

**ACQUISITION, BANKRUPTCY AND TAX CONSIDERATIONS
IN DISTRESSED ASSET PURCHASES**
**(Focusing on Concerns Uniquely Relevant to Acquiring Distressed Commercial Realty
and Loans Collateralized by Commercial Realty)**

**American Bar Association Annual Meeting
Sunday, August 8, 2010, 2 – 3:30 p.m.
Moscone Center West – Room 3018
San Francisco, California**

Program Structure and Outline

- An overview of the acquisition, bankruptcy and tax aspects of distressed acquisitions will first be provided by the applicable presenter.
- Next, the panel will discuss as a group the case studies, for purposes of illustrating practical considerations
- Print hand-outs of the case studies will be delivered at the program.

I. Overview and General Considerations (30-40 minutes)

A. Acquisition Issues

1. Types of acquisitions

a. Loans

Loan document flaws

Length of path to foreclosure- varying laws in different jurisdictions

Valuation method values underlying real estate, PLUS expense and length of time to convert the loan to real estate

Borrower bankruptcy risk

Borrower litigation claims

b. Real Property

c. Membership/Stock Interests

2. Deed in Lieu Agreements

a. Purpose

b. Key Provisions

3. Diligence and Operational Considerations

a. Declarations

Who holds declarant's rights?

Are there fees or other continuing liabilities due under declarations?

b. Lease Issues.

Estoppels and SNDA's. Need to assure that foreclosure will not terminate a leasehold interest.

Renegotiation of existing leases if tenant rent relief is an issue.

Confidentiality

Right to terminate

Rent relief is personal to tenant and may not be passed through to subtenants or assignees

Elimination of co-tenancy, ROFR or other tenant-favorable provisions

c. Title insurance issues?

Stick with the lender's policy or get an owner's policy or try to retain coverage under lender's policy will obtaining owner's policy?

d. Are all entitlements in place? Do they have stale dates?

e. Fraudulent transfer and other avoidance concerns.

f. Mechanic and materialmen's lien issues.

g. Bonding requirements of roadways or other infrastructure.

h. Sufficiency of loan documents

Who holds or posses; proof of standing to enforce?

Do they correctly describe the collateral?

i. Utilities

Estoppels from providers

Assignments of the utility agreements

Regulatory issues

j. Operating Companies within a development.

k. Tax Revenue Sharing Agreements and other Incentive Agreements

B. Bankruptcy Issues

1. Authority to File; Single Purpose, Bankruptcy Remote Entity; Presence of Devices to Deter Bankruptcy or other Enforcement Opposition?
2. Ability to Stay in Bankruptcy (even long enough to effect a fast sale)
 - a. Single Asset Real Estate Case?
 - b. What actions are subject to the Automatic Stay (exercise by government of police power is typically not stayed)
 - c. Administrative Expenses Must be Paid (who/what will pay professionals and postpetition expenses)? Use of Cash Collateral? DIP Financing?
 - d. Trustee or other change in management desired? US Trustee makes the selection of a Chapter 11 Trustee; Many Trustees are not able or willing to “operate” a complicated real estate project through to sale; A Trustee would like seek to have a manager hired. Arguably Trustee gets a statutory commission for sale, even if all net proceeds are paid over to a secured lender
 - e. Utility Provider and Other Party Rights to Adequate Assurance
 - f. Possibility of Conversion of Case to a Chapter 7
3. Valuation of Assets
 - a. Relevant to Determining Right to Payment of Adequate Protection or Ultimately Postpetition Interest
 - b. Relevant to Determining Right to Relief from Stay
 - c. Relevant to Determining whether Liens attach to Proceeds of Sale and whether Property may be sold Free and Clear of Interests without any Sharing in Sale Proceeds
 - d. Relevant to Exercise of Credit Bid Option and “Section 1111(b) Election”
4. Ability to Sell Critical Assets Free of Interests (and claims of successor liability)
5. Lien Avoidance
6. Executory Contracts
 - a. Generally may be assumed and assigned under certain circumstances subject to certain limitations (adequate assurance of future performance; cure)

- b. Compare contracts that are fully performed and those that are in the nature of personal service agreements or financial accommodations (franchise agreements; credit card agreements)

7. Transfer Taxes

8. Sales Through Plans

- a. *Picadilly*

- b. *Philadelphia News*

- c. Successor Liability (Plan v. Pre-Confirmation 363 Sale)

9. Evidencing Transfer of Interest/Claim

C. A Selection of Certain Federal Tax Oriented Techniques Useful in the Acquisition of Distressed Real Properties.

1. Sources of Equity Funding

- a. Routine “Acquisition Funding”

- (i) Domestic and foreign “all cash” purchasers.

- (ii) Limited liability entities that include “institution” investors.

- (iii) Affiliation between mortgage holder and investor

- b. Use of exchange funds for investment

- (i) Tenancy-in-Common Interests

- (A) Revenue Procedure 2002-22, a narrow “safe harbor”.

- (B) Other Revenue Rulings, Revenue Procedures and Private Letter Rulings relevant to “non-safe harbor” Co-Tenancy Arrangements.

- (C) Recent Bankruptcy filings by TIC sponsors.

- (ii) Delaware statutory trusts

- (A) Organized under Delaware statute

- (B) Rev. Rul. 2004-86, 2004-33 IRB 191 established impermissible DST trustee powers (the “7 deadly sins”).

(C) DST structure appears to work best in a master lease type scenario, that does not involve active management of future capital needs.

c. The growing use of master limited partnerships

- (i) Publicly traded partnerships are dealt with in IRC Section 7704
- (ii) A “PTP” having 90% or more of its gross income for the year from categories of “qualifying income” can report income, loss, distributions and contributions as a partnership, notwithstanding their status as publicly traded investments – IRC section 7704(c).
- (iii) Items of qualifying income generally include real property rents and gains.
- (iv) There are presently about 90 PTPs, including many “energy” companies.
- (v) In appropriate circumstances, qualified income-producing assets can be “spun off” to a PTP.

d. The prognosis for promoters owning “carried” interests

- (i) Historically, a “profits” interest, when held for in excess of 1 year, had produced capital gains.
- (ii) Representative Levin introduced the original bill that would change the treatment to ordinary income (H.R. 2834) on June 22, 2007.
- (iii) A substantially revised version was passed by the House as a part of H.R. 4213, and twice was made the subject of amendments by Senator Baucus, in an effort to win approval by the Senate, until finally tabled in late June 2010.z
- (iv) If an organizer or promoter receives a capital interest for the contribution of property to the venture, he should have a "capital" interest in the entity.

2. Maximizing Capital Gains Potential

- a. Permissible “Pre-Development” Activities consistent with investor status.

- b. Affiliated investor and developer entities.
 - c. Inheriting the “seller’s” holding period.
3. Acquiring partial Interests in the Target Property
- a. Allocation Rules Charge sufficient liabilities to “continuing” partners to postpone any recapture upon new partner’s admission.
 - b. Through December 31, 2010 (only) it may be possible for continuing partners to elect to defer cancellation of debt income, where applicable under I.R.C. Section 108(I), as clarified by Rev. Proc. 2009-37.
 - c. Since the 2004 amendments to Sections 704(c) and 754, mandatory basis adjustments are required for property having a “built in” loss exceeding \$250,000.

II. Case Studies (Hand-outs to be provided)