

# Commercial real estate in United States: overview

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## THE CORPORATE REAL ESTATE MARKET

### 1. What have been the main trends in the real estate market in your jurisdiction over the last 12 months? What have been the most significant deals?

The US commercial real estate (CRE) market continues on its post-recession recovery thanks to increased debt and equity capital availability. The commercial mortgage-backed securities (CMBS) market continues to regain volume. At the close of the third quarter of 2014, over US\$68.8 billion in CMBS had been issued in the US, compared to US\$30.9 billion and US\$60.5 billion for the same periods in 2012 and 2013, respectively. Foreign investors continue to demonstrate an interest in US CRE, accounting for US\$38.7 billion in US CRE investment in 2013 and to date in 2014 have invested US\$38 billion. The market for office property has performed impressively over the past year, and has seen nine consecutive quarters of lower or flat vacancy rates, and real estate investment trusts (REITs) continue to perform strongly due to higher liquidity and investor interest.

Recent significant deals include:

- In January 2014, MetLife Inc and Norges Bank Investment Management purchased the 12-story Thurman Arnold Building in Washington DC building from Manulife Financial Corp for about US\$505 million.
- In February 2014, Senior Housing Properties Trust purchased the two 15-story waterfront towers in Boston housing the headquarters of Vertex Pharmaceuticals Inc for US\$1.1 billion.
- In June 2014, a partnership led by New York real estate investor David Werner purchased the 5 Times Square tower at Seventh Avenue and 42nd Street in New York City for US\$1.5 billion. The sale was, by US dollar amount, the biggest sale of an entire building in New York since 2010.
- In June 2014, Vornado Realty Trust and Crown Acquisitions agreed to buy the retail portion of the St Regis Hotel and related townhouse at 697 Fifth Avenue, New York, NY for US\$700 million. The acquired property totals 24,700 square feet of retail space. The deal is expected to close by the end of 2014.

## REAL ESTATE INVESTMENT

### 2. What structures do investors typically use for real estate investment in your jurisdiction and what are the main advantages and disadvantages of each (for example, flexibility and tax transparency)?

#### Common structures

It is possible to acquire US commercial real estate (CRE) in an individual capacity, but the resulting personal liability is usually considered undesirable. It is typical for a prospective buyer to form a corporation, partnership or limited liability company as an acquisition vehicle. The following factors should be considered when choosing the type of entity:

- Tax concerns.
- Personal liability of investors.
- Management concerns.
- The transferability of ownership interests.

However, no structure can shelter an investor from potential personal liability for certain acts, including fraud or torts.

Federal and state income tax regimes should be considered when evaluating an acquisition structure. Non-US investors often structure their investment to minimise the impact of the Foreign Investment in Real Property Tax Act of 1980 (FIRPTA), which applies to certain disposals by non-US persons of interests in US real estate. In addition, non-US investors should consider the applicability of any income tax treaty between the US and the home country that may minimise or eliminate the US federal income tax burden.

#### REITs

Real estate investment trusts (REITs) are available and often used in the US. A REIT is not generally taxed on its net income and gains to the extent that it distributes the requisite income and gains to its shareholders. This tax advantage is offset by certain requirements that a REIT must fulfil in relation to its structure, assets and income. REITs are frequently used by foreign investors in the US markets as a tax efficient structuring strategy.

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### 3. What are the main sources of finance and types of investors for real estate investment in your jurisdiction? Does your government encourage overseas investment into real estate in your jurisdiction, for example through real estate investment legislation?

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Common financing structures include:

- Mortgage loan financing (debt secured by a lien on commercial real estate (CRE)).
- Mezzanine loan financing (debt secured by a pledge of equity in the CRE-owning entity).
- The issuance of preferred equity.
- A combination of these structures (*see Question 24*).

One goal in selecting a financing structure is to reduce the actual taxable income of the investment vehicle in the US. For this purpose, it is important to ensure that the payments of interest are deductible for US federal income tax purposes, as some rules may limit this deductibility.

Investors in US CRE can be divided into two categories, institutional investors and private investors.

#### Institutional investors

Institutional investors, who often invest through joint venture arrangements or real estate investment trust (REIT) structures with private investors and real estate companies, typically include:

- Pension funds.
- Financial institutions.
- Life insurance companies.

#### Private investors

Private investors include:

- High net-worth individuals and funds controlled by them.
- Real estate developers.
- Foreign investors (including sovereign wealth funds).
- Private equity funds.

Foreign investment in US real estate is generally welcomed and encouraged, although the tax implications of it are under continual review (*see Question 43*) and vary depending on the jurisdiction of the investor.

#### Restrictions on foreign ownership or occupation

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### 4. Are there restrictions on foreign ownership or occupation of real estate (including foreign ownership of shares in companies holding real estate)? Are there restrictions on foreign guarantees or security for ownership or occupation and on lending for the purchase of real estate?

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There are few restrictions on foreign nationals and entities limiting the ownership, purchase or transfer of real estate, except where the federal government has determined that national security may be at stake or protection of agricultural and natural resources is required. Various federal statutes contain disclosure and filing requirements applicable to foreign investors in US real estate. In addition, a non-US investor may be subject to the rules under the Foreign Investment in Real Property Tax Act of 1980 (FIRPTA) (*see Question 2*).

Depending on the nature of the asset being acquired, or the economic size of the transaction, certain legal pre-clearances may be necessary. The Hart-Scott-Rodino Act of 1976, an anti-trust regulation, requires any investor seeking to acquire either a 15% stake or a stake valued at more than US\$15 million in a particular security to file a notification with the federal government. Obtaining deal-specific legal advice on the effect of these statutes is important.

#### TITLE TO REAL ESTATE

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### 5. What constitutes real estate in your jurisdiction? Is land and any buildings on it (owned by the same entity) registered together in the same title, or do they have separate titles set out in different registers?

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Real estate is comprised of land, the improvements (buildings) constructed on the land, and the fixtures attached to the land or buildings. If these three elements of a parcel of real estate are owned by the same entity, they are conveyed together in one deed that is recorded in a single land registry office. Long-term leasehold interests are also considered real estate, and the leases creating them can be recorded in the land records.

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### 6. How is title to real estate evidenced? What is the name of the public register of title and the authorities responsible for managing it? Is electronic access and electronic conveyancing available?

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Title to real estate is evidenced by a deed or other transfer document, which is recorded in the county or municipal land records. The Torrens land registration system, similar to the system in effect in various civil law countries, is also used in a few US jurisdictions. The name of the public register of title (land records office), the authorities responsible for managing it, and the availability of electronic access and electronic conveyancing, varies by county and municipality.

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### 7. What are the main information and documents registered in the public register of title? Can confidential information or documents be protected from disclosure in the public register of title?

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The following are recorded in the public register of title:

- Deeds.
- Mortgages.
- Easements.
- Tax liens.
- Judgments.
- Certain leases.
- Certain assignments.
- Other documents that affect title to the commercial real estate.

Confidential information or documents cannot generally be protected from disclosure once recorded in the land records. However, confidential documents can in some cases be redacted prior to recording. It is also sometimes possible to protect the identity of an investor by creating a holding company to acquire title to real estate.

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**8. Is there a state guarantee of title? Is the authority that manages the public register liable to pay compensation for any errors it makes in relation to title registration? Is title insurance available and is it commonly used?**

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Except in the few US jurisdictions using the Torrens land registration system or equivalent (*see Question 6*), there is no state guarantee of title and the authority that manages the public register is not liable to pay compensation for errors made in relation to title registration. Title insurance is available from private insurers and widely obtained by buyers and lenders.

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**9. How can real estate be held (that is, what types of tenure and other main ownership rights exist over land)?**

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Property can be:

- Acquired outright.
- Leased, including long-term leasehold interests and short-term leases.
- Acquired and leased back to the actual user.

Alternatively, an investor can acquire the ownership interests of an entity that owns property in the US.

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**SALE OF REAL ESTATE**  
*Preliminary agreements*

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**10. What types of preliminary agreements are typically used in the sale of real estate? Are they legally binding?**

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**Brokerage agreements**

A real estate broker, typically acting as the seller's agent, lists properties through brokerage networks. For substantial transactions, the seller's broker may publicise an offering package and invite bids from prospective buyers. Sellers typically engage their brokers through brokerage agreements, which may include exclusivity provisions and generally bind the seller to pay a commission to the broker in the event of a completed sale. These agreements are legally binding.

**Bid packages**

If the seller decides to conduct an auction, the bid process typically includes a first round where the prospective buyer submits a detailed written bid package, including a description of the economic terms of the offer, the sources of the buyer's funds, the buyer's market experience and other details. The seller will usually select certain bidders to participate in a second round of bids. In response, a bidder typically submits its "best and final" offer, written responses to the seller's questions and commercial and legal comments on the seller's form of sale contract. After the second round of bids, a buyer is usually selected.

**Pre-contractual arrangements**

A letter of intent (LOI) for the acquisition can be finalised when an offer is accepted. However, it is also common to move directly to definitive contract documentation. The LOI can, at a minimum, set out the basic understanding of the parties and a confidentiality provision, or may be more comprehensive and cover some or all of the material issues in the transaction. The LOI usually states that it is non-binding until the parties enter into a definitive sale contract. Unlike certain other jurisdictions, a US seller can cease negotiations before execution of the sale contract, even though the buyer may have already incurred due diligence costs and legal fees. In such case, if the LOI required the parties to negotiate in good

faith, the buyer may try to claim that the seller is liable for acting in bad faith in terminating negotiations.

**Sale contract**

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**11. Briefly outline the typical main provisions of a corporate real estate sale contract and main real estate provisions of a typical share purchase agreement.**

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The sale contract is generally drafted by the seller's lawyers, and typically includes:

- A legal description of the real property.
- The purchase price, contract deposit, and circumstances under which the deposit (or a portion of it) may be refundable to the buyer.
- A description of any included fixtures, personal property service contracts, leases, employee obligations and other material items.
- The timing of fulfilment of any conditions precedent, the date of the closing (including any postponement rights) and a list of closing deliverables.
- Any due diligence, financing or casualty contingencies.
- A section regulating the seller's obligations until the closing date.
- Warranties and a provision regulating the consequences of any inaccuracies.
- A section regulating monetary adjustments (pro-rations) to be made at the closing and an apportionment of closing costs.

Subject to any contingencies, a purchase contract becomes legally binding on execution by the parties and delivery to the seller of any consideration required on execution.

In a sale of a company that owns real estate, the share purchase contract will also typically include negotiated warranties and covenants covering real estate-related matters. *See Question 13.*

**Due diligence**

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**12. What real estate due diligence is typically carried out before an acquisition and what key areas does it cover? Which documents are typically reviewed? Which specialist advisers are usually involved and which reports do they typically produce?**

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The major substantive areas of due diligence include review of:

- The public records through a title insurance commitment.
- A land survey.
- Environmental reports and database searches.
- Leases and tenant estoppel certificates.
- Engineering and property condition reports.
- Uniform Commercial Code (UCC) searches.
- Building and zoning code violation searches.

The above materials are typically provided by third-party specialists or search firms. The buyer's lawyer is typically involved in review, except for engineering and property condition reports, which are generally examined by the buyer or an independent engineering consultant. Aspects of review are sometimes outsourced to specialists (for example, zoning).

## Sellers' warranties

### 13. What real estate warranties are typically given by a seller to a buyer in the sale of corporate real estate and what areas do they cover? What are the main limitations on warranties, for example are they typically qualified by disclosure?

Increasingly, sale contracts do not include extensive warranties and property is instead sold "as is". Some sale contracts, however, do include heavily negotiated warranties. Sellers seek to limit warranties in areas where the buyer can conduct its own investigations, or qualify them to seller's actual knowledge. Buyers seek to include seller warranties where the results of due diligence are not conclusive, or where due diligence cannot provide the necessary level of comfort. Seller warranties may include that the:

- Seller owns the property and has the requisite power and authority to sell.
- Property does not violate any law or regulation, and does not, to the knowledge of the seller, contain environmental contamination.
- Property is not subject to any third party claims, litigation or eminent domain proceedings (*see Question 39*).

## Liability

### 14. Does a seller have any statutory or other liability to the buyer in a disposal of real estate?

Certain federal and state laws (generally applicable to residential transactions) require disclosure of the presence of lead paint or other known environmental hazards, and/or the provision of a property condition report to the buyer. Contractual liability depends on the scope of warranties given by the seller (*see Question 13*) and the negotiated remedy for breach.

### 15. Briefly outline the environmental legislation and potential liability for a buyer in a purchase of real estate. Is it common to carry out environmental surveys and searches and to obtain environmental insurance? How is environmental liability typically dealt with in the sale contract?

The federal Comprehensive Environmental Response, Compensation and Liability Act (CERCLA) and its state counterparts impose strict liability for environmental remediation on the present owner of a property. Other persons may share in that liability, such as prior owners or operators of the property. Buyers can avoid strict liability for pre-existing conditions under CERCLA and some state statutes if they perform all appropriate inquiry into the property's environmental condition before purchase. The standard for all appropriate inquiry is contained in the US Environmental Protection Agency's All Appropriate Inquiry Rule (AAIR). The AAIR prescribes protocols for the pre-acquisition performance of a Phase I Environmental Site Assessment. New owners who comply with the AAIR are protected from liability as "bona fide prospective purchasers", but that protection can be lost if the new owner exacerbates the pre-existing conditions. Buyers typically seek to limit their exposure to ongoing environmental liability through the negotiation of warranties in the sale contract, while sellers typically seek to limit such warranties to matters of which they have knowledge or that they caused. Buyers frequently purchase environmental insurance to further manage risk associated with unknown pre-existing conditions.

### 16. Can an owner or occupier inherit liability for other matters relating to the real estate even if they occurred before it bought or occupied it? Can a seller or occupier retain any other liability relating to the real estate after it has disposed of it?

A real estate buyer is generally not liable for events occurring before its period of ownership. However, a buyer can potentially inherit liability for pre-existing environmental contamination under federal, state and local laws. A buyer may also inherit certain obligations under existing leases of space in an income-producing property. A seller may retain liability as a statutory obligation, or as a matter of contract between the parties. Contractual warranties concerning the property's condition usually survive the closing, and a seller's liability can extend for a defined number of years and/or up to a specified monetary amount.

## Completion arrangements

### 17. What are the typical arrangements and main documents required for completion of the sale? When does title transfer and what are the formal legal requirements to execute the sale documents, transfer the real estate and register the change of title? Is notarisation required?

## Closing

The completion of the sale of commercial real estate occurs at a "closing", either in person at the offices of seller's or purchaser's attorneys or the office of an escrowee (typically a title insurance company), or via the e-mail exchange of electronic documents and wired funds (sometimes with originals to be subsequently exchanged).

## Registration

A deed is generally recorded in the land records immediately after the payment of the purchase price to the seller, with title insurance protecting the buyer from any intervening liens or a competing deed. In some jurisdictions, particularly in western states, it is customary for the purchase price to be placed in an escrow account held by a title insurance or escrow company, with recording of the deed and issue of the buyer's title insurance policy occurring at the same time as the release of the purchase price from escrow.

## Title

Title to real estate transfers on delivery to the buyer of a written deed, the form of which varies by state and by contract. The recording of the deed in the land records is not a condition to the transfer's effectiveness. However, certain formalities, including notarisation, are required before the deed can be accepted for recording.

## Closing costs

Buyer's costs generally include:

- **Mortgage recording tax.** If the buyer finances the acquisition with a mortgage, mortgage recording tax is payable (at the time of recordation) in a number of jurisdictions. The tax is usually a percentage of the principal amount secured.
- **Title, financing and diligence fees.** The buyer is generally responsible for payment of the:
  - title insurance premium (for its own policy and the lender's policy) and search fees;
  - cost of a land survey;

- cost of any environmental, engineering or property inspection reports required by the buyer or its lender;
- lender fees.

- **Legal fees.** The buyer will pay its own and the lender's lawyer's fees.
- **Miscellaneous fees.** Most jurisdictions impose a *de minimis* per-page fee for the recording of documents. Escrow fees are often split with the seller.

Seller's costs typically include:

- **Transfer taxes.** Real estate transfer tax, imposed by many jurisdictions based on the purchase price of the property, is generally payable by the seller, although this can vary by statute, local custom or contract (*see Question 18*).
- **Legal fees.** The seller will pay its own legal fees.
- **Miscellaneous fees.** Brokerage commissions are generally paid by the seller.

## REAL ESTATE TAX

### 18. Is stamp duty/transfer tax (or equivalent) payable on the purchase of real estate? Who pays, what are the rates and are there any exemptions? Does it apply to the transfer of shares in a company holding real estate and at what rate?

Many jurisdictions impose transfer tax based on the purchase price of the property. Some jurisdictions impose transfer tax on the creation of a long-term lease. Each state and local government sets its own rate of tax and tax basis. Statutory exemptions from transfer tax vary by jurisdiction. Transactions that are commonly exempt include conveyances:

- Under the federal Bankruptcy Code.
- To governmental agencies.
- Of real estate without consideration.
- That change identity or mere form of ownership with no change in beneficial ownership.

In addition to direct transfers of property, some states impose a tax on transfers of a controlling interest in an entity that owns property located within the state. Each jurisdiction sets its own rate of tax.

### 19. Are any methods commonly used to mitigate real estate tax liability on acquisitions of large real estate portfolios? What is the general approach of the tax authorities in your jurisdiction to such schemes?

Mortgage recording tax payable by a buyer may, in certain instances, be avoided by structuring, such as by having the mortgage secure a guarantee rather than a promissory note, or in a refinancing that involves assignment of existing debt to the new lender. Transfer taxes can in some jurisdictions be avoided by structuring a transfer of ownership interests in the entity owning the CRE (*see Question 18*).

### 20. Is value added tax (VAT) (or equivalent) payable on the sale or purchase of real estate? Who pays? What are the rates? Are there any exemptions?

No VAT or equivalent tax is imposed in the US.

### 21. Are municipal taxes paid on the occupation of business premises? Are there any exemptions?

Commercial rent tax is imposed in certain municipalities, such as New York City, to be paid by the tenant under a lease of business premises. An exemption may apply if the tenant's annual rent falls under a specified threshold, or in particular municipal districts to encourage economic development. Certain states (for example, Florida) impose a sales tax on rents payable under commercial leases.

## CLIMATE CHANGE ISSUES

### 22. Are there targets or incentives to reduce greenhouse gas emissions from buildings in your jurisdiction? Is there legislation requiring buildings to meet certain minimum energy efficiency criteria?

Individual states have enacted a range of building codes aimed at energy efficiency and the reduction of greenhouse gases. Most of these codes are voluntary or employ tax incentives to foster compliance. For significant real estate development projects under environmental impact review, some states now require an analysis of greenhouse gas emissions and opportunities to mitigate them.

### 23. Are provisions relating to the energy efficiency of buildings commonly included in contracts for the sale of real estate or in leases (for example, green leases)?

Provisions relating to the energy efficiency of buildings are not commonly included in sale contracts or in leases, although certain newer "green" office buildings include energy conservation and efficiency covenants in their form leases.

## REAL ESTATE FINANCE

### *Secured lending involving real estate*

### 24. Briefly outline the typical security package required by lenders in relation to real estate lending. How are the most common forms of security interest relating to real estate created and perfected (that is, made valid and enforceable)?

The most common form of real estate security for financing is the mortgage or deed of trust. A mortgage grants a lien on the real property to the lender, which is released when the loan is repaid. A deed of trust transfers title to the encumbered real property to a trustee for the lender, who holds title until the loan is repaid. Whether a mortgage or a deed of trust is used depends on the applicable state's legal view of real estate security (lien-theory or title-theory). The practical difference for the borrower is negligible, since the primary difference between the two is in the manner of enforcement after default. Mortgages and deeds of trust are perfected by recording in the land records in the jurisdiction where the real property is located.

### 25. What other real estate related measures do lenders typically take to protect themselves against default by the borrower?

Lenders use a number of tools to protect against a default by the borrower.

## Conditions precedent

Loan agreements will typically include certain conditions precedent that the borrower must meet prior to any funding of proceeds, such as providing borrower equity, delivering certain financial documents and certifications, and providing for acceptable loan guarantees.

## Ongoing covenants

Lenders also require borrowers to provide ongoing covenants as to certain critical matters. For example, lenders will often request that borrowers provide covenants as to satisfaction of certain financial ratios or tests. Lenders will also require borrowers to maintain the property and ensure maintenance of single-purpose entity status.

## Guarantees and letters of credit

Lenders will often request a guarantee from a credit worthy party, typically with an interest in the borrower. Guarantees may be full payment guarantees, guarantees of non-recourse carveouts contained in the loan agreement (typically borrower defaults in the nature of bad faith acts), or guarantees of completion of work. Instead of a guarantee, lenders will in some transactions accept a letter of credit from a financial institution.

## Other forms of lender protection

Lenders may also utilise any of the following methods to protect their interests:

- **Reserves.** Lenders may require that portions of the loan proceeds are held back in the form of interest, capital improvement or other reserves, to be disbursed upon satisfaction of certain conditions.
- **Cash management.** Lenders may include provisions that require the "sweeping" of property income into managed bank accounts.
- **Right of entry/management.** Loan agreements typically give lenders the right to entry and management of property affairs during events of default by borrowers.

## 26. Can lenders incur environmental liability? What measures do lenders typically take to manage potential environmental liability?

Lenders are protected from liability for contamination if they observe guidelines specified in federal and state law. Despite these statutory protections, lenders typically require borrowers and guarantors to deliver environmental indemnities at closing, whereby lenders are indemnified against environmental claims. Such indemnities typically survive full payment or termination of the loan.

## 27. Briefly outline the main remedies for lenders in relation to the secured real estate if the borrower defaults on the loan. What is the effect of the borrower's insolvency on the lender's remedies?

Though the range of available remedies varies among jurisdictions, typical remedies for default include acceleration of the unpaid balance of the loan, foreclosure, taking possession of the property to complete a construction project, and offsetting any borrower account balances against unpaid loan obligations. Typically, loan agreements will provide that lenders' remedies upon borrower default are cumulative; lenders may select which remedy or remedies they would like to pursue. In the event of borrower insolvency, the intent of the remedies is to give the lender recourse through direct access to the collateral. In the alternative, lender recourse to creditworthy entities is typically provided through guarantees (see *Question 25*).

## 28. Briefly outline key additional issues for lenders in relation to construction and development projects.

The primary concerns for lenders in construction and development projects relate to insuring the completion of such projects, avoidance of construction-related liabilities, and the risk that permanent "take-out" financing may not be obtained. Such loans are typically structured such that funding occurs in increments, each contingent upon satisfaction of certain work-related and other conditions. Funding of final proceeds upon project completion will often require that borrowers deliver final lien waivers from contractors and certificates of occupancy from local municipalities. Lenders will also typically require a guarantee of completion from a credit-worthy affiliate of the borrower (see *Question 25*) and a borrower indemnity.

## Other real estate financing techniques

## 29. Are other real estate finance techniques commonly used in your jurisdiction? For example, real estate securitisation and sale and leasebacks.

Prior to the recession, real estate securitisation was very common in the US. Securitised loans continue to make a significant comeback.

Sale and leaseback transactions are sometime used by corporate property owners as an alternative to loan financing.

## REAL ESTATE LEASES

### Negotiation and execution of leases

## 30. Are contractual lease provisions regulated or freely negotiable? Which legislation applies?

Subject to certain state-specific and municipal statutory and regulatory requirements (generally affecting residential leases), almost every provision of a lease is negotiable.

## 31. What are the formal legal requirements to execute a lease? Does the lease have to be executed by certain parties or as a deed? How do the formalities differ for a company, partnership and for individuals?

It is essential to the validity of a lease that:

- The landlord and tenant are separate parties.
- The landlord holds the title to the leased property.
- Any necessary third party consents are obtained, and if executed by an agent, the agent has the appropriate authority to execute the lease on the landlord's behalf.

The formalities of lease execution vary by type of entity and across states, but generally, notarisation and/or recordation in the land records is not required (except in the case of certain long-term leases and ground leases recorded by tenant). In some states, leases are executed as a deed.

## Rent payments

### 32. How are rent levels usually reviewed and are there restrictions on this? Is stamp duty and VAT (or equivalent) payable on rent? Is a rent security deposit required and does it have to be managed in a certain way?

Rents are set contractually within the lease and are not statutorily imposed. Rent increases are typically specified either as a percentage increase or based on a referenced index of inflation (such as the Consumer Price Index of the US Department of Labour) and are not controlled by statute (other than in the case of certain residential leases). When a lease includes an extension right, the extension term rent is often reset at a fair market rental value, determined by appraisal. VAT is not payable on rent, but certain jurisdictions (*see Question 21*) impose a tax on rents in certain circumstances. Rent security deposits are often required in commercial leases as a matter of contract, but are not required by law. Certain jurisdictions legislate the type of account in which rent security deposits under residential leases may be held and impose reporting obligations on the landlord with respect thereto.

## Length of term and security of occupation

### 33. Is there a typical length of lease term and are there restrictions on it? Do tenants of business premises have security of occupation or rights to renew the lease at the end of the contractual lease term?

Commercial occupancy arrangements are typically set out in a lease. There are many types of lease in use in the US, and typical length of the lease term will vary with the type of lease and will also be dictated by the economics of the transaction. Common types of commercial leases include:

- Triple net leases, where the tenant pays for all real estate taxes, insurance and operating expenses.
- Gross leases, where the tenant pays rent and the landlord pays the above expenses (although in a modified version, the tenant may pay its share of increases in those expenses over a specified base year).
- Ground leases, often net leases of land to be developed by the tenant.

Gross leases generally bear shorter terms than net leases, and may run from two years to 15 years, although five- and ten-year terms are common. Ground leases may have terms running from 25 years up to 99 years and longer.

The tenant's right to renew a commercial lease at the end of the term is a matter of contract. Some jurisdictions provide that if the landlord accepts rent from the tenant after expiration of the lease term, a month-to-month tenancy or tenancy at will is created, which gives the tenant certain legal rights despite the expiry of the lease term.

## Disposal

### 34. What restrictions typically apply to the disposal of the lease by the tenant? Can the tenant assign or sublet the lease with the landlord's consent? Can tenants share their premises with companies in the same group? What is the effect of a legal reorganisation or transfer/sale of the tenant on the lease and on a guarantee of the lease?

Tenants are typically restricted from assigning or subletting, subject to obtaining landlord's consent. Some state laws require that any consent is subject to the landlord's reasonable discretion (although this protection is more typical in residential leasing).

Sharing of leased premises with the tenant's affiliated company generally requires landlord consent, although some leases provide that a certain amount of square footage may be occupied by the tenant's affiliated company. Subleases or assignments to affiliated companies may be expressly permitted, sometimes with specified conditions. Restrictions on lease assignment can include restrictions on the legal reorganisation or change of control of a corporate entity. Tenants may be able to negotiate some flexibility concerning this restriction, such as by providing a replacement guarantor meeting certain specified tests.

### 35. Does a landlord or tenant retain any liability under the lease after the lease is assigned?

Most commercial leases will provide that an assigning tenant retains liability for performance of all lease obligations even after the lease is assigned, although occasionally, a tenant with strong bargaining power may negotiate a release. A landlord selling its property will typically assign its interest as landlord under all leases to the buyer. Whether the selling party retains liability for obligations under the lease arising prior to the date of sale is a question of contract.

## Repair and insurance

### 36. Who is usually responsible for keeping the leased premises in good repair and for insuring the leased premises? Are there provisions for the ownership of lease improvements?

Landlords are usually responsible for structural and roof repairs and repairs to any building systems. Tenants are generally responsible for non-structural repairs within the leased premises, and repairs of any damage caused by tenant. Commercial leases often provide that lease improvements made by a tenant that are affixed to the real estate become the landlord's property either upon installation or upon the termination of the lease.

## Landlord's remedies and termination

### 37. What remedies are available to a landlord for a breach of the lease by the tenant? On what grounds can the landlord usually terminate the lease and what restrictions and procedures apply? What is the effect of the tenant's insolvency under general contract terms and insolvency legislation?

Landlord remedies for breach of lease vary by contract and by jurisdiction. Certain state laws provide for expedited recovery of possession of the premises by the landlord after an event of default. Typical lease provisions entitle a commercial landlord to bring an action for damages, including delinquent rent and the cost to relet the premises. Landlords also typically reserve in the lease the right to accelerate the rents, so that the landlord can recover a judgment for the present value of future rents under the lease. In instances where a tenant remains in possession after termination of a lease, landlords are often entitled by contract to recover rent at a penalty rate.

The grounds on which a landlord can terminate a lease, and the notice and other procedures that apply, are a matter of contract. These typically include:

- The tenant's failure to pay rent and other amounts when due.
- Breach by the tenant of its lease obligations (often after a stated notice and cure period).
- The bankruptcy or insolvency of the tenant or a lease guarantor (but note that the federal Bankruptcy Code prevents the

landlord from exercising remedies directly against the tenant during a certain period).

- In certain cases (particularly retail leases), abandonment of the leased premises.

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### **38. Can the tenant withhold rent payments in certain circumstances, for example for serious damage to the leased premises? Can the tenant terminate the lease in certain circumstances?**

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Commercial tenants may sometimes negotiate a right to a rent abatement, or even a termination right, if the premises suffer serious damage that is not repaired within a specified period of time. Generally, however, tenants do not have a right to withhold rent. Tenant termination rights are strictly limited, although a lease sometimes may provide that the tenant can terminate if critical lease services are not delivered for a specified period or if the landlord fails to deliver the leased premises to the tenant by a specified date.

## **PLANNING AND DEVELOPMENT CONTROLS**

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### **39. In what circumstances can local or state authorities purchase business premises compulsorily? Is the purchase price market value?**

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Local and state governments and the federal government can force the sale of privately owned real property (eminent domain) for public purposes, if the compensation is equal to fair market value. What constitutes fair market value or a public purpose can become the subject of litigation.

### **40. What authorities regulate planning control and which legislation applies? Is there specific protection for special categories of buildings such as historic buildings?**

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Local zoning regulations dictate the permitted use of a property. The type of property (for example, office building, shopping centre or multi-use building) and relevant zoning laws can be used to determine the best use of the property. Variances to local zoning regulations may sometimes be obtained, with some effort. In certain municipalities, historic buildings are regulated, making it difficult to modify their appearance or demolish them.

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### **41. What planning consents are required for building works and the use of a building?**

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Local zoning laws typically dictate:

- As of right uses (uses permitted without consent of a local authority).
- Uses that require consent (or a zoning variance) from a local authority.
- Prohibited uses.

Building permits are typically required for most types of construction, and a completed project must obtain a certificate of occupancy before it can operate for its intended use.

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### **42. What are the main authorisation and consultation procedures in relation to planning consents?**

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Typically, local or regional planning and zoning boards grant initial consents. The length of the decision-making process varies by locality and depends on the complexity of the development, the number of entities involved in the review, and whether objections are made by third parties. Time frames are often extended upon request of the applicant to obtain additional support.

## **REFORM**

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### **43. Are there proposals to reform real estate law and are they likely to come into force and, if so, when?**

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The US Congress is contemplating changes to the tax code that would include the repeal of the deferral of capital gains taxes for like-kind exchanges (known as Section 1031 Exchanges). Also under consideration are changes to the Foreign Investment in Real Property Tax Act of 1980 (FIRPTA), which imposes tax liability on sales of real estate by foreign investors, whereby the sale of real estate investment trust (REIT) shares by foreign investors would not be subject to FIRPTA and the threshold whereby foreign investors may own shares in publicly-traded companies without triggering FIRPTA liability would increase from 5% to 10%. Many commentators believe these proposals have little chance of being enacted into law.



## ONLINE RESOURCES

### Internal Revenue Service

W [www.irs.gov/irm/part4/irm\\_04-061-012.html](http://www.irs.gov/irm/part4/irm_04-061-012.html)

**Description.** Official, up-to-date Internal Revenue Service's Manual containing the text of the Foreign Investment in Real Property Tax Act of 1980 (FIRPTA).

### Cornell University Law School

W [www.law.cornell.edu/ucc/ucc.table.html](http://www.law.cornell.edu/ucc/ucc.table.html)

**Description.** Unofficial, up-to-date Cornell University Law School website containing the Uniform Commercial Code (UCC).

### US Environmental Protection Agency

W [www.epa.gov/oecaagct/lcla.html](http://www.epa.gov/oecaagct/lcla.html)

**Description.** Official, up-to-date US Environmental Protection Agency website containing the text of and background on the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA).

### US Environmental Protection Agency

W [www.epa.gov/brownfields/aai/index.htm](http://www.epa.gov/brownfields/aai/index.htm)

**Description.** Official, up-to-date US Environmental Protection Agency website containing the text of and background on the All Appropriate Inquiry Rule (AAIR).

### US House of Representatives

W <http://uscode.house.gov/download/pls/11T.txt>

**Description.** Official, up-to-date US House of Representatives website containing the text of the US Bankruptcy Code.

### Federal Trade Commission

W [www.ftc.gov/bc/hsr/index.shtm](http://www.ftc.gov/bc/hsr/index.shtm)

**Description.** Official, up-to-date Federal Trade Commission website containing the text of and background on the Hart-Scott-Rodino Act of 1976.

### United States Congress

W [waysandmeans.house.gov/uploadedfiles/statutory\\_text\\_tax\\_reform\\_act\\_of\\_2014\\_discussion\\_draft\\_\\_022614.pdf](http://waysandmeans.house.gov/uploadedfiles/statutory_text_tax_reform_act_of_2014_discussion_draft__022614.pdf)

**Description.** Official text of Tax Reform Act of 2014 Discussion Draft (Feb. 21, 2014) (bill text).

W [www.congress.gov/113/bills/hr2870/BILLS-113hr2870ih.pdf](http://www.congress.gov/113/bills/hr2870/BILLS-113hr2870ih.pdf)

**Description.** Official text of Real Estate Investment and Jobs Act of 2013, H.R. 2870 (July 31 2013) (as introduced).

## Practical Law Contributor profiles



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- Representing a global private equity fund in the purchase of distressed loan portfolios valued in excess of US\$1.5 billion.
- Representing a global hedge fund in a joint venture with a New York developer to acquire and finance a Manhattan residential tower.
- Representing a major Middle East-based investor in all its acquisitions, joint ventures and financings throughout the US.
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- Representing a group of publicly traded REITs in a series of acquisitions of trophy office and retail properties across the US.
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- Representing a major national bank in leasing new headquarters in Manhattan.
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- Representing a large institutional lender in the sale of commercial loans in excess of US\$500 million nationwide.
- Representing an institutional investor and a major Asia-based investor in a joint venture with a New York developer to acquire and finance a Manhattan office tower.
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- Representing a subsidiary of a multinational banking conglomerate in a joint venture with a Massachusetts developer to acquire and develop a Boston mixed-use tower.
- Representing a publicly traded REIT in a series of acquisitions of office and industrial properties across the US.
- Representing a global private investment firm in the acquisition of a loan platform valued in excess of US\$2 billion.