



January 19, 2005

CLIENT ALERT: TRENDS FROM 2004

Trite but true: the new year is a good time to step back, assess trends and make appropriate changes in business process and documentation. Here are a few significant trends from 2004:

- **Tenant-In-Common Ownership Structure ("TIC"):** This structure comes roaring out of 2004 with promoters such as Triple Net Properties, DBSI, Argus Realy Investors, FOR 1031 and TSG seeking investors in TICs, which use national broker dealer networks to locate TIC investors. One such company came close to completing \$1billion in transactions in 2004. This product even has an industry organization: www.ticassoc.org. Some of the issues to be addressed in underwriting, due diligence and documentation of a TIC structure include:
 - Scope of TIC entity liability: joint and several liability or pro rata liability?
 - Scope of liability of the TIC principal: all carveout events or limited?
 - Points of concern: waiver of right to partition; single-purpose entity; centralized property management by a qualified manager; serial bankruptcy; subordination and standstill of remedies and indemnities among the TICs; waiver of lien rights; centralized notice; subordination of purchase rights; and securities laws representations
 - Master Lease vs. "true" TIC structures
 - Use of the Delaware Statutory Trust instead of the tenant-in-common structure
 - Transaction costs: close to 14%
- **Single Member Limited Liability Ownership Structure:** Use of a limited liability company with a single owner or member (a "SMLLC") is becoming more widespread. Owners (called "members" of a limited liability company are shielded from liability (like shareholders of a corporation). Importantly, since a SMLLC can be designated a "disregarded entity" for federal income tax purposes, so that no tax is paid by the SMLLC. It is being used in numerous structures, including the TIC structure. Issues to be addressed in underwriting, due diligence and documentation of a SMLLC include:
 - State of Formation: while rating agencies and investors favor DE, many states now mimic the DE LLC statute (and its provisions covering continuation of the SMLLC upon the death or dissolution of the sole member by the use of "springing" members, etc.)
 - Alternative to a "Two-Tier" SPE Entity Structure: use of a Board of Director structure with an independent director at the borrower (SMLLC) level
 - Points of concern: waiver of right to partition; special legal opinions (such as Federal preemption of state law with respect to authority to file bankruptcy, enforceability of entity

continuation provisions, etc.), continuation of the SMLLC upon death or dissolution of the sole member

- **Expanded Use of the Condominium Ownership Structure:** Maturing real estate markets increasingly are using this ownership structure, both for a single product type (such as retail) and for mixed uses (for example, combining lodging, residential and retail). Some of the issues to be addressed in underwriting, due diligence and documentation of a condominium structure include:
 - Possible registration under the Federal Land Sales Full Disclosure Act
 - Lien priority of owners' association assessments
 - Notice and cure rights of lender
 - Loan collateral should include a proxy agreement covering voting rights in the owners' association
 - Termination provisions
 - Notice and cure rights of lender
 - For retail developments, proper recording of tenant exclusive use provisions
 - Matters relating to the owners' association: budgets; reserves; insurance; use of insurance and casualty proceeds (and obligation to rebuild); etc.
- **Environmental:** : Trends in the environmental area include the following:
 - Insurance: Continued retraction in the market for secured creditor products. In the wake of AIG's leaving this market and the continuing investigation by New York's Attorney General into the propriety of financial insurance products, insurers generally are more restrictive on terms for secured creditor products. Policies generally are written only on a "lesser of" basis with five years being the norm for a policy period.
 - Mold: In May 2004, the Institutes of Health, an arm of the National Academy of Sciences issued "Damp Indoor Air Spaces and Health," the first comprehensive study of health and other issues associated with mold and indoor air quality. This study provides hopeful information about the lack of a causal connection between mold and many illnesses, and the first real road map on how to conduct research in this area.
 - MBA White Paper on Mold: Issuance by the MBA of its white paper on mold and commercial real estate for public comment and review. This comprehensive survey tries to focus on mold and fungus as they affect lenders and servicers of commercial loans.
- **Technology:** Increasingly the mortgage lending industry is focusing on technology as a means of increasing transaction speed, capturing and sharing important information as data and reducing costs. Significant progress was made in 2004 on a wide range of technology fronts, including:
 - Creating data standards that will permit sharing of information as data (an effort undertaken by a wide range of industry groups, including the MBA's CMISMO)
 - Groundwork for a truly "electronic" mortgage

- Moving beyond merely transmitting documents via e-mail to the use of "ftp" websites, extranets or "data rooms" where documents are "posted" for review (on a password protected basis)
- Law firms increasingly are utilizing document "merge" programs to generate loan documents (which not only increases efficiency but perhaps more importantly leads to the capture legal information as data – a concept that Winstead currently is beta testing)

If your company would like to follow up on the foregoing information, please contact Keith H. Mullen at 214.745.5839; kmullen@winstead.com, or Tom Alleman at 214.745.5103, talleman@winstead.com, so that Winstead may assist and counsel your company in implementing a solution tailored to your company's situations and needs.

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