REAL ESTATE LAW

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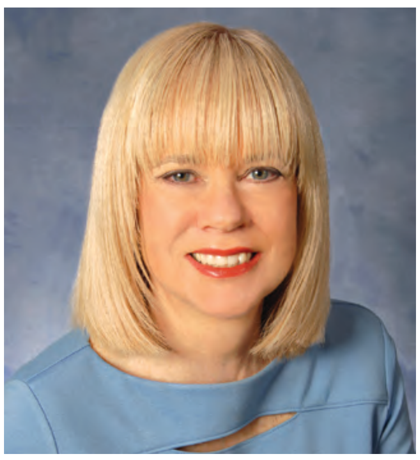
SMITH DICKSON
AN ACCOUNTANCY CORPORATION

Litigation Support for Real Estate Disputes

by Deborah Dickson, CPA, CFF, MAFF

Real estate disputes are more common that you think! Smith Dickson, CPAs has provided litigation support on real estate matters since 1995. These engagements are as diverse as they are complex. Here are a few recent examples:

Misappropriation of Funds / Fraud – Co-ownership of properties can often result in disputes. One of our clients had an ownership interest in multiple apartment LLCs which were managed by the other member – who also separately owned additional complexes. The managing party was accused of commingling all of his property and family expenses with the apartments owned jointly with our client. Smith Dickson was hired to provide forensic analysis of expenditures, disbursements, and supporting invoices, resulting in the identification of millions of dollars that were siphoned out over several decades. Another client who managed properties for overseas relatives was accused of over $3 million in misuse of funds; after our testimony, the jury reduced the damage award to $1 million.



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Creditors' Rights – Loan defaults aren't always straightforward, especially when millions of dollars are at stake in commercial properties. When our bank client foreclosed on $15 million in loans for buildings, the borrower claimed that the loans were not technically in default due to the manner in which penalties and interest were applied. Our work involved damage calculations and expert testimony.

Probate/Trust Beneficiary Disputes – Those who inherit properties often contest use of trust money for personal gain and ownership percentages, such as our client who was involved in litigation over beachfront properties with siblings. Smith Dickson reconciled the beneficiary proceeds in this matter.

Development and Contractor Disputes – These matters involve all facets of development and construction. A recent case involved a multi-phase project in which multiple owners funded different phases. Ownership percentages and land boundaries were disputed, and contractors sued over payment. Our work in this complex case involved tracing of capital and debt transactions as well as construction disbursements.

Escrow and Title – Mistakes in these matters can involve millions of dollars in damages. A recent case involved title disputes on over 100 properties owned by an LLC with numerous members located in multiple states. The underwritten title company issued clear title reports when there were actually liens. Our damage calculations proved instrumental in educating the jury to provide a resolution in this Federal criminal case.

High-Stakes Marital Dissolution Matters – One of our largest matters involved multiple real estate brokerages and properties owned throughout southern California. Litigation between the ex-spouses ensued for many years. Our work involved asset tracing, valuations, and asset equalization.

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Stuart Kane LLP

What You Should Know Before Leasing Property for Cannabis and Hemp Use

When the City of Huntington Beach imposed a fine on a landlord in excess of $150,000 for allowing a cannabis dispensary to operate out of his property, the landlord was surprised to learn that while cannabis has been legalized by California, each city has the right to regulate, restrict and prohibit commercial cannabis operations within its boundaries. In this case, Huntington Beach prohibited the operation of any such business, and that prohibition remains today.

Some Orange County cities do permit the operation of cannabis businesses. However, landlords that are considering leasing to a tenant for a cannabis-related purpose, as well as those tenants themselves, should all have a general understanding of federal, state and local cannabis laws before entering into such a lease.

Cannabis Operations

Many landlords know that, despite California's cannabis legalization, leasing to a cannabis business remains illegal under federal law, given that cannabis is still a Schedule I substance under the Controlled Substance Act. As such, if property is to be leased to a cannabis business, the lease provisions should be modified to account for the conflict between federal, state and local law.

A proper cannabis lease, for example, should accurately define and limit the business use; require that the tenant follow all laws except federal law, to the extent federal law is inconsistent with state and local cannabis laws; and provide remedies for each party should federal or state enforcement or other changes in the law occur during the term of the lease.

To the extent a landlord intends to lease to a cannabis business, the landlord should know what types of cannabis operations are permitted at their property. Regulations are specific to the jurisdiction where the subject property is located. Currently, only four Orange County cities permit some form of cannabis use or operations, as follows:

Orange County City	Permitted Cannabis Use(s)
Costa Mesa	Manufacturing; Distribution; Testing
Irvine	Testing
La Habra	Distribution; Testing
Santa Ana	Cultivation; Manufacturing; Distribution; Testing; Retail

Orange County cities not listed in the table above do not permit any type of commercial cannabis activity.

In order to operate a cannabis business, the operator must obtain state and local authority, usually in the form of a permit from the city, and a license from the state. The tenant will usually want the lease to be contingent on obtaining its permit and license, and many landlords will agree to that contingency in exchange for a non-refundable payment.

Hemp Operations

Although hemp is legal under federal law, under state and local law, hemp businesses have yet to be given as much legislative attention as cannabis has received. As a result, landlords and tenants need to be aware of the varying legal status of hemp, and the risks associated with hemp businesses before committing to lease property for hemp operations. Preliminarily, knowing the specifics of the type of hemp business that a tenant intends to operate can help landlords and tenants narrow the risks in leasing property for such use.

Pursuant to the 2018 Farm Bill, hemp is no longer a Schedule I substance under the Controlled Substance Act. Unlike cannabis, hemp can now be possessed without violating federal law. However, hemp is defined in the Farm Bill as any part of the Cannabis Sativa L. plant with a delta-9 tetrahydrocannabinol ("THC") concentration of not more than 0.3% percent on a dry weight basis. Therefore, if the hemp plant contains more than 0.3% THC, it is considered cannabis and a controlled substance.

But even though hemp has been removed from the Controlled Substance Act, it does not mean that hemp products can be sold without regulation. There are barriers to entry and potential risks to business success imposed by the U.S. Food & Drug Administration ("FDA"), as well as state and local authorities.

The FDA and the California Department of Public Health ("CDPH"), for example, have stated that cannabidiol ("CBD"), a widely-used derivative of cannabis and hemp, cannot be used in food or beverages, with the exception (on a state level) that cannabis edibles may be produced under a valid state cannabis manufacturing license and local permit. Accordingly, if a tenant intends to produce food and beverages containing CBD, but they do not obtain a cannabis manufacturing license, there is a risk to the landlord leasing to such a tenant, given that the products being produced will be deemed illegal.

Similarly, dietary supplements and medical products containing CBD are illegal unless approved by the FDA, which has only approved a few products containing CBD to date.

The quandary for some landlords and tenants, however, is that hemp products that are not food or beverages, nor claim to have medicinal benefits, are operating in a grey area. Other than hemp's declassification from a Schedule I substance, there is little guidance provided by federal, state and local authorities as to where and how hemp products may be processed and sold.

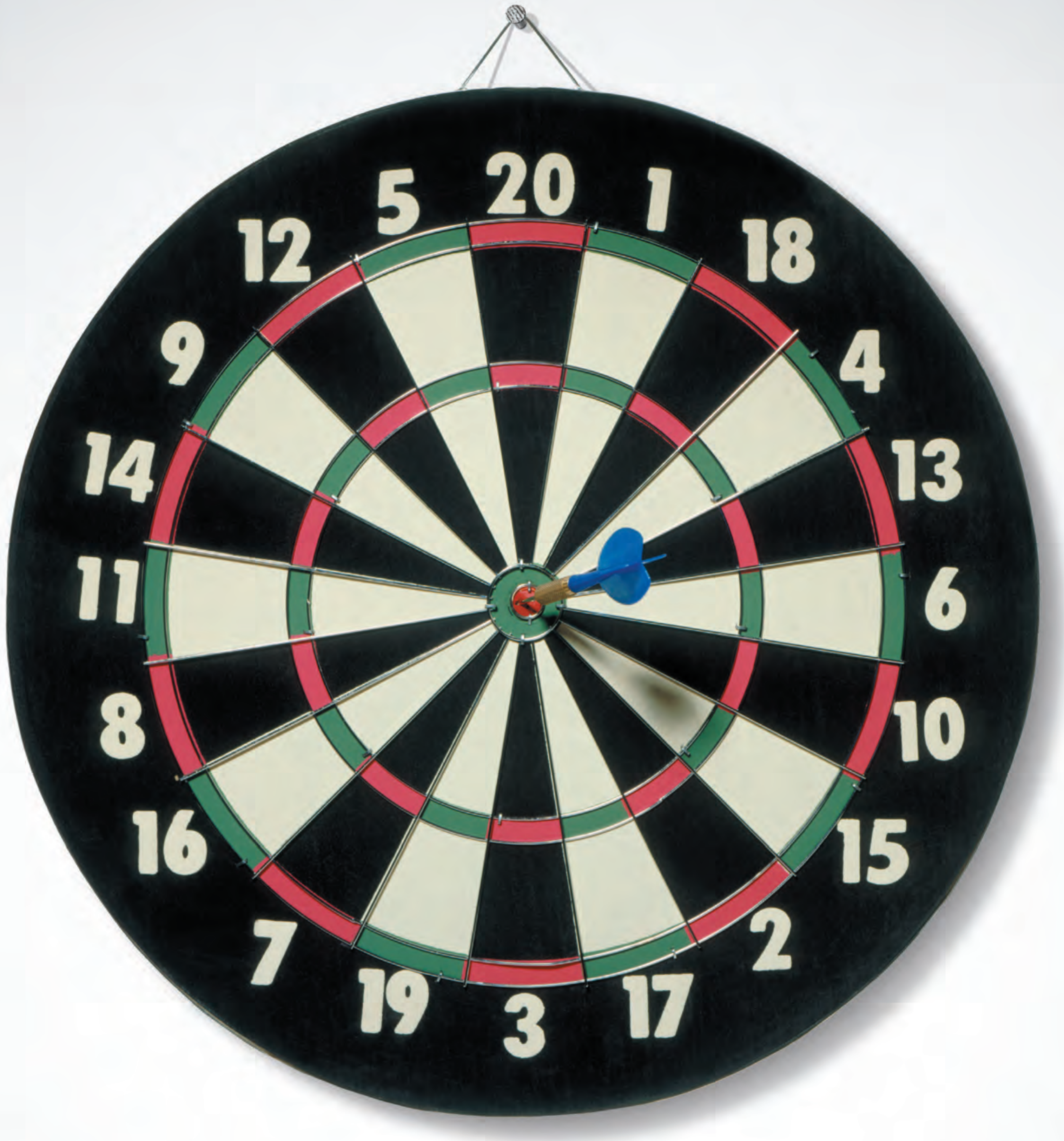
To that end, cities vary greatly in their treatment of hemp businesses. Most cities do not have any ordinance specifically regulating hemp. Some cities permit hemp manufacturing, viewing it as a legal component of an end product. Other cities state that hemp is to be treated as cannabis, given that the city does not currently have a process by which to distinguish between cannabis and hemp or to determine if CBD is derived from hemp or cannabis. This issue is further complicated by the fact that hemp is expressly excluded from the definition of cannabis at the state level and by many local ordinances, meaning that hemp cannot by law be treated the same as cannabis.

Given the ongoing evolution of the regulatory scheme for cannabis and hemp, landlords should do extra diligence regarding the intended operations of a prospective cannabis or hemp tenant, and landlords and tenants should both plan on working closely with the city and legal counsel to ensure the intended use of the property is in compliance with state and local law.

Author Bios

Cole Morgan is an attorney with Stuart Kane LLP and focuses his practice in the areas of commercial real estate and corporate law, including the negotiation and drafting of purchase and sale agreements and leases, and advising clients on due diligence and compliance issues. He has extensive experience working with clients in the cannabis industry, including vertically integrated companies, with their commercial real estate and corporate needs. Mr. Morgan can be reached at (949) 791-5128 or cmorgan@stuartkane.com.

Guido Piotti is an attorney with Stuart Kane LLP. His practice involves the representation of professional individuals as well as regional, national and international entities in a wide array of real estate, business and corporate matters. His experience includes representing and counseling clients in commercial leasing, purchase and sale of commercial property, mergers and acquisitions, divestitures, financing deals, intellectual property licensing and general corporate governance and compliance. Mr. Piotti can be reached at (949) 791-5148 or gpiotti@stuartkane.com.



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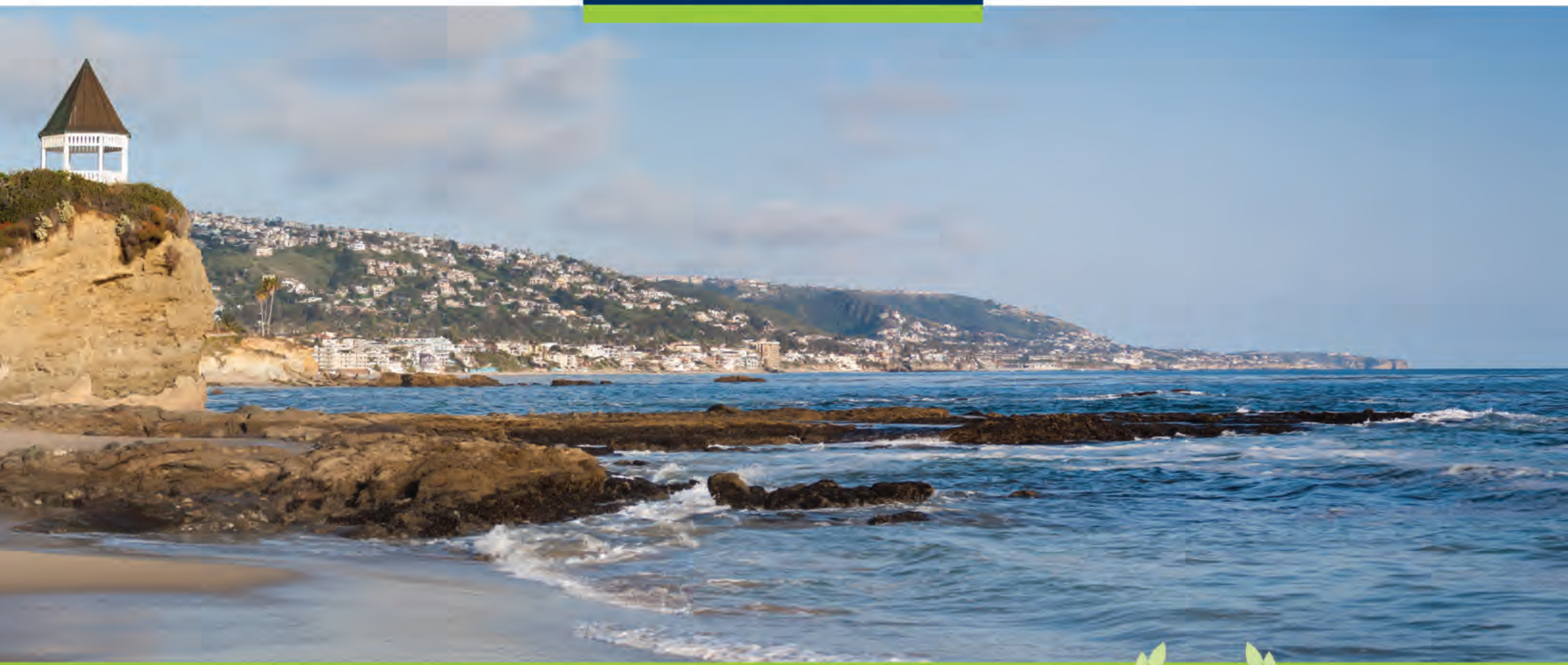

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Real Estate Investments: Unforeseen Limited Liability Company Traps in the Pursuit of Asset Protection

A limited liability company ("LLC") has been the mainstream entity for owners of income-producing property. The start-up costs associated with a LLC are relatively inexpensive, and the owner's desires to shield him or herself from personal liability make it a desirable choice. An LLC is a separate legal entity with a designated tax identification number and separate tax reporting requirements. An owner's pursuit of asset protection does not come without unforeseen traps or burdens.

Lack of Planning at the Formation Stage

In the age of technology and online corporate formation services, it may seem relatively easy to plan and form an entity. While the check-the-box online websites do typically guide the user through the formation process, they do not provide the user with a strategic plan nor assist the user with future planning or growth. A property owner will typically invest a lot of time and money into the pursuit of the target property, but sometimes will cut corners when it comes to discussing the formation with a business attorney. Saving money at the outset may result in personal liability to the owner or substantially more in income taxes or property taxes if a strategic plan is not formulated at the outset. Also, without formalizing a plan at the outset, future growth or later partial transfers to investors or family members may trigger the reassessment of the property tax base.

Transfer of Encumbered Property

For individuals, typically if the LLC is not formed prior to the acquisition of the income-producing property, they will purchase the property and obtain financing in their individual names. In some instances, acquiring the property and securing financing individually will result in more favorable rates being offered by lenders instead of financing being obtained on a property that is being held in the LLC.

A property owner who acquires real property in his or her individual name faces potential problems when the owner wants the benefits of LLC protections later. A simple transfer of the property from an individual to an LLC has an unintended consequence of violating a "due on sale or transfer clause" within the mortgage or deed of trust. Trust deeds typically restrict an individual owner from transferring property from his or her name. If the individual owner does transfer the property to an entity it may result in the lender calling the note and requiring an immediate cash payment or facing a foreclosure action.

Transfers of Insured Property

Holding insurance on real property is another arrow in a property-owner's quiver to protect against personal liability. But, a property owner who obtains an insurance policy for a property acquired in his or her individual name and later transfers it to an LLC will have an effect on the policy premiums or effectively result in the policy being cancelled. Again, this is an issue that must be considered carefully before implementing the formation of a new entity or transferring property to an entity.

"Piercing the Corporate Veil"

The limited liability protections of an LLC are sometimes perceived as an absolute shield of protection to a manager or member. While the LLC does provide some protection against claims against an individual's personal assets. California Corporations Code Section 17703.04 provides that a member of an LLC shall be subject to liability under the common law governing alter ego liability, and shall also be personally liable for a judgment of a court or for any debt, obligation, or liability of the LLC. Members of an LLC do not need to follow as many corporate formalities as a corporation. For example, an LLC does not require annual meetings of the members, nor does it require the memorialization of those annual meetings.

The perception that the members do not have to follow formalities stops with the annual meetings. In fact, it is important to be counseled by a business attorney and follow the guidance of a Certified Public Accountant. The transfer of monies between an LLC and personal bank accounts without proper documentation can potentially lead to a creditor piercing the corporate veil and attaching the personal assets of the owner. Additionally, without thoroughly understanding guarantees or indemnity language within contracts, it may also reduce the protections offer by an LLC.

Personal liability may also occur in the event of a member's participation in tortious conduct. For example, a property owner that fails to properly light a parking lot or fails to cure a known defect on the property that causes harm to another person may subject the property owner to personal liability. A property owner should regularly consult with a business attorney to address these issues and allow the attorney to assist in protecting a member's personal assets to the fullest extent of the law.

Succession of Real Estate to the Next Generation: Property Tax Perspective

The transfer of wealth from the baby boom generation has begun. Much of the transfer will include real property that currently holds a low tax base. The preservation of the property tax base to the next generation can save the next generation hundreds of thousands of dollars, if not millions over their lifetime. California permits the transfer of the property tax base from a parent to a child in certain circumstances. A primary residence that is transferred from a parent to child is afforded the benefit of transferring an unlimited amount of property tax base. For all other property (other than a primary residence), the owners may be able to take advantage of the transfer of their low tax base to their children for up to $1,000,000 in property tax base. To benefit from the transfer of the property tax basis, careful planning is required as real property held in an entity such as an LLC will not afford the property owner the benefits of transferring his or her property tax basis to the next generation.

Strategic Planning

Benjamin Franklin said that "an ounce of prevention is worth a pound of cure." The same can be said when it comes to strategic planning for entities. Whether, a property owner is going to structure a purchase of a single parcel of property or put together a complex entity structure that will require the negotiation of a joint venture agreement between a property owner and investors that provides for profit distribution, management, and defined ownership responsibilities, it is important to think through these issues at the outset.

At Ferruzzo & Ferruzzo, LLP, our experienced business attorneys can assist in guiding a potential investor in real estate or an existing owner through the perils of entity formation and maintenance, including assisting investors with joint venture agreements related to the development of real estate projects.

TIMOTHY J McELFISH, Esq. is a Senior Partner and chairs the Firm's Corporate and Real Estate Practice Group. His practice group dedicates themselves to representing business owners and entrepreneurs. Mr. McElfish also handles all aspects of Corporate Governance, Merger and Acquisitions, Real Estate Acquisition and Dispositions, and Business Succession Planning.

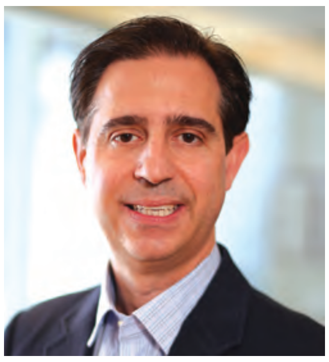
BRYAN CAVE LEIGHTON PAISNER BCLP

Foreign Investment in Certain U.S. Real Estate May Require Government Approval

By James P. Kousoulas and Mal E. Serure

Foreign investment in U.S. commercial real estate has been robust over the last few years and looks to continue to be strong in 2019. One issue that foreign investors should consider is potential review of a transaction by the Committee on Foreign Investment in the United States ("CFIUS"), which may recommend the President block or modify investments by foreign investors.

CFIUS is a Federal interagency committee authorized to review certain "covered transactions" involving foreign investment in the U.S. that may affect national security. Historically, CFIUS has focused on corporate transactions involving foreign investors - often times, relating to defense or infrastructure-and has, in certain cases, required modifications to transactions or blocked them altogether due to national security concerns. For example, in 2012, the Obama administration ordered a Chinese-owned company to divest its interests in a wind farm project that was being constructed near restricted air space at a U.S. Navy facility in Oregon. Prior to recent changes in the law, most real estate transactions were not deemed to be acquisitions of existing U.S. businesses and were not covered under CFIUS jurisdiction; however, CFIUS reviewed the 2014 acquisition of the Waldorf Astoria in New York by Anbag Insurance Group, a Chinese company, due to Chinese ownership of a hotel frequented by many United States Presidents and diplomats, and ultimately approved the acquisition. The Chinese Government's recent acquisition of Anbag may again subject the transaction to CFIUS review.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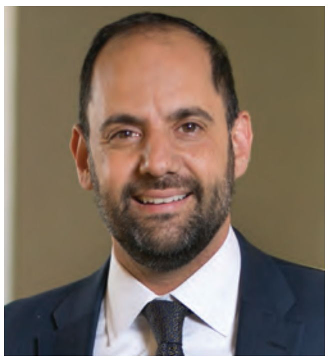
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In 2018, though, President Trump signed The Foreign Investment Risk Review Modernization Act of 2018 ("FIRRMA"), which, among other things, expanded the scope of transactions subject to CFIUS jurisdiction to include certain real estate transactions. Under FIRRMA, foreign investment in real estate that is located near a port, airport, military facility or other sensitive government location is subject to CFIUS review. Other real estate transactions that give foreign investors the ability to collect intelligence on activities at nearby facilities or that could otherwise expose national security activities at nearby facilities are also now covered transactions pursuant to FIRRMA.

While FIRRMA now requires mandatory declarations for certain transactions, filing a notice with CFIUS for a real estate transaction is, for the most part, voluntary. Following the filing, CFIUS engages in a review during which it will determine whether the proposed transaction presents national security risks. If parties do not voluntarily file with respect to a particular transaction, CFIUS has the authority to review the transaction at any time, even after closing, and to the extent that national security risks exist, the President has the authority to require modifications or demand the parties unwind the transaction. So it is important for foreign investors, their partners, lenders and counterparties to consult with counsel and consider whether their transaction will trigger national security concerns for CFIUS, and if the parties should file a notice as a preemptive action.

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