

**American Bar Association**  
**Section of Real Property, Trust & Estate Law**  
**2010 Spring Symposium**  
**Philadelphia**  
**May 6, 2010**  
**1:30 – 3:00 PM**

**Special Investors and Investment Structure Group**

**U.S. Investors, Lenders and Tenants in Troubled Foreign Real Estate: Pitfalls and Opportunities in Getting Out and Getting In**

<p><b>Florian Ehrich</b> Noerr LLP Berlin, Germany florian.ehrich@noerr.com</p>	<p><b>Dennis M. Horn – Group Chair</b> Holland &amp; Knight LLP Washington, D.C. dennis.horn@hklaw.com</p>	
<p><b>John Hutmacher</b> Blake Cassels &amp; Graydon LLP Toronto, Canada john.hutmacher@blakes.com</p>	<p><b>Dirk Lentfer</b> Noerr LLP Berlin, Germany Dirk.Lentfer@noerr.com</p>	<p><b>Luis F. Moreno</b> Haynes and Boone LLP Mexico City, Mexico luis.moreno@haynesboone.com</p>
<p><b>Sue Snyder</b> Jackson Walker LLP Austin, Texas ssnyder@jw.com</p>	<p><b>Mark Stone – Program Chair</b> Holland &amp; Knight LLP New York, NY mark.stone@hklaw.com</p>	

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## AGENDA

- 3 case studies will frame U.S. investor, tenant and lender issues arising out of foreign distressed real property interests in Germany, Mexico and Canada.
- Both distressed interests in existing properties and vulture buying and other opportunities for new investments to be discussed.
- Comparison of rights and obligations in foreign jurisdictions with generally understood U.S. rights.
- U.S. laws relating to foreign real property investments, including Patriot Act, embargo and anti-boycott laws, investment provisions in bi-lateral treaties and free trade agreements.
- U.S. tax consequences from foreign workouts.

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### Case Study 1 - U.S. Individual Investor in Germany Holding Distressed Real Estate

- Michelle Muller, U.S. citizen, bought from 2004-2007 a portfolio (assembled 1 at a time) of 10 commercial and residential units in Berlin for Euro 10,000,000.
- Each unit was purchased by a separate German GmbH which she wholly owns, and for which she made a Federal "check the box" election for U.S. tax purposes.
- Acquisitions financed by loans from a Berlin bank in the amount of Euro 8,000,000.
- Goal was to sell the assembled portfolio as a package.
- In 2010 the properties were valued at Euro 6,000,000 and Michelle's companies were not able to meet their mortgage payments.
- What should she do?

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**Case Study 1A - U.S. Individual Investor in Germany Buying New Distressed Real Estate**

- Fred Burger, U.S. citizen, desires to acquire prestigious commercial property in Berlin for Euro 10,000,000.
- In 2010 the property is purchased by a German GmbH which Fred wholly owns, and for which he made a Federal "check the box" election for U.S. tax purposes.
- Acquisition financed by loans from a Berlin bank in the amount of Euro 8,000,000.
- Fred purchased at a compulsory auction initiated by the bank that foreclosed against the prior distressed owner.
- Fred's company rents the property for a short time and sells in 2011 for Euro 13,000,000.
- What procedures were necessary to acquire in foreclosure and to rent and sell the property?

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**Case Study 2 - U.S. AAA Retail Chain in a Build to Suit Lease in Mexico - Landlord Defaults**

- Walco, an AAA retail chain tenant, enters into an agreement in 2006 with a Mexican builder, Sanco, in a build to suit lease in Mexico for a maquila operations for \$10,000,000.
- Walco forms Mexican SRL wholly owned subsidiary, Walmex, to execute the agreement and to operate in Mexico, with Walco guarantee on lease.
- Sanco makes bad investments in US realty and is unable to meet commitments to Walmex.
- Walmex seeks termination of lease, return of payments made, and damages.
- Sanco threatens damages of all rents due under the lease.
- Parties agree to cancel the lease.
- Sanco unable to repay lease/build payments, parties agree to credit lease payments against lease payments Walco or Walco affiliates owe to Sanco in other Mexican lease arrangements.
- Alternatively, assume Walmex is unable to meet its lease commitments.
- What hoops had to be jumped to get there?

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**Case Study 2A - Mexican Builder Landlord Goes Bankrupt**

- In Example 2 Sanco goes bankrupt.
- Walmex left with various leases of Sanco's bankrupt properties.
- Sanco's properties sold at auction.
- What should Walmex and Walco do?

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**Case Study 3 - U.S. Fund Provides Debtor-in-Possession Financing to Canadian Company**

- French lender in 2006 makes \$50,000,000 loan as part of large credit facility to U.S. Co. for manufacturing facilities in the U.S. and Canada.
- Significant portion of the loan is used by U.S. Co.'s Canadian subsidiary, Canman, for manufacturing facilities in Montreal.
- In 2010 U.S. parent files for Chapter 11 protection in Bankruptcy and Canman files for Companies Creditors Arrangement Act protection in Canada.
- U.S. Co and Canman seek to restructure debt and continue in business.
- U.S. based fund, Fundco, willing to provide debtor in possession financing.
- What should Fundco consider in lending funds on security of Canman real estate?

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**Case Study 3A - U.S. Bank Holds Distressed Construction Loan from Canadian Developer of Resorts**

- U.S. Bank, Finco, makes a \$50,000,000 construction loan in 2007 to a Canadian developer of hotels/resorts, Canco, for a project in Ontario.
- Canco promises purchasers of the resort interests amenities such as golf memberships, securing appropriate number of pre-sales to go forward with the condo construction.
- In 2009 the project goes way off budget, Canco runs out of money - making little payment against the construction loan-and leaving the project 75% complete.
- What are Finco's options?

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U.S. Owners of Distressed  
German Real Estate

Dr. Dirk Lentfer  
Dr. Florian Ehrich

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### Case Study 1 - "Getting Out"

What should Michelle do?

1. Check if she is obliged by law to file for insolvency because of liabilities exceeding the assets.
2. When appropriate, negotiate a "qualified subordination" of the bank's claim to eliminate over-indebtedness.
3. Sell the properties - either as an asset deal or a share deal - to avoid foreclosure proceedings and minimize losses.

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### Key facts to consider for the asset deal

1. Broker fee
  - Max. 6 % of the purchase price + VAT (19 %), generally borne by the purchaser
  - The brokerage agreement is tacitly concluded, if the broker provides a property brochure, which states the brokerage fee and the property is presented to the interested party
2. Form requirements
  - Purchase Agreement must be notarized, anything else is not binding
  - LOIs are customary for larger transactions, but not binding

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3. Title
  - No title research, no title insurance in Germany
  - If the seller is registered as the owner in the land register, a purchaser can rely on this information
4. Tenancies
  - Often purchasers are rather interested in the lease than in the property itself, especially if AAA tenants and long term leases (up to 30 years max.) are involved
  - Lease agreements in Germany with a fixed term of > 1 year are subject to termination with statutory notice if they do not comply with written form requirements pursuant to sec. 550 German Civil Code. Therefore, important lease agreements should be checked and - if necessary - "repaired" prior to the sale by way of a supplement agreement with the respective tenant

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5. Financing

- The part of the purchase price that is required to pay off existing mortgages is generally paid directly to the mortgage creditor
- If the agreed purchase price does not suffice to pay off existing mortgages, the vendor would have to provide additional funds to pay off the loan

6. Handover

- Handover usually takes place on the day after the purchase price has been paid in full
- A fixed handover date can be agreed but usually requires that the purchase price is held in a notary's trust account, which increases fees

7. Real Estate Transfer Tax

- RETT amounts to 3.5 %, in Berlin and Hamburg 4.5 % of the purchase price
- Borne by purchaser, due after signing

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**Key facts to consider for the share deal**

- RETT can be avoided if less than 95 % of the shares are acquired, the remaining 5 + x % can be purchased by an "unrelated third party" or remain with the vendor
- Due Diligence is more complex since additional corporate and tax issues must be considered
- Purchasers generally only consider a share deal if the company is a single purpose vehicle that has never engaged in any commercial activities besides holding the property

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**Case Study 1a) – "Getting In"**  
**What procedures were necessary for Fred?**

1. Identify Special Opportunity

- Bank as "de facto" vendor of distressed real estate
- Insolvency administrator as vendor
- Compulsory Auction

2. Participation at Compulsory Auction

- Foreclosure by Judicial Sale pursuant to the Compulsory Auction of Immovable Property Act (ZVG)
- The debtor can ask for bank guarantee in the amount of 10% of the property's market value from every bidder
- The minimum cash bid is announced prior to the auction, the bidder must add on any (higher ranking) mortgages that have to be taken over to identify the actual price
- The creditor can, until the end of the auction, abandon the proceedings, deny acceptance, and request a new auction date; Otherwise, the highest bidder's bid is accepted
- Special termination right of the purchaser for existing lease agreements

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3. Finding New Tenants and Conclusion of New Lease Agreements

- For new long term leases written form requirements pursuant to Sec. 550 German Civil Code must be observed
- Otherwise the Lease Agreement is subject to termination with statutory notice

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Case Study 2 - U.S. AAA Retail Chain in a Build to Suit Lease in Mexico - Landlord Defaults

by Luis Moreno Treviño



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BACKGROUND

- Walco, an American based AAA retail chain tenant, enters in 2006 into a US\$10 million dollars agreement with Sanco, a Mexican builder, regarding a build to suit lease in Mexico over an industrial facility in the Mexican border to establish "maquila" operations through its Mexican subsidiary Walmex and Walco acting as guarantor of all tenant's obligations under the lease.
- Sanco is huge developer of commercial and industrial facilities in Mexico. However, during real estate bubble in 2006 carried out considerable investments in the acquisition of commercial and residential real property in Miami and Mexican builder loses millions of dollars, going practically bankrupt, so it is not able to accomplish the edification of the industrial facility subject matter of the referenced lease agreement.

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## BACKGROUND (continues)

- Sanco's defaults over construction of industrial facility and Walmex seeks out of the lease. Walmex has paid already substantial consideration because of the build to suit component under its lease.
- Sanco's argues that Walmex tenant can't go out of lease unless it pays contractual penalties thereunder (basically all rent payments owed for the lease term) and threatens Walco for payment if Walmex does not pay.

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## Resolution

- Because there is no building to occupy, Walmex is able to convince Sanco that there is still no subject matter of lease and that if the matter is taken to court, they will for sure lose the case.
- As a result, Walmex is able to get out from lease and no penalties are imposed to Walmex nor Walco.
- Because Sanco has no capacity to pay back that which has already been paid by tenant, Walmex decides to swap those monies against rents in other facilities that it leases already to Sanco. Sanco agrees, and business relationship continues.

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## Case Study 2A – Mexican Builder Landlord Goes Bankrupted

by Luis Moreno Treviño

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## BACKGROUND

- Sanco eventually goes bankrupt and Walco (through Walmex) is left out with various leases of Mexican builder's property.
- Walmex took into consideration the possibility of acquiring Sanco's properties currently leased by it, as part of the bankruptcy process.

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## Resolution

- In accordance with Mexican law, Walmex is able to stay in Sanco's properties during the bankruptcy process and even in case those properties being sold as part of Sanco's bankruptcy process to cover different creditors' payment obligations, in light that leases goes with the land.
- Leases expiration term is close and Walmex decides to acquire the whole portfolio of industrial properties that it leases from owner and that the amounts owed by Sanco are used as part of the purchase price of such properties. Under Mexican Law, tenants have a first refusal right to acquire a leased property.

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## Some key facts to consider before leasing real estate in Mexico

- **Broker: Engagement, Who pays?**  
Usually the broker is paid by Lessor, but sometimes Tenants hire a Broker for finding a specific property, so it may differ from time to time.
- **Special Situations: Forced Auctions, Sale by Insolvency Administrator.**  
As a general rule, leases shall survive any change of Lessor taking into consideration first refusal rights that Tenants have to acquire their leased properties, pursuant to applicable Mexican law.
- **Title: Land Registry, Type of Property being Leased, Title Insurance.**  
There are in Mexico different types of properties (i.e. rustic, commercial, etc.) that are governed by different rules and provisions. Therefore, it is convenient to determine what type of real estate is being leased. Regarding title insurance, in Mexico it is commonly used when acquiring real estate by foreign investors. However, for the case of a lease, title insurance may not be necessarily required because of the fact that the investor will not be making an important investment.
- **Tenant: Termination Risks, Form Requirements.**  
Lease agreements need be in writing. In some States of Mexico, local laws require them to be recorded before the local treasury. All termination risks can be covered and contractually provided in the same lease agreement.

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## Some key facts to consider before leasing real estate in Mexico (continues)

- **Guaranty:** Should American parent guaranty a lease by Mexican subsidiary.

It is very common that Lessors require that a parent company act as guarantor of Mexican subsidiaries.

- **Notary: Form Requirements, Costs**

Leases do not have to be formalized by a Notary. However, for the acquisition of real estate in Mexico an approximate of 5% of the purchase price needs be considered for Notary's fees and related costs (including recording fees and taxes).

- **Handover: Timeline, Administration, Hidden Flaws.**

These matters can be agreed by the parties in the lease agreement. However, it is commonly agreed that Tenants are responsible for the maintenance of the leased properties (except for hidden flaws).

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## Structure to acquire Mexican property by foreigners in Mexico.

- There are two ways American investors typically enter the Mexican real estate market.
- A. By setting up a Mexican SRL (limited liability partnership) to obtain pass through income tax treatment in the US (check the box entity), and be able to directly own the property in Mexico (foreign ownership restrictions apply in so called "restricted zone"). Typically one SRL is used to own others that hold title to every piece of property to isolate liability from each of the properties' operations.
- B. By setting up a trust that owns the properties and that acts as title owner for them. Nevertheless, the American investor will act as beneficiary under that trust and thus will be able to use, enjoy and lease the property, by instructing trustee to do so on its behalf. Trustee usually is a Mexican banking institution. Note should be made that title is legally segregated into the trust estate, so trusts are considered bankruptcy remote entities. Same costs as above, with the addition of trustee services fees. Trust can also be used to issue securities.

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## Acquisition of land by foreigners in the Restricted Zone in Mexico

- Article 27 of the Mexican Constitution discusses the ownership of land and water. Article 27 grants the ownership of the land and water within the national territory to the Mexican Nation, and provides that the Nation will have the power to transfer ownership rights to these properties to private individuals, thereby creating private property.
- Section I of Article 27 grants the right to acquire the dominion of land and water only to Mexican individuals and companies. It also grants to the State the discretionary power to grant the same right to foreigners, subject to the condition that foreigners agree with the Ministry of Foreign Affairs to consider themselves Mexican nationals and not to invoke the protection of their home governments with respect to the property acquired. If this covenant is breached, all rights to the property will revert to the Mexican Nation. Moreover, this Section prohibits foreigners from acquiring direct ownership over land and water located within 100 kilometers wide from the national border and 50 kilometers wide from the coastal shores (the "Prohibited" or "Restricted Zone").

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## Foreign Investment Law

- The Foreign Investment Law of 1993 ("FIL") revoked previous decrees and regulations governing foreign investment in Mexico. However, it did not attempt to amend or modify Article 27 of the Constitution regarding the acquisition of land by foreigners in the Restricted Zone. Nevertheless, pursuant to the new FIL, foreign ownership in the Restricted Zone is available in the following cases:
- If acquired for **nonresidential** purposes (i.e., industrial, commercial, or tourism activities), through participation in a Mexican company. Acquisition must be recorded with the Ministry of Foreign Affairs.
- If acquired for **residential** purposes, through a trust. The Ministry of Foreign Affairs must authorize acquisition.

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### American Bar Association Section of Real Property, Trust & Estate law 2010 Spring Symposium May 6, 2010

U.S. Lenders In Troubled Canadian Real Estate

John Hutmacher  
Blake Cassels & Graydon LLP  
Toronto, Canada  
john.hutmacher@blakes.com

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### Case Study 3 - U.S. Fund Provides Debtor-in-Possession Financing to Canadian Company

- In 2006, French lender makes \$50,000,000 loan as part of large credit facility to U.S. Co. for manufacturing facilities in the U.S. and Canada.
- Significant portion of the loan is used by U.S. Co.'s Canadian subsidiary, Canman, for manufacturing facilities in Montreal.
- In 2010, U.S. parent files for Chapter 11 protection in bankruptcy and Canman files for *Companies' Creditors Arrangement Act* protection in Canada.
- U.S. Co. and Canman seek to restructure debt and continue in business.
- U.S.-based fund, Fundco, willing to provide debtor in possession financing.
- What should Fundco consider in lending funds on security of Canman real estate?

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**CASE STUDY 3**

Issues for Prospective U.S. Lenders when Considering Lending on the Security of Distressed Real Estate in Canada:

- A. DEBTOR-IN-POSSESSION (DIP) FINANCING
- B. CHOICE OF LENDING ENTITY
- C. STRUCTURING THE LOAN AND SECURITY
- D. REMEDIES ON DEFAULT

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**A. DEBTOR-IN-POSSESSION (DIP) FINANCING**

Bankruptcy and Insolvency Considerations:

- several different bankruptcy and insolvency rules, and different rights and remedies of creditors, in Canada when compared with U.S.
- *Companies' Creditors Arrangement Act* (Canada) (functional equivalent to Chapter 11 of *U.S. Bankruptcy Code*) vs. *Bankruptcy and Insolvency Act* (Canada) (analogous to Chapter 7 of *U.S. Bankruptcy Code*)

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Companies' Creditors Arrangement Act (Canada):

- who qualifies for relief?
- how are proceedings commenced?
- what relief can be provided?

DIP Financing:

- what is it?
- when will it be needed?
- why provide it?
- potential priority of DIP lender's security over pre-existing security interests and statutory liens

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**B. CHOICE OF LENDING ENTITY**

- a number of possibilities, although largely limited by tax and regulatory considerations:
  - direct lending by U.S. banks, insurance companies, etc. through entities that are based in U.S. (either from U.S. or from Canadian-based branch operations)
  - lending by Canadian subsidiaries of U.S.-based lenders
  - partnership in joint ventures: single-purpose entities are often created for this purpose (especially for new construction (not applicable to our fact situation))

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Tax Considerations:

- be wary of unintentional exposure to Canadian income tax
- get transaction-specific advice
- withholding tax:
  - was eliminated for most unrelated, arm's length interest payments to non-Canadians as of January 1, 2008
  - withholding tax on non-arm's-length payments of interest to U.S. residents entitled to the benefits of the Canada-U.S. Income Tax Treaty is gradually being eliminated over the course of several years
  - however, withholding tax still applies to dividends, rentals, royalties, certain convertible debt obligations, interest on participating debt, etc.

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- Fundco will be subject to payment of Canadian income tax if it has a "permanent establishment" in Canada and carries on business in Canada – thus, it is important for a lender with no Canadian presence who lends to Canadian borrower to structure affairs properly

Regulatory Matters:

- foreign banks and their affiliates may not "carry on business" in Canada without complying with regulatory requirements
- similar rules apply to foreign insurance companies and other foreign financial institutions
- ensure Canadian lending activities do not cross the line
- consumer protection rules

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**C. STRUCTURING THE LOAN AND SECURITY**

Interest Rate Concerns:

- *Interest Act* (Canada) considerations:
  - lenders may not charge any fine, penalty or higher rate of interest secured by a mortgage on real property after default than before default
  - affects manner in which interest rate is expressed and its enforceability
  - mortgages given by natural persons or an entity other than a corporation are open for repayment after 5 years upon payment of 3 months' interest
- must also be mindful of criminal interest rates

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Type of Real Property Security:

- real property security to be required by Fundco in Canada would be comparable to what it would expect in the U.S., but need to comply with various provincial/territorial rules with respect to the manner in which security is taken
- the Province of Quebec, being a civil law jurisdiction, has different terminology and concepts that apply in most of the other provinces/territories

Guarantees:

- any restrictions?

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Currency/Exchange Rate Risk:

- need for exchange rate/currency indemnities or hedges?

Choice of Law:

- Canadian borrowers may prefer Canadian law, so lenders prepared to allow Canadian law to govern the loan may enjoy a competitive advantage
- Canadian courts are less likely to impose punitive/consequential damages
- jury trials are very rare in civil disputes in Canada

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**D. REMEDIES ON DEFAULT**

- power of sale vs. foreclosure
- availability of private power of sale remedy in Province of Ontario (no need to resort to courts)
- entry into possession of mortgaged property privately or by a receiver
- lender's ability to sue for deficiency
  - we'll discuss these remedies in more detail in the context of the next Case Study (3A)

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**Case Study 3A - U.S. Bank Holds Distressed Construction Loan from Canadian Developer of Resorts**

- U.S. Bank, Finco, makes a \$50,000,000 construction loan in 2007 to a Canadian developer of hotels/resorts, Canco, for a project in Ontario.
- Canco promises purchasers of the resort interests amenities such as golf memberships, securing appropriate number of pre-sales to go forward with the condo construction.
- In 2009, the project goes way off budget, Canco runs out of money - making little payment against the construction loan - and leaving the project 75% complete.
- What are Finco's options?

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**CASE STUDY 3A**

Issues to Consider when Faced with a Distressed Loan on the Security of Canadian Real Property:

- we're dealing with an incomplete project: construction is only 75% complete
  - the project will likely be most valuable if construction is completed
  - given the significant number of pre-construction commitments from purchasers to buy condominium units in the project, there is optimism that the project is worth completing

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- Finco, being a prudent lender, will have taken an assignment of the construction and development-related agreements as part of its security, so it is able to ensure construction gets completed; but Finco has to pay for it somehow
  - **how?** by being in a position to sell the completed condo units to purchasers and the completed hotel and golf course property to a third party purchaser
- the option selected by Finco will largely depend on whether the project has any prospect of being completed in a cost-effective manner; if the project is irretrievably “under water”, Finco may prefer to cut its losses and get out of the project
- **QUESTION: Does Finco want to exit the project or stay in the game?**

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Available Tactics:

What are Finco's enforcement options and strategies?

- **enter into possession and assume control:**
  - how?:
    - privately, *i.e.*, Finco itself enters into possession
    - by court order
    - by privately-appointed or court-appointed receiver
  - factors for Finco to consider before taking possession:
    - who is currently in possession? Finco may need to prevent waste and neglect
    - in the context of a tenanted property, does the mortgaged property carry itself?
    - any prior encumbrances to be kept in good standing?

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- factors for Finco to consider before taking possession (cont'd.):
  - any significant tax or utility arrears?
  - does Finco have necessary expertise to operate the property? is property management available if needed?
  - should lender appoint a receiver? who?
  - what will be the best way to get construction completed?
- **appointment of a receiver:**
  - **how to appoint a receiver?:**
    - include right to appoint receiver in the security documentation
    - if not included in security documentation, or provision is not sufficiently precise or comprehensive, or if problems arise, apply to court; but this has its own advantages and disadvantages

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• **why a receiver?:**

- borrower continues to be the registered owner of the mortgaged property, but the borrower's duties are suspended: gives Finco a more positive role in the administration of the mortgaged property than that permitted of a lender-in-possession
- Finco can take position that the receiver is the agent of the borrower for certain acts; accordingly, the receiver may expend funds on improvements and add them to the mortgage debt, even if such expenditure may ultimately impair the borrower's right to redeem
- receiver could attempt to renegotiate original deals made by developer with purchasers to reduce financial commitments/amenities, all with a view to having the project be completed at reduced overall cost

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- receiver can liaise with construction contractor to ensure completion of the project; will the contractor grant any concessions?

**QUESTION:** What if Finco wants to do more than simply enter into possession, either itself or through a receiver? What if Finco wants to cut its losses and exit?

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**Power of sale vs. foreclosure:**

Pros and cons

- Power of sale:
  - private power of sale remedy is available in Province of Ontario only: no need to resort to any court process; this has advantages in terms of time and expense
  - private power of sale vs. court-sanctioned judicial sale
  - lender selling under private power of sale cannot do whatever it wants – there is a standard of care imposed upon the lender

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- Foreclosure:
  - lender becomes the owner of the property
  - in our fact situation, Finco may not want to become the owner of the real property and, hence, be in the hotel and golf course resort business
  - depends on how quickly Finco wants "out"; how long are they willing to stick it out?
  - what is the trend in the market for valuation of hotel/golf course properties? is the value rising or falling?

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Other Factors to Consider when Assessing Power of Sale vs. Foreclosure:

- ability to sue for deficiency:
  - different outcome depending on whether proceeding under power of sale (can sue for deficiency) or by way of foreclosure (cannot sue for deficiency)
  - any guarantors?
- surplus after sale?
- land transfer tax considerations
- dealing with borrower's defensive tactics
- the "no further proceedings" trap

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- if borrower is insolvent and has sought protection under the *Companies' Creditors Arrangement Act* (Canada), borrower may seek debtor-in-possession financing from existing lender or from an outside lender:
  - Finco will have to consider whether it wants to provide further financing in order to protect its existing position, by financing a restructuring of the developer's operations
  - Finco may be able to receive a greater return on its investment by enabling completion, as opposed to simply refusing to provide further funding, resulting in liquidation
  - Finco may also be able to negotiate a more prominent role in the restructuring, by being involved in the court process
- if Finco doesn't want to provide the DIP financing but another lender does, DIP lender can take Finco out

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Date May 6, 2010  
Sue Snyder  
Jackson Walker L.L.P.  
ssnyder@jw.com • 512-236-2240

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Section of Real Property, Trust & Estate Law  
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### Applicability

- Traditional Notions of International Law Expanding with Additional Purchases
- Distressed Asset Purchase becoming Larger Business
- Financial Institutions with Greater Government Ownership/Control
- Increased enforcement of U.S. based International Controls

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### Anti-Money Laundering Statutes

- Patriot Act and other AMLs Require Protections Against Money Laundering & Major Cash Transactions
- Patriot Act's Requirements for Money Services Businesses (defined broadly)
- What you should know . . .
  - Potential Laws in this Area.
  - When Might this Be an Issue for You.

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## Government Involvement

- Foreign Corrupt Practices Act/OECD/Local Anti-Bribery Statutes
- FCPA Enforcement on all time High
- Primarily Services Industry, but has the Potential to Be Broader (especially if government lender/receivership is involved)
- What you should know . . .
  - When would FCPA be applicable.
  - How should you guard against infractions.

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## Investment Agreements

- Important to Know if FTA, WTO, Investment Treaty, etc. is in place.
- Often afford National Treatment and Most Favored Nation Status; Due Process; Repatriation; etc.
- Still could be Foreign Investment Reviews
  - Canada: NAFTA/Investment Canada Act
  - Germany: WTO/ Foreign Trade and Payments Act
  - Mexico: NAFTA/Foreign Investment Law

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## Restrictions on People/Places Doing Business

- Office of Foreign Assets Control (“OFAC”)
  - List of Entities/People
- Embargoed Countries
- Anti-Boycotting Concerns

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## Additional Matters

- Repatriation of Profits/Transfer Pricing
- Reporting Laws
  - Currency and Monetary Transaction Reports
  - Foreign Bank Account Reports
- Currency Exchange Requirements
- Visa/Employment Issues
- Permanent Establishments
- International Tax Treaties
- Others

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## Holland & Knight

American Bar Association  
Section of Real Property, Trust & Estate Law  
2010 Spring Symposium  
May 6, 2010

U.S. Investors, Lenders and Tenants in Troubled Foreign Real Estate:  
Pitfalls and Opportunities in Getting Out and Getting In

U.S. Tax Considerations

Mark Stone  
Holland & Knight LLP  
New York, NY  
[mark.stone@hklaw.com](mailto:mark.stone@hklaw.com)

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## U.S. Tax Considerations

- Why Would a U.S. Individual Make the Check The Box Election on the GmbH?
  - Individual investors going into a deal are generally planning for profits over the course of the investment, not losses or foreclosure
  - Check the box election provides the following:
    - Disregards the separate German corporate existence for U.S. tax purposes
    - Preservation of any US preferential individual capital gains rate on sale of real property
    - Direct credit of German corporate income tax liabilities incurred from the investment against US tax liabilities (foreign tax credit)
    - Direct use of losses in early years to reduce U.S. taxable income

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## U.S. Tax Considerations (continued)

- Adverse tax consequences of check the box election arising from German lender's cancellation of debt
  - U.S. Individual includes cancellation amount in US taxable income even if she recognizes and pays tax on such amount in Germany.
  - Individual should be able to credit German income tax liability from cancellation against her US tax.
  - Individual is eligible for the same exclusions from cancellation recognition as is applicable in the US, even though the lender and the property are outside the US. These include:
    - US Title 11 bankruptcy (not pursuant German bankruptcy law) – IRC Section 108(a)(1)(A)
    - Insolvency of individual – IRC Section 108(a)(1)(B)
    - "Insolvency" of real estate – IRC Section 108(a)(1)(D), and (c)
    - Ten year deferral of tax liability of solvent investor for 2010 workouts – IRC Section 108(i)

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## U.S. Tax Considerations (continued)

- Why Would a US Corporation Likely Not Make the Check The Box Election on the Mexican SRL?
  - A US corporation, unlike an individual, may credit the foreign taxes of its foreign/Mexican subsidiary against US tax liability.
  - Walco can defer recognizing Mexican income earned by Walmex until dividends are repatriated, while the election would require immediate recognition of the income.
  - Various other factors to consider including use of start up losses and Subpart F planning.
  - Any release of tenant/Walmex liability likely would not give rise to cancellation income.

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## U.S. Tax Considerations (continued)

- Any Other US Tax Considerations for the Direct US Lender in Canadian Troubled Real Estate?
  - Normal cross-border withholding tax issues under Code and Treaty.
  - No change in tax write-off rules for bad debts in domestic versus foreign loans.
- So What Do We Take Away From the Tax Discussion?
  - Unlike certain other countries, the U.S. taxes its citizens, residents, corporations, trusts and estates on world-wide income.
  - It is necessary to examine the complex rules of the US Tax Code and Tax Treaties when acquiring foreign real estate interests and loans and plan for a number of contingencies.

The End

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