Working Through The Great Recession

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Our current economic crisis has been dubbed the “Great Recession.” Economists and prognosticators are divided on whether this recession will be U-shaped, V-shaped, W-shaped, or (hopefully not) L-shaped. There is also division on how far along the economy is on the road to recovery. But one thing is clear — the Great Recession is confronting the real estate industry with a significant set of challenges. There are many competing thoughts on the best course of action to take to meet these challenges, some contradictory, but none of them definitive. Is it possible that the answer is much more simple than classic economic models would suggest and is instead found in classic rock lyrics?:

“Ridin’ the storm out.” (REO Speedwagon)

“We got to get in to get out.” (Genesis, from The Lamb Lies Down on Broadway)

“Break on through to the other side.” (The Doors)

While the “REO” in REO Speedwagon does not refer to the real estate term of the same initials, the metaphor in the group’s lyrics, as well as the lyrics of the other two songs, remind us that what practitioners should be doing during this challenging time is simply working through it, no matter how unfamiliar the territory.

And that is exactly what is being done in the real estate industry. Financial partners find themselves taking over management of joint ventures from their operating partners. Lenders are foreclosing on equity interests under the Uniform Commercial Code. Mortgage REITs are mounting a comeback by focusing on distressed debt. Investors are preparing for the possibility that financial regulation may encompass real estate investing like never before. The four articles in this edition of REsource discuss each of these aspects of this new reality. Ultimately, these actions — and future actions to be taken to confront additional challenges that will undoubtedly arise — are simply part of the process… the process of working through the Great Recession.

— Robert M. Haight, Jr.
Editor-in-Chief
The public mortgage REIT sector, comprised of real estate investment trusts investing in residential mortgage-backed securities (RMBS), commercial mortgage-backed securities (CMBS), and related products and securities, was dealt a devastating blow by the credit crisis of 2007 and 2008. The sharp rise in default rates coupled with the plummeting market value of loan portfolios combined to create a perfect storm for mortgage REITs. Of the 38 mortgage-focused REITs that were publicly traded at the beginning of 2007, only 20 still traded two years later. Those that survived the storm were significantly, and perhaps irreparably, impaired. Where the public mortgage REIT sector had a combined equity market capitalization of over $30 billion at the beginning of 2007, this number had fallen by more than half at the end of 2008. As capital rapidly fled the sector, sponsors shelved plans for new equity offerings and withdrew any IPOs in the pipeline.

As 2009 began, however, there were signs of a reversal of fortunes in the mortgage lending market and indications that investors might be ready to again allocate capital to this once-abandoned sector.

In the residential mortgage market, the federal government’s takeover of Fannie Mae and Freddie Mac (which together represent over $1 trillion of residential mortgages) and the historically low interest rate environment have generated renewed interest in acquiring portfolios of conforming RMBS that are now perceived to be low risk.

In the commercial real estate mortgage market, the advent of government initiatives aimed at thawing the frozen credit markets, such as the Term Asset-Backed Securities Loan Facility (TALF) and the Public-Private Investment Program (PPIP), have likewise resulted in a fresh flow of capital seeking commercial mortgage-backed assets. TALF and PPIP provide for low-rate government financing to qualified investors that purchase mortgage-related securities now held by banks and other financial institutions.

Compelling Model

The mortgage REIT investment model has become increasingly compelling for three primary reasons. First, the key driver to successful investing in mortgage assets remains similar to that behind leveraged bond fund investing – positive returns are earned when the return on the portfolio of investments exceeds the fund’s cost of capital. The low-rate financing being made available under the TALF and PPIP programs may provide mortgage REITs with the low-cost capital they need to generate positive returns.

Second, the mortgage assets themselves still trade at largely depressed prices, making them attractive to some investors in spite of higher default rates. For the general public investor, mortgage REITs may afford the only immediately available means of taking advantage of a historic opportunity to invest in distressed real estate assets.
Third, a severe imbalance of supply and demand remains a meaningful concern in the CMBS market. Analysts estimate that over $250 billion of CMBS loans are expected to mature between 2009 and 2013 and it is unclear where the funds for refinancing will come from, even as local banks have increased traditional mortgage lending in recent months. Large commercial lenders continue to be either unwilling to make loans or have tightened underwriting standards to the point where available loan proceeds are falling far short of the amount of the debt coming due.

In light of these market opportunities, a variety of financial sponsors, including many notable names from the lending and private equity worlds, are seeking to tap the public markets to raise equity capital. This next wave of externally managed mortgage REITs are coming to market with the express goal of exploiting the dislocation in the market for RMBS, CMBS, and related investments. Any significant move towards historic norms in the real estate finance sector would generate meaningful returns for investors that acquire assets at the perceived “bottom of the market.” Thus, the past few months alone have seen a spate of mortgage REIT IPOs and IPO filings (see the table below) that propose to raise a total of over $6 billion of new equity capital, with more filings expected.

### SELECTED IPOs AND IPO FILINGS BY MORTGAGE REITS IN 2009
**(as of September 30, 2009)**

<table>
<thead>
<tr>
<th>Company</th>
<th>Parent/Manager</th>
<th>Proposed Offering Size (in millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>AG Financial Investment Trust</td>
<td>Angelo Gordon &amp; Co.</td>
<td>$ 300</td>
</tr>
<tr>
<td>Apollo Commercial Real Estate Finance</td>
<td>Apollo Global Management</td>
<td>$ 200 (actual)</td>
</tr>
<tr>
<td>Bayview Mortgage Capital</td>
<td>Bayview Asset Management</td>
<td>$ 500</td>
</tr>
<tr>
<td>Brookfield Realty Capital Corp.</td>
<td>Brookfield Asset Management</td>
<td>$ 500</td>
</tr>
<tr>
<td>Colony Financial</td>
<td>Colony Capital</td>
<td>$ 250 (actual)</td>
</tr>
<tr>
<td>CreXus Investment Corp.</td>
<td>Annaly Capital Management</td>
<td>$ 200 (actual)</td>
</tr>
<tr>
<td>CWCapital Realty Trust</td>
<td>CW Financial</td>
<td>$ 250</td>
</tr>
<tr>
<td>Cypress Sharpridge Investments</td>
<td>Cypress Group/Sharpridge Capital Management</td>
<td>$ 100 (actual)</td>
</tr>
<tr>
<td>Foursquare Capital Corp.</td>
<td>AllianceBernstein</td>
<td>$ 500*</td>
</tr>
<tr>
<td>Invesco Mortgage Capital</td>
<td>Invesco Ltd.</td>
<td>$ 206 (actual)</td>
</tr>
<tr>
<td>Ladder Capital Realty Finance</td>
<td>Ladder Capital Finance</td>
<td>$ 400*</td>
</tr>
<tr>
<td>Marathon Real Estate Mortgage Trust</td>
<td>Marathon Asset Management</td>
<td>$ 300</td>
</tr>
<tr>
<td>PennyMac Mortgage Investment Trust</td>
<td>Private National Mortgage Acceptance Co.</td>
<td>$ 320 (actual)</td>
</tr>
<tr>
<td>Starwood Property Trust</td>
<td>Starwood Capital Group</td>
<td>$ 932 (actual)</td>
</tr>
<tr>
<td>Sutherland Asset Management</td>
<td>Waterfall Asset Management</td>
<td>$ 400</td>
</tr>
<tr>
<td>Transwestern Realty Finance</td>
<td>Transwestern Investment Company</td>
<td>$ 500</td>
</tr>
<tr>
<td>Western Asset Mortgage Capital Corp.</td>
<td>Legg Mason</td>
<td>$ 500</td>
</tr>
</tbody>
</table>

*The sponsors have announced the indefinite postponement of these offerings.*
Questions Remain

Questions still remain, however, as to what extent the markets will embrace the new wave of mortgage REITs. In addition to ongoing anxiety about the mortgage market generally, a central concern is the TALF program itself, which is currently set to expire on March 31, 2010 for legacy CMBS and on June 30, 2010 for newly-issued CMBS. While many believe that the Federal Reserve Board is likely to further extend TALF, some investors may be unwilling to allocate significant amounts of capital to the sector without confidence in the continued availability of TALF’s low-cost financing.

Indeed, the new offerings have had mixed results to date, with those that came to market earlier in the year having decidedly better success.

On the one hand, Starwood Property Trust, Inc., a new mortgage REIT externally managed by an affiliate of Starwood Capital Group, recently completed the largest IPO of the year to date, twice upsizing its offering to a total of $931.5 million (including exercise of the underwriters’ over-allotment option). Likewise, Starwood and mid-year offerings by Cypress Sharpridge and Invesco Mortgage Capital continue to trade at or above their IPO price. On the other hand, weak market demand for other IPOs, including PennyMac Mortgage Investment Trust, CreXus Investment Corp., Colony Financial, Inc., and Apollo Commercial Real Estate Finance, forced companies to significantly reduce the size of their offerings on the eve of pricing. Two other third-quarter IPO candidates announced the indefinite postponement of their offerings.

The variance in market demand has demonstrated that not all mortgage REITs are created equal. Where a new REIT is structured as a blind pool investment vehicle, underwriters have found that investors are insisting that the actual initial value of their shares be as close as possible to the gross offering price per share, i.e., without reduction for costs or dilution before investments are made. For example, in some offerings sponsors have agreed to pay a significant portion of the underwriting fees themselves, while in others, payment of a portion of the underwriting fees has been deferred until the company meets specified returns on equity. Likewise, sponsors have been asked to reduce or defer management fees in connection with recent offerings, and to reduce or eliminate initial equity grants. Some of the new blind pool offerings have also been delayed in registration as sponsors deal with a number of complex issues resulting from, among other things, SEC rules that require sponsors to provide extremely detailed information on the historical performance of their prior investment vehicles.

Cautious Optimism

Despite these challenges, there is optimism that the new mortgage REITs and their sponsors will find a way to satisfactorily resolve many of the operational and legal hurdles over the coming months. The overwhelming success of the Starwood IPO clearly indicates that strong entrants in the sector can successfully access the capital markets, provided they offer the right combination of management alignment and price. New REITs that come to market with a portfolio of attractive assets already in hand may also experience fewer pricing pressures than blind pool offerings. The real question remains whether near- and mid-term developments in the real estate market and broader economy will bear out the new mortgage REITs’ strategy.

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Mezzanine loans bridge the “capital gap” between the proceeds of a mortgage loan and equity, and have been an important part of many real estate ventures’ financing plans. However, no venture could have planned for the severity of the current economic downturn, or its impact on mezzanine loans. Falling property values, increasing vacancy rates, and insufficient sources of refinancing have placed growing numbers of mezzanine loans in default, forcing mezzanine lenders to evaluate their remedies.

Unlike a mortgage loan, which is secured by a lien on real property, the collateral for a conventional mezzanine loan consists of a pledge of the equity interests in the borrower itself and not in the borrower’s real estate assets. Upon a default, a mezzanine lender may foreclose on its equity interest under the Uniform Commercial Code (UCC) and assume ownership of the borrower and all of its assets, including any real property.

Given the growth of mezzanine loan defaults and the proliferation of “loan to own” investors that view mezzanine loans as an alternative for accessing real estate, UCC foreclosure, once a rarity, has become a practical reality in today’s market. There are, however, a number of strategic issues that must be evaluated before proceeding to a UCC foreclosure.

First Things First

Once it appears the borrower may default, a mezzanine lender, along with experienced counsel, should review all applicable loan, pledge, and intercreditor agreements to determine the respective pre-foreclosure and post-foreclosure rights and obligations of the relevant parties.

Initially, a mezzanine lender must determine whether it can clear the hurdles set forth in the intercreditor agreement with the mortgage lender. Typically, a mezzanine lender must satisfy financial and other thresholds to be deemed a “qualified transferee” of the borrower’s equity, which allows a mezzanine lender to foreclose without the mortgage lender’s consent. Following foreclosure, a mezzanine lender may also be required to manage real property assets through a “qualified manager” and to execute replacement guaranties (including non-recourse carveout, or “bad boy,” guaranties) in favor of the mortgage lender. In most instances, it is advisable to negotiate an agreement with the mortgage lender prior to foreclosure with respect to some or all of these issues.

In addition, a mezzanine lender should consider any liabilities it may have under existing mortgage loans, as well as other liabilities that could be triggered by the foreclosure itself (including state and local real estate transfer taxes). Post-foreclosure, a mezzanine lender assumes ownership...
of the borrower, which remains subject to its mortgage and other liabilities notwithstanding the transfer. For this reason, stepping into the shoes of the borrower may not be beneficial if the mortgage loan is in default or near maturity or if operating revenue is insufficient to service the debt.

**Assuming Ownership**

Once the decision is made to exercise a right of foreclosure in the equity of the borrower, a mezzanine lender needs to determine which foreclosure remedy to pursue.

**Assignment in Lieu.** An assignment in lieu of foreclosure describes any negotiated arrangement allowing for a mezzanine lender to take title to the equity in the borrower without actually foreclosing. Although this arrangement may transfer ownership more quickly than a public sale, the transfer may be difficult to obtain where the consent of multiple parties is required.

**Strict Foreclosure.** Under UCC Section 9-620, a mezzanine lender may conduct a “strict foreclosure” by submitting a proposal to the borrower outlining the terms upon which it will accept the equity pledged as collateral. Because the borrower must accept a mezzanine lender’s proposal (or be deemed to have accepted if it does not object), strict foreclosure usually works only in situations where equity is far out of the money, or where equity sponsors do not have guaranty obligations or are otherwise motivated to part with their equity interest in the borrower.

**Public Sale Foreclosure.** The most common remedy exercised by a mezzanine lender is a public sale. A foreclosure of equity interests through a public sale is governed by UCC Section 9-610, which requires that the sale be conducted in a “commercially reasonable” manner. To conduct a public sale foreclosure, a mezzanine lender accelerates the loan, delivers notice of the sale to the borrower, any guarantors, and any other lienholders, and advertises the sale to prospective bidders in at least one national and local publication. At the sale, a mezzanine lender may credit bid the borrower’s outstanding mezzanine obligations toward the purchase of the collateral, which gives it an advantage over competing bidders because this arrangement enables a mezzanine lender to purchase the asset without putting up cash. Upon completion of the foreclosure, a mezzanine lender usually retains the right to bring an action against any guarantors to recover the deficiency between the amount of the credit bid and the total mezzanine debt.

Although the UCC suggests the sale process can be completed in as little as 10 days, borrowers are typically given at least 30 days notice. A mezzanine lender should also prepare for the possibility that the borrower will seek a temporary restraining order on or near the eve of foreclosure, claiming that the sale was not commercially reasonable. Borrowers will often challenge the adequacy of the publication notice of the sale, the amount of time in which bids were solicited, the adequacy of diligence materials made available to bidders, and the robustness of marketing efforts. More recently, borrowers have alleged (with some success) that current conditions in the credit markets amount to a *force majeure* which justifies courts delaying a mezzanine lender’s exercise of remedies. The extent to which borrowers will go to stop a sale may also depend on the terms of any bad boy guaranties executed by the borrowers’ affiliates, under which liability is usually triggered as a result of certain acts (e.g., bankruptcy) taken by the borrower.

Although borrowers are often successful in convincing courts to temporarily enjoin foreclosures, a mezzanine lender that conducts a vigorous sale process (e.g., retains a broker or auctioneer, maintains a physical or electronic “diligence room” for potential bidders, and continues settlement dialogue with the borrower) is better positioned to successfully defend an injunction action, although it may take several weeks or months to do so.

**Oh, Say, Can UCC**

As the number of distressed mezzanine loans grows, a mezzanine lender’s clear understanding of the practical issues surrounding a UCC foreclosure is essential. Even if not pursued to completion, it can be a useful tool to motivate a borrower to come to terms on a mutually acceptable workout. In any case, UCC foreclosures are likely to remain common, if not become more so, over the next few years.

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The Impact of Financial Services Reform on Real Estate Investors

by William E. Stern

The U.S. Treasury Department recently proposed legislation to implement certain of its prior recommendations for financial services regulatory reform. While there is much speculation whether new financial regulatory legislation will be passed in any form this year, if adopted, the proposal would potentially subject a broad range of organizations to regulation under the Bank Holding Company Act (BHC Act), irrespective of whether such organizations control a depository institution. The proposal could have significant consequences for organizations not already subject to regulation under the BHC Act that develop, invest in, or manage real estate investments. Consequently, organizations that become subject to regulation under the BHC Act would be required to conform their real estate investment activities to those permitted under that statute and to discontinue impermissible activities.

Double Impact

The proposal would affect two types of firms. First, some organizations that engage in general commercial activities would lose existing BHC Act exemptions that allow them to own and control savings associations or thrifts, and special purpose depository institutions such as credit card and industrial banks. Many insurance companies, brokerage firms, asset managers, and manufacturing companies that engage in real estate development, management, and investment activities own savings associations or special purpose depository institutions under these exemptions and could become subject to the BHC Act upon the elimination of the exemptions.

Second, in order to mitigate systemic risk to the U.S. economy and promote the stability of the financial system, the proposed legislation would authorize the Federal Reserve Board (FRB) to designate certain large, highly leveraged, and substantially interconnected financial companies as Tier 1 Financial Holding Companies (Tier 1 FHCs) subjecting them to comprehensive and robust prudential supervision and regulation under the BHC Act. To be considered a Tier 1 FHC, a company would need to engage, at least in part, in financial activities, which include acting as principal or agent for insurance activities, and underwriting and dealing in securities, securities brokerage, financial advisory, or investment management activities. The FRB could designate a U.S. or foreign financial company as a Tier 1 FHC if it determines that material financial distress at such a company could pose a threat to global or U.S. financial stability or to the global or U.S. economy. Although it is unclear which entities would be designated Tier 1 FHCs, large insurance companies, asset managers, and investment fund sponsors, many of which invest directly in real estate or sponsor and manage funds which invest in real estate, could potentially become subject to this designation if the proposal is adopted.

Real estate development and real estate property management are not permissible activities for financial holding companies under the BHC Act. So Tier 1 FHCs and organizations that become subject to regulation under the BHC Act would have to change their activities to conform to the requirements of the BHC Act or discontinue those activities within the five-year transition period allowed in the proposed legislation.
The BHC Act limits financial holding companies from engaging in real estate investment activities, either directly or through a controlled subsidiary or fund. However, as discussed below, there are two principal exceptions currently set forth in the BHC Act under which a financial holding company may make or control real estate investments. To qualify for these exceptions, a company that owns a depository institution would need to meet the requirements to be a financial holding company, meaning that the depository institution would need to be both “well-capitalized” and “well-managed” under standards established by the FRB, among other requirements. In addition, the proposed legislation would also require any Tier 1 FHCs or any bank holding company making an election to be a financial holding company to be and remain “well-capitalized” and “well-managed” under such standards.

**Merchant Banking Exception.** Under the so-called “merchant banking” authority, a financial holding company may, subject to certain limitations, acquire up to 100% of the ownership interests of any “portfolio company” engaged in non-financial activities. Some banking organizations currently subject to the BHC Act rely on this merchant banking exception to make real estate investments and to sponsor and manage funds that make real estate investments. Typically, the real estate is held through a special purpose entity where a joint venture partner or other third-party provides day-to-day property management. Subject to an FRB-approved extension, a financial holding company may only retain control of a portfolio company up to 10 years.

In addition, a financial holding company may not routinely manage or operate a portfolio company. Regulations clarify that the FRB will not regard a financial holding company as routinely managing or operating a portfolio company even if directors, officers or employees of the financial holding company serve as directors of the portfolio company or if the financial holding company selects some or all of the portfolio company’s directors, so long as the portfolio company has its own officers and employees who are independent of the financial holding company.

**Insurance Company Exception.** In addition, a financial holding company may also acquire or control assets, including real estate, (i) if the investment is made by an insurance company that is predominantly engaged in underwriting life, accident, and health, or property and casualty insurance (other than credit-related insurance) or providing and issuing annuities and (ii) if the investment meets certain other requirements, including a prohibition on routine management or operation of a portfolio company held pursuant to this authority. The FRB has not promulgated regulations related to this authority. Notably, however, the statutory authorization for a financial holding company to make investments through an insurance company does not on its face impose a holding period limitation. Otherwise, aside from being specific to insurance company investors, the requirements for these types of investments are very similar to those previously described with respect to merchant banking investments.

**Change Is Coming**

The prospects for passage of reform legislation remain unclear, but many expect that Congress will enact legislation next year. Recently, the House Financial Services Committee circulated a proposal that would subject certain commercial firms to the BHC Act. Unlike the Treasury’s proposal, this alternative preserves limited grandfathered rights for certain companies that become subject to the BHC Act if they segregate their financial activities in a separate unit. Debate on these proposals will likely shape the final legislation. However, given the prospect of change, real estate investors and asset managers that could become subject to greater regulation should consider how these proposals could affect their business and formulate an appropriate response.

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A typical real estate joint venture has two partners: an operator partner that invests limited capital but is responsible for day-to-day management; and a capital partner that invests most of the capital but generally takes a passive management role. With falling property values, the need for additional capital, and little hope of a promote or carried interest, some operator partners have lost the economic motivation or lack the financial resources to perform their obligations under their joint venture agreements. Consequently, capital partners are increasingly facing the prospect of assuming management of real estate joint ventures to protect and preserve their investments. But doing so is easier said than done, and there are numerous operational and legal concerns.

Pre-Takeover Considerations

Real estate joint venture agreements typically specify when the capital partner can take over management of the venture. Triggering events range from the failure to achieve specified performance hurdles to the occurrence of other enumerated events that constitute breaches of the governing documents.

If a triggering event occurs, the capital partner should review the joint venture documents, and any financing and other property-related documents, to determine the steps necessary to take over management, and the limits and consequences of doing so. Additionally, as a threshold matter, the capital partner should consider that once it becomes the manager it may have a fiduciary duty to the operator partner and that courts may impose a higher standard of care than any standard that may be specified in the joint venture agreement.

Under the joint venture agreement, a management takeover may require replacing the operator partner as the guarantor of any mortgage loan and also may accelerate any lockout period on buy-sell or forced sale rights between the partners – which could be either desirable for the capital partner given the deteriorating relationship or undesirable if it requires the capital partner to fund a buyout of the operating partner. Mortgage and mezzanine financing documents may restrict management changes without the lender’s consent, and may similarly require replacement of the operator partner as loan guarantor. Other property-related agreements such as franchise or hotel management agreements in the hospitality context may impose similar restrictions.
The capital partner should understand the relationships between the operator partner and other parties involved with the property (e.g., contractors or property managers) and consider whether removing the operator partner would jeopardize performance by such parties to the venture’s detriment. The capital partner should further understand that while it may have discussions with lenders or with such other parties (subject to its fiduciary duty to the operator partner), unless expressly granted in the joint venture agreement, it lacks the authority to bind the joint venture until it has replaced the operator partner as manager. If the joint venture is a limited partnership, the capital partner should be concerned about being deemed a general partner (and thus liable for the debts and obligations of the partnership) if, prior to removing the operator partner, it holds itself out as being able to bind the partnership.

The capital partner should consider the resources necessary to manage the joint venture. Managing a construction project, for example, can be more labor intensive than operating a stabilized asset. Regardless, the manager typically must produce budgets, operating statements, development plans, financial reports, and tax returns, and the capital partner should determine whether it can operate the joint venture utilizing its existing asset management staff. One alternative is to use outside development and management consultants.

**Assuming Management Responsibility**

Once the capital partner has decided to take over management and secured the necessary resources to do so, it should adhere to the specific takeover procedures in the joint venture agreement. Typically, the first step is to give the operator partner the required notice. It is equally important to notify all other interested parties that management has changed and the operator partner can no longer act for the joint venture. Such parties include mortgage and mezzanine lenders, the property manager, contractors, architects and other design professionals, tenants, taxing authorities, licensing boards, employee representatives and/or unions, parties in any outstanding litigation, vendors, insurance providers, and service of process agents.

It may also be prudent to amend filings with the secretary of state in the joint venture’s jurisdiction of formation to reflect the changed general partner, manager, or managing member. Notifying these parties may uncover additional issues, such as disputes with tenants, contractors, or vendors.

The capital partner should assess the current state of the joint venture’s assets. It should obtain all property files from the operator partner and consider obtaining a tax, UCC, and municipal lien search to confirm that there are no additional liens on the property, a title rundown to determine whether there are additional title encumbrances, and a forensic audit of all books and records to determine if there is evidence of impropriety and potential claims against the operator partner.

The capital partner also should promptly secure control of all bank accounts and consider opening new accounts. It may be more feasible to change authorized signatories on existing accounts, particularly if they receive tenant rent payments or are subject to a cash management agreement with a lender.

Of course, an uncooperative operating partner significantly complicates matters and resolution may only come through litigation. This will extend the period during which the asset is unstable and increases the cost to the capital partner.

After taking over management, the capital partner, if deemed a fiduciary, will owe a duty of reasonable care and loyalty to the operator partner that prohibits acting in a self-dealing manner. To protect against claims that it violated its fiduciary obligations, the capital partner should consider causing the joint venture to cover carrying costs (such as real estate taxes and insurance), and maintain the joint venture assets in a safe condition to avoid any claim of intentional waste.

**Meet The New Boss**

The current economy has, in many cases, ruptured the traditional relationship between capital partners and operating partners, and resulted in the invocation of remedies in the joint venture agreement that the parties always hoped were theoretical. Unfortunately, reality has burdened many capital partners with assuming control of joint ventures. As capital partners consider management takeover of real estate joint ventures, it is important that they weigh the responsibilities, limitations, and consequences imposed upon the capital partners against the immediate need to protect and preserve the joint venture assets.

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