Commercial Real Estate Development: Legal and Other Considerations (NJ)

A Practical Guidance® Practice Note by
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This practice note addresses some of the many considerations that developers in New Jersey – with the assistance of legal counsel – should consider after site selection and through the acquisition closing. In this practice note, the term "developer" refers to New Jersey-based, mainly ground-up developers of properties that are often urban or semi-urban in nature for many different types of uses, often mixed uses. This note includes some concluding remarks referencing multifamily residential, retail, and industrial projects.

Purely office projects are intentionally omitted from this discussion since, at the moment of this writing, office use and occupancy in New Jersey is experiencing a re-examining or, one might say, a transformation. Accordingly, this practice note does not delve into the important but somewhat recent trend of office repurposing.

Any mention of a particular municipality in this practice note should be understood only anecdotally or educationally, and not as a critique of such specific jurisdiction.

For guidance on acquiring commercial property in New Jersey (as distinguished from development deals), see Purchase and Sale of Commercial Real Property (NJ). For guidance on financing a construction project in New Jersey, see Construction Loan Transactions (NJ). For further guidance on development projects generally, see Representing Commercial Real Estate Developers: Key Elements and Land Use Ordinances for Real Estate Development.

The Purchase Contract and its Conditions

In many fundamental ways, the closing of a transaction flows from what was agreed in the purchase agreement. Purchase agreements are more commonly drafted by the seller's side, usually the seller's attorney. Therefore, whether representing the seller or the buyer/developer, each side should consider having its most senior attorney negotiate and draft the contract. With due consideration for the training of junior attorneys (and they can do well many tasks ancillary to the purchase agreements, often drafting closing-documents exhibits, a good practice), deals are often made at this phase, as the purchase agreement is finalized.

Representations, Conditions, and Covenants: Overview

In contract negotiations, the respective leverage varies from deal to deal. Thus, this practice note will not address issues of purchase price or other business terms or issues of leverage. Rather, attention here is on three types of contract provisions: (1) representations, (2) conditions or contingencies (same thing); and (3) covenants (also known as agreements). (Actually, there probably is at least one

more category, not discussed here, called indemnities.) The legal professional that truly understands these separate categories, particularly their differences, is more likely over the course of a career to protect the client and to facilitate the client's goals:

- **Representations.** Representations are statements made by a party to the contract. Commonly, one of the parties (meaningfully, the seller) makes the representations to induce the other's entry into a contract and to begin spending money on due diligence. Sometimes these representations survive for a specific time after closing. But the representations are not predictive about the future, and, by themselves, they are not necessarily a condition to the closing, and they should never be confused with a covenant.
- **Conditions.** Conditions are as they suggest – they are events that must occur, usually by one or the other (or both) of the parties, so that the other party has an obligation to close (or to perform some other act). To a large extent, and especially from the developer's perspective, the conditions are very significant, although, importantly, the non-occurrence of a condition is not a breach. The developer's team should pay extra attention to the purchase contract's conditions, which will therefore be a focus below.
- **Covenants.** Covenants are obligations that a party undertakes, often with the giveaway word, "shall," as in, "seller shall" do this or "buyer shall" use such and such efforts. Most important, the violation of a covenant is a breach by the covenanting party, often with remedies or penalties available to the other side.

Conditions

Of course, all contract provisions are important and should be negotiated thoughtfully by the buyer's attorney. However, from the developer's view, the conditions (often in a specific "conditions" section of the contract; in fact, a good purchase agreement will carefully and clearly separate the representations, conditions, and covenants) are critical because the occurrence or non-occurrence of the conditions, always within a specific time frame, dictate the extent to which the developer's funds are at risk. In fact, a typical purchase contract for the acquisition of a site for future development (in NJ and, again, probably in all 50 states) will have multiple conditions, often with different, sometimes sequential, time frames for satisfaction, as a prerequisite to the closing.

Common stages of conditions are as follows:

- A general feasibility (or due diligence) contingency period
- A title/survey review period
- A site plan and other approvals contingency period (maybe for subdivision, maybe for rezoning, or maybe to obtain a particular incentive; in New Jersey, many approvals are needed from many levels of government, especially local)
- Sometimes a separate permit contingency period is negotiated (for vertical construction or other building permits) –and–
- Sometimes (but not often in NJ development deals) a separate financing contingency period is obtained by the developer/buyer

And there are other, less common conditions, such as conditions to enter into a site work agreement with the seller which wants, or is obligated, to deliver the property in a certain condition. Or, in the retail context, often there is a condition that the parties negotiate a reciprocal easement agreement by a certain date, which would govern many matters resulting from a project that has separate owning parties.

Remember that a contract has at least two parties. As such, sellers must also agree to the (usually, buyer-favorable) conditions. One should expect that, in return for a requested condition, a seller will insist on certain performance milestones (which could be buyer covenants, beware!). For example, a seller might require that the buyer prepare plans by a certain date, and that it make submissions by another one, all designed to keep the buyer honest and to make it more likely that the condition(s) will be satisfied, thus triggering a closing.

In some deals, the seller is the party obligated to obtain certain approvals (or as mentioned above, perform certain site work). Maybe the buyer was able to shift the costs to the seller or maybe the seller wanted to control the process. Whatever the reason, it is very important that the developer's attorney insert corresponding milestones and other protections so that the seller does not have an effective termination right (whether by intention or neglect) over the contract and ultimately the development. In fact, in these circumstances — where the seller has the right or ability to manage a closing condition — it would be wise for the buyer's attorney to insist that the buyer have certain rights to take over the condition or the process. Also, in such a take-over event, consider that the buyer should have the right to recover its costs from the seller.

Consequences of Conditions: Time, Money, and Termination

Following a review of the distinctive nature of a contract's conditions, it appears that they essentially juggle three forces: time, money, and the right to terminate the deal.

The connection between time and money — always critical to a developer and as a backdrop to the contract's conditions — is exemplified by the many instances where a seller will require monetary deposits to be made by a buyer (and to go hard on certain dates) in exchange for the buyer gaining additional time to seek the satisfaction of certain conditions. Often, a buyer must make additional deposits so that it may exercise time extension rights. Also often, especially regarding extension payments, these funds will be non-refundable to the buyer. Buyers should therefore make their contracts clear that the funds, although non-refundable, are nevertheless a credit against the price due at closing.

Termination rights are critical too because the buyer/developer has already spent considerable money (in addition to time) by this point and will undoubtedly spend and borrow much more to complete the project. It would therefore be very inappropriate, one might say contrary to the whole nature of a purchase agreement for a development project, if the seller (without the buyer's consent) could somehow terminate the project at various points in time. In fact, one could argue that a purchase/development contract should have no seller termination rights whatsoever (other than following a buyer default; that is, a failure of a covenant).

Therefore, the buyer's attorney should pay close to attention to both the substance and the wording of the conditions in the contract to make sure that the seller has no such effective termination rights. This is important whether dealing with a substantive point like the seller overseeing the issuance of a certain approval, or the wording of a condition which perhaps grants a seller approval right into a particular condition thereby, perhaps unintentionally, inserting a seller termination right into the contract.

Representations Distinguished

A contrast of conditions with representations (and covenants, below) may be instructive. While the truth of certain representations as of closing may be a condition to the closing (and often are), they are not conditions per se. Therefore, rather than invoking time, money, and termination rights, representations instead raise the issue of survival (of course, conditions have no survival; they live in an alternative universe, as prerequisites). Money is only raised derivatively as a factor to the survival, as in, what does it mean for a seller's representations to survive? More specifically, what entity or holdback or guaranty will the seller provide after closing to back up such surviving representations?

Covenants Distinguished

As for covenants: the survival of same and what backs them up are, as with representations (and in contrast to conditions), also a factor. Importantly, and regarding a seller's breach of a covenant, the developer client — considering its investment in the project and its ultimate success — should insist on specific performance. Similar to the buyer's right to take over a particular condition left in the seller's hands (as mentioned above), specific performance following a seller breach of a covenant allows the buyer to preserve the transaction, thus avoiding another (effective) seller termination right. Without a buyer right to save the deal, a seller might have the incentive to calculate the cost or benefit of a potential breach, which again is tantamount to a (to-be-avoided) seller termination right.

Closing Costs and Adjustments

The analysis above, regarding the main components of a purchase agreement, is perhaps universal. These components are certainly not unique to New Jersey. So, a final word about another element of a good purchase contract, local in nature, concerning closing costs and adjustments. The customs and, in some cases, statutes governing which party pays what, and what transfer and other taxes apply, vary by jurisdiction. In New Jersey, currently: there is no mortgage recording tax (as there is in New York, which is imposed on a mortgage borrower), and sellers typically pay (by custom) the state's deed transfer taxes, which can be as high as 1.21% (depending on the price). Buyers typically pay (by custom) the costs of a title report, policy, and survey, and they — by statute — are obligated to pay a so-called mansion tax (poorly named due to the historic origins of this disliked tax) on the purchase of certain properties being sold in New Jersey for more than $1,000,000, which effectively captures many commercial properties in New Jersey being sold for development.

Approvals and Permits

One of the most important conditions in a purchase contract is the approvals contingency. The vast majority of commercial real estate transactions contemplate changes to existing uses of the land and therefore make the transaction dependent upon the receipt of certain approvals and permits (distinctions discussed below) in order for the property to be utilized for its intended purpose. The approvals and permits required for a given project can vary widely, from receipt of a continuing certificate of occupancy (to transfer ownership and continue an existing use) to the pulling of building and other construction-related permits

for vertical construction or, in the case of changes to existing uses or new development, to the need for various municipal, county, and state approvals.

Generally, approvals are defined to include all municipal approvals (site plan, subdivision, use and bulk variances, rezoning, redevelopment designation, etc.) that may be required for the use/development contemplated under the purchase contract as well as any ancillary approvals (county, state, federal) that may be required. In New Jersey, the approving entities may include the municipal planning board or zoning board of adjustment, historic preservation board, municipal governing body or redevelopment agency, county planning board, New Jersey Department of Transportation, New Jersey Department of Environmental Protection, Regional Soils Conservation District, Delaware & Raritan Canal Commission, New Jersey Sports and Exposition Authority, the Highlands Commission, and the Pinelands Commission.

Distinct from approvals are permits, which are generally intended to include permits that allow the physical construction of the interior or exterior of an existing building or the construction of a new building or structure for its intended use or occupancy.

For commercial properties where development is proposed, one must assume that most land use ordinances in New Jersey will require site plan review and approval, even for a permitted use, where there are physical changes to an existing building such as structural alterations, relocations or enlargements of any building, or when there is a change in use of any building or land, or where there is an intensification (that is, an increase in density, traffic, or other conditions) of any existing use. Developers should engage in zoning due diligence as early in the contract process as possible (do not wait until the formal due diligence period under the contract starts) so that they can propose and advocate for approvals -contingency language which meets the specific needs of the anticipated development and use of the property.

Zoning Due Diligence

Of critical note, title review alone is not sufficient for purposes of determining what restrictions are in place for a property that is being acquired. In jurisdictions like New York, purchasers of property have no affirmative obligation to search outside the chain of title for restrictions on development that may have been imposed as a condition to previous development approvals. But in New Jersey, the rule is the opposite. As such, it is of the utmost importance to know your planned use of the property and to focus on whether there are any zoning requirements or restrictions, outside of the chain of title, that affect such plan and to determine the nature and extent of any permits or approvals that are required.

Among the important zoning due diligence questions to ask when acquiring an interest in real estate are whether the proposed use of the property is a permitted use and, if not, whether it is a legal nonconforming use (which can continue to operate under certain circumstances despite not being permitted by the current zoning).

Redevelopment Plans

Aside from zoning, it important to note that in New Jersey, many municipalities (particularly more urban ones, such as Newark and Jersey City) have designated an extensive number of areas as "areas in need of redevelopment" or "areas in need of rehabilitation" under New Jersey's Local Redevelopment and Housing Law (LHRL), and therefore, they are governed by redevelopment plans that may overlay or supersede local zoning requirements. Properties within redevelopment or rehabilitation areas may be afforded additional incentives for development such as a payments in lieu of taxes (PILOT) or abatements (as discussed below), which make the development more attractive to potential buyers. But at the same time, these incentives often require additional layers of approvals and agreements with the municipality, thereby necessitating the need for buyers to seek a longer approvals contingency period under the contract.

Scope of Zoning Due Diligence

The scope of any zoning due diligence investigation should include a review of current zoning regulations to determine the status of the existing or proposed use (e.g., permitted by right, conditional use, not permitted, legal nonconforming, redevelopment/rehabilitation area, etc.) under the applicable zoning code. The developer should also have their land-use counsel review current zoning and site plan regulations (no matter what the broker tells you) for existing requirements as to when and under what circumstances a site plan approval is required (e.g., change in use, change in occupancy, modifications to signage, etc.).

If the deal is not confidential, the developer should file open public records act (OPRA) requests with the municipality where the property is located to seek copies of the following, in addition any information being provided by seller, to ensure that the developer has all publicly available information pertaining to the property:

- Prior approvals
- Zoning permits

- Certificates of occupancy (temporary and final)
- Outstanding building/construction permits and outstanding violations (fire, building, zoning, health department)

Buyers should beware of a broad representation from the seller that all work done at the property was done pursuant to applicable regulations and by licensed contractors. In addition, the buyer should visit the municipal building department to review the property's construction history, file OPRA requests (if necessary), verify dates that work was done at the property, and obligate seller to close out any open building permits prior to closing.

These investigations should also evaluate whether any permits are a required precedent to a change in occupancy, review the municipal codes for hours of operation and hours of construction limitations, and confirm whether there are any pending land use ordinances that could impact the use or operation of the property. Buyers should not rely on generic zoning reports often prepared by out-of-state agencies as the sole basis for zoning information regarding a property, as these reports are often incomplete or do not tell the whole story about a property.

Reliance on Existing Approvals

Another important consideration in any real estate transaction is whether the developer will be relying upon any existing zoning approvals and, if so, if those approvals were properly granted or have expired. Although certain approvals can run with the land and others are transferable, they also can expire depending upon the circumstances and specific municipal requirements that apply if extensions have not been received, or if building permits were not issued or if construction has not commenced.

If the developer is relying upon prior approvals, it is important to determine if any of those approvals restrict the proposed use or development of the property. For example, if the property was previously subdivided, does the subdivision approval contain a condition against further subdivision that would impact the developer's plans for the property? Likewise, if the developer intends to utilize an existing building or acquire a building that has an existing tenant, does the seller have or are they willing to obtain a certificate of zoning compliance or certificate of continued occupancy? Are there any outstanding zoning or other violations on the property?

Certificates of Occupancy

Certificates of occupancy or continuing certificates of occupancy on resale are generally the responsibility of the seller, and many municipalities in New Jersey require a certificate of continuing occupancy upon resale. In order for a certificate to be issued, the property must often be inspected for zoning and building code compliance and the seller would be required by the municipality to cure any existing violations prior to the issuance of the certificate in connection with the sale of the property. Even if the municipality does not require it, it is good practice for a buyer to ask for a certificate of zoning compliance or a certificate of continuing occupancy, where appropriate, to ensure that the property is in conformance with zoning, or, at a minimum, to require that the seller cure any open zoning or other municipal violations as a condition of closing. These concepts regarding the certificate of continuing occupancy should be addressed in the purchase agreement for an existing property being resold, preferably as a seller deliverable, hence a seller covenant.

Drafting Contingency Language

Once the developer and their counsel have done the appropriate level of initial zoning due diligence to determine the nature and scope of any approvals and permits required, the approvals contingency language can be drafted. It is often a delicate balance negotiating an approvals contingency between a seller and a buyer since the seller will undoubtedly want to limit the time and scope of the contingency while the buyer will want it to be as broad as possible and to allow for all appeal periods to have expired and the approvals no longer subject to challenge.

In some instances, it may make sense, where numerous approvals are involved, to include a list of approvals as an exhibit to the purchase contract to ensure that they are all covered by the contingency. But that could be limiting and ultimately not favorable to the buyer. While many approvals contingencies do not include building or construction permits (since they are often pulled post-closing and immediately prior to construction), some buyers want and need the assurance of having the permits in place as a condition to closing. Notably, the time frame for obtaining permits (typically 6-8 weeks assuming the conditions of the underlying land use approvals have been met) is much shorter than the time frame for obtaining municipal or ancillary approvals. As such, the approvals contingency time frame should be specifically tailored to the time frame needed to obtaining approvals, permits or both.

Timing Awareness: Applications, Hearings, and Appeals

With respect to determining the timing of the municipal, land-use approval process, there are five time frames that should be considered for development approval contract contingencies:

1 Pre-application

2 Application

3 Notice

4 Vote and resolution –and–

5 Appeal period

In New Jersey, these time frames are governed by state statute under the Municipal Land Use Law (MLUL) and by local ordinance based on the specific provisions in the municipal code governing land use, development, and zoning.

As noted above, in New Jersey it is very common for any change to the nature of a commercial property to trigger site plan review and approval. When required, pre-application meetings with board professionals and regulatory agencies are encouraged. This can be done prior to or during the due diligence period under the contract to get a sense of any issues concerning the approvals or permits and the timing for same and, if done early, it may help to better define the approvals contingency language and time frame. It is important to note, however, that some state agencies will only provide conceptual feedback and will not formally review an application for permits until after municipal approvals have been received.

Also important, land-use applications must be complete when they are submitted; that is, they should include everything on the municipality's submission checklist (application forms, corporate disclosure statement, owner consent, proof of payment of taxes, property owner lists for notice purposes, etc.). In New Jersey, the MLUL allows the municipality 45 days to determine if an application is complete. For applications such as variances or major site plans where public hearings are required, the MLUL requires that a public notice of the public hearing be published in the official newspaper of the municipality 10 days prior to the date of the public hearing. The MLUL also requires that adjoining property owners within 200 feet of the project site be provided with a certified mail notice of the hearing at least 10 days prior to the hearing. The notice is a critical component of the land-use process and vests the Board with jurisdiction to hear the application. Depending upon the classification of the application as a minor or major site plan or subdivision, the MLUL requires the board to vote within between 45 and 120 days, which vote must be taken at a public hearing. All of these time frames should be taken into consideration when determining the appropriate amount of time for an approvals condition in a purchase contract.

Finally, the appeal period for any approvals and permits contemplated in the condition should be considered. The contingency should always include language that all approvals are final and unappealable. Otherwise, a buyer faces significant risk that the approvals could be challenged after a purchase contract's contingency period has lapsed, with the buyer's deposits now non-refundable. Notably, the appeal period for anyone objecting to municipal land use approval in New Jersey is 45 days and runs from the date that a Notice of Decision is published in the official newspaper of the municipality. The appeal periods for other types of approvals and permits vary.

Incentives: UEZ, PILOT, and QOZ Program

Urban Enterprise Zones

New Jersey offers several property-tax abatements and exemptions which are managed by municipalities throughout the State. For example, Urban Enterprise Zones (UEZs) have been created throughout various municipalities in New Jersey with the goal of stimulating economic activity in distressed areas. The UEZ law provides for five-year tax abatements to existing and newly constructed residential properties and non-residential structures converted to residential use in municipalities with UEZs. Likewise, an Environmental Opportunity Zone Property Tax Exemption (EOZ) exemption is available to encourage the remediation, revitalization, and redevelopment of certain contaminated property which has been vacant or underutilized. The exemption requires a financial agreement, as per authorizing ordinance, between the developer and the municipality.

Five-Year Exemption

New Jersey's statutory scheme also offers several methods to attract commercial, residential, and industrial development to areas in need of redevelopment or rehabilitation by permitting municipalities to offer incentives to reduce tax burdens to property owners and developers. The first is the Five-Year Exemption and Abatement Law (Five-Year Exemption) which authorizes municipalities to

grant short-term tax abatements and exemptions for home improvements, commercial and industrial improvements, and the improvement or conversion of multiple dwellings. A municipality that seeks to utilize the Five-Year Exemption must adopt an ordinance specifying the parameters of the exemption and abatement in compliance with the statute, N.J. Stat. § 40A:21-1 et seq. Typically, under the Five-Year Exemption, a municipality will exempt the value of improvements as not increasing the value of the property and the property owner would be subject to pay a percentage of the total taxes otherwise due for a period of five years. Municipalities have significant discretion in how the Five-Year Exemption is utilized but there are certain statutory limitations. For example, an exemption or abatement awarded cannot exceed five years and an application for the Five-Year Exemption must be filed within 30 days following completion of the improvement or construction.

Long-Term Tax Exemption Law

The other statutory scheme is the Long-Term Tax Exemption Law (LTTE Law) which empowers municipalities to grant tax exemptions to private entities undertaking redevelopment and housing projects. The LTTE Law encourages generally larger redevelopment projects with a tax exemption for a term of up to 30 years from project completion or up to 35 years from the execution of the tax exemption agreement. To be eligible for the LTTE Law, the project must be situated in an area designated by the municipality as being in need of redevelopment and the project must be undertaken by a non-profit or limited dividend entity known as an urban renewal entity. An applicant approved under the LTTE Law usually enters into a financial agreement with the municipality. The financial agreement is essentially a contract between the municipality and the developer which will control the scope of the project, and, most importantly, the structure of the payment in lieu of taxes (PILOT). In lieu of property taxes, the LTTE Law requires developers to make an annual PILOT payment to the municipality which is often less than the taxes the property would have to pay under conventional taxation. The PILOT structure not only reduces a developer's tax burden but also provides stability of its future its tax obligations for the duration of the agreement.

Qualified Opportunity Zone

Another well-known tax incentive program for developers in the State is the Qualified Opportunity Zone Program (QOZ Program). This program allows investors to defer and eventually reduce capital gains taxes on their profits from real estate and other assets by investing those funds into projects in designated low-income census tracts throughout the United States (referred to as Qualified Opportunity Zones). In New Jersey, there are 169 designated census towns in 75 municipalities. The QOZ Program works by allowing taxpayers to defer paying federal taxes on capital gains (including those from real estate sales) invested in Qualified Opportunity Funds that invest in low-income communities, under rules released by the U.S. Department of the Treasury.

Three benefits from this tax incentive are:

1 Reinvested capital gains are deferred from taxation until exit from a Qualified Opportunity Fund or December 31, 2026, whichever comes first

2 The original capital gains reinvested in Qualified Opportunity Fund investments held for the long term receive a reduction in capital gains tax liability, discounted by 10% at the 5-year mark and by an additional 5% at the 7-year mark –and–

3 Any new gains from Qualified Opportunity Fund investments held for at least 10 years are permanently excluded from the capital gains tax

These fund investments can be held through as late as 2047 without losing tax benefits. Many developers have taken advantage of the QOZ Program for their projects by setting up their own Qualified Opportunity Fund or by attracting investment from an existing Qualified Opportunity Fund.

Feasibility: Title, Survey, and Environmental

The purchase contract having been signed, with the various approvals (and other, maybe incentives) conditions addressed, the developer focuses on a myriad of due diligence matters, some of which it might have waited until now to examine. Among these matters are two: title and survey (as one integrated subject) and environmental issues. Hopefully, the buyer's rights to review these areas, and the necessary time to do so (and with the developer's money hopefully at low risk), has been sufficiently treated in the purchase contract.

Even so, the buyer/developer should order a title report (sometimes having the seller's policy can expedite the process) and a survey as early as possible. In New Jersey, weather (like snow on the ground) may delay the surveyor's ability to complete certain environmental tests, so these factors should be considered given the ever-present time frames. The title report, once received, should be shared with the surveyor (and vice versa) so that, for example, at the end of the title review period (and certainly as of closing), all plottable exceptions to title will be on

the survey, and all state of facts for the benefit of the property and depicted on the survey are made a part of the developer's insured estate (or Schedule A) to the title policy. And everything in between should be dealt with as between the title policy and the survey so that they work together, informing and protecting the developer, who ultimately will have the benefit of an insurance policy. For guidance on title and survey review, see Title Insurance and ALTA Survey Review.

Given the potential for environmental liability under federal and state law, a developer's environmental due diligence should include what is known as an All Appropriate Inquiry (AAI) through certain types of environmental investigation. Performing environmental due diligence will identify and quantify environmental risks and may allow a buyer to avail itself of certain statutory defenses to environmental liability, such as the New Jersey Innocent Purchaser Defense and the Federal Bona Fide Prospective Purchaser Defense (BFPP). AAI under the federal BFPP requires performance of a Phase I Environmental Site Assessment. The New Jersey Innocent Purchaser Defense AAI requires performance of New Jersey Preliminary Assessment, which is similar to a Phase I, as well as a Site Investigation, if recommended by the Preliminary Assessment.

If the property has older buildings that will be demolished as part of site redevelopment, an assessment of Regulated Building Materials (RBM) should be performed. The RBM includes asbestos, lead-based paint, universal waste, and PCB-containing fixtures and transformers. The RBM assessment may provide likely additional management and disposal costs associated with RBM present in older structures.

Because these federal and state defenses to environmental liability are not ironclad, many buyers and developers of contaminated properties often purchase environmental insurance as a risk mitigant and supplement to available legal defenses. The most typical form of environmental insurance is known as a Pollution Legal Liability policy (PLL). A PLL typically has a term of 10 years, with a one-time premium paid at binding. PLL policies typically provide indemnity and defense costs for third-party claims for bodily injury and property damage, including natural resource damages (damages that the government may assess over and above cleanup costs) in some cases, related to environmental contamination. PLL policies typically exclude cleanup coverage for known conditions, but they often provide coverage for contamination unknown at the time of underwriting but discovered at a later time. For further guidance on environmental due diligence, see Environmental Due Diligence.

Financing

Few if any developments would be possible without capital. For every developer, it is important to understand the different types of construction financing available. A traditional construction loan is offered by banks or other financial institutions, and it is structured as having shorter terms and higher interest rates than permanent financing. The loan amount is typically based on a percentage of the total project cost and is disbursed in monthly draws or advances as construction progresses and as the developer satisfies the conditions for such advances set forth in the loan documents. Typical construction loans are secured by a first mortgage lien on the land on which the property is being built, the improvements to be erected on such land, and the future income and rents generated by the improvements. For further guidance on construction financing in New Jersey, see Construction Loan Transactions (NJ).

Another type of construction financing available for real estate developers is a mezzanine loan. Mezzanine loans are a type of subordinated debt, which means they are secondary to the senior debt (i.e., the first lien mortgage). Mezzanine loans are often used to bridge the gap between the amount of financing provided by the senior lender and the total cost of the project. These loans are typically offered by private equity firms or other alternative lenders and may have higher interest rates than the traditional construction loans described above. Mezzanine loans are not secured by a lien on the property, but rather by a pledge of the membership interests of the borrowing-entity. For further guidance on mezzanine loans, see Mezzanine Financing.

Additionally, when a developer secures construction financing, they are typically required to provide certain personal guarantees to the lender. One type of guarantee is a completion guaranty, or a cost over-run guaranty, which requires the guarantor to guaranty the excess of the cost of completing construction over the portion of the construction loan allocated to funding construction costs. Another standard construction loan guaranty required by construction lenders is an interest and carry guaranty. In such a guarantee, the guarantor guarantees certain costs required to carry (i.e., own) the property that are direct obligations of the property owner, such as payment of utilities, taxes, insurance premiums, interest due, late fees. For further guidance on guaranty agreements in construction financing transactions, see Guaranty and Indemnification Agreements in Construction Loan Transactions.

When negotiating construction loan documents, the developer's goal is to maintain as much flexibility over the project as possible. This includes, but certainly is not limited to, increasing thresholds for change orders, limiting lender consent rights to changes to the plans and specifications, and ensuring that the force majeure provision is as broad as possible. Each project has its own specific nuances and intricacies, so it is important for counsel and the developer to have open communication in order to identify and negotiate effectively and efficiently the many provisions in the (often) voluminous loan documents.

Concluding Observations Regarding Some Asset Types

Hopefully, the developer is now well positioned, with a sound purchase contract that has well-crafted contingencies that give the developer the time to address the myriad issues for its project while protecting its funds.

Perhaps the project is a multi-use development, more than fifteen 15 acres along one of New Jersey's many second tier (not an Interstate) highways. It has retail pads in the front, near the highway, perhaps approvals were obtained for a gas station with retail, and to the rear is a planned mix of even more and larger retail, residential, perhaps some storage and light warehouse further back. Perhaps there is even an office component of office, maybe a medical office use.

It was not long ago that many were prematurely predicting (as the saying goes) the death of retail, especially in the overbuilt counties of northern New Jersey. Industrial and warehouse properties in the southern half of the State (and elsewhere), everyone knew, had record high and growing rents, but retail was reportedly in decline.

Instead, with an online back-up presence, many smart retailers have adapted and transformed. In a word, in New Jersey (and elsewhere) retail became more experiential, less about selling the particular good on-site and more about providing the customer with an experience, which would lead to more than the purchase of a product; the buying into a brand and its concept. To a large extent, even the warehouse properties (some very large ones too) participated in this retail transformation. Many of these warehouses now serve as last-mile facilities in support of retail.

Yet New Jersey still is overwhelmingly residential. And while much can be said regarding multifamily residential development in New Jersey, one significant feature is that it is often urban in nature. Single-family homes will probably always be significant in New Jersey, but the growth seems to be in the urban, multifamily sector. In many places, despite the declining state of the general economy, residential rents are also at all-time highs. If more municipalities, rather than reduce some of the aforementioned incentive programs, expanded and facilitated them, and if approvals and permits could be made more efficient from both the consideration of time and money, then New Jersey might compete for growth with other states.

In such a climate, many more New Jersey municipalities could develop attractive downtowns, with great, experiential retail and with new multifamily residential, all within walking distance. This, apparently, is what many urban planners purportedly want. It is also happens to be a dynamic and sustainable goal, one that will transform and improve the many State towns – in short, just what New Jersey needs.

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Philip Markowitz has more than 20 years of experience representing the transactional commercial real estate needs and interests of his clients – helping them efficiently navigate an array of complex development, investment and leasing matters.

His national client roster spans a broad range of stakeholders within the commercial real estate sector, including developers, landlords, tenants, institutional owners, investors, borrowers, purchasers and sellers, and other corporate users of real estate.

Philip is deeply experienced overseeing the legal aspects of acquisitions and developments across all real estate asset types, including within the hospitality sector – where he also manages the corporate components of these transactions, including joint venture, franchise and management agreements. He is also particularly well-versed in leading negotiations in the retail leasing environment.

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