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Asia-Based Investors in U.S. Commercial Real Estate Can Mitigate Losses by Defending their Legal Rights

The U.S. commercial real estate market has been a popular investment target for Chinese and other Asia-based investors. However, a commercial property market downturn has left many of them vulnerable to losses. We explain how investors can deploy strategies to enforce their legal rights – even against big industry players – to protect their bottom lines.

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Many Chinese and other Asian investors have poured money into the U.S. commercial real estate market, whether investing directly in property or through commercial mortgage-backed securities (CMBS) or real estate investment trusts (REITs). However, the pandemic, the fastest interest rate hike in decades and a drawback from risk-taking by U.S. regional banks in the wake of bank failures have dealt grievous blows to the market, leading many investors vulnerable to mortgage defaults and lower valuations on their investments.

Rather than bear the losses, Asia-based investors can often limit the damage and obtain recoveries if they deploy proactive or counteroffensive strategies to enforce their legal rights, even against the biggest industry players.   Below are some examples of what some investors may face.

U.S. Commercial Real Estate Disputes

Establishing losses in a joint venture. Many Chinese and other non-U.S. investors invest directly in U.S. commercial real estate property through a joint venture. However, with the market flagging, many partnerships see losses as they need help to lease or sell their properties. This comes at the same time as many mortgage payments come due.

The question then becomes: how should these losses be shared? Surprisingly, many joint venture contracts are written without contemplating such a scenario, especially given complex voting and equity rules in many of these partnerships. Investors should consider deploying creative, cross-border strategies against major players to protect their interests.

Holding deal participants accountable. With mortgage delinquencies and defaults rising, many commercial mortgage-based securities (CMBS) will likely come under special servicing.

The pooling and servicing agreement enables certificate holders with a certain percentage of voting rights (normally above 25%) to direct the trustee to sue the special servicer. The directing holder, with approval from the trustee, can often direct the special servicer or appoint a successor special servicer to pursue a variety of claims regarding the underlying mortgage loans and the “reps and warranties” that accompanied them.

Challenging valuations. The valuation of the collateral underlying a CMBS—i.e., the commercial mortgage loans it holds—greatly impacts bondholders’ loss position, control rights and in turn ability to maximize recoveries. Asia-based investors need to be willing to stand up to other bondholders – even industry giants – regarding valuation of the CMBS portfolio to protect their financial interests.

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As the U.S. commercial real estate market continues to chill, Asia-based investors would do well to consider their options as early as possible. Rather than accept their losses, they should consider protecting their legitimate legal and business interests to ensure a more favorable outcome.

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