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Pillsbury Winthrop Shaw Pittman LLP

The New Commercial Real Estate Loan Reality: Breaking Up is Hard to Do

by Wendelin White and Susan Michelich

The current economic downturn and severely constrained credit markets are spawning a resurgence of lender liability claims in the commercial real estate world not seen since the 1980s and 1990s. While lenders are burdened with defaulting borrowers, borrowers are facing the effects of lenders failing or refusing to fund loan advances, sometimes because of dramatically declining property valuations and sometimes because they, too, are struggling financially. Construction projects, in particular, are jeopardized by lenders turning off the spigots. As a result, lender liability claims are on the rise. Since many of these cases have not yet made their way through the courts to final judgment, the lessons to be learned still are taking shape. However, there are guideposts and landmines for lenders and borrowers alike to be found in these cases.

Common Lender Liability Claims

The basis of lender liability lawsuits is a body of law comprised of various contract, tort and other common law theories, as well as federal and state statutory law. Some of the most common types of claims are as follows:

Breach of Contract

Breach of contract claims have been based on, among other scenarios, a lender's refusal or failure to disburse loan funds or termination of a loan commitment. In *Glatt v. Bank of Kirkwood Plaza*, 383 N.W. 2d 473 (N.D. 1986), developers sued their lender for anticipatory repudiation of a $1.7 million loan commitment to finance the purchase of condominiums and construction of related facilities. Anticipating that the development would not be a success and that the developers would not be able to meet the financing conditions, the lender withdrew the commitment. An appellate court upheld the jury verdict for the developers as to liability, as evidence existed to support the jury's finding that the developers could have met the loan conditions, but the court remanded the proceeding as to the amount of damages.

Breach of Implied Covenant of Good Faith and Fair Dealing

This theory is based both in contract and tort law. In essence, a covenant of good faith and fair dealing requires that both parties to a contract exhibit good faith in performing under the contract, observe the spirit of the agreement and not interfere with the other party's right to receive the benefits of the bargain. Most jurisdictions recognize an implied obligation, even where it is not expressly set forth in a contract. In *K.M.C. Co., Inc. v. Irving Trust Co.*, 757 F.2d 752 (6th Cir. 1985), the Sixth Circuit affirmed a judgment against a lender for breaching an implied duty of good faith when the lender terminated funding without providing prior notice to the borrower. The application and interpretation of this implied covenant, however, varies across jurisdictions. The trend appears to be toward a more limited application of this theory, with courts holding that there is no breach of a separate duty of good faith when a lender enforces the terms of a contract.

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Economic Duress

If a lender threatens the borrower with the exercise of a right or remedy that the lender has no legal right to exercise, and the borrower does not have a meaningful choice but to give in (e.g., comply or face bankruptcy), the borrower may have a claim for economic duress. In *Edge of The Woods, Limited Partnership v. Water's Edge Marketing Corporation*, 2000 Del. Super. LEXIS 35 (Del. Super. Ct. February 7, 2000), the plaintiff developers sued their lender following alleged underfunding of a condominium development project. The developers argued that the releases of liability they had given the lender were obtained through threats of foreclosure and bankruptcy. The court ultimately found that the "threats" were merely lawful, hard-bargaining tactics. Economic duress is more likely to be successful as an affirmative defense than as an affirmative tort entitling one borrower to damages; duress as an affirmative tort is only recognized in a handful of jurisdictions.

Tortious Interference with Contract

A borrower may have a claim under this theory if its lender is aware of the existence of a contract between the borrower and a third party and intentionally induces a breach of the contract, resulting in damages to the borrower. For example, in *Lincor Contractors, Ltd. v. Hyskell*, 692 P.2d 903 (Wash. Ct. App. 1984), the developer was largely successful in a claim for tortious interference with its construction contract after the lender refused to disburse funds until the general contractor was removed. However, lenders often have successfully defeated tortious interference claims by showing that their actions were justified in order to protect legitimate legal rights or business interests.

Breach of Fiduciary Duty

A popular lender liability claim in the 1980s was that the relationship between borrower and lender had expanded to a fiduciary relationship, in which the lender owes a duty to act in the borrower's best interest. Particularly in the construction loan context, borrowers argued that this special relationship arose because the lender had the ability to control disbursements and other aspects of the construction. However, courts have since generally limited the application of this theory, holding it applicable only in certain narrowly defined contexts.

Recent Lender Liability Cases

As noted above, there is a new wave of lawsuits by developers attempting to minimize their losses from incomplete projects. Two of these cases are highlighted below.

Destiny USA Holdings, LLC v. Citigroup Global Markets Realty Corp.

Destiny was the developer of an addition to a mall in Syracuse, New York. Citigroup had agreed to lend $155 million in construction financing. It also acted as agent for all of the project's lenders and was responsible for approving all advances of money from the various funding sources. The loan documents contained a customary "balancing" provision requiring the borrower to "balance" the loans by depositing any deficiency with the lender if the funds remaining to be advanced under the loans and other sources of funds were insufficient to complete the improvements and pay other related costs. Citigroup allegedly honored many disbursement requests despite such deficiencies and regularly deducted interest payments from these advances. In June 2009, when the construction was 90 percent complete, Citigroup declared a default based on an approximately $15 million deficiency and the borrower's failure to pay the monthly interest due and refused to continue disbursing funds. Destiny sued for specific performance or an injunction enjoining Citigroup from refusing to advance funds. In July, a New York state court issued a mandatory preliminary injunction requiring Citigroup to resume funding, declaring, based on specific balancing language in the loan agreement and the custom and practice between the parties, that the notices of deficiency and default were erroneous and void and that the lender had breached its contract and its fiduciary duty as agent. An appeals court subsequently issued a stay of the injunction pending Citigroup's appeal. On November 13, 2009, the appeals court upheld the order granting the preliminary injunction. It concluded that Destiny had established a likelihood of success on the merits due to convincing evidence that tenant improvement costs should not have been included in the calculation of the deficiency. Further, the court found that there would be irreparable injury if the injunctive relief was withheld, because the unique nature of the project made it impossible to calculate damages with precision and,

The New Commercial Real Estate Loan Reality: Breaking Up is Hard to Do (continued)

due to the economic climate, alternate funding was not available. The court also found that a balancing of the equities favored granting the injunction because of the significant public interests involved in the project. However, the court also conditioned the injunction on Destiny's posting an undertaking in the amount of $15 million within 20 days. This amount would be paid to Citigroup as reimbursement for damages if Citigroup is ultimately successful on the merits and it is determined that Destiny was not entitled to the injunction. The appeals court also vacated the orders of the lower court that voided the notices of deficiency and default. It concluded that the determinations of whether tenant improvement costs should be included in the deficiency calculation and whether the lender breached the loan agreement were matters to be decided in a full hearing on the merits, not on a motion for a preliminary injunction. The final outcome of this litigation is yet to be determined. What may limit the applicability of this case, however, is the political context. The trial court viewed the project as a unique and important public-private, "green" redevelopment, toward which a city agency had committed $170 million.

Fontainebleau Las Vegas LLC v. Bank of America

Fontainebleau Las Vegas LLC, the developer of a $2.9 billion casino resort in Las Vegas, filed a lawsuit in April 2009 against Bank of America and other lenders after the lenders called the borrower in default and halted funding. Fontainebleau had obtained $1.85 billion in construction financing through a mix of credit facilities, including several term loans, to be funded first, and a revolver, to be the final-stage funding. The lenders under the revolver terminated the agreement based on an unspecified default. Although Fontainebleau had apparently acknowledged a significant deficit in the construction budget and admitted it would be seeking bankruptcy protection, it denied breaching the loan agreement and claimed that the agreement required funding notwithstanding the existence of any default. In June, approximately 120 investment companies that helped to finance the project sued the lenders. They alleged, among other things, that the final-stage lenders improperly failed to fund the revolver, resulting in a reduction in the value of the investment companies' collateral and disabling Fontainebleau from repaying the funds they advanced. Several Fontainebleau entities have since filed for bankruptcy protection, and Fontainebleau is currently in discussions with potential buyers of the resort.

Emerging Trends

It remains to be seen what effect these and other cases will have on lenders' ability to exercise discretion in the enforcement of certain customary rights under loan documents, such as property reappraisals, audit rights and balancing and remargining provisions, and on borrowers' rights in the face of declining commercial real estate values and severely constrained debt markets. Lender liability law will evolve as these cases make their way through the courts, and the law may be choppy from jurisdiction to jurisdiction. In the meantime, a trend in lender practices appears to be taking shape. Ultimately, rather than taking projects from developers through foreclosure or otherwise, lenders are trying to limit their disbursements for properties where values have declined and instead are calling on borrowers and guarantors to increase their equity investments in those properties. In these instances, borrowers have little leverage to refuse lender demands unless they are willing to give up the property, as most projects can ill afford the time and expense of litigation. Further, since the last upswing in lender liability litigation, there has been an increase in the complexity of deal structures on the lender side, including participations, syndications and mezzanine debt, making disputes among lenders whose interests may not be aligned inevitable as well. If there is a lesson to be learned from the current spate of lender liability litigation, it is that all parties are likely to be better served by coming together to work out problem loans than by heading to court to resolve their differences.

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Round Two ... Commercial Real Estate

By William S. Waller and David Tabibian

Just as some begin to catch their breath from the collapse of the residential housing market, most people are gearing up for the next and more threatening wave of defaults—the commercial real estate market. Industry analysts estimate that more than $1 trillion in commercial real estate debt will mature between 2010 and 2013. Like homeowners before them, many owners of commercial properties will need to refinance their debt in order to avoid foreclosure. However, with the credit market barely thawing, refinancing may not be possible for all property owners, especially those who have little to no equity in their property.

Although commercial real estate was not the primary focus of the real estate bubble, it has nevertheless fallen victim to the downward trend and will continue to do so at a more rapid pace in 2010, as the next wave of foreclosures and workouts hits the commercial market. It is safe to say that 2010 will present formidable obstacles in this regard, particularly in the commercial financing market.

Unlike in prior real estate downturns, the prevalence of commercial mortgage-backed securities, or CMBS, greatly compounds the current problems facing the commercial real estate market. Some analysts, including those at Blumberg Capital Partners, estimate that more than $200 billion in commercial real estate loans that were turned into securities will need to be refinanced, and close to $70 billion of that amount will need to be written off as bank losses. Analysts at Deutsche Bank AG estimate that total lifetime losses on banks' core commercial-mortgage holdings could reach somewhere between 11 and 15 percent. These losses mean that many banks will need to raise more capital in the near future, leading to a refreeze of the credit markets. This prediction seems especially true given the widespread nature of the commercial financing market—the majority of home loans were made by only 10 or so large financial institutions; in contrast, thousands of small and regional banks have loaded up on commercial property debt.

The majority of home loans were made by only 10 or so large financial institutions; in contrast, thousands of small and regional banks have loaded up on commercial property debt.

Moreover, concerns about maturing commercial debt are compounded by the fact that virtually no asset class will escape this recession unharmed. Retail and hospitality have been notoriously slow for some time now. Office properties in many markets also suffer from declining demand, including in places that were once seen as safe-haven markets for investments, such as in New York, San Francisco and Los Angeles. Similarly, industrial properties are adversely affected by slowing trade and retail sales. Even multifamily apartment properties face trouble, as rental vacancies continue to rise, since many people have opted to move in with family or friends to reduce housing expenses.

Owners of commercial properties are further plagued by the fact that it truly is a renter's market. On the retail front, commercial tenants who entered into long-term leases just a few years ago now are successfully requesting credits or reductions in rent. For hardier tenants, this presents an opportunity to renegotiate leases on relatively favorable terms, but for many other tenants that stand on less sound footing (including large national retail chains forced to deal with unprofitable locations), these are steps that merely delay the inevitable—that is, tenants will be in default if they are unable to assign or sublease to a suitable replacement tenant. Leases with acceleration clauses also may cause tenants to reconsider simply

Round Two ... Commercial Real Estate (continued)

defaulting and handing the keys over to the landlord. Although this option may make sense in a normal economy by shifting the duty to mitigate the economic harm onto the landlord, that duty may be of little value when the probability of re-renting out a large space in this market is extremely low.

In 2009, most banks, including bailout recipients, were extremely conservative in extending credit, in part because of the shaky commercial forecast ahead. However, since the Federal Reserve opened up its Term Asset-Backed Securities Loan Facility (TALF) program to newly issued CMBS this past summer (in a direct effort to stimulate commercial real estate lending), there has been some thawing of the credit markets. As a result, some property owners, mindful of the challenges ahead, see a window of opportunity and are securing refinancing now, while others may be counting on further federal intervention to stave off a commercial real estate disaster. Regardless, everyone should be prepared for uncharted territory.

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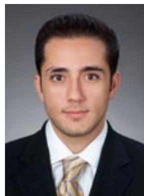

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Q&A: Troubled Banks and Commercial Real Estate

by Rosemarie Oda

Reports from regulators and market analysts suggest that efforts to stabilize the nation's financial system over the past year may have succeeded to some extent, at least with respect to some of the largest banks. However, 100 banks already have failed this year, and more than 400 may be on the secret "troubled bank" list maintained by the Federal Deposit Insurance Corporation (FDIC). This article answers some of the questions commercial real estate borrowers have regarding what happens if their bank fails.

Q: Who regulates banks and other financial institutions?

A: The regulator of national banks is the Office of the Comptroller of the Currency (OCC), the regulator of federal thrifts (also referred to as savings associations, federal savings banks, savings and loan associations or S&Ls) is the Office of Thrift Supervision (OTS). The insurer and regulator of federal credit unions is the National Credit Union Administration. We have a dual banking system and a dual system for thrifts and credit unions. The regulator of state-chartered banks, thrifts and credit unions in California is the Department of Financial Institutions. State banks also are regulated by a federal banking agency—either the Federal Reserve Board (the Fed) for members of the Fed, or the FDIC for nonmember banks. All national banks are both members of the Federal Reserve and FDIC insured. All thrifts are insured by the FDIC. Thrifts specialize in residential mortgage lending and consumer loans. The regulator of bank holding companies is the Fed, but the OTS regulates thrift holding companies. When a failing bank is closed by its primary regulator, the FDIC is appointed as receiver or conservator.

Q: How can I find out if my bank is in trouble?

A: Publicly held banks, of course, must publish financial statements. A bank closure may be preceded by an announcement of a qualified opinion from the bank's auditors that the bank may no longer be a "going concern." This occurred with Corus Bank and Guaranty Bank, though Corus was not closed until more than four months after the announcement.

All banks are required to file Reports of Condition, or "Call Reports," which the FDIC publishes on a quarterly basis on the FDIC's Institution Directory (available on the FDIC's website). Capital ratios can be deceiving, since what agency regulations describe as "well-capitalized" levels serve as a floor and do not accurately reflect the amount of capital that a banking agency truly regards as adequate. The FDIC website provides a peer report for comparisons.

The FDIC, the OCC, the OTS and the Fed publish lists of publicly and privately held banks subject to three types of formal enforcement actions: cease and desist orders, removals and civil money penalties. These enforcement actions, though brought by different federal banking agencies, are basically similar to one another in content and can provide some clues as to the source and extent of problems. For example, issues with capital coverage and the allowance for loan and lease losses may indicate serious problems. Other, informal enforcement actions, such as memoranda of understanding, are not published by the agencies, but banks may disclose them, and such informal actions usually precede formal enforcement action and may serve as red flags.

Q&A: Troubled Banks and Commercial Real Estate (continued)

Q: If my bank is sold as a whole bank, is that a good thing?

A: If a bank is closed by the OCC or its state regulator, the optimal outcome for everyone except shareholders would be for another bank to acquire the failed bank itself. Despite failure, business continues as usual. Unfortunately, sales of whole banks are becoming increasingly rare as banks focus on rebuilding capital instead of growing by acquisition.

Q: What happens if my bank is not sold as a whole bank?

A: During due diligence, a prospective bank purchaser may negotiate with the FDIC as to which loans it will leave behind or heavily discount or the FDIC will guarantee against loss. The FDIC may pool loans with those from other failed banks, and it is forced by statute to find the least costly way to resolve a bank failure. Interestingly, despite the fact that deposits are liabilities, they represent valuable new customers as well as cheap funding and may be assumed without any asset purchase. Remaining assets may be sold to a non-bank if no bank is interested. A large borrower may be interested in buying its own loan at a discount or bidding for other bank assets at an FDIC closed bank auction, including bidding on loans to its competitors.

Q: What is the usual closing and liquidation process?

A: The FDIC begins the closing process at least three months prior to actual closure. Once closed, the Receivership Business Plan is posted on the FDIC's website. The more difficult it is for the FDIC to line up a buyer for the bank, the longer the process. Corus Bank reported negative capital for June 30, 2009, but its second quarter Call Report was not released until just before it was closed on September 11, 2009. Clearly, the FDIC was unable to find a bank purchaser. In addition to acting as conservator or receiver, the FDIC may charter a wholly owned subsidiary national bank to take over the failed bank.

Q: How would repudiation affect a borrower?

A: If no bank purchases the entire failed bank, the FDIC as receiver or conservator may repudiate any contract, loan or lease. As a result, any commitment to advance funds provided under a construction loan for the remaining stages of a project may disappear. Or a landlord might lose the benefit of any higher rent it negotiated with the bank to reflect current market rates, or a loan negotiated to finance an acquisition of property may be cancelled. If the FDIC decides to repudiate a contract, the other party will be notified and have the opportunity to make its case, but the standard for repudiation is minimal: whether performance of the contract is burdensome or whether repudiation will promote the orderly administration of the receivership.

Even the timing for repudiation is in the FDIC's favor, and it need only be "within a reasonable time," thereby allowing the FDIC to repudiate loans after the closing but as of the date of closing. Oral side agreements that are not in the interest of the FDIC as receiver may be invalidated, so borrowers should put any understandings in writing to protect themselves. The side agreements still may be repudiated, but borrowers will have no chance at all without written confirmation of terms.

Q: Is the FDIC more likely than a bank to foreclose on a real estate secured loan?

A: Banks are probably more likely to renegotiate commercial real estate loans than the FDIC; otherwise, banks may have to place loans that are more than 90 days past due on "nonaccrual," and banks that are accruing interest appear more profitable. Banks also do not like to charge off loans, especially if they are provided a plausible rationale for expecting future payment by the borrower. The FDIC, on the other hand, has little motivation to give a borrower a break and, instead, will try to minimize further losses.

Q&A: Troubled Banks and Commercial Real Estate (continued)

Neither banks nor the FDIC rush into foreclosure proceedings, preferring to collect debts rather than to manage or resell real estate. But the FDIC probably has less interest in accumulating commercial real estate than banks do. Even if the loan-to-value ratio has increased because of fallen values, that may affect pricing of the loan on resale, but it probably would not by itself make the FDIC more likely to foreclose than a bank, unless the market is plummeting.

Q: We're in the middle of a construction project. What options are available?

A: Your options depend on the current stage of construction and your company's financial position. Obviously, the closer your project is to completion, the better. You should amass documentation to convince the FDIC that your project is worth more completed than unfinished—appraisals, consultant reports, etc. You should look for another lender, or, if you are able, you may try to buy your own loan from your bank at a discount. Gather evidence that you are creditworthy, obtain third-party guarantees or letters of credit or obtain personal guarantees from your principals. There would be some special urgency to this effort if your current lender has an unusual portfolio or characteristic that might make the bank difficult for the FDIC to sell, which increases the odds for repudiation as the FDIC looks for ways to save taxpayers money.

Q: Can I challenge the repudiation process?

A: Yes, but the FDIC also has broad protection from judicial interference with receivership activities. Claims for repudiation will not give rise to punitive or exemplary damages, damages for lost profits or opportunity or for pain and suffering. Litigation against the FDIC usually is not advisable.

The FDIC is funded by insurance premiums paid by banks, so the closer it is to depleting its funds and to borrowing from the Treasury Department (it can tap up to $500 billion), the closer it comes to being treated as an appropriated funds agency whose expenditures are questioned by Congress. The financial strain on the FDIC's own budget, and the potential cost to taxpayers, motivates its staff to save money without much regard for the damage inflicted on others. The best way to handle the situation is to communicate with FDIC staff on a humane and friendly level, and to point out frequently the many horrible consequences to your company should a loan be repudiated.

Q: Can nonfinancial institutions acquire assets of failed banks?

A: Private equity firms, including firms that have made significant real estate investments, have taken a lot of interest in purchasing failing or failed banks. Money was made in the last crisis by firms that purchased real estate assets and discounted loans from the Resolution Trust Corporation. Although banks usually will get the first pick, other entities have been encouraged by the FDIC to purchase receivership assets. The FDIC offers information about asset sales, including real estate assets, on its website. Some private equity firms have grouped together and agreed to passivity commitments to avoid each being characterized as a controlling owner and being regulated as a bank holding company by the Fed.

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Tilting at Windmills? The Rise of Stand-Alone Commercial Real Estate Receivership Actions

by Patrick J. Potter and Jerry L. Hall

Rather than immediately commencing foreclosure proceedings, lenders and special servicers (acting on behalf of the lender) are seeking the judicial appointment of receivers with greater frequency when commercial real estate workout negotiations fail to produce the desired results and the borrower is not otherwise prepared to "turn over the keys." A stand-alone receivership action is simply a lawsuit filed in state or federal court by the lender seeking the appointment of a third party to displace existing management and operate the property that serves as collateral for the loan.

Obtaining a receiver can be an expensive and time-consuming process. As in other civil litigation, the borrower is entitled to answer the complaint, raise defenses, assert counterclaims and conduct discovery. A lender often will have a borrower sign a pre-negotiation letter in which the borrower agrees to pay the lender's legal fees. However, none of the lender's or special servicer's costs and legal fees will be recoverable from the borrower if the loan balance exceeds the collateral value, which frequently is the case, and the loan is non-recourse. When the borrower is determined to retain control of the property as long as possible, these costs will be substantial.

When workout negotiations reach an apparent impasse, lenders and special servicers often feel the obligation to do something in order to put pressure on the borrower.

Moreover, the results are by no means guaranteed. Appointing the receiver is subject to the court's discretion and usually is considered an extraordinary remedy. Often the court will not appoint a receiver absent proof by the lender or special servicer of waste, borrower fraud, failure to pay taxes or insurance or some similar act or omission placing the property at risk; though, receivers have been appointed where the property is declining in value. This premise is true even when the borrower has expressly consented to the receiver in the loan documents, though in such instances the court often will shift to the borrower the burden of proving why a receiver should not be appointed. Ultimately, if the borrower is operating the property competently and honestly, the court will be reluctant to appoint a receiver, and the lender or special servicer should not expect to prevail.

Even if, after the delay, expense and uncertainty associated with the receivership action, the lender or special servicer prevails and obtains a court order appointing a receiver, this may not conclude the matter for a borrower determined to retain control of the property. If the borrower files for Chapter 11 bankruptcy relief within 120 days of the receiver's appointment, the receiver loses all management rights and must immediately return possession of all property to the borrower. Although the bankruptcy court has discretion to excuse the receiver from such requirements, requesting such relief likely will result in the lender or special servicer incurring more unrecoverable litigation costs in seeking a remedy that is not granted. Bankruptcy delays and cost concerns may be reduced if the borrower has given a "springing guaranty" providing for guarantor liability upon a voluntary or coordinated involuntary bankruptcy of the borrower.

Tilting at Windmills? The Rise of Stand-Alone Commercial Real Estate Receivership Actions (continued)

Lenders and special servicers have their reasons for not immediately foreclosing. These reasons may include lack of sufficient internal property management capabilities, property complications, environmental concerns, current property values and the delay associated with foreclosing in some states. When workout negotiations reach an apparent impasse, lenders and special servicers often feel the obligation to do something in order to put pressure on the borrower. However, in situations where the borrower is competently and honestly managing the property, but is simply unable to service the loan (for example, because a tenant left the building thereby reducing revenue) or refinance or repay the loan at maturity (because tighter credit markets have made it more difficult to obtain financing and loan-to-value ratios are significantly lower, therefore requiring greater equity investment), seeking the appointment of a receiver may be an ineffective way of getting the borrower's attention. Or it could be worse: a waste of precious financial resources coupled with a delay in what may be the inevitable foreclosure and bankruptcy filing. Lenders and special servicers confronting these situations may be better served by doing nothing for a period of time or by "biting" the proverbial "bullet" and commencing the foreclosure sooner.

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SKS Investments Wins LEED Platinum Precertification for 1100 Broadway Project

by Robert C. Herr and Noa L. Clark

SKS Investments LLC (SKS), a developer and owner of commercial real property based in Northern California and longtime client of Pillsbury, recently received exciting news regarding an office building it is developing in Oakland, California. Impressively, the 20-story, multi-tenant office tower, commonly known as 1100 Broadway, qualified this past summer for platinum status under the Leadership in Energy and Environmental Design (LEED) precertification rating system.

LEED ratings are the most widely recognized and commonly accepted benchmarks for green building standards. They are based on accepted energy and environmental principles and are classified (from highest to lowest) as platinum, gold, silver and certified. Although a project may be fully LEED certified only after the design and construction work is complete, under the LEED for Core and Shell program, a project can be precertified during the design-development stage based on the project's design stage submittal materials. This achievement is the highest precertification rating available and serves as a formal recognition by the U.S. Green Building Council of the project's expected LEED certification based on its current designs.

SKS's accomplishment was the result of teamwork and the incorporation of sustainability principles in the early phases of the project's design, which SKS spearheaded. From the outset, sustainability and achievement of LEED certification were important goals for SKS. With these objectives in mind, SKS selected members of its project team and worked closely with them early in the process to ensure that sustainable features were incorporated into the project's design. By incorporating sustainability principles at an early stage, SKS streamlined the LEED certification process and also minimized the costs associated with designing a green building. Later in the design process, as the plans for the 1100 Broadway project evolved, SKS and the project team realized that attaining the highest LEED certification, LEED platinum, would be a possibility.

1100 Broadway is one of the few new multi-tenant office projects in the United States to receive a platinum precertification rating.

Although there are upfront costs associated with designing and constructing a LEED platinum project, SKS expects that not only will the building be healthier for its tenants and the environment as a result of its green design, but it also will operate more efficiently, resulting in significant cost savings over its lifetime. For instance, based on the energy model developed as part of the LEED precertification process, SKS expects to realize the following benefits as compared to a building that meets only the applicable energy-efficiency standards set forth in Title 24 of the California Code of Regulations: utility cost reductions of approximately 25 percent, translating into savings of between $100,000 and $150,000 per year; and CO_2 emission reductions of approximately 25 percent.

Key design features of the 1100 Broadway project that led to its platinum precertification achievement include the incorporation of photovoltaic solar panels on the roof of the project's mechanical penthouse; an underfloor air distribution system that is significantly more energy efficient than conventional HVAC systems; floor-to-ceiling windows composed of high-performance glass that maximizes natural light while increasing

SKS Investments Wins LEED Platinum Precertification for 1100 Broadway Project (continued)

energy efficiency (by reducing heat loss and glare); a roof garden that helps reduce heat gain and absorb storm water; and a storm water capture and reuse system that captures rainwater, that is then filtered and treated on-site and finally reused in non-potable building uses. The 1100 Broadway project also will reduce pollution and land development impacts from automobile uses since the project site is conveniently located next to key regional bus lines and subway, railroad and ferry stations.

1100 Broadway is one of the few new multi-tenant office projects in the United States to receive a platinum precertification rating, and it promotes SKS's goal of designing and developing a building that demonstrates how sustainable office buildings are an integral part of the country's efforts to combat global warming and reduce dependence on fossil fuels.

Pillsbury has worked with SKS from the beginning stages of the 1100 Broadway project in 2006. A team led by Laura Hannusch represented SKS in negotiating the purchase transaction documents for the development site from a private seller and the neighboring garage from the Redevelopment Agency of the City of Oakland, and a team led by Robert Herr worked closely with the client and its project team throughout the project's approximate two-year entitlement process. Entitlements for the 1100 Broadway project were obtained in February 2008, and Pillsbury continues to work closely with SKS as it moves forward toward project construction.

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Owners, Architects and Contractors Need to Address LEED Responsibilities and Liabilities in Their Contracts

by Scott E. Barat and James P. Bobotek

As part of the global effort to reduce "carbon footprints," many property owners and developers have made obtaining a Leadership in Energy and Environmental Design (LEED) certification from the U.S. Green Building Council or, as to projects registered after June 2009, the Green Building Certification Institute (GBCI) part of the normal process of designing construction projects. Obtaining LEED certification for buildings may be a fundamental part of an owner's corporate ethos or strategy or simply a reaction to pressure from tenants and purchasers, who increasingly expect new buildings to be LEED certified. For some, it also may be driven by state and local building codes, which are being amended throughout the country to require new buildings to obtain a certain minimum LEED certification.

With this mandate for LEED certification comes both risk and costs. The risk is that the GBCI, an independent, non-governmental organization, will determine, often months after a building is completed, that the building does not satisfy the requirements of the requested LEED certification level. (Indeed, uncertainty regarding LEED requirements is a timely concern of owners because the new LEED v.3 requirements are just coming into effect.) Should this happen, the costs can be dramatic. The owner will have spent a significant design and construction premium to build in accordance with LEED, only to fail to get the required certification. Purchase contracts, leases and even loan documents may be conditioned on the building's obtaining a LEED certification, and failure to do so may result in lost deals and profits. Some states and localities require owners to post expensive bonds to ensure that the required LEED certification is obtained. Failure to achieve the certification may result in that bond being called and the owner's having to reimburse the surety for all amounts paid under the bond.

Accordingly, it is important that the parties most directly involved in obtaining LEED certification for a building—the project architect and construction contractor—understand their respective responsibilities and ensure that their respective contracts recite those responsibilities and the extent of liability for the resulting damages if LEED certification is not obtained.

Obtaining LEED certification for buildings may be a fundamental part of an owner's corporate ethos or strategy or simply a reaction to pressure from tenants and purchasers, who increasingly expect new buildings to be LEED certified.

Owners, Architects and Contractors Need to Address LEED Responsibilities and Liabilities in Their Contracts (continued)

Responsibility

Architects should design the building so that it meets the desired LEED certification level. It benefits the owner and the architect, therefore, to understand precisely which LEED "points" will be sought in order to achieve the desired certification. In other words, the architect and owner (and the owner's LEED consultant, if the owner has retained one) should develop a LEED "scorecard" that sets forth the applicable points necessary to meet the project's desired certification level. The architect then can design the project with the goal of achieving those points.

For at least two reasons, however, architects should not be placed in the position of guarantying that the desired certification will be obtained. First, certification depends in part on the actions of the contractor—its means and methods—in implementing the project design. Second, architects' professional liability insurers may well consider such a covenant as (a) an agreement to provide services at a level higher than the applicable standard of care, (b) a guaranty, and/or (c) an assumption of liability that would not otherwise be imposed by law on the architect. Most professional liability policies provide coverage only for an architect's professional services that fall within the standard of care accepted in the architect's community. In addition, such policies generally contain exclusions for claims based on breach of warranties or guaranties, and also for assumption of liability that the architect would not have but for its contractual agreement to do so. Thus, there may well be no insurance coverage for an architect's express or implied contractual covenant to ensure that a certain LEED certification level will be achieved.

It helps neither the architect nor the owner for the architect to take such a risk if insurance is not available to pay for resulting failures. Accordingly, owner/architect agreements should avoid language that could be construed as a guaranty of a certain result. Instead, they should make clear that the LEED certification and scorecard are an important part of the owner's program for the project, and that the architect will perform the design services in accordance with the standard of care to effect the owner's program. Given the prevalence of LEED in the current environment and references to sustainable design even in form documents issued by the American Institute of Architects, designers will be hard pressed to avoid liability for negligently failing to take LEED requirements into account in the design. Owners also should consider paying for a "peer review" of the architect's LEED-related design, which is a form of assurance that everything was done to maximize the chances of obtaining the required certification.

Contractors should construct the building so that it meets the desired LEED certification level. In large measure, however, contractors are building what is on the drawings and specifications; if necessary elements of a LEED certification are missing, it is not the contractor's obligation to build them. But many elements of LEED certification can be satisfied only by the contractor's adherence to certain performance guidelines and criteria: for example, by meeting requirements for construction activity pollution prevention, erosion and sediment control, storing and collecting recyclables and diverting construction demolition materials from landfills. These items can be set forth in the LEED scorecard and made a part of the construction contract. Moreover, the contractor has control of, and therefore should have responsibility for, developing and maintaining record keeping and filing systems that GBCI may require as part of the project's LEED certification process and complying with any requirements of GBCI in connection with maintaining and preserving such records. The contractor's responsibilities as to the foregoing should be spelled out in the construction contract.

Liability

We know of no published court decision that deals with the question of architect or contractor liability for failure to meet the desired LEED certification level. But as sure as the sun rises, those cases will be litigated in the near future. (One Maryland case that involved this issue, *Southern Builders, Inc. v. Shaw Development Company*, was settled out of court.) As discussed above, the potential damages to the owner are very real and possibly quite large. Owners should be sure that

Owners, Architects and Contractors Need to Address LEED Responsibilities and Liabilities in Their Contracts (continued)

their contracts do not include language that may operate to bar recovery of these kinds of damages, such as a "mutual waiver of consequential damages" or similar provisions so prevalent in form documents.

On the other hand, architects and contractors should be aware of the possibility that if they miss even one of the LEED "points" assigned to them as their responsibility to achieve, the entire project may fall short of the required number of points, and the owner will sustain significant damage. For that reason, owners, architects and contractors should attempt to share liability for LEED failures in an equitable manner. Because this issue is so new, there is no "market" method by which the liability is shared. We have seen provisions by which parties forfeit fees if the LEED certification is not obtained and provisions that set a "per point" liquidated damages amount for each point not obtained.

Creative, practical thinking by all parties involved should lead to acceptable results and will minimize the need for courts to apportion liability for the failure to obtain the desired LEED certification.

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Managing Seismic Risk in the Legal Arena

by Mark N. White

Studies indicate there is a strong likelihood of earthquakes more significant than the Loma Prieta (1989) and Northridge (1994) earthquakes striking the San Francisco Bay Area (the Bay Area) and/or Los Angeles County (LA County) in the next 30 years, causing significant injury to people and property and giving rise to claims against commercial property owners. However, as discussed below, there are practical steps that owners of large, vulnerable structures may take to manage the legal risk associated with the next significant seismic event.

During the past 103 years, the major urban centers of the Bay Area and LA County have not experienced the peak ground accelerations attributable to the 1906 San Francisco earthquake. The ground accelerations (often measured as a percentage of gravity: "g") caused by the Loma Prieta and Northridge earthquakes were significantly smaller and less threatening to large, privately owned structures in the densest urban centers of those two regions than those experienced during San Francisco's 1906 earthquake. Information released in 2008 by the United States Geological Survey indicates that, during the next 30 years, there is a significant risk of earthquake ground accelerations that exceed the levels of the 1906 San Francisco earthquake and an even greater risk of ground accelerations that far exceed the levels of the Loma Prieta and Northridge earthquakes. Should these predictions become reality, millions of square feet of large, privately owned structures likely will perform poorly during the earthquake and might be seriously impaired for extensive periods after the seismic event, resulting in a host of potential legal claims, many for personal injury and death.

The first thing that owners of these large structures should do is engage a competent seismic specialist to analyze the facility (taking into account soil conditions unique to the site) and predict its performance in two or more possible seismic events.

The unacceptable performance of the Cypress Structure during the Loma Prieta earthquake

To provide an example of the potential consequences of a structure's poor performance during an earthquake, consider the collapse of the elevated stretch of highway known as the Cypress Structure in Oakland, California, during the Loma Prieta earthquake. Peak ground acceleration in the vicinity of the Cypress Structure was on the order of .25g during the Loma Prieta earthquake. The demands on the Cypress Structure created by this earthquake exceeded its capacity, and large sections of it collapsed. Most structural specialists agree that the collapse was unexpected and unacceptable, especially because peak ground accelerations of less than .4g should not threaten the structural integrity of a well-designed and reasonably constructed elevated highway of its type and age. The consequences of the failure of this structure were staggering: more than 40 people died on the Cypress Structure that day, and more than 150 were seriously injured. The State of California ultimately paid more than $70 million to settle virtually all meritorious claims for wrongful death and personal injuries; by so doing, no cases went to trial.

Managing Seismic Risk in the Legal Arena (continued)

Managing possible unacceptable performance in the next substantial earthquake

If an earthquake causes ground accelerations of .6g in either the Bay Area or LA County within the next 30 years, it is expected that many of the large, privately owned structures located in those areas will perform poorly and will cause fatalities and personal injuries, in some instances exceeding the casualties caused by the collapse of the Cypress Structure. This hypothetical legal exposure may be reduced if the owners of these structures take remedial action before the earthquake.

Predictions of seismic performance

The first thing that owners of these large structures should do is engage a competent seismic specialist to analyze the facility (taking into account soil conditions unique to the site) and predict its performance in two or more possible seismic events. This "seismic assessment" will address the likelihood that seismic demand will exceed the capacity of the structure in hypothetical seismic scenarios. For instance, the seismic assessment should address the likelihood that the peak ground acceleration and corresponding "interstory drift" of the structure will cause it to lose its capacity to handle future seismic loads or to lose its capacity to handle simple gravity loads.

Corrective action

If the seismic assessment warns of unacceptable performance during a short time horizon (say a 50 percent chance of collapse within 10 years, which would be considered a serious risk by many structural consultants), the owner should take steps to manage the extraordinary legal risk associated with the use and operation of the vulnerable facility. For instance, the owner should consider changing the use of the facility until its seismic capacity is increased and, in extreme cases where collapse is believed to be "imminent," the owner should consider vacating the structure and, if possible, transferring operations to a safer facility.

In other situations, where the structure is less vulnerable, the owner may want to continue occupancy of the structure for "interim use" while remediation plans are developed and then vacate the structure during physical remediation of the facility (or during its demolition and replacement). The seismic specialist should provide guidance to the owner on how long interim use is prudent under the circumstances. Reliance on legitimate and well-reasoned advice of this type also may reduce the potential exposure to death and personal injury claims, because the owner may be able to prove that its reliance on the seismic specialist and its management of the structure was reasonable under the circumstances. As a practical matter, these solutions will often require careful coordination with existing leasehold tenants, including providing temporary alternate space during periods of concentrated construction.

Possible theories of liability

Under California law, wrongful death and personal injury claims may be predicated on "premises liability" theories. For instance, claimants may rely on California's general statutory provision that "[e]veryone is responsible, not only for the result of his or her willful acts, but also for an injury occasioned to another by his or her want of ordinary care or skill *in the management of his or her property* or person, except so far as the latter has, willfully or by want of ordinary care, brought the injury upon himself or herself." Cal.Civ. Code § 1714(a), italics added. Claimants may argue that their injuries were sustained as a proximate result of the negligent management of the owner's structure before the earthquake in question, including the failure to take tangible steps to assure that the capacity of the structure met and exceeded foreseeable earthquake demands. Claimants likely will rely on the general rule of premises liability as set forth in *Sprecher v. Adamson Companies,* 30 Cal.3d 358, 368 (Cal. 1981), which states that a landowner has a "duty to take affirmative action for the protection of individuals coming upon the land. . . ." Claimants may well argue that this duty arises because ownership of land includes the right to control and manage the premises. The owner's "mere possession with its attendant right to control conditions on the premises is a sufficient basis for the imposition of an affirmative duty to act." *Id.* at p. 370. The right to control the premises lies at "the very heart of the ascription of tortuous responsibility" in premises liability actions. *Id.* at p. 369.

Managing Seismic Risk in the Legal Arena (continued)

Whether the private owner of the structure is deemed negligent should turn on certain findings by the trier of fact:

1. Whether a condition on the property created an unreasonable risk of harm;
2. Whether the owner knew or, through the exercise of reasonable care, should have known about it; and
3. Whether the owner failed to repair the condition, protect against harm from the condition or give adequate warning of the condition.

California Forms of Jury Instruction: Civil Jury Instructions, Ch. 10, *Premises Liability*, § 1003 (Matthew Bender). A public owner of the structure will be subject to similar lines of inquiry by the trier of fact when a claim of "dangerous condition" is pursued. *See id.* at Ch. 11, *Dangerous Condition of Public Property*, § 1100.

Defenses to "premises liability" and "dangerous condition" claims against, respectively, private and public owners, take into account the reasonableness of remedial action taken by the owner, including the following considerations:

1. The length of time and opportunity to take remedial steps to increase the seismic capacity of the structure, after the owner became aware (or should have become aware) of its inadequate capacity.
2. The probability and gravity of potential injury.
3. The extent to which individual persons (or property) are foreseeably exposed to risk of danger arising from an earthquake.
4. The practicability and cost of protecting against that danger.

See, e.g., Cal. Government Code § 835.4, with regard to claims against public entities.

Conclusion

Before the next significant California earthquake, owners should consider taking the following steps to better manage the risks arising from the seismic performance of their structures:

1. Develop an institutional program for assessing the seismic capacity of structures and for remediating those with inadequate capacity.
2. Engage qualified seismic specialists to perform seismic assessments. For instance, one of the hypothetical scenarios should consider seismic demand created by an earthquake that has roughly a 50 percent likelihood of being exceeded in 25 years.
3. If the seismic assessment indicates that structural performance would be unacceptable in the event of a near term seismic event, develop a remediation program for that structure, and an "interim use plan" during the period before remediation is complete, including possible vacation (or demolition), in light of the views of the structural specialists as to how long it is "prudent" to continue using the structure.

These practical steps will help the owner establish that its management of the structure was reasonable under the circumstances, including managing the ever-present risk of seismic activity in California's major urban centers.

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A “Suburb on Steroids?”: The Transformation of Tysons Corner

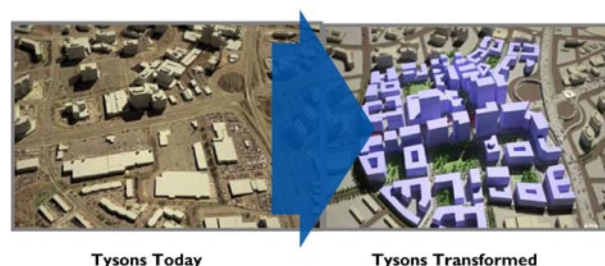
by David S. Houston and Emily K. Winton

Over the past 50 years, Tysons Corner, in Fairfax County, Virginia, has grown from the rural crossroads of Routes 7 and 123 to one of the country's premier commerce and technology centers. Primarily dominated by office and high-end retail development, Tysons Corner is currently the nation's 12th-largest office market with more than 25 million square feet of space, home to the sixth-largest shopping mall in the United States (Tysons Corner Center, containing 2.5 million square feet) and the headquarters to many of the nation's largest companies, including Booz Allen Hamilton, Capital One Financial, Freddie Mac, Gannett Corporation and, following a recent move from California, Hilton Hotels. In addition to the office and retail uses, Tysons Corner has more than 1 million square feet of industrial/flex space and more than 4,000 hotel rooms.

Despite its thriving office, retail and hospitality market, Tysons Corner currently lacks many traditional urban characteristics such as residential development, public transportation, open space and pedestrian-friendly accommodations. Instead of a typical grid-style street system with sidewalks and bike paths, Tysons Corner has several six-lane highways snaking through the 1,700-acre automobile-centric area, ushering in and out a workforce of approximately 135,000 every day. By comparison, there are currently only 17,000 residents. For these reasons, Tysons Corner has been labeled by some as a “suburb on steroids.”

All of this is slated to change with the extension of the Metrorail mass transit subway system through Tysons Corner to Dulles Airport and Loudoun County, Virginia. By 2014, four Metro stations are planned to open in the Tysons Corner area as part of the new Silver Line. With the impending arrival of mass transit, the Fairfax County Board of Supervisors assembled a 36-member committee of developers, county officials and citizens (the Tysons Land Use Task Force or Task Force) to create a new master plan for the area. The plan also is receiving input from the Fairfax County Planning Commission's Tysons Committee. Once adopted, the new plan will become part of the county's Comprehensive Plan text for the Tysons Corner Urban Center.

On September 16, 2009, the Fairfax County Department of Planning and Zoning staff presented a “Straw Man II” draft to the Tysons Committee and the Task Force. This plan recommends creating a “true urban downtown” for the county. Specifically, the Task Force blueprint calls for the creation of a people-focused urban setting by attracting dense and tall mixed-use, transit-oriented development (TOD), developing a civic infrastructure (including facilities and programs for arts and culture, recreation and education) and continuing to grow the community as a leading economic and employment center, while at the same time placing a strong emphasis on environmentally friendly, sustainable development and conservation of natural resources. The planning horizon for implementation of the new plan extends to 2050.



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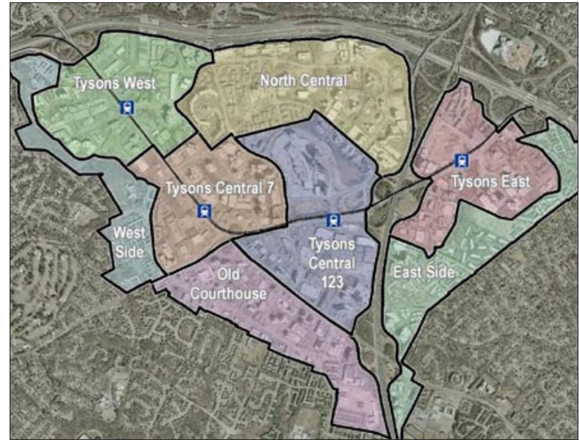
A "Suburb on Steroids?": The Transformation of Tysons Corner

Eight Planning Districts

The plan for Tysons Corner envisions the development of eight separate districts: four urban TODs around each of the Metrorail stations, and four non-TOD communities. All of the districts will have a mixture of uses. Clusters of tall, high-density buildings will surround the four Metro stations in the TODs, with 75 percent of all new development being located within one-half mile from a station (i.e., walking distance). Although the allowable density has been hotly contested, the Task Force has determined that densities should be based on the distance of the development from a Metro station. Density bonuses likely will be available to developers in exchange for their sharing of the costs of developing the districts' infrastructure and other amenities, such as open space and trails, arts and cultural facilities, affordable housing and green buildings.



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The maximum floor area ratio (FAR) recommended by the Task Force is 6.0, but, when the second draft of the plan was published in September, the planning staff had reduced the density to 4.8. This 20 percent reduction in density likely will be the subject of further discussions at future Task Force meetings and public hearings. Restaurants, entertainment and retail will be interspersed with office and residential uses to attract residents, visitors and workers on a 24/7 basis. The non-TOD communities generally will be located between the TODs and the edges of Tysons Corner and will feature parks and civic uses, mixed-use neighborhoods and local-serving restaurants and retail.

Transportation

The current transportation regime in Tysons Corner will be redesigned through the establishment and construction of a "grid of streets" on top of the existing mega-blocks, resulting in many smaller blocks of a more typical urban size. Also, the addition of transportation options to increase transit usage and decrease vehicle trips is an essential component of the overall plan. These options include new circulator routes, community shuttles, feeder bus service and vastly improved pedestrian and bicycle routes and connections. The plan's objective is to significantly increase the transit usage within the area, from the current rate of 3 percent of work trips to 31 percent.

It is anticipated that changes in the transportation system will attract residents, make the community more livable and ease the traffic congestion that plagues the area. Ultimately, the goal is to develop a community where owning a car is unnecessary due to the diverse and accessible transportation choices. The new plan envisions increasing the number of residents in Tysons Corner to 100,000 and the number of jobs to 200,000.

Implementation Strategy

Although the county has made great progress in developing a vision for the future of Tysons Corner, the transformation will require a strong, detailed implementation strategy and a unified group of interested parties dedicated to moving the plan forward. The Fairfax County draft plan recommends an execution strategy with the following elements: detailed planning, creation of an implementation entity, new funding strategies, a regulatory framework, public-private partnerships, private-

private partnerships and phasing. By focusing on these plan components, the county hopes that by 2050 Tysons Corner will evolve into an environmentally friendly, mixed-use urban center, while maintaining its dominance as the premier business and commerce center that it is today.

Next Steps

A final draft of the plan will be presented to the Planning Commission for public hearings and a recommendation to the Fairfax County Board of Supervisors in the first quarter of 2010. The board then will conduct further public hearings and take its final action during the second or third quarter of 2010. Key issues that will be aired during the public hearings will be maximum density, the lack of additional road improvements to the major roads presently serving Tysons Corner, the availability of funding for the massive amount of infrastructure and public facilities proposed and the impact on the communities that border Tysons Corner, such as McLean and Vienna. Depending on the timing of the region's economic recovery, zoning applications to implement the plan will follow soon after its adoption.

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UK Real Estate Investment— The Times, Are They A-changing?

by Sukhi Walia and James Campbell

Does the closing in late September of Blackstone's £1billion acquisition of a 50 percent stake in British Land's prime (and arguably most prestigious) 30-acre Broadgate Circus site finally signal that the bottom of the London commercial real estate market has been reached? Are property prices stabilizing after a 45 percent fall since the peak of 2007? Has a recovery begun?

Certainly, there is a pool of money waiting to be invested that is now beginning to find a home in UK real estate. As was reported in Bloomberg on June 22, 2009, John Richards of Hammerson (one of Europe's leading property companies) believes that the decrease in rental rates is slowing, with fewer tenant defaults expected in the prime commercial property sector—although investors are cautioned to consider that rents still are subject to downward pressure and unemployment and lack of credit for businesses could affect demand. However, despite these caveats, The Times recently reported that the amount of vacant office space fell from about 10 million square feet in the first three months of 2009 to 8.6 million square feet at the end of September 2009, and the latest figures from the Investment Property Databank reveal that capital growth returned in the UK market for the first time in 26 months during August, further bolstered by September's 1.1 percent average gain in values across the office, retail and industrial property sectors, indicating the sharpest improvement in values in three years. Along with yields firming in the prime sector, there certainly appear to be real signs of life after the downward spiral that has beset the British real estate market. With relatively secure income and available yields on commercial property running at 8 percent (compared with an average figure of 4.6 percent at the height of the boom in 2007), coupled with the prospect of capital growth, it may come as no surprise that investors are now doing deals. As Mike Slade of Helical Bar plc told the *Daily Telegraph* on July 22, 2009, "People are buying—they don't want to miss this opportunity—and that's what causing this spurt."

After a brief "wait and see" hiatus, the prime central London residential market has been buoyed by foreign money pouring in.

In spite of these encouraging trends, some experts believe that the number of distressed sales could rise, despite the recent disinclination of UK banks to force sales (by turning a blind eye to clear breaches of loan-to-value covenants) for fear of crystallizing billions of pounds of losses. However, with prices apparently stabilizing and with pressure to begin lending again, this policy of leniency by the banks may not be sustainable for very much longer. As there is growing appetite from investors with millions raised and ready to spend on UK commercial property, it is suspected that the deadlock may soon be broken, as more buying opportunities become available.

David King, chairman of property services at NB Real Estate (which was retained by Religare Hichens Harrison plc following its multimillion-pound acquisition of 100 Cannon Street handled by Pillsbury), stated in an interview with *Perspectives on Real Estate* that he believes the Cannon Street deal could not have better timed the bottom of the London market. Indeed,

UK Real Estate Investment—The Times, Are They A-changing? (continued)

there is perhaps a certain irony that Standard Life Investments, the seller of 100 Cannon Street with £8billion of property under management, only last month launched its UK commercial property fund into the wider market following signs of an improvement in the domestic market. Barry MacLennan, Standard Life's investment director of mutual and like funds, quoted in *Citywire* in late August, said "We believe that investor confidence is returning to the commercial property market with the UK furthest advanced in the cycle." Henderson Global, Foreign & Colonial, Apache Partners, Mountgrange Investment and AIM-Listed Max Property Group, all of whom have set up new funds with millions to spend, would no doubt agree with this view, as would fund managers for Threadneedle's UK Property Trust and Legal & General's UK Property Unit Trust, which have both halved their cash positions in recent months, taking advantage of buying opportunities.

Although prime rents may be stabilizing, they are unlikely to return to peak levels for a number of years, especially with the loss of thousands of financial sector jobs over the last year. Tenant demand and unemployment will be key drivers. For example, in order to attract Nomura back to London's "square mile" financial district from Canary Wharf, an incredible six-year rent-free period was offered—an indication of the extent of current oversupply in the market. That said, with the UK now beginning to emerge from recession, tenant demand for space eventually will pick up and rents will harden, especially with the stalling of a number of London office developments, which will not be kick-started until new tenants can be found. Prime location and reliable tenants on long-term leases still remain key to astute investment. A further restraining factor is the limited availability and cost of leverage, with bank lending unlikely to recover for several years as the banks repair their balance sheets.

For well-funded overseas buyers, like Religare Hichens Harrison, there is the added attraction of weaker sterling. The reports of sovereign wealth funds eyeing UK property, with South Korea's state pension fund apparently considering paying £800 million for HSBC's tower at Canary Wharf, may not be way off the mark when one considers the added attractions of a clear and straightforward legal system and still-depressed capital values. After a brief "wait and see" hiatus, the prime central London residential market has been buoyed by foreign money pouring in. Evidence of this is Pillsbury's handling of the acquisition of two multimillion-pound penthouse apartments in a prestigious new development overlooking Lords, the home of cricket.

Savvy investors would be well served to monitor the UK real estate market for investment opportunities, as there are signs that the market may be on the rebound.

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