



LEGAL UPDATE Mar 3, 2022

# The Effect of US Sanctions Against Russia on Commercial Real Estate Documentation

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President Biden promised “devastating sanctions” if Russia invaded Ukraine. Russia did. And so the most recent sanctions ensued. Those sanctions may have a direct effect on documents that are signed daily in the commercial real estate industry. This legal update walks through the recent sanctions and what clients should be aware of before signing real estate related documentation.

On February 21, 2022, President Biden issued Executive Order 14065 which, among other things, prohibits the transfer, payment, export, withdrawal, or otherwise dealing in “all property and interests in property that are in the United States (“US”) or come within the possession of any US person of companies or persons” determined by the Secretary of the Treasury to be, among other things, operating in the Donetsk or Luhansk regions of Ukraine. The next day, February 22, 2022, the Treasury Department’s Office of Foreign Assets Control (“OFAC”) identified a large number of such companies/persons adding them to OFAC’s listing of Specially Designated Nationals (“SDNs”).

The day after that, February 23, OFAC similarly blocked the property of additional persons—this time pursuant to Executive Order 14024 which was directed at, among other things, companies and persons engaged in activities that undermine the peace, security, political stability or territorial integrity of the US or its allies. On February 24, OFAC blocked dealings with respect to certain property of another large group of Russian-related companies and persons. OFAC added still more parties to the listing of

SDNs on February 25 and February 28. At the same time, OFAC prohibited various transactions with leading Russian banks.

As a result of these recent US sanctions, US persons must undertake due diligence to ensure that they do not engage in transactions with blocked companies and persons for several reasons, as the list of blocked companies and persons has been meaningfully expanded in recent days. First, there are potential criminal or administrative penalties, even possible prison time, that can result from OFAC violations. Second, OFAC representations stating that the representing party is not on an OFAC list are already prevalent throughout documentation in all stages of a real estate transaction, as further discussed below.

### ***Nondisclosure Agreements (“NDAs”) and/or Access Agreements***

As the starting point for most real estate transactions, NDAs and Access Agreements are among the most frequently signed documents for prospective real estate investors. Real estate professionals should be on the lookout for OFAC representations or covenants in these documents. These provisions are not typical in real estate NDAs or Access Agreements, but when presented with such a provision, buyers should confirm that they are able to make the applicable representation. Additionally, if a buyer is asked for such OFAC representations or covenants, it would not be inappropriate to ask the seller for a mutual representation in return.

### ***Purchase and Sale Agreements (“PSAs”)***

PSAs frequently have mutual representations, made by both the buyer and seller, with respect to OFAC. A typical PSA representation will say that the buyer or seller are not identified on any lists maintained by OFAC. Buyers will often attempt to negotiate the buyer OFAC representation so as to not include affiliates or investors, for the purpose of limiting the parties about whom the representation is being made; this can be especially important, given that a buyer may not yet know their ultimate source of equity for a transaction on the day of PSA execution and thus should not give a representation with respect to parties with whom the buyer does not yet know that they are partnering. On the other hand, from the buyer’s perspective, the seller OFAC representation should be as broad as possible, so the buyer can later make a representation that they have not done business with anyone on any OFAC lists (both to the investors and its lenders), and also to help the buyer avoid exposure to the penalties associated with OFAC violations. When representing a seller, there is

more certainty around the source of the equity already in the transaction, so it is generally easier to give a broader OFAC representation.

## ***Commercial Leases***

Most landlord commercial lease forms will contain a representation for the benefit of the landlord, which states that the tenant (1) is not on any OFAC list and (2) is not conducting any business or engaging in any transactions with anyone on an OFAC list. This is important to the landlord, because, in addition to the landlord's broader desire to avoid potential OFAC penalties, the landlord will typically need to make similar representations and covenants to their lender, including that the landlord will not do business with parties on an OFAC list. As such, it is important for tenants to be aware of the scope of the OFAC representation made in their commercial leases. Additionally, if a tenant is asked to give an OFAC representation in a commercial lease, it should not be controversial to ask the landlord for a mutual representation.

## ***Property Management Agreements***

Property management agreements will typically contain mutual representations on the part of the owner and property manager that neither party is on an OFAC list.

## ***Loan Documents***

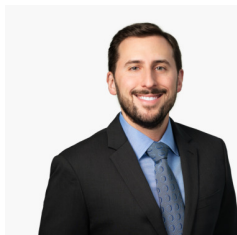
As an owner of real estate and borrower of funds, many loan documents will contain some of the more stringent OFAC representations and covenants seen in typical commercial real estate documents. For example, on the day of closing, a broad representation is typically made which says that no one on an OFAC list has any direct or indirect interest in the borrower or guarantor. Additionally, there is typically an ongoing covenant in loan documents which states that none of the borrower parties will engage in any dealings or transactions with parties that are on an OFAC list. As such, as discussed below, it is very important for borrowers to understand the origins of their equity, and properly protect themselves with "back-to-back representations" in joint venture agreements and real estate fund or offering documents.

## ***Joint Venture Agreements ("JVs"), Real Estate Fund Documents, and Real Estate Capital Markets***

It is critically important in capital raising documents that sponsors obtain representations and covenants from investors that they are not and will not be on any OFAC lists or otherwise subject to any OFAC sanctions, and are not doing business with parties on said lists; this is important because sponsors will need to make these representations to their lenders (see the loan document paragraph above). As such, to the extent that JV and real estate fund documentation are permissive with respect to transferability, such documentation will typically contain an ongoing covenant which says that neither party can transfer any interest in the venture to anyone on an OFAC list. As a side note, a large part of our practice is in the world of regulation D private placement offerings, where accredited investors purchase interests in LLCs, limited partnerships, and Delaware statutory trusts through broker dealers and registered investment advisors; in this context, the managing broker dealer (“MBD”) agreements will typically have a representation that the MBD has procedures in place to ensure that no securities are sold to individuals sanctioned by OFAC. Additionally, sponsors are protected further by a similar representation in the actual purchase agreement that investors sign when purchasing securities.

Should any of the above OFAC representations or covenants be breached, it could lead to a default under various commercial real estate documents, in addition to potential criminal or administrative penalties and/or prison time associated with OFAC violations. A default under real estate documents could have serious ramifications, such as a termination of lease, termination of property management services, JV buyout rights, a cash trap trigger, or even foreclosure. As such, US persons engaged in real estate should undertake appropriate due diligence to ensure that they do not engage in transactions with blocked companies and persons under OFAC rules as recently expanded. The most current list of blocked companies and persons under OFAC can be found here: <https://home.treasury.gov/policy-issues/financial-sanctions/specially-designated-nationals-and-blocked-persons-list-sdn-human-readable-lists>.

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