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APRIL 2015

REAL ESTATE

FOUNDATION

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How NMTCs Benefit Real Estate Community Development Initiatives

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Federal and State Programs

The New Markets Tax Credit ("NMTC") program was enacted by Congress as part of the Community Renewal Tax Relief Act of 2000. The program, under Section 45D of the Internal Revenue Code ("IRC"), is intended to spur investment in low-income communities, with the hope that jobs would be created and lives would be improved in such communities. A number of states have enacted similar programs, which are often "twinned" with the federal program. Although the states' interest in applying credits is expanding, the programs differ among the states and often have stricter requirements than the federal program. *(See a map of the state programs at* www.novoco.com/new_markets/nmtc/state_nmtc_programs.php.) Since its inception, the Community Development Financial Institutions ("CDFI") Fund has made 836 allocation awards allocating $40 billion in tax credit authority through a competitive application process. The expectation is that the program will be renewed before the end of 2015 for a minimum of two years, if not permanently.

The program allows investors to subsidize or provide "gap" financing for improvements to property or expanding businesses that are located in a qualified census tract. In return, investors receive a 39 percent tax credit over seven years, provided that the parties involved comply with the statutory provisions of the program outlined in Section 45D. Investors, typically large financial institutions, can also leverage their investment, which may provide an after-tax return in excess of nine to ten percent.

Illustrative Projects

NMTC projects have provided financing for numerous projects around the country developed by for-profits and nonprofits alike,[1] including a bilingual health center, a mixed-use project in Baltimore, food processing facilities, a food bank, manufacturing facilities, charter high schools in New York City, and a biomedical office park. The University of Arizona's medical school received $25 million in NMTC allocation, which was a key element in the strategy for revitalizing downtown Phoenix. The project led directly to permanent and construction jobs, as well as spurring follow-on investment.

Multiple Roles

A business may play multiple roles in the new market tax structure, aside from making an equity investment (in exchange for the 39 percent credit). It may organize and be certified as a community development entity ("CDE") by the CDFI Fund or it could be the ultimate beneficiary as a qualified active low-income community business ("QALICB"), which is typically a developer or operating business.

The Investor

Although investors in the NMTC program are typically large financial institutions such as Goldman Sachs, US Bank, Bank of America, JP Morgan, and PNC, any taxpayer can be an investor in the program. Investors make a qualified equity investment ("QEI") in a CDE. A QEI is generally any equity investment in a CDE if the investor obtains the interest at its original issue solely in exchange for cash; substantially all of the cash is used by the CDE to make qualified low-income community investments; and such investment is designated on the CDE books as a QEI.

There is incentive for the investor to borrow funds from a leverage lender to make the equity investment, which increases the return the investor receives.

> The NMTC program, both federal and state, provides an opportunity for businesses by subsidizing or financing projects located in qualified census tracts in exchange for allowing an equity investor to receive a 39 percent tax credit over a seven-year period.

The Community Development Entity

The CDE then must use "substantially all" of the QEI to make a qualified low-income community investment ("QLICI"). A QLICI typically includes any equity investment in or loan to a QALICB, and financial counseling and other services specified in the regulations to business and residents of low-income communities.[2]

The Leverage Lender

A party may be a leverage lender, which is typically unrelated to the QALICB developer (but is often affiliated), and must provide bona fide debt to the investor in order to obtain the benefits of a leveraged structure. Examples of leverage lenders are community banks and charities. A lender's loan increases the amount of an investor's cash investment, which in turn leads to a greater credit and results in a benefit to both the investor and the QALICB.

The Ultimate Beneficiary, the QALICB

The ultimate beneficiary of the investment is a QALICB, which is typically a developer or an operating business. The QALICB receives loan proceeds or an equity investment from a CDE, and is the entity that generally engages in the community development activity in the low-income community.

Exiting and Recapture

Once the QEI is made, there is a seven-year compliance period. If any "recapture event" occurs during that compliance period, the NMTCs claimed by the investor are recaptured and any future credits are forfeited. "Recapture event" is a statutorily defined term that includes a CDE ceasing to be a CDE, substantially all of the QEI ceasing to be used for investments in QLICIs, and the investment being redeemed by the CDE. At the end of the seven-year compliance period, the investor will have received all the NMTCs for which it is eligible. At such time, the investor and CDE will likely want to unwind the transaction and exit the structure, which is typically accomplished through the use of a "put/call" technique that generates a subsidy or grant equivalent to the QALICB. The put and call will likely be priced substantially below the investor's original investment in the fund.

After the investor is removed from the structure, either through the exercise of the put or the call, the QALICB may then take steps to have the fund, which it now controls, liquidate the CDE. The QALICB will often use one of the QLICI notes previously held by the CDE to repay the leverage lender. The result here is that the structure leaves the QALICB on its own, and the leverage lender holding the QLICI note.

It is important to note that the net benefit to the project can then be measured by looking at the amount of the investor's equity investment less all fees, professional and administrative costs, and the price of the put/call.

Cancellation of Indebtedness Income

Cancellation of Debt ("COD") income may be generated at the time of the "exit." Under Section 61(a)(12), a discharge of indebtedness constitutes gross income to the debtor. A debtor's acquisition of its own debt for less than the principal amount of the debt constitutes cancellation of indebtedness and is gross income. Similarly, the code provides that the acquisition of debt by a related party to the debtor is considered to be an acquisition of indebtedness by the debtor. Thus, as a NMTC unwinds and notes change hands, the parties must be aware of a potential COD issue. A QALICB that has operating losses may offset COD ordinary income that it receives, or it could pay the note over 25-30 years to defer taxability. However, the QALICB would need to pay interest annually during the life of the note.

Conclusion

The NMTC program, both federal and state, provides an opportunity for businesses by subsidizing or financing projects located in qualified census tracts in exchange for allowing an equity investor to receive a 39 percent tax credit over a seven-year period. The program benefits for-profits and nonprofits alike. By using a put/call exit structure, the QALICB typically receives an overall net cash benefit to the project, which "but for" the NMTC subsidy, would not otherwise be viable.

In this article, Mr. Sanders has drawn liberally from his **article**, "The IRS View of Joint Ventures Involving Tax-Exempts in Today's Climate," published in the *Taxation of Exempts* (November/December, 2014). Portions of this article have also been excerpted from his **book**, *Joint Ventures Involving Tax-Exempt Organizations, Fourth Edition* (John Wiley & Sons, Inc., 2013). ▫

1. "How Nonprofit Organizations Can Use the New Markets Tax Credit," by Michael I. Sanders, *Taxation of Exempts* (November/December, 2009). Click here for the full article.
2. The safe harbor for "substantially all" of the QEI being used for QLICIs is 85 percent. A CDE must make QLICIs within 12 months of receipt of the investors' QEIs.

NOTEWORTHY REAL ESTATE DEALS

Blank Rome's real estate group recently closed the following noteworthy deals:

- **Acquisition of an office park located outside Washington, D.C., from Boston Properties**. The purchase was financed with a loan from **Natixis** of $215 million. The entire property is leased to the U.S. government.
- **Acquisition of an Affordable Housing apartment building** in lower Manhattan. The price was in excess of $110 million and was financed with a mortgage loan of $86.5 million.
- **$120 million financing by Wells Fargo Bank, National Association** to a 39-story tower NYC Co-op in connection with the Co-op's acquisition of a fee interest in the land underlying the building.

What's Your Priority? An Open-Ended Examination of Pennsylvania's Mechanics' Lien Law

BY STEVEN A. SHOUMER AND EDWARD W. ENOCH, JR.


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On July 9, 2014, then Pennsylvania Governor Tom Corbett approved an amendment to Pennsylvania's Mechanics' Lien Law of 1963[1] (the "Lien Law") by signing into law Senate Bill 145. Officially named Act 117 of 2014[2] ("Act 117"), this new law effectively overturned the holding by the Superior Court of Pennsylvania in *Commerce Bank/Harrisburg, N.A. v. Kessler*[3]—and mercifully ended a two-year period of confusion and anxiety for construction lenders and title insurers doing business throughout the Commonwealth.

An Overview of the Law Pre-*Kessler*

In their most basic form, mechanics' liens are designed to allow aggrieved contractors and subcontractors to file a lien against real property as security for the payment by owners (in the case of contractors) or by contractors (in the case of subcontractors). While mechanics' liens are a legitimate tool for claimants who have spent money and/or time in good faith reliance on future compensation, their practical application is often wrought with uncertainty. Mechanics' liens do not have a common law history in Pennsylvania, and lawmakers have struggled to find a version of the Lien Law that fairly accounts for the divergent interests of owners, contractors, and construction lenders, yet still provides the concrete certainty that is necessary for a fully efficient credit market.

Generally, the priority of a lien is determined by the date on which the lien was filed. Uncompensated contractors, however, often times do not have a claim until long after the lien of a construction mortgage has been placed on record. The Lien Law recognizes this inequity and provides certain exceptions in favor of contractors that allow the priority of the mechanics' lien to relate back to the date of "visible commencement" of the contractors' work. In the case of ground-up construction, this means that if any visible work on the property predates the recording of a mortgage, the mechanics' lien has a chance to jump to the front of the priority line as if the lien had been filed on the date that visible work initially began (even if the actual initial work has been completed and paid for in full).

In 2007, the priority pendulum was shifted, as the "relate back" exception was softened by an amendment to the Lien Law.[4] Among other things, the 2007 amendment carved out certain open-end mortgages from the exception, thereby creating an exception to the exception. The open-end mortgage carve-out, however, was limited to loans where the "proceeds…are used to pay all or part of the cost of completing erection, construction, alteration or repair of the mortgaged premises secured by the open-end mortgage." In effect, so long as the loan proceeds were used to pay for so-called "hard costs" of construction, lenders and their title insurers could be confident that the lien of an open-end mortgage would maintain priority over any mechanics' liens filed after the date that the mortgage was recorded, regardless of the date of visible commencement of work on the property.

The Kessler Effect

In *Kessler,* the Superior Court of Pennsylvania obliterated the commonly held belief that open-end mortgages enjoyed a type of super-priority over mechanics' liens. The following is a brief summary of the facts in *Kessler,* presented in chronological order: (i) a contractor was hired to build a home for Stephen and Lisa Kessler and shortly thereafter began excavation on the lot; (ii) the Kesslers received a construction loan for $435,000, and used a portion of the proceeds to cover their closing costs; (iii) an open-end mortgage was recorded pursuant to the construction loan;

(iv) the contractor completed construction; (v) the Kesslers defaulted on their mortgage and failed to make payments to the contractor; (vi) both the lender and the contractor obtained default judgments against the Kesslers; and (vii) great uncertainty ensued. The substantive issue before the court was whether, under the Lien Law, an open-end mortgage whose loan proceeds were used to cover both hard and soft costs related to the project should be subordinated to a statutory mechanics' lien by relating back the effective date of the mechanics' lien to commencement of the contractor's work. At the time, the common interpretation of the Lien Law would have provided a quick and easy "no." With a jaw-dropping interpretation of a seemingly innocuous phrase in the Lien Law, the court held that the contractor should indeed get paid.

Expressing concern that potentially unscrupulous lenders might take advantage of the open-end mortgage carve-out from §1508(c)(2), the court interpreted the phrase "the proceeds" to mean "all of the proceeds."[5] To add a touch of salt to the wounds of all lenders throughout the Commonwealth, the court further narrowed the carve-out by expressly excluding protection for open-end mortgage loans where anything less than "all" of the proceeds were used for the precise purposes set forth in §1508(c)(2): "Completing erection, construction, alteration or repair of the mortgaged premises."[6] In the wake of *Kessler,* previously impervious construction lenders and exception-slashing title insurers were left to rely on a statute that would refuse to safely harbor their loans if even one dollar of the proceeds was used for soft costs. Predictably, the effects were not limited to the "unscrupulous lenders" that the *Kessler* holding envisioned; developers' access to construction financing came into question as the industry was forced to invent techniques, inefficient as they were, which allowed borrowers to use loan proceeds for certain project related soft costs without completely stripping lenders of required title insurance coverage against mechanics' liens. Unless a borrower was willing and able to use its own equity to fund the acquisition, closing fees, satisfaction of existing liens, insurance premiums, and other soft costs that were commonly covered by construction loan proceeds in the pre-*Kessler* era, lenders had to enforce cumbersome safeguards such as bifurcating loan structures or requiring multiple lien waivers. Combined with a sluggish economic recovery after the 2008 recession, this suddenly impaired credit market provided the perfect storm for a potentially protracted period of stagnated development in Pennsylvania.

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Act 117, to the Rescue

Officially approved by Governor Corbett on July 9, 2014 (which was made effective September 7, 2014), Act 117 further amended the Lien Law and, in effect, legislatively overturned the controversial *Kessler* holding.

Pursuant to Act 117, instead of the all-or-nothing prerequisite imposed by the *Kessler* holding, the Lien Law now limits the availability of the open-end mortgage carve-out from §1508(c)(2) to transactions "where at least ***sixty percent*** (60%) of the proceeds are intended to pay or are used to pay all or part of the ***costs of construction.***"[7] This compromise accounts for the practical reality that an efficient financing market relies on the borrowers' ability to use a portion of construction loan proceeds for various costs other than those strictly attributable to erection, construction, alteration, or repair, while still addressing the concerns from the *Kessler* holding's hypothetical where an unchecked lender and owner might collude "to defeat lien rights by using as little as $1.00"[8] of the proceeds towards hard construction costs.

In what appears to be a direct response to *Kessler,* Act 117 further clarifies the open-end mortgage carve-out by providing a definition of "costs of construction." The phrase is defined as "all costs, expenses and reimbursements pertaining to erection, construction, alteration, repair, mandated off-site improvements, government impact fees and other construction-related costs."[9] The definition goes on to provide various examples of costs that would qualify as "other construction-related costs." The statutory construction indicates that the list is provided by way of example and not limitation, thereby providing additional flexibility with respect to items not specifically contemplated by Act 117. To fully understand how Act 117 interprets "costs of construction," the entire definition is as follows:

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"all costs, expenses and reimbursements pertaining to erection, construction, alteration, repair, mandated off-site improvements, government impact fees and other construction-related costs, including, but not limited to, costs, expenses and reimbursements in the nature of taxes, insurance, bonding, inspections, surveys, testing, permits, legal fees, architect fees, engineering fees, consulting fees, accounting fees, management fees, utility fees, tenant improvements, leasing commissions, payment of prior filed or recorded liens or mortgages, including mechanics' liens, municipal claims, mortgage origination fees and commissions, finance costs, closing fees, recording fees, title insurance or escrow fees, or any similar or comparable costs, expenses or reimbursements related to an improvement, made or intended to be made, to the property."

Conclusion

While Act 117 was undoubtedly celebrated by lenders and title companies in every county of the Commonwealth, it would be imprudent to judge the worthiness of this amendment without at least a cursory consideration of the underlying logic and history that necessitated it. Taken as a whole, the Lien Law, as amended by Act 117, recalibrates the scale of lien priority by allowing construction loan proceeds to be earmarked for expenses other than hard construction costs without destroying the open-end mortgage lien, but imposes a reasonable threshold to deter unfair efforts to side step a contractor's legitimate expectation of timely payment. As of the date of this article, Pennsylvania courts have yet to publish an opinion interpreting the newly amended law. Any future *Kessler*-like surprises notwithstanding, this adjustment should achieve the legislature's presumed purpose of balancing the varying, and sometimes competing, interests of all parties to a construction loan transaction. In turn, construction lending is now more available—and that should make everyone happy, irrespective of where they may fall on the balance sheet. □

1. 49 P.S. § 1101 et seq.
2. Senate Bill 145, Printer's No 2208 (Approved as Act 117 of 2014 on July 9, 2014) (full text available at www.legis.state.pa.us).
3. *Commerce Bank/Harrisburg, N.A. v. Kessler,* 46 A.3d 724 (2012), appeal denied *per curiam,* 62 A.3d 380 (2013).
4. House Bill 1637, Printer's No 4229 (Approved as Act 52 on June 29, 2006) (full text available at www.legis.state.pa.us).
5. Kessler, 46 A.3d at 734
6. Id.
7. 49 P.S. §1508(c)(2)
8. Kessler, 46 A.3d at 733
9. 49 P.S. § 1201(15)

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Preferred Equity Investments and Mortgage Lending: Issues for Lenders and Borrowers

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Real estate owners and developers have been increasingly turning toward preferred equity structures and investments in order to raise much needed capital for the purchase, renovation, and development of real property where such capital is unavailable from traditional lending sources. Historically, these shortfalls in capital were often funded through subordinate and mezzanine financing. One reason for the increase in preferred equity investments is likely due to the distaste of some mortgage lenders in making mortgage loans where there is or will be subordinate or mezzanine financing in place. However, preferred equity investments are often structured essentially as disguised mezzanine and subordinate financing wherein the third-party investor is promised a certain return on its investment and granted remedies, much like a secured lender, in the event the investment is not repaid in a specified period of time.

Accordingly, these investments raise many of the same issues and pitfalls for lenders as mezzanine and subordinate financings would, including potential transfers of management and controlling interests in their borrower as well as a decrease in the economic resources being available for the property and repayment of their loan. Lenders have responded to these concerns by tightening their loan documents and underwriting standards to limit and identify these structures. However, because preferred equity investments come in many shapes

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Preferred Equity Investments and Mortgage Lending: Issues for Lenders and Borrowers (continued from page 6)

and sizes, there is no "one-size-fits-all" solution available to lenders. Further, borrowers often turn to preferred equity investments late in a transaction when lender underwriting of the borrower and the transaction has already been completed, which inevitably leads to delays in closing and frustration by all parties. This article will briefly discuss some of the problems and challenges to lenders and borrowers raised by these investment structures and some of the ways in which lenders and borrowers have attempted to address these issues.

How Are Preferred Equity Investments Structured?

Preferred equity investments in real estate transactions come in various forms and, unlike subordinate or mezzanine loans, are typically documented in the borrower's organizational documents. Generally, the deals are structured as an investment by a third-party investor in the real estate owner or various affiliates in the chain of ownership in exchange for a direct or indirect ownership interest in the real estate owner entitling it to a preferred/priority return on its investment. Sometimes, the preferred equity investment is structured much like a loan where (i) "interest" on the investment is required to be paid monthly by the "borrower" regardless of available property cash flow; (ii) the entire investment is required to be paid by a certain maturity date; (iii) default rate "interest" and penalties are assessed against the "borrower" in the event payments are not made timely; and (iv) a default in the repayment of investment potentially results in the loss of management and/or ownership control by the "borrower" in the company in favor of the investor or other third-party. This type of structure is generally known as a "hard" preferred equity structure and presents the most problems for a lender. Often, this type of structure will require the lender to underwrite the loan much as it would a subordinate or mezzanine loan, and will require the investor to enter into direct negotiations with the lender (much like a mezzanine borrower would negotiate an intercreditor agreement with a senior lender) to ensure that its payment requirements and enforcement rights do not trigger a default under the senior loan. Further, "hard" preferred equity structures often require that the lender underwrite the proposed investor, a process that is both time consuming and labor intensive and could potentially significantly delay the closing of a transaction.

Alternatively, a "soft" preferred equity structure combines elements of the above, but (i) may not require payments of "interest" to be made on the investment unless the property is generating sufficient excess cash flow (after payment of debt service on the senior loan and property operating expenses); (ii) may not have a set maturity date or absolute payment obligation; and (iii) may eliminate some or all of the harsher remedies in the event the investment is not paid back timely. Generally, these investments, which more closely resemble a typical joint venture type agreement between partners, are more acceptable to a lender in that they present less or no interference with the management and cash flow from the property. Adding to the dilemma facing a lender is the fact that because preferred equity investments come in many forms, unlike subordinate or mezzanine financing, it may not be as readily apparent to the lender what type of preferred equity investment is being used for a proposed transaction without a thorough and careful examination of the borrower's organizational documents, something a lender is generally reluctant do in the underwriting stage of the loan. Such analysis is further complicated by the fact that borrowers may not finalize a deal with their investors until the transaction is almost ready to close.

Lenders' Response

Lenders have responded to the prevalent use of preferred equity structures in two primary ways. First, in the underwriting stages of the loan, lenders have tightened their underwriting standards and are now requiring borrowers to make clear what type of preferred equity structure is contemplated as being utilized. This underwriting requirement puts pressure on borrowers to finalize their deals with their investors earlier than they might have done in the past. Both Freddie Mac and Fannie Mae require multifamily lenders to cause all borrowers to complete, prior to loan approval, detailed analyses of any preferred equity structures to determine whether a "soft" or "hard" preferred equity structure is contemplated. The detailed checklists required by Freddie

Mac and Fannie Mae are designed to determine and classify what type of preferred equity is being considered. The analysis of this information often involves the utilization of the lender's legal counsel at an early stage of the loan in order to ensure that the lender understands the type of preferred equity being proposed, and in order to address any of the issues that may be raised by the use of such structure.

Second, lenders have responded by beefing up their loan documents to prohibit the use of preferred equity investments, much like the traditional provisions in loan documents that prohibit secondary or subordinate financing. Once again, the devil is in the details, and lenders need to make sure that their language is not overly restrictive so as to prohibit ordinary joint venture type investments that should present no issues to a senior lender.

Borrowers Beware

Similarly, borrowers need to read these provisions very carefully to make sure that their proposed structures do not violate these agreements since these provisions are often drafted so broadly so as to prohibit almost any type of third-party investment no matter how far down the ownership chain the investment occurs and no matter how "soft" the contemplated preferred equity investment is intended to be. To make matters worse, violations of these provisions are very often classified as prohibited transfers under the loan documents, which could result in recourse liability to the borrower and any guarantor of the loan. Accordingly, it is crucial for borrowers to understand the provisions and restrictions contained in the loan documents to make sure they are not inadvertently violated.

Key Takeaways for Lenders and Borrowers

Preferred equity investments are here to stay and will play an important role in filling the gap that may be left by traditional financing. It is important for borrowers and lenders to understand that preferred equity structures can often result in issues for lenders and borrowers in real estate financing transactions. Lenders need to understand what type of preferred equity is being contemplated by the borrower early on in their underwriting of a loan in order to evaluate any potential legal or underwriting issues raised by the proposed structure. Borrowers need to disclose and finalize their deals with their investors early on in the underwriting process to ensure that their lenders are able to address any concerns of the investors and issues raised by the proposed structure. Finally, borrowers need to carefully scrutinize the loan documents to determine that the proposed preferred equity structure will not violate the terms of their loan documents. □

NJ Townships Possess Broad Zoning Powers to Preserve Environmentally Sensitive Land

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On January 26, 2015, the New Jersey Supreme Court in the matter of *Griepenburg v. Township of Ocean* unanimously affirmed a municipality's right to designate property as "environmentally sensitive" in order to restrict "high-density development." *Griepenburg v. Twp. of Ocean,* 105 A.3d 1082, 1097 (N.J. Jan. 22, 2015). This case, which has been winding its way through New Jersey courts for seven years, involved a series of ordinances enacted by the New Jersey Township of Ocean ("Township") as part of a comprehensive municipal zoning plan and "smart growth" planning process. *See id.* at 1086.

The Griepenburgs

The plaintiffs, the Griepenburgs, have owned 34 acres of land in the Township since 1985. *See id.* at 1086-87. Their home is on a two-acre lot, while the balance of their 32 acres consists of undeveloped woodlands. *See id.* at 1087. Until recently, parts of these undeveloped lands were zoned commercial, thereby permitting the development of hotels, retail space, offices, and medical facilities. *See id.* As such, the Griepenburgs enjoyed significant future development potential under the existing zoning scheme, including several purported offers from hotel chains to purchase their property. *See Griepenburg v. Township of Ocean,* 2013 N.J. Super. Unpub. LEXIS 2154, at *3 (N.J. App. Div. Aug. 29, 2013).

The Township of Ocean

In 2004, the Township became interested in concentrating development in a town center and slowing development in the outer portions of the Township in an alleged effort to protect environmentally sensitive coastal areas through the creation of a so-called "green belt" of undeveloped forest land. *See Griepenburg,* 105 A.3d at 1084-85, 1094. In furtherance of this plan, the Township, in 2006, "down-zoned" the Griepenburgs' property to an environmentally sensitive land

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NJ Townships Possess Broad Zoning Powers to Preserve Environmentally Sensitive Land (continued from page 8)

use designation, thereby prohibiting any opportunity for commercial development. *See id.* at 1085. This action effectively destroyed the Griepenburgs' ability to commercially develop their land. *See id*.

The Appellate Division's Ruling

As a result, the Griepenburgs sued the Township, arguing that this exercise of municipal zoning power was arbitrary, capricious, and unreasonable. In support of this allegation, the plaintiffs contended that this environmentally sensitive zoning designation was improper because the subject property contained "no environmentally sensitive characteristics" such as "open waters, wetlands, floodplains, steep slopes, or…documented [threatened and endangered species] habitat[s]." *See id.* at 1089. Without such environmental "constraints," the plaintiffs argued, the Township was merely trying to acquire the Griepenburgs' property for use as open space without paying fair market value. *See id.*

On appeal, the Appellate Division sided with the plaintiffs, invalidating the zoning ordinances in an unpublished opinion. In so holding, the Appellate Division indicated that any land designated as "environmentally sensitive" must contain environmentally sensitive characteristics such as floodplains or endangered species habitats. *See Griepenburg v. Township of Ocean,* 2013 N.J. Super. Unpub. LEXIS 2154, at *18.

NJ Supreme Court Ruling

In its January 2015 opinion, the New Jersey Supreme Court took a broader view of a township's ability to zone environmentally sensitive areas. *See Griepenburg,* 105 A.3d at 1093-94. In reversing the Appellate Division, the court concluded that the plaintiffs' property itself did not have to contain specific environmental conditions as long as the zoning decision fit into a larger scheme to protect the environment. *See id.* On this point, the court reasoned that the designation of the plaintiffs' property as "environmentally sensitive" was a valid exercise of the Township's authority pursuant to the Township's plan to preserve "undisturbed, contiguous, forested uplands, of which plaintiffs' property is an integral and connected part," to protect a surrounding "sensitive coastal ecosystem." *See id.* at 1084-85.

The court further stated that the plaintiffs should first have sought administrative relief by way of a zoning variance application before challenging that the ordinances, as applied to their property, constituted a taking without just compensation. *See id.* at 1095-96. Finally, the court indicated that, if the owners' variance application is denied, they can then pursue their inverse condemnation claims. *See id.* at 1096. Notwithstanding the court's emphasis as to the exhaustion of administrative remedies, the plaintiffs noted an administrative action would be futile as they would be unable to establish the positive or negative criteria necessary to obtain relief from the inclusion of their property in an Environmental Conservation District.

Conclusion

Accordingly, while the New Jersey Supreme Court's decision strengthened the ability of municipalities to rezone land it deems to be "environmentally sensitive," the court left open the possibility that such decisions can still face judicial scrutiny. Challenges to such zoning classifications, however, will be difficult given the Supreme Court's acknowledgement that even though this property may not have contained environmentally sensitive characteristics, it served to act as a buffer between other environmentally sensitive areas. □

California Legislative Update

Postponement of Implementation of the Final Phase of the AB 1103 Energy Disclosure Requirements for Nonresidential Buildings of 5,000 to 10,000 Square Feet

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California Public Resources Code § 25402.10 (commonly referred to as "Assembly Bill 1103"or "AB 1103") states as follows:

(a) On and after January 1, 2009, electric and gas utilities shall maintain records of the energy consumption data of all nonresidential buildings to which they provide service. This data shall be maintained, in a format compatible for uploading to the United States Environmental Protection Agency's ENERGY STAR Portfolio Manager, for at least the most recent 12 months.

(b) On and after January 1, 2009, upon the written authorization or secure electronic authorization of a nonresidential building owner or operator, an electric or gas utility shall upload all of the energy consumption data for the account specified for a building to the United States Environmental Protection Agency's ENERGY STAR Portfolio Manager in a manner that preserves the confidentiality of the customer.

(c) In carrying out this section, an electric or gas utility may use any method for providing the specified data in order to maximize efficiency and minimize overall program cost, and is encouraged to work with the United States Environmental Protection Agency and customers in developing reasonable reporting options.

(d) (1) Based on a schedule developed by the commission pursuant to paragraph (2) an owner or operator of a nonresidential building shall disclose the United States Environmental Protection Agency's ENERGY STAR Portfolio Manager benchmarking data and ratings for the most recent 12-month period to a prospective buyer, lessee of the entire building, or lender that would finance the entire building. If the data is delivered to a prospective buyer, lessee, or lender, a property owner, operator, or his or her agent is not required to provide additional information, and the information shall be deemed to be adequate to inform the prospective buyer, lessee, or lender regarding the United States Environmental Protection Agency's ENERGY STAR Portfolio Manager benchmarking data and ratings for the most recent 12-month period for the building that is being sold, leased, financed, or refinanced.

(2) The commission shall establish a schedule by which an owner or operator is required to meet the requirements of this subdivision.

(e) Notwithstanding subdivision (d), this section does not increase or decrease the duties, if any, of a property owner, operator, or his or her broker or agent under this chapter or alter the duty of a seller, agent, or broker to disclose the existence of a material fact affecting the real property.

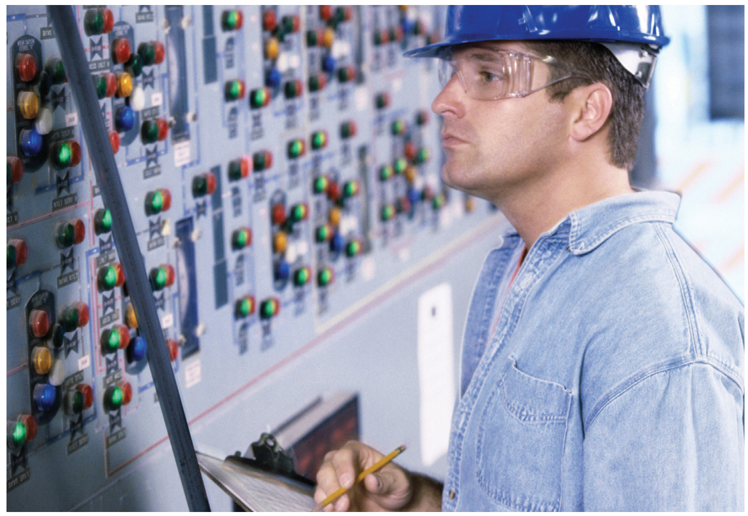
AB 1103 requires owners or operators of nonresidential buildings to disclose the U.S. Environmental Protection Agency's ("EPA") ENERGY STAR Portfolio Manager benchmarking data and ratings for the most recent 12-month period to:

(1) a prospective buyer, no later than 24 hours prior to the execution of a purchase and sale agreement;

(2) a prospective tenant of an entire building, no later than 24 hours before execution of the lease;[1] and

(3) a prospective lender providing financing secured by the entire building, with the submittal of the loan application.

The term "nonresidential building" is defined in California Public Resources Code § 25130 as any building that is heated or cooled in its interior, and is of an occupancy type other than Type H (generally, hotels, apartment houses, convents, and monasteries), Type I (generally, dwellings and lodging houses), or Type J (generally, private garages, carports, sheds, agricultural buildings, fences over 6 feet high, tanks, and towers), as defined in the Uniform Building Code, 1973 edition, as adopted by the International Conference of Building Officials.



In order to obtain the information necessary to comply with the disclosure requirements, owners and operators of nonresidential buildings subject to the energy disclosure requirements must open or update an account on the EPA's ENERGY STAR Program Portfolio Manager website (www.energystar.gov) no later than 30 days prior to the disclosure deadline. Once the account is opened or updated, owners and operators of nonresidential buildings must use the California Energy Commission's compliance website (www.energy.ca.gov) to complete and submit the compliance report.

AB 1103 became effective in phases. As of July 1, 2013, AB 1103 applied to nonresidential buildings with total gross floor area of more than 50,000 square feet. As of January 1, 2014, AB 1103 applied to nonresidential buildings with total gross floor area between 10,000 and 50,000 square feet.

With regard to nonresidential buildings with total gross floor area between 5,000 and 10,000 square feet, AB 1103 was to apply beginning on July 1, 2014. However, on September 2, 2014, the California Office of Administrative Law approved the California Energy Commission's emergency regulatory action to amend existing regulations to have AB 1103 apply to nonresidential buildings with total gross floor area between 5,000 and 10,000 square feet as of July 1, 2016.

1. With respect to leases, disclosure is not required for multi-tenant buildings per California Code of Regulations, Title 20, §1684.

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