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Real Estate

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USA

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Contributed by Troutman Sanders LLP ***Authors:*** Mark L. Elliott, Walter D. Fisher, Jr, Stephanie E. Greer Fulcher, William G. Homiller

Law and Practice

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Troutman Sanders LLP has cultivated its reputation for a higher commitment to client care for over 120 years, with a diverse practice mix, workforce and footprint that includes 12 offices across the United States. Ideally positioned to help clients across sectors realise their business goals, the firm's 650 attorneys transact for growth, resolve mission-threatening disputes and navigate complex legal and regulatory challenges. Troutman Sanders' Real Estate & Finance department comprises the firm's Real Estate, Real Estate Finance and Multifamily Housing Finance practices, focusing on data centres, energy, hospitality, investment, acquisition and disposition, joint ventures and investments, land use and zoning, leasing, multi-family housing finance, and retail.. With nearly 100 attorneys practising across the country, the team regularly handles some of the nation's largest real estate matters. The team provides negotiation and advocacy for both domestic and international clients in all areas of real estate transactions, including the development, acquisition, sale, financing, leasing, management and operation of individual properties and large real estate portfolios. The firm handles commercial and industrial real estate matters in a wide variety of industries and has particular depth in multi-family housing, retail, energy and hospitality.

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1. General

1.1 Main Sources of Law

Real estate law in the USA is a combination of state and federal statutory law and associated regulations issued by governmental agencies, state common law (which is based on court decisions and precedent), and local laws, ordinances and regulations.

1.2 Main Market Trends and Deals

The election of President Donald J. Trump, and of a Republican majority to both houses of the US Congress, introduced an element of uncertainty to the US economy beyond what might typically be expected when a new administration takes office. The Trump administration's focus on reducing governmental regulatory constraints (eg, in the context of federal environmental protections), facilitating major tax reform, and making significant adjustments in US trade policy has been closely monitored by the US business community in general, and by the commercial real estate industry in particular. Although the long-term impact of the new administration has yet to be determined, the strong US stock market and overall economic growth since the November 2016 election have been positive indicators.

Real estate activity, including investment, financing and new development, in 24-hour cities and second-tier cities in the USA continued to be strong in 2017. However, some product types, like luxury multifamily, moderated to a degree as a result of market conditions that included more restrictive equity and debt availability, rising vacancy rates and slower rent growth. Other product types, such as hospitality, continued at a robust pace. Additionally, the industrial and logistics real estate market remained strong in 2017 with low vacancies and healthy new development, driven significantly by a steady rise in the e-commerce segment of the economy.

Inbound capital, both equity and debt, from other countries continued to be extremely strong in 2017, helping to supplant more limited capital availability from traditional sources in the USA, Asia, Europe and the Middle East were the key global locations from which capital flowed into the USA.

The "baby boomers" – those born between 1946 and 1964 – have continued to impact commercial real estate activity in a variety of ways. Due to the size of the baby boomer generation, the needs of this very material demographic are creating new markets (and changing existing ones), particularly with respect to healthcare facilities and housing. This phenomenon is expected to continue, as the requirements and expectations of aging citizens in the USA drive demand for facilities that are readily accessible and designed for active senior lifestyles.

Notable US real estate transactions in 2017 included the massive Hudson Yards mixed-use project on the west side of Manhattan. The development, one of the most significant real estate projects ever undertaken in the USA by size (up to 18 million sq ft of commercial and residential space, 14 acres of common open space, and a 750-seat public school, among other features), continues to progress. In Manhattan, office towers continued to dominate the largest single-property investment sales transactions by dollar amount: 245 Park Avenue traded for USD2.2 billion, 60 Wall Street traded for USD1.04 billion, and a 48.7% stake in One Worldwide Plaza sold for USD840 million. In Los Angeles, some of the largest commercial real estate transactions also involved office buildings, including the USD1.34 billion sale of four Westwood office buildings, the USD511 million sale of the Colorado Center office project and the conveyance of two Playa Vista office buildings for USD429 million. Additionally, there were some large multi-property commercial real estate transaction closings in 2017, such as the sale by the Bissell Companies of its Ballantyne Corporate Park holdings in Charlotte to Northwood Investors. The transaction comprised over 4 million sq ft of office space, four hotels and the Ballantyne Golf Club, commanding a sales price of USD1.2 billion.

1.3 Proposals for Reform

The most significant proposal for real estate reform affecting commercial real estate in the USA was the comprehensive tax reform law, which was passed by the U.S. Congress and signed by President Donald J. Trump in December 2017. In balance, the new tax law, which took effect on 1 January 2018, is expected to have neutral-to-positive impacts on commercial real estate investment and development in the USA with owners of REIT stocks receiving favourable treatment and Section 1031 like-kind exchanges and capital gains treatment being preserved for commercial real estate.

2. Sale and Purchase

2.1 Categories of Property Rights

The following categories of property rights can be acquired.

- A fee simple ownership right: this is the most complete ownership of property that a party can have; an owner in fee simple has all the rights to and the use of the property.
- A ground lease right: the owner holds the entire interest, for only an identified time, subject to whatever contract terms are in the ground lease.
- Rights as a tenant under a space lease: the holder of the interest has the rights to use identified space in completed improvements, plus common areas, for a specified time.
- An estate for years or life estate for the benefit of a specific party: the user has full right to use the property, but only for a specified time.
- An easement right, or right to use and enjoy the property for a specific purpose: typical easement rights include access rights over a portion of a property and easements to conduct certain activities on property for a certain time period.

2.2 Laws Applicable to Transfer of Title

Commercial real estate transfers in the USA are governed by the laws of the state in which the real estate is located. While the requirements differ from state to state, a deed of conveyance must be signed by the individual who owns the property or who is properly authorised to sign and deliver the deed on behalf of the legal entity that owns the property, and such signatures typically must be witnessed and notarised by a notary public who is trained and certified for such purpose. Depending on the laws of the relevant state and, in some instances, municipality where the real estate is located, different types of real estate (eg, residential, industrial, office, retail, hospitality) may have unique conveyance requirements compared to other real estate types (such as environmental disclosures for residences, etc). Additionally, state laws vary greatly with respect to transfers of licences and rights that may accompany a transfer of real estate (eg, liquor service licences that may be relevant to restaurant businesses).

2.3 Effecting Lawful and Proper Transfer of Title

While the requirements differ from state to state, every state's real estate conveyance laws require that deeds of conveyance be signed by the seller of the real estate and, to be fully enforceable, registered/recorded and indexed in a public records repository or filing office, so that a chain of title to the property will exist and be available for inspection by all parties and the public in general. Many local real estate records filing offices (often counties within states) make real estate records available electronically.

Also, the use of electronic signatures for signing deeds and other real estate encumbrance documents is increasing, but their use is not uniformly accepted and state law differs from state-to-state and even from county-to-county within specific states as to whether electronic signatures are valid. Generally speaking, different types of real estate (eg, residential, industrial, office, retail, hospitality) do not have unique filing requirements when compared to other real estate types, although state laws do sometimes require specific information or recitations to be included in conveyance instruments for certain types of real estate (residential, for example) that may not be applicable to other types of real estate. Title insurance is very commonly acquired by purchasers in US real estate transactions and, in fact, it is rare for title insurance not to be part of a real estate closing in the USA. Title insurance requirements, availability and pricing differs from state-to-state.

2.4 Real Estate Due Diligence

Purchasers of commercial real estate typically commission an environmental consultant to conduct physical due diligence/inspections of the property and to prepare a report addressed to the purchasers. Such inspections generally include some level of environmental review and analysis, which may include taking soil and groundwater samples if an environmental issue or concern is detected, and testing of building materials (eg, determining if asbestos is present) if the property has a building on it. For properties that contain building improvements which the purchaser intends to keep in place after the acquisition of the property, the purchaser may also inspect the soundness of the building structure, foundation, walls and roof. For properties that will be developed by the purchaser, often soil compaction/composition tests are conducted as part of the due diligence activities. Purchasers also routinely have a title examination and a survey of the property completed to verify that the seller actually owns title to the property and to ascertain existing easements, restrictions and other covenants that will be binding on the purchaser and the property following conveyance of title. Additionally, a purchaser frequently will conduct other inspections, including checking the zoning/land use status of the property, completing market diligence and studies (eg, for a contemplated retail or multifamily project), and confirming the availability of utilities in sufficient capacity to serve the property for its intended use by the purchaser.

2.5 Typical Representations and Warranties

The number and types of representations and warranties included in commercial real estate purchase and sale agreements in the USA vary substantially from transaction to transaction, depending on many factors, including the relative negotiating leverage of the parties, the identity of the seller (eg, a foreclosing bank seller versus a seller in a non-distressed situation), the pricing of the property, and the known conditions, if any, impacting the property (eg, a manufacturing site that has known environmental conditions may merit certain specific, targeted environmental representations and warranties). Almost all purchase and sale agreements include key representations and warranties that address the seller's ownership of title to the property (although the quality of title, in terms of title encumbrances, often are not covered): the seller's proper organisation and existence (if not an individual), its authorisation to enter into the agreement pursuant to its formation and governance documents, and its solvency/non-bankruptcy status; and basic information regarding the environmental condition of the property (frequently limited to the specific actual knowledge of specific individual officers or representatives of the seller and limited to actual, active environmental law violations or the absence of such violations). Other representations and warranties that may be included in the purchase and sale agreement include those relating to the physical condition of the property, the zoning status of the property, access to public roads, the availability of utilities to serve the property, the existence of information and materials in the seller's possession relating to the property and the delivery of such information and materials to the purchaser and a myriad of other issues that may be posed by the unique circumstances and attributes of the property.

For non-residential properties, it is not common for representations and warranties to be provided or imposed on the parties by statute or common law and, in fact, the general rule is caveat emptor (ie, purchaser beware – meaning that the purchaser may not assume or rely on any representations or warranties that are not expressly made in writing by the seller).

Remedies available to a purchaser for a seller's default relating to representations and warranties are governed by the terms of the purchase and sale agreement, and such terms are heavily negotiated. Most commonly, before a transaction closes, a seller of real estate is liable for specific performance of its obligations under the agreement or may be subjected to the purchaser's termination of the agreement, which sometimes will also allow the purchaser to recover certain out-of-pocket costs and expenses from the seller. If a representation or warranty of seller survives the conveyance of the property to the purchaser and is breached or a breach is first discovered after the closing of the transaction, the purchaser often will be permitted to pursue a legal action for rights and remedies at law or in equity against the seller, but such remedies after closing often are limited in time and exposure amount. Additionally, purchase and sale agreements frequently afford purchasers expanded rights and remedies against sellers who engage in conduct that is intended to result in a breach by such sellers of the terms of the agreements. Finally, a seller that engages in fraudulent conduct vis-à-vis a purchaser may be subjected to remedies that are predicated not on the terms of the purchase and sale agreement – eg, a tort cause of action – but such remedies outside the terms of the agreement require truly egregious conduct on the part of sellers.

2.6 Important Areas of Law for Investors

The most important factors for an investor to consider when purchasing real estate are: the quality of the documents which create cashflow for the property (the leases or other use rights agreements), if any; the ability of the investor to exit (sell) the property when the seller desires to do so; and the uses to which the property may be put (which might be limited by local zoning laws).

On the first issue, an investor needs to understand what rights the tenant or other users have to either demand services or concessions (which would be an expense to the owner) or to terminate a lease prior to the natural expiration of the term. While as a matter of law it would be difficult for a tenant to terminate a lease prior to the end of the term (usually accomplished by claiming a constructive eviction, which is a difficult right to enforce), many tenants will negotiate for early termination rights in their leases, for certain causes (from a failure to provide services to a plain right of early termination, usually for a fee paid to the landlord).

On the second issue, there may be things about the structure of ownership (for example, the investor's real estate interest is only a ground lease or the investor owns the property subject to high interest debt with a substantial prepayment premium) that could impact a subsequent buyer's interest in purchasing that asset from an investor. What an investor is willing to live with and what the universe of purchasers is willing to own can be two very different things.

On the issue of uses, property can go through several uses, depending on the surrounding property and market. For example, a small retail use with local tenants may not be the ideal, highest and best use of a parcel of land, and the rights of an owner to repurpose the property to some other use (say, a hotel or an apartment) could be a critical element in keeping value for the property.

2.7 Soil Pollution or Environmental Contamination

Liability for soil and groundwater contamination can arise under several federal statutes, and it can arise under state statutes and common law.

The most well-known federal statute, the Comprehensive Environmental Response Compensation and Liability Act ("CERCLA") – more commonly known as "the Superfund statute" – allows a party to acquire title to contaminated property without incurring liability, if the property is purchased after 31 January 2002, and if that party satisfies the elements of either of two affirmative defences. Most notable among the common elements of both defences are: (i) the requirement to perform "all appropriate inquiries" regarding a property before acquisition – typically satisfied by performing a Phase I Environmental Site Assessment; and (ii) the requirement to exercise "due care" regarding any existing releases at the subject property. This second requirement means that a new owner cannot turn a blind eye to ongoing releases at a property, but it remains unclear exactly what a new owner must do to satisfy the "due care" obligation. Purchasers should review the "common elements guidance" published by the US Environmental Protection Agency ("EPA") for more information on the Bona Fide Prospective Purchaser Defense and the Innocent Landowner Defense.

Federal law also establishes liability for contamination at certain hazardous waste management sites under the Resource Conservation and Recovery Act ("RCRA") and for releases of polychlorinated biphenyls ("PCB") under the Toxic Substances Control Act ("TSCA"). Purchasers of properties where "large quantity generators" or "treatment, storage and disposal facilities" have been located or properties where releases of PCBs have occurred should be cautious. RCRA and TSCA do not contain the defences to liability discussed above. RCRA also establishes clean-up liability for petroleum underground storage tanks ("USTs"), which attaches to the owner or operator of the UST system. While identifying the operator of a UST system is usually straightforward, state law regarding whether a UST system is a fixture typically determines the owner of the UST system.

In addition to the federal statutes, most states have their own statutes establishing liability for contamination, and there can be common law tort claims for trespass, nuisance, negligence and strict liability. The precise contours of these sources of liability vary from state-to-state. Furthermore, many states have delegated authority from the EPA to enforce their own hazardous waste and UST programmes under RCRA. Purchasers should be careful to understand the nuances of the relevant states' programmes.

Finally, many states have established "brownfields" or "voluntary clean-up" programmes, which provide a mechanism for resolving liability for a contaminated site. In fact, some states afford innocent purchasers with reduced investigative and remedial requirements as well as reductions on income and property taxes in order to incentivise redevelopment. Purchasers should be careful to understand the eligibility requirements of a state's programme and determine whether (i) reduced clean-up requirements are available for innocent parties, and (ii) an innocent party must enrol in the programme before acquiring title in order to be eligible.

2.8 Permitted Uses of Real Estate Under Zoning or Planning Law

Most, but not all, urban municipalities in the USA have zoning and land-use laws and ordinances that limit or restrict the specific uses that may be made of properties in their jurisdictions. The nature and application of zoning and land use laws and ordinances varies significantly from municipality to municipality and the determination of uses allowed on a tract of real estate requires careful analysis and consideration. Typically, a purchaser may ascertain the zoning or land use restrictions that apply to a specific tract of real estate by visiting the relevant zoning or planning office for the municipality where the property is located and viewing the records maintained in such office; often, the zoning and land-use records also are accessible electronically through the website of such zoning or planning office.

Municipalities are increasingly amenable to entering into development agreements with owners of real estate to either modify existing zoning and land-use restrictions or to impose an entirely new development scheme on the property. Such development agreements often are sanctioned by state statutory law and must comply with specific requirements and limitations in such laws in order to be valid and enforceable. Development agreements sometimes address a myriad of issues and topics beyond the types of development and uses that may occur on the real estate, including: possible dedications of portions of the property for public use (eg, as public parks, fire and emergency service stations, schools, etc); sharing of costs between the private property owner and the municipality for certain improvements (eg, parking decks, public parks, etc) that may be constructed on the property; architectural features and characteristics of building and other structures to be developed on the property; and the phasing of development of different portions of the property.

2.9 Condemnation, Expropriation or Compulsory Purchase

The governmental taking of land for a public purpose is permitted and is known as "condemnation" or "eminent domain". The US Constitution requires that the government pay the owner "just compensation" for the property taken. Federal and state statutes and rules vary regarding the procedures for carrying out condemnation and determining just compensation.

2.10 Taxes Applicable to a Transaction

Costs of conveyance of real estate vary, state-by-state, as does the custom and practice of which party bears the costs of conveyance. Costs include: a fee on the conveyance of property, as a percentage of the value of the property conveyed; costs to record documents; documentary stamps; and title insurance premiums. Note that title insurance is a voluntary cost incurred in a transaction (not required by any laws), but is a critical element of any purchase and sale, and foregoing the purchase of title insurance in a conveyance is rare. As a general rule, costs are more likely to fall upon the purchaser.

Certain costs (such as transfer taxes paid in connection with deeds) can be avoided if a conveyance is made at the entity level (such as the sale of partnership or membership interests). A sale performed on that basis may lack certain other title protections the purchaser would obtain by getting title insurance, though, so cost savings might be offset by practical risk.

2.11 Legal Restrictions on Foreign Investors

Legal restrictions on foreigners owning real estate include state laws, which vary state-to-state (such as a limit on farmland ownership by foreign owners, which exists in certain states), and a variety of federal laws which include:

- the Hart-Scott-Rodino Act (which imposes reporting requirements for larger foreign investments, including acquisitions of real estate);
- the International Investment and Trade in Services Survey Act (which includes reporting requirements and specifies forms that must be filed with the Department of Commerce to report the acquisition of real estate by a non-US resident, excluding residential real property for personal use);
- the Agricultural Foreign Investment Disclosure Act (which requires a foreign entity acquiring or transferring an interest, other than a security interest in agricultural land, to file ownership reports); and
- the Foreign Investment in Real Property Tax Act (which imposes federal income tax liability on income earned from transfers of US real estate by foreign owners).

3. Real Estate Finance

3.1 Financing Acquisitions of Commercial Real Estate

A commercial real estate acquisition is generally financed with a term mortgage loan, repayment of which is secured by a lien on the acquired real estate in favour of the lender. The amount of the loan available to the borrower (and thus, the amount of equity to be invested in the subject real estate by the borrower) is determined based in part upon the value of the property.

Term loans used to acquire real estate come in a variety of forms, depending upon the type of property being acquired and the intended use of the property. For example, an acquisition mortgage loan could be a simple term loan, fully drawn at closing, or it might be an acquisition and construction loan, with the loan structured to be drawn in a series of advances over time which are to be used to pay costs of construction of a new improvement on the land acquired. A mortgage loan could be a fixed rate loan or a variable rate loan. It could be a bridge loan, with a life of only one to three years, designed to provide interim financing to a project prior to the imposition of longer-term, permanent financing. The loan could be syndicated senior debt (that is, a loan made by a group of lending institutions), or the loan could be structured as a senior mortgage loan with either junior or "mezzanine" financing. Mezzanine financing is a loan made by a lender to an entity that owns a real property-owning entity; collateral for such debt is a pledge of the mezzanine borrower's ownership interests in the property owner, rather than a lien directly on the subject real property. All forms of real estate acquisition loans are usually non-recourse to the borrower, although lenders typically exclude certain "bad acts" within the borrower's control from non-recourse provisions. The occurrence of any one of the bad acts can trigger a lender's right to seek recompense directly from a borrower, rather than relying solely upon its remedies against the collateral. All forms of real estate acquisition loans are usually non-recourse to the borrower, although lenders typically exclude certain acts within the borrower's control, such as non-payment of taxes, failure to maintain insurance coverage, and misapplication of funds, from non-recourse provisions. The occurrence of any one of those acts can trigger a lender's right to seek recompense directly from a borrower, rather than relying solely upon its remedies against the collateral.

3.2 Typical Security Created by Commercial Investors

While the structure of a mortgage loan depends upon the underlying transaction, certain elements are consistent across mortgage loan types.

Real estate lenders require a first-priority lien on the subject real estate to secure repayment of the real estate acquisition loan. This lien is granted in the form and subject to the legal requirements and conditions prescribed by the state in which the real estate resides. Liens in real estate are granted either via a mortgage, a deed of trust, or a deed to secure debt, such form being dictated by the applicable state's law. Nearly every jurisdiction requires such instruments be in writing, contain a description of the secured indebtedness and of the subject real estate, and be executed by the parties thereto. In addition to a lien upon real estate, real estate lenders also typically require borrowers to grant security interests in property related to or used in connection with the real estate – eg, leases, rents and tangible personal property-like equipment – and give them collateral interests in contracts and agreements that are integral to the operation of the property, such as property management agreements or agreements with architects, engineers and general contractors. A lender's security interest in non-real estate collateral associated with the real estate is governed by the Uniform Commercial Code as adopted in the applicable state, and lenders must take extra steps prescribed by the state's statutory framework to create and ensure the priority of their liens on such related personal property. As noted, mezzanine loans are secured not by liens in real estate, but by a pledge of the mezzanine borrower's ownership interests in the property owner.

3.3 Restrictions on Granting Security over Real Estate to Foreign Lenders

Generally, there are no restrictions on a foreign lender's right or ability to receive a lien or security interest in real estate in the USA. However, borrowers could be prohibited by US anti-terrorism laws or economic sanctions from sending loan-related payments or granting security interests to, or otherwise receiving loans from, foreign lenders based in certain countries. Also, borrowers in certain industries may be subject to regulations that restrict their ability to transfer assets to foreigners. Many states require foreign companies doing business in that state to qualify to do business there in order to bring an action in the courts of that state. Additionally, foreign lenders may be subject to tax liability in connection with their activities different than that imposed upon US lenders. Finally, the terms of the Foreign Investment and National Security Act of 2007 may prohibit a foreign lender from actually foreclosing on collateral real estate or otherwise retaining title to foreclosed real estate.

3.4 Taxes or Fees Relating to the Granting and Enforcement of Security

Each state imposes fees on the recording of mortgages and UCC-1 financing statements which create and perfect liens against real property and related personal property. The costs vary by state. Some, but not all, states impose mortgage taxes – usually calculated as a percentage of the indebtedness being secured by the mortgage. Several states, such as Florida, impose documentary taxes associated with execution of loan documents in the state, including promissory notes.

3.5 Legal Requirements Before an Entity Can Give Valid Security

Fundamentally, for a borrower to give valid security over real estate assets, the borrower must exist, and it must own the assets over which it purports to convey an interest. Additionally, before borrowers acquire property, finance the acquisition of property, or grant a lien or security interest in property, they must comply with the rules and regulations governing their own internal organisational structure. The borrowing entity must have properly authorised the acquisition and financing, in accordance with its governing documents, and the individual(s) executing documents on behalf of the borrower must be properly authorised by the borrower to execute such documents. Lenders usually require a borrower to be registered to do business in the state where the property is located, if it is not resident in that state (although this is not a condition to a borrower's ability to validly grant a security interest in, or impose a lien upon, real estate assets).

3.6 Formalities When a Borrower Is in Default

Enforcement of a lender's security interest in real estate must conform to the requirements of state law and to the terms of the instrument that created the lien or security interest. Some states permit a lender – via "power of sale" – to pursue and facilitate a foreclosure of real estate; other states require that a foreclosure sale be affected by (an often more ponderous) judicial process. The statutory foreclosure process mandated by most states will dictate some form of notice to a defaulting borrower and other interested parties and public notice of a foreclosure sale. Many states provide a period following a completed real estate foreclosure sale within which a foreclosed borrower may exercise a right of redemption to re-acquire the property or within which an "upset bid" may be made. Lenders are permitted in most jurisdictions to "credit bid" – to receive title to the property via the foreclosure sale. However, a foreclosing lender will receive title to the property subject to any liens that retain priority over its mortgage lien. As a result, lenders generally place meaningful emphasis on ensuring borrowers terminate or otherwise subordinate third-party interests in the real estate collateral that could supersede their own in a foreclosure scenario.

3.7 Subordinating Existing Debt to Newly Created Debt

In most jurisdictions, recordation of a mortgage instrument before recordation of a competing mortgage will operate to establish priority of the interests. Lenders can, and sometimes do, agree to subordinate existing loans to newly created indebtedness via written agreement. One common type of such an agreement is an "Intercreditor Agreement". An Intercreditor Agreement is used to define priority of lenders in a transaction that has more than one layer of financing (such as senior, junior, and mezzanine debt). Terms that are addressed in an Intercreditor Agreement include: the priority of liens of the various lenders; when lenders may enforce their rights against real estate collateral; timing and priority of loan repayments; and limitations on the lenders' ability to modify the terms of their respective loans. Additionally, in some scenarios, tax liens and certain kinds of security interests in personal property – such as purchase money security interests – automatically supersede a lender's perfected security interest in the same property, even if the lender's interest would otherwise have had priority due to its being created first.

3.8 Lenders' Liability Under Environmental Laws

As a general rule, lenders are not liable under federal or state environmental laws for simply holding a lien or security interest in real estate. Two major pieces of federal environmental legislation – the Comprehensive Environmental Response, Compensation, and Liability Act ("CERCLA") and the Resource Conservation and Recovery Act ("RCRA") – as well as many state environmental statutes, provide "secured creditor" exemptions with respect to liability for environmental violations and related fines.

However, even in the context where a lender may otherwise qualify for protection as a "secured creditor", a lender can become liable for environmental problems if it actively participates in the operation of the subject property (either before or after it acquires title via exercise of remedies under mortgages), causes new environmental issues at a property following its acquisition of title, or fails to comply with ongoing environmental compliance obligations after it owns the property. Courts undertake a fact-specific analysis to determine whether a lender's participation in the management or operation of a property rises to a level that would nullify any secured creditor exemptions. Secured creditor exemptions cannot protect lenders in all instances, however. Some environmental legislation does not contain a "secured creditor" exemption (eg, the Clean Water Act). Generally, secured creditor exemptions do not protect lenders against third-party tort claims based on personal injury or property damage due to environmental contamination on property serving as collateral for a loan or otherwise acquired by a lender through exercise of its remedies.

3.9 Effects of Borrower Becoming Insolvent
Security interests or liens in favour of a lender are not automatically voided simply due to a borrower's insolvency or bankruptcy filing. However, a borrower bankruptcy makes it much more difficult to realise a lender's security interest in real estate and real estate-related collateral. After a borrower bankruptcy filing, a lender is forced to "stay" (or cease) any remedial action it otherwise could take against the borrower and participate in a bankruptcy court's analysis of the interests and priorities of a borrower's various creditors. Repayment of the loan will be contingent upon the bankruptcy court's review of the lender's claim. Bankruptcy courts can determine that a lender's claim is fraudulent, and therefore voidable, if certain criteria are met (such as the bankruptcy court's determination that the borrower's granting of a lien to the lender was made with the intent of defrauding other creditors). A fraudulent conveyance determination can result in reclassification of a lender's claim to a claim with a much lower priority, making it harder for the lender to receive repayment in full.

4. Planning and Zoning

4.1 Legislative and Governmental Controls Applicable to Strategic Planning and Zoning
State legislatures define the degree of autonomy local governments have in regulating land use issues within their jurisdictions. All states, however, authorise local governments to regulate land development in their jurisdictions. This is typically accomplished through locally-adopted zoning ordinances, comprehensive plans and other development-related ordinances such as site plan ordinances, subdivision ordinances, storm water and environmental ordinances.

4.2 Legislative and Governmental Controls Applicable to Design, Appearance and Method of Construction
The design and appearance of new and renovated buildings are typically regulated through the use of overlay ordinances, historic district regulations or "Form-Based Code" ordinances. For such regulations to be enforceable, there must be a nexus between design issues and the governmental interest being furthered. Independent of design or appearances issues, states and municipalities typically adopt building codes to address the methods of construction for new and redeveloped structures. Building codes generally are quite extensive and their requirements vary depending upon the uses proposed for the structure.

4.3 Regulatory Authorities
Local governments, subject to state authorisation, typically regulate the allowed uses and the degree of development permitted on individual parcels. This is accomplished primarily through their zoning, subdivision, site plan, landscape, signage, storm water and other environmental ordinances. In addition, there are often other region-specific criteria, such as air installation compatible use zones (AICUZ) affecting residential uses, view shed restrictions affecting mountain slopes and historic district restrictions governing building heights and facades.

4.4 Obtaining Entitlements to Develop a New Project
If a project is permitted "by right" (that is, it is allowed under the applicable governmental use restrictions applicable to the parcel), the process for a new project is typically administrative in nature with no public process or input. However, some municipalities also allow public input and notice for "by right" developments. If a development is not "by right", then discretionary amendments to the comprehensive plan and/or zoning map (re-zonings) are the most common methods to develop the project. Discretionary approvals require public notice and typically at least two public hearings. During this process, third parties can participate and object or demonstrate support for the project.

4.5 Right of Appeal Against an Authority's Decision
There are rights of appeal to land use decisions. The right to appeal a local government's decision for a "by right" development is typically narrow compared to the right to appeal a discretionary approval. The timeline for appeal varies from state-to-state but typically an appeal must be filed within 30 to 60 days of the municipalities' decision. In most states, the courts will defer to the municipality's decision as long as its decision is fairly debatable.

4.6 Agreements with Local or Governmental Authorities

It is possible and often preferable to enter into agreements with local governments to facilitate a project. Typically, approvals are contingent upon specific conditions agreed to by the applicant and local government. These take various forms, including proffers (which are recorded deed restrictions), planned use development ordinances that create new standards for the development, development agreements and cost participation agreements (if the local government is participating in the cost of public improvements for the project).

4.7 Enforcement of Restrictions on Development and Designated Use

Municipalities have a wide array of enforcement options depending upon the type of approvals or agreements that exist between the municipality and the developer. During construction, municipalities have the right to impose "stop work" orders on a project for non-compliance or to activate performance bonds to allow the municipality to complete the obligations of the developer. Once the developer has completed the project, the municipality may enforce the zoning and land use restrictions in the courts through zoning violation warrants or suits for specific performance.

5. Investment Vehicles

5.1 Types of Entities Available to Investors to Hold Real Estate Assets

The most frequently used ownership entities are limited partnerships ("LPs") and limited liability companies ("LLCs"). Generally, LLCs are preferred to LPs as investment vehicles because none of an LLC's owners (known as "members") is liable for the debts and obligations of the entity, while an LP has at least one partner (known as the "general partner") who is liable. An LP may be preferred where state taxes on capital and revenue are imposed on LLCs and not on LPs, or where LPs are more favourable to non-US investors due to the requirements of their home country's tax laws.

Both LPs and LLCs are usually preferred over corporations (other than REITs, described below) because corporate income is taxed at the corporate level, and then the dividends paid to the corporate owners ("shareholders") are taxed again. LPs and LLCs, unless the owners elect to be taxed as a corporation, are not taxed at the federal level, and all of their income is "passed-through" and taxed only at the owners' level. Corporations that own real estate often do so in connection with their trade or business (eg, factories).

Other entity types can be used as well, such as S corporations and general partnerships, but their use is infrequent due to taxation and liability concerns, respectively. Real estate investment trusts ("REITs") are corporations or business trusts that elect REIT status which allow them to pass-through income to their owners, like LPs and LLCs; however, because of the complex qualifications required of REITs under the US tax code, investments in REITS are normally limited to large income-producing assets or portfolios of assets.

5.2 Main Features of the Constitution of Each Type of Entity

With respect to LPs and LLCs, almost all features of their operations are negotiated among the partners or members in an LP's limited partnership agreement or in an LLC's limited liability company agreement, including how and by whom decisions are made. Major decisions typically require the consent of the partners or members and often include:

- a sale or refinancing of the principal asset;
- certain major leases;
- construction matters, such as budgets and hiring of contractors; and
- decisions affecting the continuation of the entity, such as merger and consolidation, termination and bankruptcy.

These agreements also establish the priorities of economic distributions and payment of agreed-upon fees among the partners or members and provide how and when additional capital may be called from the partners or members. It is important that these agreements properly address income tax considerations, because the allocation of economic benefits and tax liabilities of ownership must comply with detailed regulations under the US tax code or risk having unintended tax outcomes. Finally, both types of agreements will generally have provisions allowing for certain owners to buy the interests of other owners, or to have the assets sold under certain circumstances.

Many activities of corporations, including REITS, are governed by the organising state's applicable corporate statutes. In closely held corporations, the owners (shareholders) may enter into shareholders' agreements which establish, among other things, how votes are cast and how interests in the corporation may be bought and sold or otherwise transferred. Economic distributions within corporations are less flexible than within LPs and LLCs. Each share in the same class of ownership shares is entitled to the identical economic distribution as each other share in that class. In order to allocate economics in a corporation differently among shareholders, multiple classes of shares must be created with different priorities of payments and claims on a corporation's distributions.

5.3 Minimum Capital Requirement

Many states may have statutory minimum capital requirements for corporations, including REITS organised as corporations. The required amounts tend to be relatively nominal but will vary from state-to-state. As a rule, there is no minimum capital requirements for an LP or LLC, which may capitalise itself as it deems necessary in order to do its business. There is a body of case law holding that if a corporation or LLC is inadequately capitalised for its business, under certain circumstances the courts may hold the shareholders or members responsible for the debts and obligations of the corporation or LLC (ie, "piercing the corporate veil").

5.4 Applicable Governance Requirements
The governance structure in LPs are set out in the agreement of limited partnership and require that most decisions be made by the general partner. Most states' laws allow certain voting rights for the limited partners without jeopardising their status as limited partners; however, one of the reasons that limited partners do not have liability for the obligations of an LP is that they generally do not have control of the day-to-day activities of the partnership.

In an LLC there are two types of governance structures. One is the so called "member-managed" structure where the members are responsible for managing the limited liability company. How the members make decisions – by majority, super-majority or unanimous vote depending on the nature of the decision and the relative weight of each member's vote – is set forth in the limited liability company agreement. The other type of LLC is a manager-managed limited liability company in which a person or entity (who may or may not be a member) is designated as the manager with decision-making rights as set forth in the limited liability company agreement. The members who are not managers often retain the right to consent to certain major decisions.

For corporations, including REITs, governance is set forth in their articles of incorporation and their bylaws. The articles of incorporation is a filed, public document containing certain statutorily required information such as the name, registered office and registered address of the corporation. The bylaws govern how shareholders vote for the members of the board of directors, how the board elects officers, the duties of the officers, the frequency of shareholder meetings, the frequency of board of directors' meetings and other routine matters. In most corporations, all day-to-day decisions are made by the officers without approval of owners who are not officers. Certain decisions outside the normal course of business will be made by the board of directors, again without input from owners who are not part of the board. Unless an owner is a director or officer, its only governance right is to vote periodically for members of the board, or in connection with certain statutorily required matters, such as merger transactions.

5.5 Annual Entity Maintenance and Accounting Compliance
Annual entity maintenance and accounting compliance costs for entities will vary from state-to-state, both in connection with the state of the entity's organisation and the state where its real estate asset is located, if different. In most states, the mere ownership of real estate does not require the entity to qualify or register to do business in that state, but that is a limited exception and generally applies to the ownership of undeveloped land. Common attributes of active ownership, such as development and leasing, require an entity organised elsewhere to qualify to do business in the state where the real estate is located. Most states require the filing of annual reports from entities that are organised in that state or that are qualified to do business there. An annual report is normally a simple statement confirming addresses and basic information about the entity, and is typically accompanied by a nominal filing fee (less than USD500 per year), although the fee is higher in a few states and may be based on the revenue of the entity.

In most states that have a state income tax, if an entity is a pass-through entity for federal income tax purposes it also will be a pass-through entity for state income tax purposes, but it may need to file an appropriate state tax form to facilitate direct taxation of the owners of the entity. There are one or two states, however, that impose income or similar taxes on LPs and LLCs. For corporations, there will be income tax in those states that have an income tax; however, most of those states will not separately tax REITs. Accounting costs for non-tax state filings will not, as a rule, be significant as those filings typically do not contain significant financial information. On the other hand, tax filings and the accounting costs related to those filings will be more significant and will depend on the complexity of the particular company and the amount and nature of its assets and income.

6. Commercial Leases

6.1 Types of Arrangements Allowing the Use of Real Estate for a Limited Period of Time
Leases, licences, and easements are the most common agreements that allow the use of real estate owned by someone else. Most jurisdictions require agreements granting the use of real estate for a term of one year or longer to be written.

6.2 Types of Commercial Leases
Commercial leases can vary based on the nature and scope of the property leased (a ground lease versus a lease of space within a building), the condition of the leased premises delivered by the landlord (as-is versus build-to-suit or turnkey), and the extent of the tenant's responsibility for the costs of maintaining and operating the leased property (triple-net versus gross and other negotiated variations).

6.3 Regulation of Rents or Lease Terms
Rent is typically freely negotiable. The other terms of commercial leases are typically negotiable, too, although federal, state and local laws may require specific disclosures or govern the effectiveness of negotiated provisions, such as the landlord's remedies in the event of a default by the tenant.

6.4 Typical Terms of a Lease
Length of Lease Term
The term of a commercial lease is most often negotiated as a number of years and may include renewal options for the tenant. Commercial landlords often require a minimum initial term of three years. Ground leases tend to have longer terms, allowing for the financing of construction and the operation of the property by the tenant as though it is the owner.

Maintenance and Repair of Real Estate Actually Occupied by Tenant
Where a tenant is leasing a portion of a building, it is typically required to maintain the portion of the building it occupies at its own cost, while the landlord is responsible for the maintenance and repair of the roof, the exterior of the building, the building's structural components, common areas, electrical and mechanical systems, subject to reimbursement of certain of those costs by the tenants. For ground leases and other long-term leases of an entire building or parcel to one tenant, the tenant is typically obliged to conduct all maintenance and repair for the leased property.

Frequency of Rent Payments
Rents are typically paid in monthly instalments in advance of the month for which the rent is owed. In special circumstances, landlords will allow tenants to pay at the end of each month ("in arrears") or on an annual basis.

6.5 Rent Variation
Rents typically escalate during the term. The increases are usually annual, but they could be negotiated to increase at shorter or longer intervals during the term.

6.6 Determination of New Rent
Rent increases are negotiated in advance and take effect automatically during the term of the lease, typically by a fixed amount or as a percentage increase or pursuant to a formula that accounts for inflation – for example, by reference to increases in the Consumer Price Index.

6.7 Payment of VAT
As to whether VAT is payable on rent, this depends on the state in which the property is located. Most states do not impose a tax on rents.

6.8 Costs Payable by Tenant at Start of Lease
Tenants are often required to pay a security deposit to the landlord prior to the start of the lease, which the landlord will hold to secure the tenant's obligations under the lease throughout the term or for a shorter period of time, as negotiated. If improvements are being made to the premises before the tenant takes possession, there may be planning, engineering or construction costs incurred by the tenant prior to the start of a lease. Landlords often require the first month's rent to be paid at the time the lease is signed.

6.9 Payment of Maintenance and Repair
Areas used by multiple tenants, referred to as "common areas", are maintained by the landlord. Tenants are ultimately responsible for the costs of maintaining the common areas, either by paying the landlord a share of the costs in proportion to their respective shares of the leasable area, or by paying a higher rental rate that the landlord deems to include such costs.

6.10 Payment of Utilities and Telecommunications
Tenants typically contract for utilities and telecommunications services directly with the provider. To the extent necessary, landlords will grant rights to the service providers to install and maintain their own equipment and facilities at the property.

6.11 Insuring the Real Estate That is Subject to the Lease
For multi-tenant properties, the landlord carries the insurance for damage to the building and collects reimbursement from the tenants for their proportionate share of the insurance premiums. The insurance is often required to be in the amount needed for full replacement of the building and to insure against damage by casualty.

6.12 Restrictions on Use of Real Estate
The lease may contain restrictions on the tenant's particular use of real estate. Landlords often impose restrictions on uses that may be incompatible or in competition with, or otherwise objectionable to, other tenants of the property. Local zoning laws and private covenants that apply to the property may also restrict the tenant's use of its leased premises.

6.13 Tenant's Ability to Alter and Improve Real Estate
Most commercial leases require the tenant to obtain the landlord's consent to any alteration or improvement to the real estate, although some landlords pre-approve minor alterations subject to certain conditions. When deciding whether to grant consent, landlords will commonly require a tenant to provide plans for its proposed improvements, use a contractor acceptable to the landlord, post security for the costs of the work (or otherwise provide assurance that the work will be fully paid to avoid contractors' liens), and

promise to restore the property to its original condition at the end of the lease term.

6.14 Specific Regulations
Most leasing regulations imposed by governmental entities apply to residential properties only, and their impact is to ensure the safety and health of the residents, to establish standards for the allocation of rights and responsibilities between landlords and tenants, and to prevent unlawful discrimination. Commercial leases are not nearly as regulated but are subject to common law. Zoning laws can restrict the uses within a particular category of real estate, and certain jurisdictions may require that a lease contain specific disclosures about the landlord or the condition of the property.

6.15 Effect of Tenant's Insolvency
Most commercial leases allow the landlord to call the tenant in default of the lease if the tenant becomes insolvent. At that point, the landlord can pursue any available remedies against the tenant.

There are two primary considerations for the landlord if the tenant is insolvent: (i) what portion of the amount owed to the landlord under the lease will be repaid, and (ii) whether the landlord can regain control of the leased premises. If the insolvent tenant files a petition for bankruptcy, the bankruptcy court will determine how much of the proceeds of the bankruptcy estate the landlord will receive. This is a process that could take years to complete. The court may also prevent the landlord from repossessing the premises until it can decide whether to have the lease assigned or released. The landlord is subject to the bankruptcy "stay" in the meantime, which prevents the landlord from taking action with respect to the leased space until the court allows.

6.16 Forms of Security to Protect Against Failure of Tenant to Meet Obligations
Tenants can post a security deposit in the form of cash or a letter of credit. The landlord may also accept a guarantee of the payments and performance required under the lease from a reliable, creditworthy source.

6.17 Right to Occupy After Termination or Expiry of a Lease
The rights of commercial tenants that occupy the real estate beyond the expiry of the lease term – an act called "holding over" – are often defined in a commercial lease. Absent a specific holdover provision, a tenant may legally be deemed a month-to-month or year-to-year tenant on the same terms as the expired lease, which the landlord may not desire. When negotiating the lease, the landlord should require that any holdover tenant:

- has a diminished legal claim to possession of the premises, either as a trespasser or a tenant-at-sufferance, which may be terminated by the landlord at any time;
- is responsible for paying a steeply increased rent (eg, double) during such possession; and
- is responsible to the landlord for all damages, including consequential damages, that the landlord incurs as a result of the tenant's holdover.

6.18 Right to Terminate Lease
A major casualty to or condemnation of the leased premises or the property on which it is located will often give rise to a right for either landlord or tenant to terminate the lease. Additionally, landlords may terminate the lease in the event of an uncured default by the tenant.

6.19 Forced Eviction
A tenant can be forced to leave either through a judicial eviction process or, in those states and jurisdictions that permit, through non-violent private action by the landlord (such as by changing the locks). An eviction conducted privately by a landlord could be immediate, so long as it is done in accordance with the applicable provisions in the lease. The time required to complete a judicial eviction depends on the jurisdiction, but it often requires a few weeks.

6.20 Termination by Third Party
When a government or other third party is not a party to a lease, it is not in a legal position to terminate the lease agreement between the landlord and the tenant. A governmental or municipal authority with the power to take real estate from a private property owner (through a process called "condemnation") may institute condemnation proceedings that trigger a right of either the landlord or tenant to terminate the lease, or it may force a termination of a lease by taking all of the real estate which is subject to the lease.

7. Construction

7.1 Common Structures Used to Price Construction Projects
The most common methods of pricing construction projects are based on: (i) the cost of the work plus a fee ("cost-plus" pricing), subject to a cap called the guaranteed maximum price ("GMP"), or (ii) a stipulated sum, which is a fixed price. Cost-plus/GMP pricing requires more owner effort because the contractor's costs are audited, but is also more transparent and provides the owner with a chance to realise savings. Therefore, cost-plus/GMP pricing is more common than fixed pricing on projects of significant size or duration or where a sophisticated owner is involved.

7.2 Assigning Responsibility for the Design and Construction of a Project
The most common project delivery method is design-bid-build, in which the owner engages a designer to design the project and separately engages a contractor to construct the project. Also, fairly common is design-build project delivery, in which the owner engages a single entity (the design-builder) both to design and construct the project.

Construction manager "at risk" ("CMAR") is another delivery method that is sometimes used; it is less common but encountered in certain project types, industries and geographical areas. With CMAR, the owner engages a designer to design the project and separately engages a construction manager ("CM") to provide preconstruction services. When the design is near completion, the CM proposes a price and other terms to construct the project. If that proposal is accepted by the owner, the CM then also serves as the constructor of the project.

7.3 Management of Construction Risk
Construction contracts often include indemnification, warranty and insurance requirements on the part of the contractor. They often impose narrower indemnification and insurance requirements on the owner. Construction contracts also frequently include a mutual waiver of consequential damages. Many states have "anti-indemnity" statutes that limit to varying degrees the ability of the owner to require the contractor to indemnify the owner for the owner's own negligence.

7.4 Management of Schedule-Related Risk
Liquidated damages ("LDs") are commonly used to address the risk of late delivery by the contractor. LDs provide a set, negotiated amount that the contractor pays the owner (often on a per diem basis) if the project or a designated portion thereof is late and the delay is unexcused. If a delay is instead excused, contracts vary regarding whether and to what extent the contractor may recover delay-related costs and damages from the owner (such as additional general conditions costs for the contractor's extended onsite presence). Some states prohibit or limit contractual provisions that attempt to bar a contractor from recovering damages for excused delay

7.5 Additional Forms of Security to Guarantee a Contractor's Performance
Payment and performance bonds are common (and often required) on public works projects. They are much less common on private projects because they are optional and add significant cost, but they are sometimes used. Parent guarantees are also sometimes used, depending on the circumstances, but they are not common.

7.6 Liens or Encumbrances in the Event of Non-Payment
All states allow contractors on private projects to lien the project if they are not paid. Many states also grant lien rights to designers. State lien laws vary significantly in approach. States typically provide several options for the owner to discharge a lien. For instance, the owner may settle with the lien claimant and have the lien claimant discharge the lien as part of the settlement. Statutes also often allow the owner the option to discharge a lien by posting a surety bond in place of the lien, permitting the lien to be removed as a title encumbrance while preserving the owner's right to contest the underlying claim and still providing security (ie, the bond) to the lien claimant.

7.7 Requirements Before Use or Inhabitation
Most jurisdictions in the USA require a certificate of occupancy or its equivalent before a project can be inhabited or occupied.

8. Tax

8.1 VAT
There is no value added tax ("VAT") or equivalent payable on the sale or purchase of corporate real estate.

8.2 Mitigation of Tax Liability
Depending on the laws of the applicable state, various structures, such as sales of interests in real estate-owning entities instead of sales of real estate assets, are sometimes employed to reduce or avoid real estate transfer taxes.

8.3 Municipal Taxes
Municipal taxes and exceptions vary greatly by state and municipality.

8.4 Income Tax Withholding for Foreign Investors
Foreign investors are subject to US federal income and withholding tax on their income earned in connection with transactions involving real estate located within the USA. The type of tax applicable to foreign investors generally depends upon the level of the investor's participation in the underlying transaction. In the absence of special circumstances, a foreign investor may generally fall within one of two tax regimes – passive participation and active participation in US real estate transactions.

Passive Participation
Foreign investors are subject to US tax on their US source "fixed or determinable annual or periodic" ("FDAP") income. FDAP income includes dividends, interest and rents from real property but does not include gains from the sale of real property or other capital assets. FDAP income derived by foreign investors is subject to US withholding tax at

a flat rate of 30% of gross income, which may be reduced by an applicable income tax treaty. Foreign recipients of FDAP income are not required to file a US tax return and, thus, are not required to report that income. Rather, taxes attributable to FDAP income are collected through withholding. FDAP income withholding applies to gross amounts of income, without reduction for related expenses.

Active Participation
Foreign investors (including foreign corporations and non-resident alien individuals) that are treated as engaged in a US trade or business are taxed at the regular graduated rates on income effectively connected with such trade or business ("ECI"). Thus, following the Tax Cuts and Jobs Act enacted in December 2017 (the "Tax Act"), those foreign investors are generally subject to US tax as US persons, taxed at the maximum rate of 21% for corporations and 37% for individuals. Unlike passive income, the amount of taxable active income earned by a foreign investor may be reduced by applicable deductible expenses, including depreciation, property taxes and mortgage interest. Generally, a foreign investor is required to file a US tax return on the amount of its taxable active net income, and only under limited circumstances would the collection of related taxes be enforced through withholding. Further, subject to the "branch profits tax" discussion below, income tax treaties generally do not reduce a foreign investor's tax liability associated with active real estate income. If a foreign investor is treated as a corporation for US tax purposes and operates a US business as a branch, such investor may be subject to an additional "branch profits tax" on profits earned by the branch which are remitted to the foreign investor outside the USA. Unless reduced or exempted by an applicable tax treaty, the statutory rate for the branch profits tax is 30%.

Regardless of a foreign investor's level of activity with respect to underlying real estate, gains from the sale of a "U.S. real property interest" ("USRPI") are treated as active income pursuant to the Foreign Investment in Real Property Tax Act ("FIRPTA"). USRPI generally includes (i) an interest in real property located in the USA or the Virgin Islands, or (ii) the stock of a US real property holding corporation ("USRPHC"). A US corporation is generally a USRPHC if, at any time in the five years prior to the disposition of the corporation's stock, the fair market value of its USRPIs equals or exceeds 50% of the fair market value of its assets. In connection with the sale of a USRPI, the transferee must deduct and withhold a tax of 15% on the total amount realised by the foreign investor on the disposition.

Foreign investors who anticipate earning ECI often do not wish to file US income tax returns. As an alternative measure, such investors may hold their US real estate through entities that are taxed as corporations which "block" the flow-through of ECI to the foreign investor. However, the effective US tax rate imposed upon a foreign investor generally will be impacted by the use of a blocker corporation. A US blocker is subject to corporate-level tax of 21% on its net income, and an additional withholding tax of 30% may apply with respect to dividends from the blocker, unless a tax treaty applies. However, liquidating dividends from a US blocker are generally not subject to US withholding tax. By contrast, dividends from a foreign blocker are not subject to US withholding tax; however, a foreign blocker may be subject to both corporate income tax of 21% and branch profits tax of 30% (subject to reduction by tax treaty) to the extent of any ECI. Further, gains attributable to sales of USRPIs may be taxed under the FIRPTA regime even where a blocker structure is used. The disposition of stock in a blocker which is a USRPI will be subject to US tax unless the gain inherent in its US real property has been recognised by the blocker corporation.

A foreign investor may seek to use a real estate investment trust (a "REIT") as a form of blocker entity. A REIT is a corporation that, if operated properly, may pay no corporate-level income tax because its dividend distributions are tax deductible, and it is generally required to distribute its income each year. REITs are often treated as USRPHCs and, thus, gain from a sale of REIT shares may be subject to the FIRPTA regime. However, a foreign investor may take advantage of a special rule that allows it to exit its investment tax-free through the sale of its REIT stock, so long as it owns, directly or indirectly, less than 50% of the value of the REIT's shares throughout a five-year look-back period. To qualify as a REIT, the US entity must make an election to be taxed as a REIT and satisfy certain ownership, income and asset tests, among others.

8.5 Tax Benefits
There are certain tax benefits that derive from owning US real estate, including depreciation deductions, a 20% deduction for certain REIT dividends, and an election to opt out of the new interest deduction limitations under the Tax Act.

8.6 Key Provisions in the Federal Tax Reform Legislation
Among several significant changes to the US federal income tax rules, the Tax Act reduces the marginal US corporate income tax rate from 35% to 21%, limits the deduction for net interest expense, shifts the USA toward a more territorial tax system, and imposes new rules to combat erosion of the US federal income tax base. The Tax Act includes several provisions that impact foreign investors in US real estate.

Gain on the Sale of a Partnership Interest by a Foreign Person
The Tax Act provides that if a foreign person sells, exchanges or otherwise disposes of an interest in a partnership that engages in any US trade or business, gain or loss on the dis-

position will be treated as ECI to the extent the foreign person would have had ECI had the partnership sold its assets. Thus, a foreign person's sale of a partnership interest will be subject to US income tax at graduated rates if the partnership is engaged in a US trade or business. The transferee of a partnership interest subject to this provision must withhold a portion of the tax equal to 10% of the amount realised on the disposition of the interest unless it receives an affidavit affirming that the transferor is not a foreign person.

20% Deduction for Income Earned From Pass-Through Entities

Taxpayers (including individuals, trusts and estates) who have domestic "qualified business income" ("QBI") from a partnership, S corporation, or sole proprietorship are entitled to a deduction of the lesser of such QBI or 20% of taxable income. QBI generally includes income from most domestic businesses. However, for taxpayers earning income above USD207,500 (or USD415,000 in the case of a joint return), income from a business involving the performance of services in the fields of law, consulting, health, accounting, financial services, brokerage services, investing and investment management, as well as trading or dealing in securities, partnership interests or commodities (or any other trade or business where the principal asset of such trade or business is the reputation or skill of its employees or owners) are not eligible for the deduction. For taxpayers earning income above USD207,500 (or USD415,000 in the case of a joint return) who are not engaged in an excluded field, the allowable deduction equals the lesser of (i) 20% of QBI or (ii) the greater of either 50% of W-2 wages paid by a pass-through trade or business, or 25% of such W-2 wages plus 2.5% of the unadjusted basis of any tangible depreciable property that is used in the production of qualified business income. The Tax Act also allows a 20% deduction (without regard to the wage limitation described above) for a taxpayer's (i) aggregate dividends from a REIT (excluding capital gain dividends or dividends that would otherwise qualify for capital gains rates), (ii) qualified co-operative dividends and (iii) qualified publicly traded partnership income, subject to certain limitations.

Interest Expense Deduction Limitation

The Tax Act restricts the deductibility of interest paid or accrued by certain businesses ("business interest"), including interest paid on existing indebtedness and regardless of the form of the business. The deduction for business interest generally is limited to the sum of business interest income and 30% of adjusted taxable income ("ATI"). ATI generally is earnings before interest, taxes, depreciation and amortisation ("EBITDA") for tax years beginning before 2022 and earnings before interest and taxes ("EBIT") for tax years thereafter. Previously disallowed business interest expense may be carried forward indefinitely, subject to certain limitations. A real property trade or business (ie, any real property development, redevelopment, construction, reconstruction, acquisition, conversion, rental, operation, management, leasing, or brokerage trade or business) may elect not to be subject to the interest deduction limitation. However, if such election is made, depreciation recovery periods of real property would become longer, and the immediate expensing of qualified improvement property would not be available. Once made, this election is irrevocable. Foreign investors owning US real estate through a blocker corporation may be impacted by the 30% limitation on the deductibility of interest on loans from investors to the blocker corporation.

Recovery Period for Real Property

Under prior law, the accelerated cost recovery ("MACRS") period for real property was 39 years for non-residential real property and 27.5 years for residential rental property, while the alternative depreciation system ("ADS") recovery period for non-residential real property and residential rental property was 40 years. The Tax Act maintains these MACRS and ADS periods with the exception of the ADS period for residential real property, which is reduced to 30 years. Further, the Tax Act provides for a general 15-year MACRS recovery period and a 20-year ADS recovery period for "qualified improvement property". A real property business that elects to not be subject to the 30% limitation on deductibility of interest must use the ADS recovery periods.

These recovery period changes under the Tax Act are effective for property placed in service after 31 December 2017.

Revised Withholding Rates

In connection with the reduction of the marginal US corporate and individual income tax rates to 21%, and 37%, respectively, the Tax Act also reduces the withholding rates on distributions by: a partnership of ECI to foreign partners to 21% for corporate partners and to 37% for individuals and other non-corporate partners; a REIT (or other qualified investment entity) and certain domestic entities (ie, a domestic partnership, trust, or estate) of a USRPI to 21% (or, to the extent provided in regulations, 20%) of realised gains; and a foreign corporation of a USRPI to 21% of recognised gains.

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