CADWALADER

Talking About Workouts and Restructurings

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LawWise Podcast: Real Estate Workouts and Restructurings

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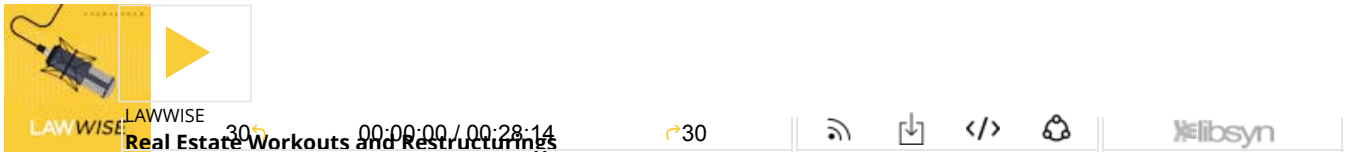
In this Law*Wise* podcast, real estate finance partner Steve Herman and special counsel Loren Taub take a look at the return of workouts and restructurings – a direct result of the coronavirus pandemic. Steve and Loren examine the steps that lenders and borrowers can take to effectively manage these transactions.

If you cannot access the podcast below, please **click here** to listen.



CFIUS Basics for Real Estate Lenders

October 28, 2020 | Issue No. 17

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I. Introduction

President Trump's early August 2020 Executive Orders prohibiting transactions with ByteDance Ltd. ("ByteDance"), the Chinese owner of the popular social media app TikTok, and, separately, ordering the divestiture of ByteDance's U.S. business operations, have thrust the activities of a once-obscure Executive Branch interagency body – the Committee for Foreign Investment in the United States ("CFIUS") – into everyday conversation. CFIUS's increasingly high-profile status reflects its expanded jurisdiction and authority under the 2018 Foreign Investment Risk Review Modernization Act of 2018 ("FIRRMA") and the Treasury Department's implementing regulations, which were made final earlier this year.[1] The scope of transactions that now may come under CFIUS review is much broader, including the commercial real estate space. Lenders who operate in this market should familiarize themselves with CFIUS, its authorities, and its considerations, especially as foreign investment begins to pick back up along with the overall economy.

II. What Is CFIUS?

CFIUS is an interagency executive branch body composed of key departments and agencies that serves the President in overseeing the national security implications of foreign direct investment in the United States economy. If a proposed transaction falls within CFIUS's scope of authority, the President has the discretion to suspend, block, or approve the transaction or to conditionally approve the transaction subject to negotiated mitigation measures. CFIUS also has the power to review transactions after the fact, and if it identifies issues for which it would have required mitigation, the President has the right to unwind the transaction post-closing.

III. What Do Commercial Real Estate Lenders Need to Know about CFIUS?

Although CFIUS always had the authority to review real estate transactions to the extent that they involved a foreign person obtaining control over a U.S. business, and such control could threaten U.S. national security,[2] FIRRMA expanded CFIUS's jurisdiction to explicitly capture certain real estate transactions involving the purchase, lease, or concession of certain real estate by a foreign person – "covered real estate transactions." Commercial real estate lenders should be aware, though, that there may be instances in which other "covered transactions" – known as "covered control transactions" and "covered investments" – could be implicated.

A. Covered Real Estate Transactions

FIRRMA expanded the scope of CFIUS's authority to review "covered real estate transactions," which are defined under FIRRMA as purchases, leases, or concessions to a foreign person of certain "covered real estate" that affords the foreign person at least three of the following rights, whether or not exercised:

- The right to access the real estate;
- The right to exclude others from physically accessing the real estate;
- The right to improve or develop the real estate; or
- The right to attach fixed or immovable structures or objects to the real estate.

Real estate lenders thus need to understand what constitutes “covered real estate” and who might be a “foreign person.”

Covered real estate is defined as real estate (a) related to certain identified ports or (b) located within a particular distance of certain military installations or identified U.S. government property. CFIUS regulations – and the CFIUS website – provide a list of the ports, installations, and government property. CFIUS also recently unveiled a map search tool that interested parties can use to determine whether a certain piece of real estate is located within proximity to one of the listed facilities.

A foreign person, for CFIUS purposes, means:

(1) Any foreign national, foreign government, or foreign entity;

(2) Any entity over which control is exercised or exercisable by a foreign national, foreign government, or foreign entity; or

(3) Any entity over which control is exercised or exercisable by a foreign person.

B. Covered Control Transactions

Commercial real estate lenders may find themselves involved in a “covered control transaction” to the extent that the transaction involves a “long-term lease or concession arrangement under which a lessee (or equivalent) makes substantially all business decisions concerning the operation of a leased entity (or equivalent), as if it were the owner” or if CFIUS’s national security concern stems from the real estate aspects of the purchase of a U.S. business.**[3]** In recent years, CFIUS has scrutinized covered control transactions due to the proximity of the U.S. business to sensitive government facilities or the nature of the real estate itself. Some notable examples include: (i) the 2012 review by CFIUS of the acquisition by Ralls Corp., a Chinese-owned entity, of a wind farm in Oregon located near a U.S. Navy base and the subsequent order by President Obama requiring Ralls to divest itself of ownership of the wind farm; (ii) the 2014 acquisition of the Waldorf Astoria Hotel in New York City by Anbang Insurance Group, a Chinese-insurance conglomerate, which was reviewed and ultimately approved by CFIUS; and (iii) the 2017 conditional approval by CFIUS of the acquisition by COSCO Shipping Holdings Co., Ltd., a Chinese shipping company, of the controlling interest in Hong Kong-based ocean container shipping company Orient Overseas International Ltd., which had a long-term concession for the operation of a container terminal in Long Beach, California.

C. Covered Investments in a TID U.S. Business

Under FIRRMA, CFIUS now has the authority to review certain non-controlling “covered investments” in U.S. businesses associated with Technology, Infrastructure and Data (a so-called “TID U.S. business”). A TID U.S. business is one which falls into one or more of the following categories:

(1) A U.S. business that produces, designs, tests, manufactures, fabricates, or develops one or more critical technologies.

(2) A U.S. business that performs specified types of work on covered investment critical infrastructure.

(3) A U.S. business that maintains or collects, directly or indirectly, sensitive personal data of U.S. citizens.

Commercial real estate loans are less likely to be affected by covered investments, as commercial real estate developers, owners and operators would not typically constitute a TID U.S. business.

D. Exceptions and Safe Harbors

With respect to real estate transactions, the implementing regulations include several exceptions and/or safe harbors, including the following:

- ***Excepted Real Estate Investors***. Certain “excepted real estate investors” are exempt from CFIUS scrutiny. To qualify as an “excepted real estate investor,” an investor must have a substantial connection with an “excepted real estate foreign state” and satisfy certain other criteria. The “excepted real estate foreign states” are currently only Australia, Canada, and the United Kingdom; this list is not expected to expand any time soon.
- ***Urban Centers.*** Transactions involving real estate within an “urbanized area” or “urban cluster” (as defined by the U.S. Census Bureau) do not constitute covered real estate transactions, unless the real estate is within a covered

port or within one mile of certain identified U.S. military installations.

- ***Commercial Office Space in Multi-Unit Commercial Buildings***. The purchase, lease, or concession of commercial office space in a multi-tenant commercial building is not a covered real estate transaction if the foreign person does not (a) hold more than 10% of the total square footage of commercial office space in the building; or (b) represent more than 10% of the total number of tenants for commercial space in the building.
- ***Securities Underwriter***. An acquisition of securities by a person acting as a securities underwriter in the ordinary course of business is not a covered real estate transaction.
- ***Loans***. The extension of a mortgage, loan, or similar financing arrangement by a foreign person for the purchase, lease, or concession of covered real estate is not itself a covered real estate transaction. However, a loan or mortgage may become a covered real estate transaction if (a) there is an imminent or actual default or other condition and (b) there is a significant possibility that a purchase or lease by, concession to, or a change in rights involving a foreign person may result from the default of other condition and that would constitute a covered real estate transaction.

E. Notification of Covered Transactions to CFIUS

Mandatory notice rules do not apply to covered real estate transactions. While the parties to a covered real estate transaction are not required to file a notice with CFIUS, CFIUS has the authority to review the transaction at any time, even after it has closed and the President has the power to unwind such transactions.

If the parties to a transaction believe that the transaction may constitute a covered transaction, then the parties may seek CFIUS approval by either (a) filing a voluntary long-form "notice" with CFIUS detailing the subject transaction or (b) filing a short-form "declaration" with CFIUS, which is a truncated version of the more lengthy voluntary notice. If CFIUS approves a notice or a declaration, then the transaction is exempt from any further scrutiny by CFIUS, except in certain limited circumstances.

F. Length of CFIUS Review

FIRRMA proscribes the following fixed time frames:

- ***Declarations***. If the review is triggered by a declaration, then CFIUS has 30 days to complete its entire review. If, during its review, CFIUS uncovers issues that it wants more information about, it can require the parties to submit a long form notice and start the notice process described below.
- ***Notices***. If the review is triggered by a notice filing, then CFIUS has 45 days to complete its first level "review." If, during the review, CFIUS determines it needs additional time, then it is able to initiate an "investigation" that could last up to an additional 45 days. At any point during its investigation, CFIUS may refer the transaction to the President, at which point the President has 15 days to make a decision.

IV. Conclusion

Although historically very few real estate transactions have triggered any intervention by CFIUS, recent statutory and regulatory changes have greatly expanded the scope of CFIUS's jurisdiction into this area. Commercial real estate lenders should be attuned to transactions in which foreign persons are acquiring control rights over real estate that is located close enough to certain ports, airports, military bases, or other sensitive sites such that their control over such property might pose a threat to U.S. national security interests. The risk to commercial real estate lenders is that they finance a transaction that later has to be unwound. Consequently, as part of its due diligence process on any loan where there is a foreign person who has direct or indirect control rights over the borrower or the property, commercial real estate lenders should make sure to confirm that either (a) the property is not covered real estate that would fall within CFIUS's jurisdiction; (b) the transaction is not otherwise a covered transaction; or (c) CFIUS has already reviewed the transaction and provided a safe harbor letter to the parties evidencing its approval of the transaction.

[1] See, e.g., Keith Gerver's February 13, 2020 Clients & Friends Memorandum, entitled "**Final Regulations on Expanded Authority of CFIUS to Review Foreign Investor Transactions Go into Effect**."

[2] See 31 C.F.R. § 800.210 (definition of covered control transaction) and 31 C.F.R. § 800.208 (definition of control).

[3] See 31 C.F.R. § 800.249.

The Only Guarantee in Life Is That There Are No Guarantees

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By **Susan Vuernick**
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On May 26, 2020, New York City Mayor Bill de Blasio signed into effect New York City Local Law 55 of 2020 (the "Guaranty Law") that amends the administrative code of New York City[1] to prohibit the enforcement of provisions in a commercial lease or other rental agreement that provide for personal liability of a natural person who is not the tenant (*i.e.*, a guarantor, but not an *entity* guarantor) for certain charges under the lease in cases where the tenant has been impacted by the COVID-19 pandemic for defaults that accrued between March 7, 2020 and September 30, 2020. Specifically, the Guaranty Law prevents property owners from holding personal guarantors of certain commercial tenants liable for debt obligations incurred when (i) the tenant had to stop serving patrons food or beverage on the premises or had to cease operations under Governor Cuomo's Executive Order 202.3; (ii) the tenant was a non-essential retail business owner subject to in-person limitations under Governor Cuomo's Executive Order 202.6; or (iii) the tenant was required to close to the public under Governor Cuomo's Executive Order 202.7. If any one of these conditions is met and there is a personal guarantor of the tenant's lease, the landlord will be prevented from enforcing that guaranty in order to collect unpaid rent, utilities, fees, building maintenance charges, or taxes owed by the tenant arising from defaults occurring between March 7, 2020 and September 30, 2020.

The Guaranty Law has recently been challenged in litigation[2]. On July 10, 2020, landlords Marcia Melendez and Ling Yang (the "Plaintiffs") sued in the Southern District of New York seeking to invalidate the Guaranty Law, among other laws. The Plaintiffs claim that the Guaranty Law (1) violates the Contracts Clause of the U.S. Constitution by "rewrite[ing] Plaintiffs' contracts with their tenants, stripping Plaintiffs of remedies to enforce personal guaranties that were a material benefit of those agreements"; (2) is not a reasonably necessary means of promoting a legitimate public purpose because it "impermissibly impose[s] a drastic impairment when other more moderate courses would have equally fit any legitimate purpose the defendants sought to advance"; and (3) directly conflicts with the New York State Legislature's grant of emergency power to Governor Cuomo because it "prescribes a wholly different set of procedures that property owners and tenants must abide by during the pendency of the Pandemic" from those procedures set forth in Governor Cuomo's executive orders. Plaintiffs additionally argue that the Guaranty Law "burdens landlords and benefits tenants in ways not necessary to advance the City's policy goals. And, these laws benefit a far wider segment of the tenant community than is needed to advance any legitimate governmental interests."

Since the case is still pending before the Southern District, there is no clear answer as to whether or not commercial tenants should rely on the Guaranty Law. This presents difficulties because, as a practical matter, personal guaranties to commercial leases are often the only effective means of a landlord recovering on a tenant's default. Under the Guaranty Law as it exists today, the personal guarantor would not be responsible for rental arrears between March 7, 2020 and September 30, 2020. However, if the court rules that this law is unconstitutional, then the same guarantors may be liable for such arrears.

We will continue to monitor this case and any other cases pertinent to legal constraints.

[1] N.Y.C. Administrative Code § 22-1005.

[2] See *Melendez et al. v. The City of New York, et al.*; 1:20-cv-05301 (S.D.N.Y.).

Executive Order Extending Moratorium on Commercial Evictions until January 1, 2021

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On October 20, 2020, in response to the continued health and economic hardships faced by New York business owners due to the COVID-19 pandemic, Governor Cuomo signed a new executive order extending the statewide moratorium on commercial eviction until January 1, 2021. The new order extends an existing executive order which prohibits the enforcement of any eviction of any commercial tenant, or a foreclosure of any commercial mortgage, in each case, for nonpayment of rent, if the property is owned or rented by any individual that is eligible for unemployment insurance or benefits under state or federal law or otherwise facing financial hardship due to the COVID-19 pandemic.

Governor Cuomo had recently extended an existing moratorium on residential eviction until January 1, 2021, and this order now offers the same protections to commercial properties.

We will continue to monitor these and other proposed legislation of interest and provide updates as needed.

Hotel Financing Series, Part 4: Deciphering the Pitfalls in Dealing with Franchise and Non-Disturbance Agreements

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In this part 4 of our hotel financing series, we discuss some of the most important hotel agreements, why they are key to the value of the hotel, and the tools which lenders often use when liaising with franchisors and hotel managers to protect the value of their security.

Franchise Agreements

Where a hotel is operating under a franchise model, the franchise agreement with the franchisor is arguably the most important document. The franchise agreement grants a licence to the hotel operator/franchisee (being OpCo) to run the hotel under its brand name, under conditions prescribed by the franchisor. The hotel operator will need to ensure they meet the set of conditions, as failure to do so may give rise to termination rights by the franchisor and the removal of the hotel as a branded hotel. We discuss below some of the key conditions and issues which arise in a typical hotel financing transaction.

One of the key prerequisites in obtaining a franchise arrangement is availability of funding. Running a hotel is a capital-intensive business, and operating a hotel within a franchise model requires additional prescribed costs set out in the franchise arrangements to keep up with the brand requirements. It is common for franchisors to review the financial status of the ultimate sponsor to ensure the hotel operator has sufficient financial backing to meet many expenses, such as ongoing capital expenditure, licence fees, central system fees/contributions, marketing costs and so forth. Sometimes franchisors would also require parental guarantees from the sponsor. The lender needs to understand these arrangements, and to the extent any cash collateral has been provided by the borrowing group in favour of the franchisor, a priority arrangement may be required.

Where the hotel owner requires the assistance of a professional hotel manager, the franchise agreement usually requires such appointment to be first approved by the franchisor. The franchisor may have a list of criteria the hotel managers need to meet, in terms of experience, track record, etc.

In addition to funding arrangements, other key conditions the hotel owner needs to adhere to are the brand standards. In short, these require the hotel to be operated and marketed in a way that adheres to the general standard of hotels under the same brand. This includes, among other things: 1) maintaining the fittings and furnishings of the hotel, which requires ongoing investment in refurbishments and commitment to capital expenditure with respect to upgrades; 2) adhering to particular brand requirements, including staff training, the provision of specific furnishings and décor, the availability of particular services, maintenance of a minimum customer satisfaction rating, etc.; and 3) security and other regulatory requirements. The franchisor would monitor this by having periodic inspections as well as regular reporting by the franchisee, and often these are documented in reports (as most branded hotel groups are quite stringent and have a set process for an ongoing assessment of its hotels across the world). It is important for the lender to obtain copies of these reports (or at least sufficient information) so that the lender is aware of the issues flagged and therefore need to be addressed. Failure by the hotel owner to rectify the issues may lead to termination by the franchisor in the most severe scenarios.

Non-Disturbance Agreement

It is common practice for the lender, franchisor and hotel owner to enter into a non-disturbance agreement (“NDA”) with respect to the franchise agreement. This is usually in the franchisor’s prescribed form, with some amendments tailored to the transaction. The terms of this document vary between transactions but generally it would cover the following:

1) Acknowledgement of lender’s security over hotel owners' assets as well as agreed priority. The franchise agreement usually prohibits the hotel owner from granting security, and the NDA provides consent for this for the

financing. To the extent there are competing financial interests (for example, if the obligors give a guarantee or payment bond to the franchisor under the terms of the franchise agreement), then priority is agreed between the lender and the franchisor.

2) An agreement not to exercise termination rights until the lender is notified. This provision is to avoid terminating the franchise agreement by the franchisor and therefore significantly decreasing the value of the hotel (as the brand is so important). It is often agreed between the lender and franchisor that the franchisor provides notice to the lender of any material breaches by the hotel owner, and gives the lender an opportunity a right to cure such default prior to terminating the franchise agreement.

3) Lender's step-in rights. Along with the termination rights point above, the lender has the right to "step in" to the shoes of the borrower and rectify any default to avoid termination of the franchise agreement, or upon an event of default under the facility, as a tool to take over the franchise agreement and operate the hotel in exercising its enforcement rights.

4) Agreed procedure regarding sale of hotel/change of hotel manager. In circumstances where a change of hotel manager is necessary (for example, if the hotel manager is not performing in a satisfactory manner, or in a distress scenario where the lender is looking to sell the hotel and the purchaser has their own hotel manager), it is important to establish pre-agreed procedures with respect to approval from the franchisor. As mentioned above, often the franchisor has a right to approve the appointment of the hotel manager, and the NDA may set out the pre-agreed requirement which should minimise any procedural hold-up in appointing a new hotel manager and therefore speed up any sale process.

The hotel lender also needs to understand the other costs associated with the hotel management and franchise agreements, how these issues impact the value of its collateral, and how these agreements impact its rights and remedies as a hotel lender.

In the next part of this series, we will examine hotel management arrangements.

Bill Ackman Keynote, Real Estate Panels at Fifth Annual (Virtual) Finance Forum on November 12

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Bill Ackman, the CEO and Portfolio Manager of Pershing Square Capital Management, L.P., will give the keynote address at this year's Finance Forum. Ackman is also the Chairman and CEO of Pershing Square Tontine Holdings, Ltd., a newly organized SPAC that raised $4 billion in its initial public offering in July, making it the largest SPAC IPO in history. The Finance Forum takes place virtually on the afternoon of November 12th.

Ackman will join Cadwalader partner Stephen Fraidin for a discussion covering the current state of the financial markets, implications of the presidential election, the resurgence of SPACs in 2020, and more.

This year's Finance Forum will once again feature live panel sessions with leaders in the U.S., UK, Europe and international commercial real estate, fund finance, middle market lending, distressed finance and securitization. Panelists will discuss the pressing issues and latest transactional and regulatory developments in their markets, providing key insights made more important by the uncertain environment.

Two panels of particular interest to *REF News and Views* readers include:

- CRE Operating, Investing and Underwriting in the Age of COVID. This panel will be moderated by Cadwalader partner Chris Dickson and will feature Oksana Beard, Global Head of Debt Capital Markets, Goldman Sachs; Donald Frey, Senior Vice President & Assistant Treasurer, Simon Property Group; Jon Martin, Managing Director, Wells Fargo; and Kim McKee, Senior Vice President and Market Manager – Commercial Real Estate, U.S. Bank.
- Getting Real About Real Estate Workouts and Restructurings. This panel will be co-moderated by Cadwalader partners Steve Herman and Bonnie Neuman and will feature Simon Burce, Executive Director, J.P. Morgan; Zachary Cohn, Senior Vice President, Brookfield Asset Management; Mario Ramirez, Senior Vice President – Acquisitions/Capital Markets, Vornado Realty Trust; Robert Sitman, Managing Director, Blackstone Real Estate Debt Strategies; and Alan Williams, Senior Vice President and Head of Asset Management, KeyBank Real Estate Capital.

More than 1,000 industry leaders are already registered for the event.

For more information and to register, click **here**.

Recent Transactions

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Cadwalader is advising the sellers in the sale of three prime retail properties on New York's Madison Avenue, a transaction reported in ***The Wall Street Journal***. The transaction involves the $45 million purchase by Swiss luxury clothing retailer Akris of three properties that are located between East 69th and 70th Streets, and include three ground-floor retail spaces and a combined 15 residences on the floors above. The closing is expected to occur in the fourth quarter. The Cadwalader team includes senior counsel Fred Altschuler, partner Steven Herman and associate Michael Anglin.

Other recent transactions include:

- Representation of administrative agent and lender in an aggregate mortgage and mezzanine financing of up to $171 million secured by 529 Fifth Avenue.
- Representation of lender in connection with the origination of a revolving credit facility in the initial principal amount of up to $250,000,000, subject to increase up to $500,000,000, to finance multifamily properties and utilizing a SOFR index.
- Representation of the lenders on a $165 million CMBS loan to refinance Silverstein Properties' office building at 120 Wall Street in Manhattan, as reported in *The Commercial Observer*.