Pillsbury Winthrop Shaw Pittman LLP

Spring | 2007

# Pillsbury on Real Estate

## Inside



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# Bulk Sales

## Provide Notice or Pay the Price

by Marjorie P. Fisher and Rhina M. Roberts

Real estate lawyers trained to worry about title and survey matters in purchase transactions may be surprised to learn that overlooking bulk sales requirements can cause as much pain as a missed access easement. Particularly at risk are sellers and purchasers of real property and improvements with associated personal property having more than nominal value—such as hotels, resorts, office buildings with fitness centers or any building with a restaurant operated by the owner.

In this article we examine the impact of bulk sales laws in California, the District of Columbia, Maryland, New York and Virginia, and provide practical pointers to protect clients in the initial drafting of a purchase and sale agreement.

### Purpose and Scope of Bulk Sales Acts

The term "bulk sales" in most jurisdictions refers to a transfer in bulk of all or substantially all of the personal property, merchandise, equipment or inventory of a seller when the transfer is not in the ordinary course of business. These transactions are governed by Article 6 of the Uniform Commercial Code, which has been adopted in most jurisdictions, the primary purpose of which is to put creditors of the seller on notice that the majority of the seller's assets are being sold. This protects creditors from a seller's attempt to avoid paying debts by fraudulently transferring assets and makes it difficult for a seller to dispose of assets without first settling prior claims.

The scope of bulk sales laws differs by jurisdiction, and in some jurisdictions may not be a factor even in deals apparently involving a "transfer in bulk" of the seller's property. Virginia, for instance, limits the application of its bulk sales laws to a business engaged in the sale of its "inventory," which is defined as "goods, other than farm products, which are leased by a person as lessor; are held by a person for sale or lease or to be furnished under a contract of service; are furnished by a person under a contract of service; or consist of raw materials, work in process, or materials used or consumed in a business." (Va. Code § 8.9A-102(a)(48)).

The scope of the District of Columbia's bulk sales laws is identical to Virginia's with the exception that it also applies to restaurants, cafes, bakeries and similar businesses engaged in selling food or drinks. (D.C. Code § 28:6-103(a)). New York's bulk transfer law is similar to the District of Columbia's, but the distinguishing factor is its application to all businesses that principally sell or rent merchandise, rather than inventory, from stock. (N.Y. UCC § 6-102). California has equally narrow bulk sales laws, which apply to restaurants and to any business engaged in selling its inventory. (Cal. Comm. Code § 6103(a)).

In contrast, other states have bulk sales acts that apply to a broader range of transactions. Maryland, for example, applies its law to restaurants, all bulk transfers of goods located within Maryland, all companies whose principal business involves the sale of merchandise from stock, and "all vendors and sellers of alcoholic beverages, regardless of the form in which such beverages are sold, and regardless of whether sold on a wholesale or retail basis." (Md. Code Com. Law, § 6-102(3)). While the applicability of bulk sales laws is an essential factor when determining whether a transaction is subject to bulk sales requirements, equally important is the itemized list of transfers that are exempt from the bulk sales provisions. This list is provided in each statute and should be reviewed carefully.

## Notice Requirements

Bulk sales statutes in most jurisdictions place an affirmative obligation on the purchaser to provide the seller's creditors with notice of the pending transfer, even though the seller is responsible for paying any outstanding debts to its creditors. The timing of the notice varies in each jurisdiction and ranges from 10 to 45 days prior to the transfer. The manner of notice also varies depending on the location of the sale. For instance, California has extensive notice provisions, requiring the purchaser (i) to record the notice of the sale in the office of the county recorder, (ii) to deliver a notice to the county tax collector in the county in which the assets are located, and (iii) to publish the notice in a newspaper of general circulation. (Cal. Comm. Code § 6105). New York, on the other hand, requires the purchaser to prepare a simple form setting forth the sales price of the personal property being sold and submit it to the New York State Department of Taxation and Finance at least 10 days prior to the transfer date. (N.Y. Tax Law § 1141(c)).

Bulk sales laws also serve to provide notice to the local taxing authority to ensure that sales and use taxes have been properly paid by the seller through the closing date. A taxing authority can use the sale as an opportunity to audit the sales and use taxes paid by the seller for the previous several years. For example, the New York State Department of Taxation and Finance can audit the books and records of the seller for three years prior to the transfer. Again, the sales and use tax liability is properly attributable to the seller, because it applies to sales that occurred during the seller's period of ownership, but can become the liability of the purchaser if the notice requirements are not satisfied and the taxes are not paid.

## Failure to Comply

The consequences of failing to comply with bulk sales notice requirements vary by jurisdiction and can result in the imposition of significant penalties. In Maryland, failure to comply renders the entire transfer ineffective, while in California the transaction remains valid but a purchaser may be held accountable for claims against the seller from the seller's creditors in an amount equal to the difference between the creditor's claim and the amount that the creditor could have recovered had proper notice been given. (Md. Code Com. Law, §§ 6-104-105; Cal. Comm. Code § 6107).

Additional disparate penalties apply if the responsible party fails to pay sales and use taxes in connection with the personal property that is conveyed in a bulk transfer. The penalties arise under the state's tax statutes and frequently impose liability upon the purchaser in the form of a lien on the personal property conveyed, and/or hold the purchaser liable for the amount of unpaid sales and use taxes.

**The consequences of failing to comply with bulk sales notice requirements vary by jurisdiction and can result in the imposition of significant penalties.**

In New York and the District of Columbia, for example, a purchaser's failure to provide notice of a bulk sale within the specified time period will result in "a first priority right and lien" on any sums to be transferred to the seller in the amount of any sales taxes due. In addition, both jurisdictions prohibit the purchaser from paying to the seller any form of consideration to the extent of the amount of the lien and subject the purchaser to liability for the payment of any outstanding taxes. (N.Y. Tax Law § 1141(c); D.C. Code § 47-4462).

## Personal Property Tax

The sale of all or substantially all of the assets of a company may also trigger an additional personal property tax (not to be confused with a deed transfer or recordation tax). In some jurisdictions, such as New York, the purchaser is required to pay tax on the value of the personal property transferred if the purchaser fails to provide notice of the bulk sale. The seller typically collects this tax at closing and remits it to the taxing authority (in contrast to transfer and/or recordation taxes, which may be payable by either party, or split, based on custom).

The tax rate on personal property is typically higher than any transfer or recordation tax. Generally, this tax is paid by the purchaser but, depending on the jurisdiction, may be paid by the seller, while transfer and recordation tax is sometimes split by the parties or otherwise partially or wholly paid by the seller. Consequently, an unwary purchaser may end up bearing a heavier tax burden if the purchaser unwittingly agrees to attribute a higher value to the personal property transferred.

## Practical Pointers

All parties should familiarize themselves with the tax obligations of the jurisdictions in which any personal property is located before finalizing a purchase agreement, determining whether a bulk sales act applies to the transfer in question and whether the personal property conveyed will be subject to personal property, sales and/or use taxes. If so, the parties should allocate the purchase price to the real property and personal property (and factor the taxes into the economics of the transaction) and clearly address responsibility for bulk sales compliance and all taxes in the purchase agreement, to the extent permitted by law.

Purchasers should be sure the agreement obligates the seller to convey any personal property free and clear of liens and encumbrances, specifically including any tax obligations. Purchaser's counsel should also add to their form closing checklists the line items for personal property tax payment obligations as well as the bulk sales notice requirement, specifying the date the notice is due and where the notice must be posted or delivered.

Purchasers also should consider requiring sellers to escrow a portion of the closing proceeds, to be released only after the parties receive a "clearance" notice from the applicable taxing authority. The amount of the escrow will vary depending on the jurisdiction and should take into account whether the applicable taxing authority has the right to audit the seller's sales and use tax payments for any time period prior to closing, and what the seller's financial statements reveal the correct sales and use tax liability to be.

Alternatively, the purchase agreement could contain an indemnity from the seller for any sales and use tax liability attributable to the period before closing, backed by a letter of credit or a guaranty from a qualified individual or an entity that will continue to exist after closing and will hold assets sufficient to cover any potential tax liability. In all cases, the purchase agreement should require the delivery at settlement of any taxes due on the sale of the personal property, preferably via remittance by the escrow agent to the taxing authority.

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# Caveat Emptor

## Transfers of Ownership Interests May Trigger Unexpected Transfer Taxes

**by James M. Grosser and Stefanie M. Nelson**

Entity-level transactions, in which interests are acquired in partnerships, business trusts or limited liability companies owning real property, may trigger real property transfer taxes in a number of jurisdictions. This result often comes as a surprise to investors and other participants, because typically no deeds are required to be granted or recorded in these transactions.

Transfer taxes apply to entity-level transactions through statutes equating transfers of “economic interests” or “beneficial interests” in real property with actual transfers of legal title to real property for purposes of applying real property transfer taxes.

Under the typical economic interest statute, the transfer of a direct or indirect controlling economic interest in an entity holding legal title to real property is treated as a transfer of the real property to the new owner. Depending on state law, the deemed transfer may consist of all or a portion of the real property. Because transfer tax rates often range as high as 3% of the fair market value of the underlying property, the bite from these taxes may materially alter the economics of entity-level transactions. Therefore, participants in entity-level transactions are well advised to consider fully the impact of transfer taxes on price and structure.

In planning for the impact of real property transfer taxes on entity-level transactions, the first task is to determine whether the properties are located in jurisdictions that tax economic interest transactions. Participants should keep in mind that even though economic interest provisions date back at least to the 1980s in some states, the set of jurisdictions taxing economic interest transactions is not static.

Because economic interest transactions may be viewed as economically equivalent to transactions involving direct interests in real property, it should be expected that some state legislatures will face pressure, under the rubric of “loophole closing,” to expand their transfer tax codes to pick up economic interest transactions. This is the case especially in times of lean state budgets. Presently, a partial listing of the states with economic interest provisions in their transfer tax codes includes California, Connecticut, Delaware, the District of Columbia, Illinois, Maine, New Hampshire, New Jersey, New York, Pennsylvania and Washington.

### Considerations for Deal Structuring

Once it has been determined that the transfer tax laws of a particular jurisdiction include provisions for economic interest transactions, there are a number of opportunities and pitfalls that parties should keep in mind when structuring their deal:

**Taxable Transactions.** In some jurisdictions (e.g., Delaware), the transfer of any economic interest, however slight, may be taxable. In most others, there is no tax unless the economic interest acquired is a “controlling interest.” Controlling interest definitions vary somewhat from state to state, but a typical formulation defines an interest in more than 50% of capital or profits as a controlling interest. In controlling interest jurisdictions, transfer taxes may be avoided by structuring the transaction so that the purchaser acquires less than a controlling interest in the properties located in the jurisdiction. Note that it is typically not possible to avoid economic interest provisions by utilizing additional pass-through ownership tiers.

**Tax Base.** In many jurisdictions, the tax base for an economic interest transaction is the fair market value of the underlying real property. Therefore, it may be advantageous to close taxable acquisitions when the fair market value of the target properties is as low as possible, for example, prior to completion and stabilization. Also, care should be taken to document the fair market value of the target property by obtaining an appraisal or other contemporaneous documentation of value.

**Tax Rate.** Real property transfer taxes may be imposed by states, counties and/or cities, and each taxing jurisdiction in a given state may impose the tax at a different rate. Therefore, the effective tax rates on properties within a given state may vary markedly depending on the level of county and city rates. As an example, in California, the all-in tax rate currently ranges from a low of 0.11% to a high of more than 1.6%.

**Documentation Requirements.** It may be necessary to record a document or file a return with the appropriate local agency when completing an economic interest transaction.

**Payment Obligation and Price.** Economic interest laws may impose the tax payment obligation on the property owner, the seller of the economic interest, or the purchaser of the economic interest. Liability may be joint and several. Regardless of which party bears the legal obligation to pay the tax, the parties will need to negotiate the impact of the tax on the purchase price for the real property interest.

## Examples from Major Markets

The following descriptions illustrate the varied ways in which states have implemented economic interest transfer taxes. Of course, these are only summaries; parties should consult the applicable statutes before proceeding with a transaction in any of these states.

**California.** The California tax code authorizes cities and counties to implement a "documentary transfer tax," which includes a provision that treats the termination of a partnership or other entity taxed as a partnership under Section 708 of the Internal Revenue Code as a taxable transfer of all realty owned by that partnership in the applicable county or city. Although it is necessary to check each individual county or city code, the tax base for many California cities and counties is the fair market value of the realty, net of encumbrances, and the tax liability is joint and several.

**District of Columbia.** Washington, DC imposes a "recordation tax" on transfers of more than 50% of the equity in a partnership or other entity that owns a certain amount of real estate. The tax is 2.2% of the consideration allocable to the real property, and the buyer and seller are jointly and severally liable for the tax.

**Illinois.** The state tax rate is a mere 0.1%. Properties in Chicago, however, are subject to a total tax rate of 0.9%, consisting of the 0.1% state tax, a 0.05% Cook County tax and a 0.75% City of Chicago tax. Three separate returns must be filed. Additionally, for properties located in Chicago, forms must be filed with the Department of Water Management and the Department of Buildings before the tax can be paid.

**Maryland.** Several times in recent years, the Maryland General Assembly has considered legislation that would impose an economic interest transfer tax, but such legislation has repeatedly been defeated. The most recent bill passed the Maryland House of Delegates, but the legislature's session adjourned before the bill came to a vote in the Maryland Senate. That bill would have imposed recordation and transfer taxes on the transfer of a controlling interest in an entity that owns at least $1 million worth of property in Maryland. It is possible that a similar bill will be introduced in the next session, which is scheduled to begin in January of 2008.

**New York.** Both the State of New York and some of its cities and counties have instituted a "real property transfer tax" on transfers of a controlling interest—50% or more of the capital, profits or beneficial interest—in a partnership or other entity. The state tax is 0.4% of the fair market value of the property or interest therein, apportioned based on the percentage of the ownership interest transferred. The city and county taxes vary, and in some cases they are substantially higher than the state tax. Liability for this tax is initially on the seller, but if the seller fails to pay on time, liability becomes joint and several.

**Pennsylvania.** The Pennsylvania tax applies to partnerships and other entities treated as "real estate companies" that become "acquired companies" upon the acquisition of at least a 90% interest over a three-year period. The state tax rate is 1%. Cities may impose additional taxes, at rates as high as 3% in Philadelphia and Pittsburgh. The definition of "acquired company" under the Philadelphia municipal code is broader than the definition under state law, and picks up multi-tier transactions that are missed by the state tax.

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# 'Reasonableness' in Consenting to an Office Sublease

**by Robert N. Weinstock and Michael G. Silver**

For office tenants, the rights and obligations related to assignment and subleasing are extremely valuable aspects of space and expense management, particularly for those tenants whose financial and personnel needs tend to fluctuate. However, office leases typically require the consent of the landlord to consummate a proposed assignment or sublease, and the standard governing this consent often is the subject of heavy negotiation. Here are some issues to consider in the landlord consent process and tips for proper, thoughtful and comprehensive drafting of the relevant lease provisions.

## What Standard Governs Landlord's Consent?

If the office lease is silent, i.e., no standard is provided, then some states, including California and Maryland, recognize an implied duty on the part of the landlord to act reasonably, on the theory that public policy counsels against restraints on alienation and implies a covenant of good faith and fair dealing. A majority of jurisdictions, including Texas and New York, however, have rejected such an approach.

In most cases, the parties will agree upon a standard that will govern the landlord's decision-making process. Landlord-favorable provisions will give the landlord "sole" or "absolute" discretion, while tenant-friendly provisions will dispense with the concept of consent altogether and instead will impose only a notice requirement. The most common and balanced approach—but the one that can lead to some ambiguity—will provide that the landlord's response may not be unreasonably withheld, conditioned or delayed.

## Reasonableness Standard

What are some examples of denials of consent that courts have found to be "reasonable" in this context? A landlord acts reasonably in denying consent if a tenant does not provide sufficient information about the proposed subtenant, or if a landlord can show that a proposed subtenant is not suitable for a particular location. The Wisconsin Court of Appeals, for example, affirmed a landlord's denial of consent to a proposed sublease of high-end riverfront property to agencies providing training programs for low-income individuals. There is a fine line, however, between a landlord utilizing this appropriate rationale and rejecting a potential assignee or subtenant based on personal taste or convenience, which are not considered reasonable.

The case authority is clear that a landlord cannot use the consent process as an opportunity to renegotiate the economic terms of the lease. In *1010 Potomac Associates v. Grocery Manufacturers of America, Inc.*, 485 A.2d 199 (D.C. 1984), the District of Columbia Court of Appeals held that a landlord acted unreasonably when it denied consent to a proposal where the tenant intended to sublease the same space it had recently taken pursuant to an option to expand and also refused to split the profits of the sublease with the landlord. The court held that the landlord had acted unreasonably by denying consent solely for economic reasons, as the purpose of the consent clause is protection of the landlord's "ownership and operation of the particular property," not its "general economic condition." A landlord may take steps, however, to mitigate its reasonable concern about sweetheart deals between tenants and major subtenants for below-market rent, such as prohibiting subleasing at a rental rate below what the landlord is then asking for other space in the building.

## Recent Case Law

A recent Third Circuit case, *Buck Consultants, Inc. v. Glenpointe Associates*, WL 431149 (3d Cir. 2007), encapsulates many of the relevant issues. A tenant in a New Jersey office complex proposed to sublease approximately 50,000 square feet to a subtenant that was already a tenant in the building. The landlord denied consent, claiming that the sublease's relatively short term, combined with the scheduled expiration of the subtenant's other leases and subleases in the building, would result in a large vacancy at one particular date in the medium term and potentially affect the landlord's ability to meet its financing obligations. Consequently, the deal between the tenant and subtenant fell through. The tenant sued for a declaratory judgment and damages based on a variety of claims and also stopped paying rent, which triggered a counterclaim by the landlord for rent payments. The district court granted summary judgment for the tenant on all of its claims except for tortious interference with contract.

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The Third Circuit affirmed the district court's finding that the landlord had acted unreasonably and denied consent based on pretext. As the evidence showed, the landlord had attempted to condition its approval of the sublease upon the tenant's expanding and extending its direct lease for 15 years and for higher rent. Given the then-current market conditions and the terms of the landlord's financing, the landlord had not demonstrated that its consent to the sublease would lead to a default on its mortgage and therefore endanger its ownership of the building. Thus, the court concluded that the landlord's true objective was to "position itself more fortuitously, i.e., the very type of general economic concern which is considered unreasonable under New Jersey law."

The appellate court, however, reversed the lower court's finding that the landlord had acted in bad faith and concluded that the district court conflated the concepts of unreasonable behavior and bad faith, the latter of which required proof of subjective and wrongful intent. Nor had the tenant demonstrated to a sufficient degree that, as a matter of law, the landlord had materially breached the lease. The appellate court thus remanded the case to the district court to determine the appropriate remedies. The district court has not yet adjudicated the remand, so the case's impact on this area of law is currently unclear.

One interesting aspect of the case to follow on the remand is whether the district court will reiterate its prior holding that the aggrieved tenant was within its right to withhold rent payments. In the past, courts have split on the issue, often holding that even an unreasonable withholding of consent does not relieve a tenant of rent obligations.

## Practical Applications

The question of reasonableness in this context likely will continue to challenge and often perplex landlords, tenants and subtenants alike, so what lessons should these parties take away from this discussion?

First, they should consider the ramifications of not including a standard in the landlord consent clause of the master lease, as some jurisdictions impose a duty on landlords to act reasonably as a matter of law and some jurisdictions do not.

Second, courts will give landlords leeway to reject potential subtenants or assignees based on their belief that such individuals or entities are not suited to the particular location, but such a determination may not be based on subjective criteria or whim.

Third, courts will scrutinize closely the stated reasons for denying consent. Savvy parties will consider agreeing on a list of circumstances deemed to be reasonable bases for denying consent.

Fourth, landlords may want to attempt to limit tenants' remedies by inserting a compulsory arbitration clause providing that if the arbitrator finds for the tenant, the arbitrator's remedy shall be limited to an order permitting the sublease or assignment, with the tenant not being entitled to monetary damages in such event.

Finally, as the recent Third Circuit case demonstrates, a landlord should steer away from using the consent process as a way to improve its general economic status or bargaining position with its current tenants, unless it can argue persuasively that the transfer would endanger its ownership interest in the building.

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# Condo-Hotels
## How to Avoid the Predicted Storm

by Christian A. Salaman

After the runaway success of condominium hotel projects—also called "condo-hotels"—over the last several years, cries of doom and gloom are now becoming more common. The naysayers point to factors such as slowing residential real estate sales, rising adjustable rate mortgages and unrealistic expectations for rental revenues. Some believe that sales of condo-hotel units may be rescinded (or "unwound") by displeased unit owners. Others prophesy even worse—that developers will be litigated into submission by class action attorneys representing these displeased owners. While a few projects will probably fail because of poor economic decisions, with a little preparation, developers can effectively avoid any storm that may occur in the market.

Condo-hotels allow some or all of the "units" at a hotel to be sold with the intent that they will be made available as hotel guest rooms through a rental program that divides revenues and expenses between the unit owners and the hotel. The intertwining of condominium ownership, hotel operations and shared revenues and expenses places condo-hotels at the convergence of real estate laws, hotel management arrangements and securities laws. If developers want to avoid the thunder of class action attorneys, they must pay particular attention to federal and state securities laws.

Developers generally need the sales of condo-hotel units to avoid being characterized as sales of "securities." The following are key steps to avoid such characterization:

**Implement a voluntary rental program.** The choice by a unit owner to participate in a rental program must be voluntary. Potential purchasers must be allowed to purchase a unit even if they do not subscribe to a rental program.

**Do not share revenues or expenses within a rental program.** A rental program cannot "pool" revenues or expenses among the various units. Each unit must be allocated its own revenues and expenses.

**Do not discuss the economic returns of a rental program with potential purchasers.** Developers cannot discuss the economic returns of a rental program or the economic benefits of any particular management company that operates the hotel or a rental program.

**Do not advertise or market a rental program.** While the availability of a rental program may be confirmed, and relatively simple questions unrelated to the economic benefits of a rental program may be answered, developers should not discuss in detail or otherwise promote a rental program.

**Separate the sales and the rental program functions.** Developers must separate the sales office and the rental program office. Details of a rental program should only be provided by rental program personnel.

**Do not enter into a rental program agreement before a purchase contract.** No rental program agreement should be entered into before the purchaser has entered into a purchase contract for the unit.

**Do not impose material occupancy limitations on unit owners.** Developers cannot materially limit, through purchase contracts or condominium documents, the ability of unit owners to occupy their units. However, reasonable occupancy limitations imposed by a rental program or local zoning laws are allowed.

Condo-hotels raise more business and legal issues than hotels or residential condominiums do on their own. Proper handling of securities law issues may be the key step that allows developers to enjoy peaceful, sunny days.

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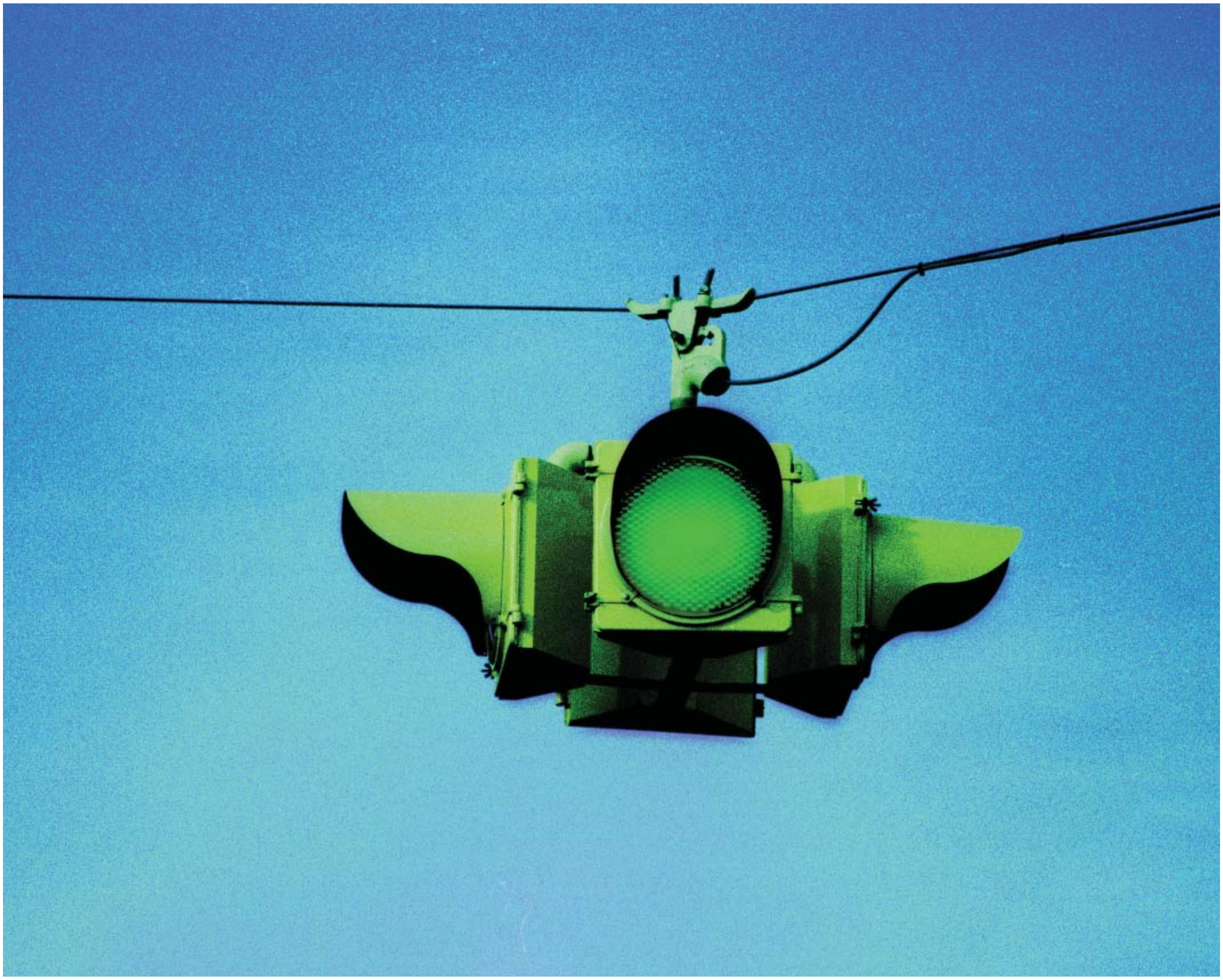

# Time to Go Green

## Recent Legislation to Promote Green Building

by Diane Shapiro Richer, Benjamin M. Lee and Phil T. Feola

**Green building can be loosely defined as the practice of building and renovating facilities to increase efficiency, promote occupant health and minimize impact on the natural environment through better design, construction, operation, maintenance and removal.**

On December 28, 2006, the Mayor of the District of Columbia signed the Green Building Act of 2006, mandating strict "green building" requirements for new construction and substantial improvements of existing nonresidential buildings, which passed Congressional review and became law on March 8, 2007. While there has been an increasing focus on green building and sustainable development practices across the country, the District's legislation is important because it makes Washington one of the first major cities to phase in mandatory green building requirements for private developers.

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The DC legislation is of particular interest because of the potential impact it may have on other jurisdictions committed to implementing green building practices. Across the country, over 400 mayors from cities including New York, Chicago, Boston, Los Angeles and San Francisco have signed the U.S. Conference of Mayors' Climate Protection Agreement, agreeing to "practice and promote sustainable building practices using the U.S. Green Building Council's LEED program or a similar system." At least one other major city, Boston, recently enacted mandatory green building legislation requiring all new and rehabilitation construction projects over 50,000 square feet, commercial and noncommercial, to be LEED-certified.

While it is not clear whether other cities will adopt mandatory requirements similar to those adopted in Washington, DC and Boston, there appears to be a general acceptance that green building has gone mainstream. Understanding and dealing with the issues early in the process will permit better planning for and integration of green practices, ultimately saving time and money and producing a higher-quality project.

## What Is Green Building?

Green building can be loosely defined as the practice of building and renovating facilities to increase efficiency, promote occupant health and minimize impact on the natural environment through better design, construction, operation, maintenance and removal.

The nonprofit U.S. Green Building Council (USGBC) has developed standards for Leadership in Energy and Environmental Design (LEED), which are the leading standards for the design, construction, operation and certification of green buildings. The LEED standards facilitate the establishment of uniform standards by localities. USGBC has created different certification categories for different types of projects.

**LEED Certification Categories**

| | |
|---|---|
| LEED-NC | New Commercial Construction |
| LEED-CS | Core and Shell Projects |
| LEED-CI | Commercial Interiors |
| LEED-EB | Existing Buildings |
| LEED-H* | Homes |
| LEED-ND* | Neighborhood Development |
| LEED for Schools* | |
| LEED for Retail* | |

**In development or being tested*

LEED-certified projects are awarded either Certified, Silver, Gold or Platinum status, depending on the number of points the project earns. Points are tallied on a scorecard and awarded based on six different factors: indoor environmental quality, sustainable sites, materials and resources, energy and atmosphere, water efficiency, and innovation and design, allowing the developer to choose from a suite of building design choices having positive environmental outcomes.

## Recent Legislation

As the green building movement has gained momentum, a number of cities and states have pursued various methods to promote green building.

**District of Columbia.** Washington, DC has pioneered mandatory requirements for public and private development, with phased-in requirements for District-owned buildings of 10,000 square feet or more starting in 2008 and for privately owned commercial buildings of 50,000 square feet or more beginning in 2009. In 2012, new and substantially improved commercial buildings of 50,000 square feet or more will be required to meet LEED-NC 2.2 or LEED-CS 2.0 at the standard certification level. The DC legislation also provides incentives to promote early adoption of green building practices, including expedited permitting reviews, grants and technical assistance, and establishes a Green Building Advisory Council.

**Arlington County, Virginia.** Since December 2003, Arlington County has required all site plan projects (those applying for a special exception from the zoning ordinance) to include a LEED-accredited professional as part of the project team, submit a LEED scorecard as part of the site plan application and prepare and implement a construction waste management plan. Any site plan project not receiving LEED certification must contribute $0.03 per square foot to the county's Green Building Fund. Developers also may participate in the density incentive program, which allows greater density for certain types of projects depending on the LEED certification level sought.

**Montgomery County, Maryland.** On November 28, 2006, the Montgomery County Council enacted its Green Building Law, requiring newly constructed or extensively modified non-residential or multi-family residential buildings of 10,000 square feet or greater to receive a Certified LEED rating (or contain equivalent energy or environmental designs) or reach the LEED Silver rating (or equivalent energy or environmental designs) if the county finances at least 30% of the project.

**New York.** On January 1, 2007, the Green City Buildings Act became effective. It requires that capital projects by New York City agencies of $2 million or more, projects that receive 50% or more of the costs from city funds, or capital projects that receive $10 million or more from the city receive a LEED Silver rating or higher. Schools and hospital projects falling within the above categories must achieve a LEED-certified rating. In addition, projects over $12 million subject to the act also must reduce energy costs by at least 20-25%.

In addition, the State of New York recently extended its Green Building Tax Credit, originally enacted in 2000. This legislation allows applicants to apply between 2005 and 2009 for a Credit Component Certificate, which may be claimed against corporate, personal income, insurance corporation and banking corporation taxes between 2006 and 2014. The amount of the credit is determined by the cost of the project and the project's qualification under six separate program components: Whole Building Credit, Base Building Credit, Tenant Space Credit, Fuel Cell Credit, Photovoltaic Module Credit and Green Refrigerant Credit.

**San Francisco, California.** On September 28, 2006, the mayor announced that the city was finalizing a new directive to give priority permit review to all new and renovated buildings that qualify for a LEED Gold rating or its equivalent, and, as of February 2007, city planners were considering mandating green building standards for new, privately developed buildings. Highlighting the local nature of green building requirements in California, several cities in the Bay Area, including Pleasanton, Cotati, Livermore, Novato and Sebastopol, already have mandatory green standards.

## Benefits of Green Building

In addition to the expedited permitting, density bonuses and potential tax credits already noted, the Energy Policy Act of 2005 provides a federal tax deduction of between $0.30 and $1.80 per square foot through 2008 for commercial buildings placed in service after January 1, 2006 that meet certain efficiency standards. However, in addition to the financial and practical incentives, green building is quickly becoming accepted as a building practice that makes good business sense by potentially facilitating lease-up and producing energy cost reductions, healthier buildings with better indoor air quality, more comfortable temperatures, more natural light, healthier finishes and potentially healthier tenants and employees.

Some developers, seeing the many benefits of green building practices, are getting ahead of the legislative curve and are incorporating green building into their corporate philosophies even before it becomes mandated.

For example, Boston Properties is pursuing LEED certification for all of its new buildings going forward. "It was not a hard decision for us to begin designing and developing LEED-certified buildings," reports Peter Johnston, Boston Properties Senior Vice President and Regional Manager of the Washington, DC region. "Having audited a number of our recently completed buildings, we found that our projects already achieved a majority of the points necessary to be certified by the USGBC."

**Some developers, seeing the many benefits of green building practices, are getting ahead of the legislative curve and are incorporating green building into their corporate philosophies...**

Despite initial concerns of substantially increased costs for green building, the additional cost for a certified LEED building can be as low as 1.5-3.0%. While these costs can increase dramatically at higher levels of certification, costs are continuing to decrease as designers and contractors become more familiar with the process.

As enticing as the benefits of green building appear, and as quickly as many localities are moving to incentivize or require green building practices, the green building movement presents a new set of issues in the development and design process.

Consideration of green building issues should be one of the first steps in any project. It often proves to be very expensive to incorporate LEED certification after site selection and design have been completed. While many LEED points can be achieved by making minor changes such as installing high-efficiency HVAC, using waterless urinals and recycling construction waste, for large projects the process requires an expert interdisciplinary team of lawyers, architects, engineers and consultants to take a holistic approach from the very early stages of the project.

Despite the promise of energy and cost savings, developers need to make sure that these results are actually achieved once the final product is finished and delivered. In some situations, the expected benefits may not be realized, whether due to contractor performance or otherwise. Therefore, construction contracts need to clearly outline performance expectations and allocate liability for any failures to achieve these results. Similarly, where a developer achieves LEED-CS certification for core and shell, leases need to be "greened" in order to spell out expectations and liability for a tenant's build-out of the interior portions under LEED-CI standards.

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# Time to Go Green: Recent Legislation to Promote Green Building

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Without these expectations clearly outlined in advance, disputes can arise between landlord and tenant as to the scope of work and the level of "greening" to be performed in the space.

In conclusion, interest in and acceptance of green building practices has increased dramatically. The passage of DC's Green Building Act of 2006 may signal a shift from green building as an aspirational goal to a mandatory reality in our new global consciousness. With the current trend pointing to increased emphasis on green building, developers will save time and money and create better-integrated projects if they proactively work to incorporate green building from the inception of the development process.

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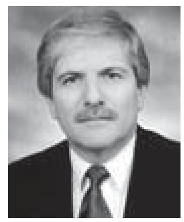

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