

Landmarks



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Bitcoin: Building a Better Bargain Bit by Bit?



Barry J. Guttman

With the recent collapse of Mt. Gox, the world's largest bitcoin exchange, the digital currency bitcoin is once again making headlines. Before that, however, Manhattan-based brokerage Bond New York made news after announcing its willingness to accept bitcoin as a form of payment. Bond's decision has sparked intense discussion among commercial real estate (CRE) professionals about whether and to what extent bitcoin can be used for CRE transactions.

Before delving into bitcoin's potential use in CRE transactions, some background is necessary: What is bitcoin? Bitcoin is a type of "cryptocurrency," a currency that exists solely in a digital form and can be converted to more conventional currencies through the use of online exchanges like Mt. Gox. Where the supply of physical currency is constrained by the government's decision of how much money should be in circulation, bitcoin's supply is constrained by the computer program that allows anyone with a computer to create—or, in bitcoin parlance, "mine"—bitcoins. The program constrains supply by only releasing bitcoins to a user once that user's computer has solved one or more difficult math problems. Because the math problems increase in difficulty with every problem solved, bitcoin supply increases at a decelerating rate. Because the program only allows for a maximum supply of approximately 21 million bitcoins, bitcoins retain a positive value. To ensure that users can be confident in the value of their bitcoins, every bitcoin transaction is irreversible and recorded in a publicly visible ledger. The combined effect of these measures, bitcoin proponents contend, is to create a stable currency that can function as an alternative to physical currencies.

Despite all these efforts, however, bitcoin has many perceived weaknesses that give pause to potential investors or companies evaluating bitcoin as a payment method. In the interest of brevity, this article will only look at four that are relevant to CRE. First, as an exclusively digital currency, bitcoin is vulnerable to hacking and susceptible to technological failure. The two reasons behind Mt. Gox's collapse appear to be that (1) hackers stole approximately \$460 million worth of bitcoins from Mt. Gox and (2) \$27 million worth of bitcoins simply disappeared from Mt. Gox's servers. Bitcoin's purely digital nature means that unless these issues can be permanently solved, bitcoin cannot gain widespread adoption in CRE because it cannot function as a stable store of value.

In that vein, bitcoin's second weakness is its volatility. Although bitcoin's volatility has slowed in recent months, its price is still subject to wild fluctuations. For example, in December 2013 bitcoin's value plummeted from \$1,240 to \$870 per bitcoin (an approximately 30% drop) after China's central bank prohibited Chinese financial institutions

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Get to Know Jeffrey A. Abrams



Jeffrey A. Abrams

Who: Jeffrey A. Abrams is Partner-in-Charge of Benesch's Indianapolis office, an Executive Committee member and member of the firm's Real Estate & Environmental Practice Group.

What Jeff wants you to know about the real estate industry: The real estate world is on a slow incline. The good thing is that the marble is not rolling downhill any more. Some banks are aggressively making loans and proposals while others are still being conservative in their approach. Banks make deals happen, and the more that participate, the more deals will be made.

What Jeff would be doing if he wasn't practicing law: Playing golf and traveling with Lynn (my wife) and family (when they can). But not necessarily in that order if Lynn is reading this.

Jeff's favorite hobby: Unquestionably golf with friends.

The best thing about being a real estate attorney: I get to work daily with lots of my friends, and if I can help them make money, even better.

Jeff's favorite thing about living and working in the Indy area: People are friendly. I walk down the street and strangers smile; when I walk in the lobby of our building, strangers look you in the eye and say hello. It's a Midwest friendly attitude.

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from dealing in bitcoin. From an investment standpoint, bitcoin's volatility may be a strength, because it can yield high returns. However, whether from a CRE perspective or otherwise, this volatility fundamentally undercuts bitcoin's ability to facilitate transactions as a stable store of value.

A third weakness is the uncertainty of bitcoin's treatment under the law. Is bitcoin a currency or a commodity? How is bitcoin taxed? So far, these questions remain largely unanswered. Congress is only in the preliminary stages of considering bitcoin regulations, with the Senate having heard testimony about bitcoin in November 2013. On December 20, 2013, the Congressional Research Service published *Bitcoin: Questions, Answers, and Analysis of Legal Issues*, a sweeping paper summarizing bitcoin's mechanics, its potential advantages and disadvantages, and its possible legal and regulatory issues. Following that report, in January 2014, the Law Library of Congress issued a report entitled *Regulation of Bitcoin in Selected Jurisdictions* that reviewed bitcoin's treatment by various governments around the world. In an interview with CNBC that month, Treasury Secretary Jack Lew said the government is concerned about bitcoin's potential use for illegal or violent activities. The New York State Department of Financial Services is formulating a regulatory regime for bitcoin that might include requiring entities functioning as bitcoin money transmitters to register for a "bit-license." The legal and regulatory uncertainty surrounding bitcoin causes some investors to be wary about bitcoin's future and some companies to be leery about accepting bitcoin as payment. CRE is no exception.

Fourth, specifically in the CRE context, the largely anonymous nature of bitcoin transactions can cause numerous complications. Bitcoins are stored in users' digital wallets, which are like bank accounts. Like email addresses, these wallets are often identified only by pseudonymous user names, making identifying the underlying user highly challenging. If the parties in a CRE transaction have a preexisting relationship, anonymity is likely a non-issue; however, if the parties have communicated solely online, anonymity can be at odds with aspects of CRE transactions relying on clearly identifying the parties, including FIRPTA, title insurance, tax reporting and recordation requirements.

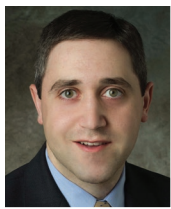
Notwithstanding these weaknesses, businesses have adopted bitcoin as a method of payment. Several prominent online companies now accept bitcoin, including online retailer Overstock.com and game maker Zynga Inc. In CRE, bitcoin has not gained wide acceptance. Other than Bond, only two other companies have publicly announced that they will accept bitcoin for CRE transactions. Title company Vista Abstract announced that it will permit bitcoin transactions, and real estate crowdfunding start-up RealtyShares announced that it will allow investments made in bitcoins.

Bond, Vista and RealtyShares all point to several reasons they adopted bitcoin. One, bitcoin is convenient; buyers can easily pay by simply using the bitcoin accounts on their mobile devices, rather than incurring the difficulty of negotiating payments with banks or other third parties. Two, in a similar vein, transaction costs are much lower because bitcoins are transferred directly from one user to another. Three, bitcoins facilitate international transactions because there are no wire fees or other fees to convert between currencies. Four, as a purely digital transaction, bitcoin is instantaneously fast.

Time will tell if Bond, Vista and RealtyShares prove to be CRE clairvoyants or if bitcoin was nothing more than a grown-up video game-like fad. No matter what happens, we at Benesch will keep you up to date on all real estate-related bitcoin news.

For more information, please contact **BARRY J. GUTTMAN** at bguttman@beneschlaw.com or 216.363.4547.

Understanding Defeasance Transactions



Lee Korland

The threat of rising interest rates over the upcoming year has sparked an increase in the number of defeasance transactions that are occurring in the commercial real estate

market. Many property owners that are holding stabilized and well-positioned assets that are subject to near-term CMBS (commercial mortgage-backed securities) debt maturities are opting to refinance now and defease an existing loan, rather than waiting until the CMBS debt is closer to maturity and open to prepayment. For these property owners, the savings associated with refinancing now and locking in a lower interest rate (before any potential spike in interest rates) outweighs the additional costs associated with completing a defeasance.

A defeasance is a complex and highly structured transaction that comes into play for securitized commercial real estate loans when the borrower under such a loan wants to sell the property or refinance the loan prior to maturity. As part of the defeasance process, there is a substitution of collateral, where the lien (i.e., mortgage) on the real estate gets released and replacement collateral is provided. There are very specific guidelines as to what type of substitute collateral is acceptable, and this substitute collateral is typically in the form of U.S. government securities that must be purchased and are then pledged in favor of the lender.

In certain respects, a defeasance transaction involving a CMBS loan is similar to a prepayment of a conventional commercial real estate loan in that the lien on the real estate gets released and the borrower is generally excused from any further liability in connection with the repayment of the loan. However, there are also some key differences when a defeasance occurs. For example, while the borrower as part of a defeasance is generally released from further liability, the loan is not

actually repaid when the defeasance closes. Rather, the loan and the underlying promissory note remain outstanding, with any liability relating to the loan and note being transferred to a newly formed and unaffiliated successor borrower, and with the pledged government securities continuing to serve as collateral for the remaining term of the loan. The cash flow from such securities also covers the debt service payments for the balance of the loan term.

Additionally, there are often fairly significant third-party costs associated with completing a defeasance of CMBS debt that are not present when prepaying a traditional real estate loan. The loan servicer, a certifying accountant, a successor borrower (and the borrower's legal counsel), counsel for the lender, the borrower's legal counsel and a securities intermediary are all involved in completing a defeasance, resulting in additional costs. Specialized defeasance consultants are also typically engaged and can greatly streamline and simplify the process. In total, these additional third-party costs can often range from approximately \$50,000 to more than \$100,000.

When considering pursuing a defeasance in order to complete a sale or refinance, a defeasance consultant can provide up-front estimates and calculations as to the costs involved with respect to third parties and with respect to the purchase of the securities that will serve as the substitute collateral. The defeasance consultant, together with the borrower's legal counsel, can also assist in navigating the lengthy checklist of requirements that must be satisfied to close the defeasance and to comply with all associated governmental regulations. A defeasance can often be consummated within 30 to 60 days (and most loan documents have strict terms regarding the prior notice of a planned defeasance that is required to be given to the loan servicer), although an expedited closing is often possible. Furthermore, the actual defeasance closing process takes 2 to 3 days, which in turn necessitates careful

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WHAT'S TRENDING



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Pass this copy of *Landmarks* on to a colleague, or email **MEGAN PAJAKOWSKI** at mpajakowski@beneschlaw.com to add someone to the mailing list.

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coordination and planning to ensure a smooth simultaneous closing on any related sale or refinancing.

The key factors that often drive whether pursuing a defeasance makes sense include the remaining term and interest rate on the applicable loan, the current pricing and yield on U.S. treasuries, real estate market conditions and trends, and a property owner's short- and long-term business objectives. The longer the remaining term on the loan being defeased, the higher the cost will be for the purchase of the substitute collateral. For loans that do not mature in the next 12 to 18 months, the cost for such securities that serve as the substitute collateral is often prohibitive and negates any value in pursuing the defeasance. In addition, it is important to evaluate whether the loan can be defeased only through the open prepayment window near the end of the loan term, or whether the loan must be defeased through maturity. The opportunity to share in any potential residual profits from the securities that are purchased as substitute collateral, as well as the potential tax deductibility of any costs incurred in completing a defeasance, should also be considered when evaluating a possible defeasance transaction.

While defeasance can be a complicated process involving extra costs, it also provides property owners with needed flexibility to sell or refinance assets. Furthermore, given the number of securitized loans made over the past decade, combined with a fear of rising interest rates that are causing a surge in the number of property owners looking to refinance now before rates trend higher, defeasance transactions will continue to be a reality in the market. With proper advisors and a solid understanding of the process and hurdles, defeasance transactions can be successfully structured, navigated and closed.

For more information, please contact **LEE KORLAND** at lkorland@beneschlaw.com or 216.363.4189.

RECENT TRANSACTIONS

- Represented the investor group in the disposition of a 235,000+ SF grocery-anchored shopping center in northern Ohio.
- Represented the developer in a joint venture and \$30+ million construction financing for a 320,000+ SF multifamily apartment development in Austin, Texas.
- Represented a senior lender in construction financing for the \$170 million redevelopment of a large urban office complex into a mixed-use development with a hotel, apartments, grocery and retail space, and multiple public and private financing sources.
- Represented the investor group in a \$11+ million refinance of a shopping center near Milwaukee, Wisconsin.
- Represented a Fortune 500 company in the disposition of 65+ acres of outparcels near Charlotte, North Carolina.
- Represented the lender in a \$41 million acquisition and construction loan for a warehouse and distribution facility in the Chicago area.
- Represented the lender in two loans totaling over \$17 million for the refinance and construction of an urban apartment project in Indianapolis.
- Represented the purchaser of a 250+ unit multi-building apartment complex for a purchase price in excess of \$12 million.
- Represented a regional bank in documenting a \$20+ million construction loan for a multifamily project in Evansville, Indiana.
- Represented a national lender in documenting an \$12 million loan for a distribution facility in Illinois.
- Represented the owner of an office building in the lease of significant space to a major hospital.
- Represented a national bank in documenting a \$27 million acquisition and construction loan in a mixed-use urban project with retail, a parking garage and multifamily units.
- Represented the seller in a loan assumption and disposition of two warehouse properties in South Carolina for a purchase price of \$18 million.
- Represented investor group in the acquisition of a \$9 million shopping center in Indiana.
- Represented the lender in a \$15 million construction loan for an apartment project in northwest Indiana.

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NEWS ABOUT US

- **NORMAN W. GUTMACHER** gave a presentation to approximately 300 franchisees of quick-service restaurants on valuations (and things that could be done to improve the value) of restaurants.
- In February, **MADELINE T. McGRANE** attended CREW Network's Winter Leadership Summit in Salt Lake City, Utah. Madeline attended the Summit in connection with her role as the Chapter Liaison between the local CREW Cleveland chapter and CREW Network. The Summit included delegate training, a panel discussion on governance and succession training for local boards, and Professional Development Training presented by Christine Spray, Founder & President of Strategic Catalyst, Inc. In addition to formal presentations, there was plenty of time to network with other CREW members from the U.S. and Canada.

WE'RE GROWING FOR IT.

MY BENESCH MY TEAM

Our thriving **Real Estate & Environmental Practice** puts more than two dozen of the Midwest's most experienced transactional attorneys to work for our clients. Doing deals. Representing buyers, sellers, developers, lenders, investors, landlords and tenants. Keeping our clients ahead.



Featured Professionals (left to right) JEFFREY J. WILD, Chair, JEFFREY A. ABRAMS, JOY A. BARRIST, KIAMESHA-SYLVA G. COLOM, MARILYN DULIC*, TAMAR GONTOVIK, NORMAN W. GUTMACHER, BARRY J. GUTTMAN, KATHERINE M. KERRIGAN*, ANDREW A. KLEIMAN, LEE KORLAND, JEAN KERR KORMAN, DAVID MANSBERY JR., KEVIN D. MARGOLIS, MADELINE T. McGRANE, CHRISTIAN F. MORATSCHEK, NORMAN R. NEWMAN, ROBERT C. ONDAK JR., ADAM N. SAURWEIN, JAMES H. SCHWARZ, DANIEL SPIRKO, HOWARD A. STEINDLER, MICHAEL K. SWEARENGEN, JENNIFER E. VALENCIC*

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