full range of such agreements necessary for the operation of the property, allow for sufficient latitude to negotiate the best terms for these agreements and can be understood and complied with by personnel regularly handling contracting for the property. A lender will want to candidly assess its likely servicing capabilities, considering whether its servicer will be equipped to evaluate the terms and provisions of contracts requiring lender approval and the volume of such contract reviews and approvals that its servicer can handle on a timely basis. Although borrowers frequently negotiate "deemed approval" language providing that a contract requiring lender approval is deemed approved under the loan documents if the lender or its servicer fails to reject or approve a contract submitted in the manner required under the loan documents within a specified time period, neither the lender nor the property owner should rely on this as a substitute for carefully considered approval parameters. Once those general parameters have been established in the course of negotiations, the parties and their counsel should ensure that they are sufficiently detailed to provide clarity for ongoing servicing and compliance. For example: (i) the loan document provisions describing contracts requiring lender approval should be clear about the various types of agreements that may have different approval criteria so that a definition intended to capture only property management agreements for the comprehensive management of the overall property is not so broad as to overlap with another defined term intended to capture contracts for more limited services at the property; (ii) limitations on the term of contracts not requiring approval should be clear as to whether the threshold term includes extension options; and (iii) any dollar threshold should be clear as to its application to variable payments and whether the amount applies to a 12-month period, the entire contract term or another time period.

Conclusion

Loan document provisions for lender approval of service and supply contracts for complex properties rarely receive the level of attention during negotiations that other major loan document provisions (such as those regulating transfers or leasing) typically receive. However, these provisions may produce uncertainty and unintended results for both parties, if not given adequate attention prior to closing.

Update on New EB-5 Regulations

February 25, 2020 | Issue No. 9

By **David Sheps**
Associate | Real Estate

On July 24, 2019, the U.S. Citizenship and Immigration Services ("USCIS") published a new rule with respect to the EB-5 Immigrant Investor Program (the "Program"). Congress created the Program, as part of the Immigration Act of 1990, to facilitate the creation of jobs during a recession when banks were reluctant to make construction loans. By offering lawful permanent resident status through the issuance of green cards, the Program provides a pathway to citizenship for foreign investors who make significant investments in new commercial enterprises that create at least 10 full-time jobs. While investors are eligible for the Program for investment in enterprises in any location in the United States, investments in certain areas, such as rural or high-unemployment areas which are deemed to be "Targeted Employment Areas" (or "TEAs"), allow investors to reap the benefits of the Program for a significantly smaller investment.

Investments of capital into a new commercial enterprise can be made either as an equity purchase or a loan. In the equity purchase option, which is the simpler option, the investor contributes capital directly into the job-creating project and, in turn, becomes an equity owner of the project. The loan option, however, necessitates an additional step because the USCIS requires that the investor's money be "at risk" throughout the immigration process and, therefore, the capital must be initially provided as equity, and not as a loan, to the job-creating project. To satisfy this requirement, the investor makes an equity contribution to an EB-5 fund, which, in turn, lends the money to the job-creating project. Although more cumbersome, the loan option is the preferred option of most investors as it offers a clear path to exit at the time of the loan's maturity.

Although critics, citing widespread abuse and allegations of gerrymandering of TEAs, have advocated for change to the Program for many years, the new rule is the first significant revision to the Program since 1993. In an effort to allow for a more fair and consistent process, and to alleviate the risk of gerrymandering, the USCIS eliminated states' ability to designate certain geographic subdivisions as high unemployment areas. Instead, the Department of Homeland Security (of which USCIS is a part) will be the sole decision maker as to the designation of TEAs and will follow a uniform but more strict standard. More importantly, however, the new rule raises the threshold investment amount needed to qualify for the Program by 80%. Previously, to be eligible for a green card, applicants were required to invest either $1,000,000 in a non-needy area or $500,000 in a TEA. Under the new rule, the minimum requirement was increased to reflect the rate of inflation since the Program's creation in 1990 to $1,800,000 for a non-needy area and $900,000 for a TEA, with such amounts automatically adjusting for inflation every five years.

As the new rule went into effect on November 21, 2019, we can't yet be certain how it will affect the market. However, the new standards for TEAs will likely reduce the number of eligible projects in major metropolitan markets, and the new threshold amount will require developers to work harder to raise capital from a smaller pool of investors who can afford to make the larger investment. Foreign investors may divert funds to other countries with less stringent investment requirements. As this source of alternative lending may dry up, developers may need to turn to more traditional lending sources to fund larger portions of their projects. Banks may need to decide if they are willing to increase leverage, and developers may be forced to inject more equity into their projects.

Despite these new hurdles, many industry analysts believe that the market will absorb the price increase. Over the past number of years, demand for the EB-5 visas has far exceeded the yearly allocation, and as such, a decrease in the number of applicants may not cause a decrease in overall investment. With the increased investment threshold, developers can raise the same amount of capital they previously raised, but from fewer investors. While the increased investment threshold and stricter designation guidelines will surely keep some investors from taking advantage of the Program, only time will tell if these changes will be beneficial or cause a widespread change to funding in the market.

Email Footers: Proceed with Caution

February 25, 2020 | Issue No. 9

By **William Lo**
Associate | Real Estate

It is a common understanding that many forms of English law transactions are now conducted through varying types of electronic communication, whether it be by email or some other web-based form of messaging service. It is also a general rule of English law that contracts can be made informally – that is, in most cases for a contract to be legally binding, it need not necessarily have any structural formality. This means that legally binding contracts can be formed through oral conversations, texts, WhatsApp messages and email.

However, under English law, we also have The Law of Property (Miscellaneous Provisions) Act 1989, where its significance is largely known amongst lawyers for setting out the formalities to a contract of sale of land, which does require to be '*in writing*'. It was because of this deep-rooted piece of English legislation that in 2019 the High Courts considered whether an email footer should be treated as a signature to a legally binding contract.

In this article, we take a look at what was decided in *Neocleous v Rees [2019] EWHC 2462(Ch)* and how the Courts regarded email footers in creating legally binding contracts for the sale of property.

The Law of Property (Miscellaneous Provisions) Act 1989

It is section 2 of The Law of Property (Miscellaneous Provisions) Act 1989 ("LP(MP)A") that provides the requirements for a contract for the disposition of an interest in land. It states the following:

Section 2. Contracts for sale etc. of land to be made by signed writing

1. A contract for the sale or other disposition of an interest in land can only be **made in writing** and only by incorporating all the terms which the parties have expressly agreed in one document or, where contracts are exchanged, in each.
2. The terms may be incorporated in a document either by being set out in it or by reference to some other document.
3. The document incorporating the terms or, where contracts are exchanged, one of the documents incorporating them… **must be signed** by or on behalf of each party to the contract.

The title to section 2 refers to "*signed writing,*" and this is further elaborated upon in sub-sections (1) and (3) where it states that the contract must be made in writing and must be signed. However, what does "*signed writing*" mean in today's modern times?

The Law Commission says that electronic signatures can be used to execute documents. On the basis that "*writing*" can include electronic communications such as email, would an email footer suffice to constitute signing? This was considered in *Neocleous.*

Neocleous v Rees [2019] EWHC 2462(Ch)

In *Neocleous*, the parties came to a settlement to resolve some existing rights of way litigation – one such term of the proposed settlement was that Ms Rees would purchase a small parcel of land from Mr and Mrs Neocleous. Given that this was a transfer of land, Section 2 of the LP(MP)A had to be complied with in order for there to be a valid disposition.

The sale was not documented in any conventional form of written settlement agreement. However, the lawyers did exchange the following emails:

1. Ms Rees's lawyer to Mr and Mrs Neocleous's lawyer setting out the principal terms of the intended settlement. Such email also invited confirmation that those were agreed; and
2. a reply from the Neocleous's lawyer confirming that he agreed with the terms of their email.

Ms Rees later decided that she no longer wished to proceed with the purchase of land; her lawyer argued that there was no binding agreement in respect of this. Mr and Mrs Neocleous maintained, however, that the email exchange between the lawyers were tantamount to a legally binding contract as the automatically generated email footers from

each lawyer (which stated their name, position, firm and contact details) constituted signatures for the purposes of Section 2(3) of the LP(MP)A.

Does email footer = signature?

The Courts in *Neocleous* held that the email footer of Ms Rees' lawyer did, in fact, render a signing for the purposes of Section 2(3) of the LP(MP)A.

It was further held that, although the email footer was an automatically generated one (*i.e.*, added to every email sent by that lawyer), to apply the rule that a footer of this nature must be added to every email would have to involve the conscious and deliberate act of application in the relevant setting in Microsoft Outlook. The very fact that the lawyer had manually typed 'many thanks' at the end of the email was found by the Courts to be further "*authenticating intent*" that he was relying on the automatic footer to sign off his name. As such, the email exchange between the lawyers was found to have formed a legally binding contract of sale of land.

The Courts further added that the ordinary person would regard an automatically generated email footer as a contractual signature, holding that:

"*Many an "ordinary person" would consider that what is produced when one stores a name in the Microsoft Outlook "Signature" function with the intent that it is automatically posted on the bottom of every email is indeed a "signature" … In the current age, that would in my judgment be capable of encompassing the wording of the footer to Mr Tear's email.*"

Consequently, the Courts held that email footers, regardless of whether they are automatic, are capable of amounting to signed writing such that the lawyer had indeed signed the email on behalf of his client, thereby establishing a legally binding contract.

Real Estate Finance Associates

February 25, 2020 | Issue No. 9

We are seeking commercial real estate finance associates with significant experience representing commercial and investment banks, debt funds and other regulated and non-regulated lenders.

The ideal candidates will have experience with requirements for securitization, syndication and participation of commercial mortgage, construction and mezzanine loans. Exposure to the representation of commercial real estate developers, owner/operators and borrowers is a plus.

Click **here** to apply.

Recent Transactions

February 25, 2020 | Issue No. 9

Here is a rundown of some of Cadwalader's recent work on behalf of clients.

- Represented lender on a mortgage loan secured by a portfolio of five hotels located in or near Charlotte, North Carolina.
- Represented lender on a $140 million loan secured by six Embassy Suites hotels in various states.
- Represented the lenders in a $485 million renovation loan for the Hard Rock Hotel & Casino in Las Vegas, Nevada, which is being rebranded as the Virgin Hotels Las Vegas.
- Represented the lender in a $275 million financing secured by the Sheraton Downtown hotel in Dallas, Texas.

Real Estate Events

February 25, 2020 | Issue No. 9

March 25, 2020

CREFC 5th Annual Women's Network Symposium

Location: Cadwalader's New York Office
Organizer: CREFC

June 8-10, 2020

CREFC Annual Conference 2020

Location: New York
Organizer: CREFC