Greenbaum Rowe Smith & Davis LLP
COUNSELORS AT LAW

Published Articles

2019 Real Estate Update: Trending Issues & Topics of Interest

Greenbaum, Rowe, Smith & Davis LLP Client Alert

March 20, 2019

For the fifth consecutive year, we are pleased to present this annual Update newsletter, in which our real estate and redevelopment attorneys weigh in on a variety of topics.

The articles that follow reflect the types of issues we encounter in our daily representation of clients. They also address recent and prospective legislative and regulatory developments with targeted relevance to New Jersey's commercial and industrial real estate market -- and with impact on the state's overall business climate and economy.

As in the past, this year's Update covers many bases. Our authors have carefully analyzed their respective topics in order to provide clarity and perspective. They offer strategic guidance and shed light on best practices. They address current concerns and look ahead to developing trends and issues.

We welcome your feedback on this publication, and if a particular article whets your appetite for more information, we are always available to answer your questions. If you'd like to discuss any of the issues presented and their potential bearing on your individual portfolio and overall business strategy, please get in touch.

Table of Contents

Is Legalized Adult Use Cannabis Finally Coming to New Jersey?

Jack Fersko

The legalization of adult use cannabis has been anticipated in New Jersey since Governor Murphy took office. After considerable negotiation between the Governor and the state legislature, as of this writing it appears there actually will be a vote on legislation to legalize adult use cannabis. This represents positive news to those who believe that the legalization of adult use is overdue.

The excitement over this latest development is enhanced by the recent news of a bill to "normalize" banking relations for the cannabis industry, the "Secure and Fair Enforcement Banking Act of 2019" (SAFE Banking Act) that was introduced in the House of Representatives by a bipartisan group of 106 members of Congress.

While much has been written in recent months concerning New Jersey's adult use program and the various provisions undergoing debate, this article will touch briefly on a few highlights that we feel are of interest to those readers who may purchase or lease real estate (as a landlord or tenant) for a cannabis operation. We recognize that as of this writing, there is neither a guaranty of passage nor a guaranty that further change will not alter significantly the current proposed iteration of the law. Nevertheless, here is a "tasting" of the many issues that will affect cannabis-related real estate transactions.

The law will establish a new five member Cannabis Regulatory Commission in the Department of Treasury that will oversee the adult and medical use programs in place of the Department of Health. Multiple forms of licenses will be available, including a Class 1 Cannabis Grower license, a Class 2 Cannabis Processor license, a Class 3 Cannabis Wholesaler license, and a Class 4 Cannabis Retailer license. With permission of both the State and municipality, a licensed cannabis retailer may secure an endorsement to operate a cannabis consumption area at its retail facility for the onsite consumption of cannabis.

As proposed, owners of multifamily housing (which generally speaking refers to three or more units of dwelling space) may prohibit or regulate smoking of cannabis, but may not prohibit or otherwise regulate the non-smoking consumption of cannabis otherwise authorized by the law. In other respects, the owner or party that controls a property is not precluded from prohibiting or regulating the consumption, use, display, transfer, distribution, sale or transportation of cannabis on their property

In lieu of a percentage tax on sales, there will be a $42 per ounce tax imposed by the State. In addition, municipalities that do not ban cannabis may enact an ordinance that imposes a tax of up to one percent of the receipts from sales by a cannabis wholesaler, two percent of the receipts from sales by a cannabis grower and a cannabis processor, and three percent of the receipts from sales by a cannabis retailer.

While many municipalities have already prohibited cannabis in their jurisdictions, those ordinances will not be of any force or effect under the proposed legislation. In order to outlaw cannabis, a municipality will have to enact a new ordinance within the timeline prescribed by the law, or the municipality will be compelled to allow licensees to operate within its borders. For those municipalities that do permit a cannabis operation, they will have the right to address zoning for each authorized class of operation. For those that either fail to address zoning or fail to prohibit properly a cannabis operation, growing, cultivation and processing will be deemed to be a permitted use in all industrial zones, and retail sales will be deemed a conditional use in all commercial zones or retail zones.

Interestingly, a cannabis grower may not operate or be located on land that is valued, assessed or taxed as an agricultural or horticultural use under the Farmland Assessment Act of 1964. In addition, a licensee is not eligible to receive any State or local economic incentives, and a property owner, developer or operator of a project that will be used in whole or in part for a licensed facility will not be eligible for State or local economic incentives. It is further important to note that the issuance of a license at a location that is the subject of a State or local economic incentive will invalidate the right of the property owner, developer or operator to continue to benefit from the incentive once the license is issued.

Applicants are required (with some limited exceptions) to establish a labor peace agreement with a bona fide labor organization. In addition, and noteworthy for landlords that may perform tenant fit-up work, applicants are required to use best efforts to employ union labor in the construction or retrofitting of their business facilities.

We recognize that the foregoing represents a very limited number of issues under the latest draft of legislation, and that there are a host of provisions in the law that are not addressed in this writing. Once enacted, however, a more detailed analysis will follow.

The Connection Between Commercial Property Tax Assessments and Purchase Prices

Thomas J. Denitzio, Jr.

It is not uncommon, in the face of escalating costs to operate local government, for municipalities to scrutinize the relationship between purchase prices and the property tax assessments of commercial real estate in their annual search for additional sources of revenue. We are, in fact, witnessing a relatively recent but increasing trend where municipalities appeal their own tax assessor's assessments in an aggressive manner, and we expect this trend to continue. For this reason, purchasers of commercial real estate should be concerned about the effect of the purchase price on their property's tax assessment.

Assessors are prohibited from increasing assessments on properties which are sold and not revising assessments on properties which are not sold. This practice is referred to as the "welcome stranger" pattern of assessments, which the New Jersey Supreme Court has found unconstitutional. The Supreme Court held that these so-called "spot assessments" resulted in unconstitutional discrimination, the remedy for which is a rollback of the increased assessment to its previous level.

Municipalities typically defend a spot assessment claim by pointing to New Jersey's taxation statute, which requires assessors to determine, on an annual basis, the assessable value of each taxable property in the taxing district.

Thus, there is a tension between the assessor's duty to assess property annually at its full and fair value (assessment maintenance) and a property owner's right to be free from the imposition of an assessment increase for arbitrary or discriminatory reasons.

New Jersey's courts have held that assessment maintenance may be appropriate in limited circumstances only for legitimate non-sale reasons. These include the construction of new improvements; the assessment of a formerly exempt property; the conversion of an apartment building to a condominium; the adoption of vacancy decontrol; and subdivision.

Furthermore, the Tax Court of New Jersey has held that a municipality's appeal seeking an increase in the assessment of an apartment complex, admittedly because it sold at a price indicating that the property was under-assessed, did not constitute an illegal spot assessment. The assessor advised the municipal attorney that the property had sold but did not increase the assessment. Because the purchase price could be used as cogent evidence of value, the municipality would likely obtain a judgment increasing the assessment in circumstances where the assessor would be prohibited from increasing the assessment based solely on the sale.

It is clear that increasing the assessment of a single property solely because it has been sold is an illegal spot assessment. It is equally clear that in an appropriate case there are methods available to a taxing district, such as assessment maintenance or filing an appeal, to circumvent the welcome stranger doctrine.

If you believe you are the victim of a spot assessment, or are required to defend an appeal by a taxing district seeking to increase your assessment, we encourage you to seek legal advice.

Investing in Qualified Opportunity Zones in New Jersey

Matthew J. Schiller and Kellianne Greenwood

In October 2018, the U.S. Department of the Treasury released its initial set of proposed regulations and commentary concerning the opportunity zone program (OZ Program), a key component of the federal Tax Cuts and Jobs Act (TCJA), enacted in 2017. The purpose of the OZ Program is to encourage development within qualified "Opportunity Zones" (QOZs) through various tax incentives. Developers, investors and property owners alike may be able to take advantage of the numerous tax benefits and development opportunities that can arise from the OZ Program. In order to do so, however, it is critical to understand the OZ Program's time sensitivities and development requirements as the Treasury continues its efforts to finalize OZ Program regulations.

QOZs are designated census tracts with a poverty rate of 20% or a median family income of up to 80% of the median income of the metropolitan area or of the statewide median income. There are 169 census tracts (in 75 municipalities) in New Jersey that were designated by Governor Murphy (and approved by the Treasury) as QOZs - the maximum number allowed in New Jersey under the TCJA. Accordingly, no additional QOZs will be created or designated in New Jersey without further action by Congress.

Under the OZ Program, any capital gains (i.e., short or long term capital gains) timely invested into a Qualified Opportunity Fund (QOF) could receive three primary tax benefits:

TAX BENEFIT #1: The investor defers payment of taxes due for the capital gain invested into a QOF until the earlier of (i) the sale of its QOF interest, or (ii) December 31, 2026, when taxes will be due for the deferred capital gain.

TAX BENEFIT #2: 10% of the deferred capital gain will be forgiven if the QOF interest is held for 5 years or more (the capital gain was invested into a QOF prior to December 31, 2021). If the QOF interest is held for 7 years or more (the capital gain is invested in a QOF before December 31, 2019), an additional 5% (15% total) of the deferred capital gain will be forgiven.

TAX BENEFIT #3: If the QOF interest is held for at least 10 years after investment there will be no tax on the gain realized from its initial QOF investment (i.e., the initial capital gain investment) upon sale.

Under the OZ Program, at least 90% of a QOFs assets must be qualified opportunity zone property (QOZ Property). QOZ Property is property: (1) purchased after December 31, 2017; (2) whose "original use" commences upon acquisition or is substantially improved upon acquisition; and (3) that is used/located in a QOZ. QOZ Property can include partnership interests or stock in a qualified opportunity zone business (QOB). Thus, if acquiring an existing building, the building must be "substantially improved" within 30 months after acquisition (i.e., double the basis of the building), as measured by the additions/ improvements made thereto (note: the land need not be "substantially improved"). Notably, the proposed regulations also provide a "Working Capital Safe Harbor" qualifying cash/financial property as QOZ Property so long as (i) there is a written plan designating the funds for the acquisition, construction or substantial improvement of QOZ Property; (ii) there is a written schedule for the planned use of the funds within 31 months; and (iii) the funds are actually used in accordance with the schedule.

For a trade or business to qualify as a QOB, substantially all (i.e., 70% per proposed regulations) of the tangible property owned or leased by the business entity must constitute QOZ Property. Moreover the entity must be a QOB both (a) when the QOF acquires its equity interest in the entity and (b) during substantially all of the QOF's holding period of that business.

A QOF is defined in Section 1400Z-2 of the Internal Revenue Code as "any investment vehicle organized as a corporation or partnership for the purpose of investing in qualified opportunity zone property." The term "partnership" includes a syndicate, group, pool, joint venture, or other unincorporated organization. Under the proposed regulations, QOFs may also be organized as a limited liability company as long as it is classified as a corporation or partnership for federal tax purposes. Therefore, it is potentially possible to form a New Jersey limited liability company and qualify as a QOF as long as it is properly organized. Also, an existing entity may qualify as a QOF even if it was formed prior to the QOZ legislation, provided that the asset will not be considered QOZ Property for purposes of the 90/10 test. Those wishing to use existing entities should therefore proceed with significant caution.

Parties wishing to invest in a QOF must be "Eligible Taxpayers" - individuals, C corporations (including real estate investment trusts), partnerships, S corporations, trusts, and estates.

Joint ventures will be common under the OZ Program. QOFs will likely seek to partner with a company that has experience in developing projects within New Jersey in order to use that knowledge and local resources to maximize profit. In setting up such a joint venture, it is critical to have an operating agreement that supports the management and profit structure and divides responsibility between the QOF (s), other equity partners, and the developer partner, and contemplates the maximum benefit of the tax structure under the OZ Program.

Notwithstanding significant interest in the OZ Program, it remains a substantial "work in progress" and numerous unanswered questions therefore remain. The recent shutdown of the federal government temporarily delayed the Treasury's public hearing concerning the initial proposed regulations and the promulgation of additional/revised regulations. With the federal government now reopened, it is anticipated that the Treasury will quickly act to finalize the OZ Program regulations and promulgate additional revenue rulings to provide further clarity in light of given of the OZ Program's many time sensitivities. Moreover, here in New Jersey it remains to be seen whether the state legislature will act to conform the state's tax regulations with the benefits of the OZ Program in order to help maximize investment opportunities within the state.

Proposed Legislation Continues to Threaten PILOT Programs

Robert Beckelman

Last year, we reported on two pieces of legislation that, by proposing to amend payment in lieu of taxes (PILOT) programs, would undermine or inhibit redevelopment projects by rendering them economically infeasible or too risky. S867 requires redevelopers receiving any tax exemption pursuant to a PILOT Program to pay prevailing wages, which could potentially negate the financial benefit of the PILOT Program. S59, by requiring payment of a portion of the PILOT payment to the school district based upon a cost-per-pupil formula for each school-age child residing in a redevelopment project, would either greatly disincentivize municipalities from entering into PILOT agreements for residential projects (given the uncertainty of what revenue it would be able to retain from the PILOT payments) or result in municipalities seeking to pass this risk onto the redeveloper (which could render the project too risky or diminish anticipated returns to the point of infeasibility). To date, neither of these bills have been advanced by the Legislature since their introduction in January of 2018.

There are two additional bills that have since been introduced, both of which propose a sharing of PILOT payment revenues with school districts.

A4287 requires PILOT Programs in municipalities which are Abbott or School Development Authority (SDA) Districts to pay the full regular apportionment of the PILOT payment that it would receive under ad valorem taxes. The impact of this bill would be limited to New Jersey's thirty-one SDA Districts, which by definition are located in poorer communities that generally reap the greatest benefits from redevelopment and may be riskier areas for investments by redevelopers. Thus, while it may appear intuitive that the SDA Districts should receive a share of local PILOT payments and not be subject to exemption under PILOT Programs, this bill could undermine the goals of PILOT Programs to encourage investment in these areas.

A3969 requires payment to the school district of the full regular apportionment of the PILOT payment that they would receive under ad valorem taxes for all PILOT Programs, a requirement that would completely undermine the economic return of virtually every PILOT Program. As currently structured, a municipality and redeveloper can negotiate a win-win, with the redeveloper paying less that it would under ad valorem taxation and the municipality receiving more under the PILOT Program than from ad valorem taxation. If redevelopers are required to pay the full rate of the school portion of taxes, only the municipal portion of the taxes otherwise due are in play for negotiation, with 5% of that going to the county under current law. Since the school portion of local taxes comprises the most significant portion of the local tax bill in the vast majority of municipalities (averaging over 50%), removing this from the equation for negotiation will not leave enough room to strike a win-win in most New Jersey municipalities.

There are other pending bills seeking to add transparency and accountability to PILOT Programs. A4289 requires the New Jersey Department of Community Affairs (NJDCA) Division of Local Government Services to maintain data on all long-term tax exemptions granted by municipalities under the "Long Term Tax Exemption Law" and make that data available on its website. A1636 removes any property that has received financial assistance through the Grow New Jersey Assistance Act from eligibility for an exemption under either the Long Term Tax Exemption Law or the Five Year Exemption and Abatement Law (the Short Term Tax Exemption Law). The aim of this bill is apparently to preclude what the bill's sponsor perceives as double-dipping into public funds. Certain projects, however, might genuinely be eligible and worthy of consideration for more than one incentive program, and if an applicant meets the qualifications for incentives under the Grow New Jersey Assistance Act there is no implicit reason it should not also be eligible for a PILOT Program.

For PILOT Programs, the most potentially damaging bill is S1701, which would effectively put an end to PILOT Programs under the Long Term Tax Exemption Law. As initially introduced, this bill requires applicants under the Long Term Tax Exemption Law to provide a detailed cost-benefit analysis concerning the impact of granting or not granting the PILOT upon the municipality and other taxing districts (school boards and counties), as well as projected costs to the municipality for services associated with such project and the net financial benefit or cost to the municipality. The municipality would then be required to post this analysis on its website or provide it to NJDCA to be posted on its website. The municipality would then be required to conduct its own independent cost-benefit analysis of the proposed PILOT, which would also be provided to NJDCA.

As introduced, S1701 would result in additional costs associated with the preparation of this cost-benefit analysis to both redevelopers applying for PILOT Programs and to municipalities considering PILOT Programs, although municipalities would likely seek to pass their costs onto the applicant. While this could potentially discourage some redevelopers from seeking PILOTs, and also inherently increases the burden of establishing a case for a PILOT, there is something to be said for assuring an actual need for and demonstrating the potential benefits of granting PILOTs - and also for providing a more transparent process that permits the public to better understand PILOT Programs. This could conceivably result in more public support for PILOTs, which are largely misunderstood and generally perceived by many members of the public simply as a tax break for wealthy developers.

S1701 was amended in one significant respect in June 2018, following a hearing before the Senate Budget and Appropriations Committee. The bill now requires that all taxing districts receive a portion of the PILOT payment in the same proportion as property taxes. As noted previously, A3969, which only required payment to the school district from the PILOT based upon its regular tax rate portion, would likely undermine the viability of PILOT Programs in a vast majority of New Jersey municipalities. To the extent there were any municipalities where a PILOT Program may still have been viable under A3969 (the relatively few municipalities in which the greater portion of tax payments go to the municipality and county and not the school district), S1701 would assure the infeasibility of PILOT Programs in those municipalities as well, thereby effectively repealing the Long Term Tax Exemption Law. All PILOT

Programs would necessarily result in a net loss to the municipality, as well as the school district and county, effectively removing any financial incentive the municipality may have to consider a PILOT. The current PILOT structure makes the project feasible by providing the redeveloper with some level of tax relief, while concurrently increasing revenue to the municipality, typically the public entity most directly impacted by the project. S1701 eliminates this structure and essentially converts Long Term Tax Exemption Law PILOTs into a simple tax abatement.

We will continue to monitor legislative developments and the efforts of industry associations and lawmakers to support rational and sensible reforms to PILOT Programs by increasing transparency and accountability while assuring that PILOT Programs remain an effective means of promoting viable redevelopment projects across New Jersey.

An Update on New Jersey Transit Villages

Maureen E. Montague

The New Jersey Department of Transportation (NJDOT) launched the Transit Village Initiative in 1999. This is now a multi-agency program led by NJDOT and NJ Transit - together with eight other agencies - which creates incentives for municipalities to redevelop or revitalize the areas around transit (train and bus) stations using transit-oriented development (TOD) design standards in conformity with the New Jersey State Development and Redevelopment Plan (State Plan).

The inter-agency Transit Village Task Force has established criteria and an application process for prospective Transit Village designations. The criteria for designation include, among other things, the adoption of a TOD redevelopment plan or TOD zoning ordinance that includes transit-supportive design guidelines, identification of specific TOD sites and projects, identification of bicycle and pedestrian improvements, identification of community and/or cultural events, and the inclusion of affordable housing in the Transit Village district. The Transit Village district encompasses a half-mile radius around the transit station. In order to be designated a Transit Village, the municipality must document that there are multiple TOD projects planned for the area within the district. Designation provides a municipality with certain benefits, including technical assistance and priority funding from some state agencies, and eligibility for grants from the NJDOT.

There are currently 33 municipalities that have received the Transit Village designation after demonstrating a commitment to revitalizing and redeveloping the area around their transit facilities to create compact, mixed-use neighborhoods with a strong residential component. These designations have led to a broad range of development projects. Municipalities including New Brunswick, Morristown, Metuchen, Jersey City and Bloomfield have seen a great deal of development, however other municipalities have faced hurdles.

Bound Brook's flood risk has been addressed with the 2016 completion of the borough's portion of the Green Brook Flood Risk Management Project by the Army Corps of Engineers. Somerville has approved plans for a mixed-use development near its train station on the site of a former landfill, after struggling to redevelop the site for more than thirty years. West Windsor, after litigation regarding the proposed density of a 25-acre site adjacent to the Princeton Junction train station, is in discussions with a new developer for mixed-use development, including 800 residential units with 16.5% of the units to be designated as affordable housing units. Pleasantville, earning its Transit Village designation in 1999, received a $400,000 Transit Village grant in 2018 for curbs, sidewalks, crosswalks and other streetscape improvements.

In a separate measure, on November 2, 2018 Governor Phil Murphy signed into law a bill requiring NJ Transit to establish an office of real estate economic development and TOD. The purpose of the new office is to assess and develop recommendations for economic development and TOD opportunities for parcels of real property owned by NJ Transit. The hope is that the full inventory and emphasis on economic development within NJ Transit will generate more private-sector interest in developing agency-owned properties, ultimately creating a new revenue stream that could ease the burden on riders. Such development could, in turn, complement existing and contemplated TOD projects in both designated Transit Villages and in non-designated municipalities.

Commercial Real Estate Debt Markets Update: Growth, Challenges and Changes

Lydia C. Stefanowicz and Charles J. Wilkes

With nearly a decade of growth in the rearview mirror, and with the effect of rising interest rates, the federal government shutdown, international trade tensions and political uncertainty both at home and abroad overshadowing the economy, what is the outlook for the commercial real estate (CRE) debt markets in 2019?

The consensus is that the outlook for new CRE mortgage loan originations is complicated. There is a deep pool of available capital, but as a result of the rising interest rates and higher property prices, there is a relatively shallow pool of new acquisition and development opportunities that meet underwriting standards. On a national level, the U.S. economy and job market continue to expand at a steady pace, but trade tensions and political turmoil are creating uncertainty generally, which in turn impacts the real estate markets. A growing number of large and mid-sized industry participants are in a "sell" or "hold" mode, believing that the CRE market is in the final stages of the current expansion

On a local level, New Jersey's Gold Coast remains a center of activity for multi-family development, and the industrial warehouse markets along the New Jersey Turnpike and other logistics hubs underlie the thriving industrial sector. New Jersey is the nation's prime location for the rapidly expanding e-commerce logistics sector, and urban areas in and around Jersey City, Newark and, to a lesser extent, Camden are experiencing a surge of commercial and residential development. On the other hand, however, many suburban and ex-urban locales are saddled with a glut of underutilized, obsolete office and retail space. Underinvestment in infrastructure generally restrains development throughout the state. In addition, net outmigration, consistently high taxes and state fiscal difficulties are impeding overall economic growth. In short, there will be new opportunities for investors and lenders, particularly around redevelopment projects, but there is good reason for caution as well.

Another year of stiff competition among lenders for quality deals also raises questions about whether market discipline on lending standards will continue, or whether heightened competition may result in an easing of standards. Depository bank institutions represent, by far, the largest segment of CRE lenders. Banks have generally enjoyed strong earnings in recent years, and are exhibiting a willingness to make larger loans and to meet aggressive competition from non-bank lenders. In addition, some of the rollbacks in Dodd-Frank regulatory restrictions will provide banks with additional capital for CRE lending.

Nevertheless, regulatory pressures are likely to keep lending standards generally conservative over the next year. Increasingly stringent anti-money laundering, flood insurance and other requirements will result in increasingly extensive due diligence for even the highest quality CRE mortgage loan opportunities. At the same time, the CMBS sector is shrinking and the number of CMBS loans maturing in 2019 is low, reflecting the weak loan demand of ten years ago. The low interest rates that spurred so much growth in the CMBS markets are a thing of the past. Life insurance company lenders will remain a steady and conservative source of capital, particularly to the multi-family and Class A office segments of the CRE market, offering longer terms and fixed rates. And while private debt funds have grown rapidly in number in recent years, they account for less than one percent of CRE lenders. They continue to offer higher leverage and expedited closing timetables at premium pricing, and provide capital to properties that fail to meet the underwriting criteria of traditional CRE lenders.

Finally, the scheduled termination of the London Interbank Offered Rate (LIBOR) market at the end of 2021 will likely lead to changes in interest rate pricing structures and options for lenders and borrowers in 2019. The Alternative Reference Rates Committee (ARRC), a group of private market participants convened by the Federal Reserve Board and other financial regulators, is currently planning for the transition from LIBOR to one or more alternative reference rates. The Federal Reserve Bank of New York is now publishing the Secured Overnight Financing Rate (SOFR), which is the ARRC's recommended alternative to LIBOR. The ARRC is also developing recommended "fallback" language for LIBOR-based agreements. The ARRC will encourage market participants to include its fallback provisions in their loan documents to provide contractual mechanisms for (a) replacing LIBOR with an alternative reference rate when LIBOR ceases to exist and (b) adjusting interest rate spreads to properly reflect the differences between LIBOR and the new reference rate. With over $350 trillion dollars' worth of financial derivative contracts, mortgages, bonds and other commercial loans bearing interest at rates based on LIBOR, the transition will impact every aspect of the debt market, including CRE.

During 2019, lenders and borrowers should take stock of their existing and pending LIBOR-based loans and other financial contracts and be aware of ongoing developments in the transition away from LIBOR.

Strategies for Navigating Real Estate Issues in Implementing a Business Succession Plan

Senwan H. Akhtar

In working with closely-held businesses to develop and implement their business succession plans to create a smooth transition from the company founders to successor owners, we find that real estate issues are of crucial importance. This is well demonstrated by our recent representation of a client in a $15 million leveraged recapitalization and corporate restructuring transaction.

The transaction was triggered when the company's founding shareholder notified the company of his desire to retire as a shareholder and board member. At the same time, the company desired to elevate two senior executives by admitting them as shareholders and as board members. Working with our client's accounting firm, we assisted in structuring the retirement and buy-out of the founding shareholder and the simultaneous buy-in of the two senior executives.

Although at first glance these may appear to be purely corporate transactions, the examples below illustrate a number of critical real estate issues that we negotiated in connection with this matter.

Loan Agreement Covenants. The recapitalization transaction was financed by a $15 million loan which was documented by an extensive credit agreement. Credit agreements often contain provisions restricting the borrower's ability to purchase and lease real estate. As our client intended to move its leased headquarters to a new location in the near future, we negotiated an exception in the loan agreement allowing the client to enter into a new lease for its headquarters without the lender's approval. We were also aware of the company's growth plans; therefore, we negotiated a provision allowing the company to enter into new leases (other than its headquarters) without the lender's consent, to the extent the client determines the new locations are required for its continued business operations.

Ownership of Real Estate. We advised our client that as to any real estate owned by the company, the mortgages encumbering each parcel of real estate must be reviewed to determine whether they contain "due on sale" clauses stating that the mortgage holder's consent is required whenever shares are transferred or upon the change in the company's board or management.

Lease of Real Estate. Our client leased offices in multiple states throughout the east coast. Although our client did not intend to assign any of its leases to other companies, we analyzed the real estate leases to determine whether they state that transfers of shares within the company is deemed to be an assignment of the lease which requires the landlord's prior approval. Many leases were silent on this issue, and in these cases, we advised the client whether under each state's law, a transfer of shares is deemed to be an assignment of the lease which requires the landlord's consent. We further advised that leases for any new offices should expressly state that transfers of shares in the company will not be deemed to be assignments of the leases.

Landlord Lien Waivers. The loan was secured in part by a lien on the client's equipment, which was located in several of the leased locations. The lender required our client to provide landlord lien waivers which would allow the lender to enter the leased locations and access the collateral in the event of a default under the loan. We advised the client not to agree to any covenant in the loan agreement that guarantees the client will obtain landlord lien waivers, since our client did not have control over the landlords' actions. Instead, we negotiated language in the credit agreement providing that the client will use reasonable efforts to obtain landlord lien waivers. Therefore, a landlord's failure to provide a lien waiver would not result in a default under the loan.

As many closely-held businesses are currently in the process of transitioning ownership of their companies to the next generation of leaders, we anticipate that these and other real estate issues will continue to arise. Our multi-disciplinary approach to business succession matters enables us to assist clients in giving careful consideration to all aspects of the law that are implicated in connection with their business succession plans.

Statutory Water & Sewer Connection Fee Credit System Offers Significant Savings for New Jersey Redevelopers

Robert S. Goldsmith and Irene Hsieh

On August 10, 2018, legislation impacting the assessment of water and sewer connection fees for redevelopment projects and affordable housing projects was adopted in New Jersey. The law has two parts, the first of which establishes a "credit system" for redevelopment projects under which qualifying properties will receive a credit for any previously paid connection fee that applies to their new redevelopment use. Thus, a redeveloper will pay only the difference (or the "delta") between the new connection fee and the previously-paid connection fee. The second prt of the legislation amends the statutory language that currently exists for connection fee reductions for certain types of affordable housing, extending it to encompass all types of affordable housing projects. The legislation affects county and municipal sewerage and water authorities and facilities.

The authors of this article played a major role in the drafting of the legislation, a continuation of the firm's longstanding interest in the idea of a connection fee credit system based on the "delta" of a connection fee. Several years ago, we had successfully implemented this concept for a redevelopment project at the former site of Anchor Hocking's glass manufacturing facilities in Aberdeen. The project site's former use as a glass manufacturing company meant that the historical water and sewer usage was very significant. Using the "delta" concept that is now the basis for the legislation's credit system, the firm was able to save our redeveloper client more than $1 million in connection fees.

After the success of the "delta" concept for the Aberdeen project, the firm worked closely with the New Jersey Builders Association, with the support of NAIOP, to draft legislation that would codify this credit system for all redevelopment projects. We worked to draft and refine the legislation, and participated in approximately three years of negotiation and discussion with the Association of Environmental

Authorities to craft a mutually acceptable bill that would serve the dual purpose of aiding redevelopment efforts and equitably compensating municipal authorities for connecting into their water and sewer systems.

This new legislation makes it easier for redevelopers and water/sewerage authorities to reach agreement on connection fee costs. Since the bill's 2018 passage, New Jersey redevelopers have enjoyed substantial reductions in connection fee costs due to the statute. For affordable housing projects in particular, the reduction in fees means that the money which would have gone to connection fees can either be reinvested in the project, improving it for the community, or can be used to sustain the financial viability of critically necessary affordable housing.

Here are some examples of anticipated future cost savings related to a number of pending projects throughout the state:

- K. Hovnanian expects that its connection fees for an inclusionary project in Cedar Grove will be reduced by approximately $135,000
- The Walters Group expects that its connection fees for an affordable housing project in Lumberton will be reduced by approximately $150,000
- Community Investment Strategies, Inc. expects that its connection fees for an affordable housing project in Galloway will be reduced by approximately $140,000
- Woodmont Properties expects that its connection fees for an affordable housing project in Washington Township will be reduced by approximately $65,000
- Woodmont Properties expects that its connection fees for an affordable housing project in Roxbury will be reduced by approximately $55,000
- The redeveloper of a project in southern New Jersey expects that its connection fees will be reduced by more than $1 million

With the connection fee legislation having already realized more than $1 million in savings for redevelopers, both water/sewer authorities and redevelopers are enthusiastically embracing the new legislation. This can only mean good news and help sustain an environment for redevelopment to continue thriving here in New Jersey.

New Jersey Title Insurance Update

Kenneth T. Bills

Title insurance policies in New Jersey are not "one size fits all." While there are approved standard forms for owner's and lender's title insurance policies, those are only a starting point. All of the major title insurance companies doing business in New Jersey are members of the New Jersey Land Title Insurance Rating Bureau (NJLTIRB), which annually publishes a Manual of Rates and Charges that sets forth all of the rates, fees and charges that have been approved by the New Jersey Commissioner of Banking and

Insurance and all of the policy endorsements approved for use in New Jersey.

The most recent Manual became effective on February 1, 2019. It provides for more than 100 approved endorsements, five of which are new in 2019. Three of this year's new endorsements, the ALTA 11.1-06, the ALTA 11.2-06 and a Partial Release of Mortgage Premises Endorsement, insure against a loss of lien priority as a result of modifications to the lender's original mortgage, such as an increase in the amount of the loan or a partial release of the mortgage. The ALTA 11.1-06 and the ALTA 11.2-06 endorsements are issued for the same premium as a mortgage modification policy. The charge for a Partial Release of Mortgage is $300. Also new this year are an ALTA 39-06 endorsement that insures that the title insurer will not deny liability under a policy or endorsement solely on the grounds that the policy or endorsement was issued electronically, available without charge, and a revised form of subdivision endorsement, available for a charge equal to 5% of the base policy premium, but not less than $100.

With more than 100 approved endorsements to select from, and substantially different charges depending on the specific endorsement, it is important to have the advice of an attorney who is knowledgeable as to the endorsements available, and can evaluate which are applicable to your transaction.

Two Appellate Division Rulings Impact New Jersey Redevelopment Law

Steven G. Mlenak

As more and more redevelopment projects are undertaken each year - not surprising given New Jersey's status as the most densely-populated state in the country - it follows that the state's courts would be busier than usual dealing with cases involving redevelopment. Over the past year, the Appellate Division of the New Jersey Superior Court handed down two important decisions that will have an impact on redevelopment projects going forward. This article provides an update on those cases.

Applied Monroe Lender, LLC v. Hoboken Planning Board

This case dealt with whether a municipality could deny a property owner the ability to seek planning board approvals if the property was located in an area in need of redevelopment and the property owner was not designated as the redeveloper of the property, even if the redevelopment plan does not impose such a requirement.

In *Applied Monroe*, the developer purchased the subject property at a bankruptcy sale. The prior owner of the property was designated as a redeveloper and had executed a redevelopment agreement with the City of Hoboken. Applied Monroe, however, was never designated by the City as the redeveloper of the property and no redevelopment agreement with Applied Monroe was ever executed. After its purchase, Applied Monroe sought approvals from the City's Planning Board. The Planning Board denied Applied Monroe's application because the property was located in an area in need of redevelopment and Applied Monroe was not the designated redeveloper.

Applied Monroe appealed the denial, which was affirmed at the trial court level. On further appeal, the Appellate Division found for the City, holding that properties located in areas in need of redevelopment must first, as a technical requirement, the property owner must be designated by the governing body as a redeveloper pursuant to the provisions of the Local Redevelopment and Housing Law (LRHL). While such a requirement is not uncommon in redevelopment plans, this case holds that such requirement need not be in a redevelopment plan for municipalities to enforce it. Presumably, this holding would apply for all types of land use approvals, including subdivision approval.

Borough of Glassboro v. Grossman, et al.

The Borough of Glassboro sought to condemn a mostly vacant lot located within an area in need of redevelopment. The property was approximately a block away from an ongoing mixed-use redevelopment at Rowan University consisting of retail space, classroom space, 1,870 student-housing beds, 109 apartments and a 1.75 acre park with an estimated value of $450 million.

Pursuant to the LRHL and the Eminent Domain Act, the Borough obtained an appraisal of $125,000 for the property. After unsuccessfully negotiating with the property owners to acquire the property, the Borough commenced condemnation proceedings, which were challenged by the property owners. The Borough provided that their intended use for the property was for "increasing availability of public parking..." and, during a trial court hearing, the Borough's attorney stated that "public parking is only a possible use, and that the property might be used for some other purpose related to redevelopment."

The Appellate Division held that under the LRHL, a "local government can only acquire, through its condemnation powers, a land or building 'which is necessary for the redevelopment project'." The Court held that the acquisition of property for redevelopment must be "reasonably necessary" and established a two-prong test for determining whether a municipality's proposed use for a property to be condemned was "reasonably necessary." The test requires the municipality to (1) articulate the purpose tied to a specific redevelopment project and (2) present evidence to substantiate that purpose. The Court emphasized that such showing would only be necessary should the condemnation be challenged. If challenged, and upon submission by the municipality of such evidence, the burden would remain on the property owner to disprove the municipality's evidence of necessity by a preponderance of the evidence.

Here, the Court held that the Borough did not pass the test articulated above and, as such, the proposed condemnation was found to not be reasonably necessary. Municipalities, and redevelopers working with municipalities on redevelopment projects requiring the condemnation of property, should be aware of the test created in this case and should be prepared to demonstrate a necessity for the acquisition of any property prior to commencing condemnation proceedings.

Redevelopers and municipalities alike should work with experienced redevelopment attorneys to ensure that their redevelopment projects comply with the holdings in these and other applicable cases.

Key Components of Due Diligence in Commercial Real Estate Transactions

Regina E. Schneller

A critical aspect of a commercial real estate purchase is the evaluation of various matters, conditions and risks associated with the property during a contractual due diligence period. The customary timeframe for due diligence is sixty days, during which time several investigations are often directed by the purchaser's lawyer and performed by various professionals. These may include the following:

- Review of a current title insurance commitment, together with the seller's vesting deed, mortgages, liens and encumbrances, flood and tidelands searches, declarations, covenants, easements, restrictions of record, environmental deed notices, probate records and all endorsements to the commitment requested by the purchaser or the mortgage lender, including a survey endorsement.
- Examination of a current accurate survey that confirms direct access to the property from a public road, provides a metes and bounds description of the property, plots all easements and other items set forth in the title commitment, depicts all buildings and other improvements, includes a zoning table, the number of parking spaces, building setbacks and how items such as easements may impact the property, and is certified to the purchaser, the title company, the mortgage lender and the purchaser's lawyer.
- Evaluation, with the assistance of a trusted and reputable environmental consultant, of any and all information relating to the property's environmental condition (obtained from the seller or developed by the environmental consultant during a thorough assessment of the property) to determine whether the seller has received any notices of violations from any governmental authority including the New Jersey Department of Environmental Protection, and examination of the historical uses and business operations at the property to determine if the proposed sale will trigger the Industrial Site Recovery Act.
- Review of all land use applications, planning board and/or board of adjustment resolutions which may include variances, building permits, certificates of occupancy, certificates of continued occupancy, fire inspection certificates and any notices of violations, and examination of pertinent local zoning ordinances to confirm that the uses at the property are permitted and that all buildings and other improvements at the property are conforming.
- Review of all available financial information relating to the property, including, without limitation, real estate taxes, operating costs, rent roll and utility bills, copies of all lease agreements and correspondence between the seller and tenants at the property with particular emphasis on the amount of rents, additional rents, security deposits and rent concessions, any defaults, options to renew or purchase, rights of first refusal, brokerage provisions and tenants' payment histories.
- Review of all service contracts for snow removal, building maintenance, lawn care and other similar and customary property services to determine whether such contracts are terminable or binding on the purchaser and whether they are assumable, and all brokerage agreements regarding the sale or leasing of the property.

The above due diligence tasks are not intended to serve as a comprehensive list. As is often the case in complex real estate transactions, the unique characteristics of some properties, and the initial results of the basic investigations, may necessitate additional due diligence in order to achieve the comfort level that the client seeks prior to closing of title. The nature and extent of the lawyers's role in conducting due diligence should be specified clearly at the outset of any purchase transaction.

New Jersey's Affordable Housing Determinations Are (Finally) Nearing Completion

Steven Firkser

Since 2015, the New Jersey courts have been undertaking the determination of affordable housing obligations in the state's 565 municipalities. This past year saw significant developments in this process that should finally lead to the construction of residential projects with affordable housing components throughout the state.

The courts assumed control over affordable housing determinations after the New Jersey Supreme Court decided in March 2015 that the Council on Affordable Housing (COAH) had failed in its responsibilities to adopt regulations defining municipalities' obligations to ensure the construction of housing for low and moderate-income families. As a result, more than 375 municipalities filed declaratory judgment actions in 2015 seeking to establish - and the trial courts appointed special masters to assist in determining - the municipal obligations for affordable housing, which are also referred to as "Mount Laurel" obligations.

In the trial court proceedings, the municipalities and housing advocates retained experts to determine the appropriate number of units to serve the housing needs that accumulated between 1999 - 2015, the "gap period" during which COAH failed to adopt and implement rules that could survive legal challenge, as well as the prospective need for housing for the period from 2015 - 2025. The numbers produced by those experts were widely disparate, and a court determination was needed to fix the obligations. Along the way, a number of municipalities settled their obligations in order to avoid the uncertainty and cost of trial.

Last March, Judge Mary C. Jacobson in Mercer County issued a comprehensive decision following a 40-day trial to determine the fair share housing obligations for Princeton and West Windsor Township. Judge Jacobson acknowledged the complexities and uncertainties involved in developing a methodology to calculate numerical affordable housing needs, and reviewed the alternatives advocated by the experts for the municipalities and housing advocates. She also relied on an independent court expert, Richard Reading, to assist her in fashioning a fair and reasonable estimate. Judge Jacobson struggled with the alternatives advocated by each expert, and combined the most convincing aspects of each model.

The court ultimately determined that the total housing need for the period from 1999 - 2015 for New Jersey was 74,248 units, which was approximately two times higher than the calculations of the municipal expert and half of the housing advocates' calculation. The total prospective need for New Jersey for the period from 2015 - 2025 was 85,382 housing units, which was more than three times higher than the municipal expert's assessment and 55% lower than the housing advocates' expert assessment.

Judge Jacobson's decision is not bulletproof and can still be appealed, but the court presented a fair and reasonable approach in considering all the expert opinions. The decision has provided a foundation to determine the low and moderate-income housing needs in all municipalities in the state that has carried considerable weight with the other trial courts.

Richard Reading, also appointed as a special master in other counties, has provided reports for other counties setting forth the municipal obligations. Numerous towns have utilized the updated numbers to formalize settlements with housing advocates rather than engage in a lengthy trial in which the courts would most likely follow Judge Jacobson's methodology and conclusions. The courts have also aggressively persuaded the parties to reach a resolution through agreement rather than trials.

As a result, more than 250 municipalities have entered settlements with the leading housing advocate, Fair Share Housing Center, as well as with developers who have intervened, leaving only a handful of cases in each county that require resolution. The courts are pressuring the parties to enter settlements in these remaining cases, and nearly all should be resolved this year by settlement or trial.

For cases that are not resolved, the municipalities will have to address the numbers determined by the court's analysis. These cases are likely to involve issues related to realistic development potential in the municipality, and to consider constraints on development such as the unavailability of vacant land, environmental conditions, and lack of sewer service and other utilities. Municipalities can also seek to apply bonus credits and adjustments to reduce the actual number of units that need to be constructed. In cases awaiting trial, there may still be an opportunity for property owners willing to provide affordable housing on their properties to present those alternatives to the court.

For municipalities entering settlements, developers may also have an opportunity to participate. The determination of the numerical obligations is not the final analysis, and the municipalities have to demonstrate their compliance in meeting their obligations. This has provided opportunities for developers to suggest redevelopment of existing properties such as vacant retail centers and office parks for housing construction. Developers who are willing to include affordable units in an inclusionary development (generally 15% - 20% of the total units set aside for affordable housing) can assist the municipalities in meeting their obligations. Further, when municipalities present their housing plans, interested developers will also have the opportunity to contest the validity of those plans and seek to include their properties with an affordable housing component.

The resolution of pending court cases by settlement or trial does not end the municipal obligations for affordable housing, as the municipalities must enact ordinances and approve developments that satisfy the obligations in the settlements. Towns that renege on these obligations act at their peril. In one recent case, East Brunswick sought to obstruct one of the developments approved in its settlement agreement, compliance plan and judgment of repose. When the developer was proceeding to obtain approvals, the Mayor and Township sought to amend its ordinance permitting the residential development without seeking court approval. The trial court issued an injunctive order preventing the Township from amending the ordinance, restrained the Mayor from any participation in the Planning Board's consideration of the application, and appointed a special master to oversee the development application. The court also warned that if the Township had any further violations of the compliance judgment, the court would consider an application to enjoin all further development in the Township and have the special master oversee all applications for approvals in the Township.

The courts will remain the forum for resolving affordable housing issues for the foreseeable future. While the Supreme Court hoped for a legislative solution to address the affordable housing obligations, efforts in the legislature have stalled, leaving the courts as the only means to resolve the municipal obligations through 2025. The state has another six years to provide a solution for the next round beginning in 2025.

New Jersey Court Ruling Addresses Enforceability of Waiver of Subrogation Provisions in Homeowners Association Documents

John H. Hague

A continuing issue in the relationship between community associations and their constituent property owners has been the allocation of responsibility for damages to the residences as a result of a casualty originating in the common elements or common property. It is commonplace for homeowner association documents to provide that the homeowner's insurance policy must contain "waiver of subrogation" provisions for the benefit of the association. Waiver of subrogation provisions may also benefit residential owners for casualty originating in their units.

By way of example, if a fire occurs in the common element attic space and spreads to the unit below, the unit owner could claim that the association was negligent in maintaining the attic space, resulting in the fire that caused damage to the unit. Subrogation is the right of the unit owner's insurance company, which pays for the damage, to assert the unit owner's claim for damage against the association. A waiver of subrogation provision in the policy would prevent the insurance company from asserting such a claim against the association, and could also prevent the insurance company from asserting a claim against an adjacent unit owner.

In the Appellate Division of the Superior Court of New Jersey's 2009 decision in *Skulskie v. Ceponis*, the by-laws provisions of a condominium association that required unit owners to have their insurance companies waive subrogation was enforceable. In that case, water damage to a unit was paid for by the damaged unit owner's insurance company. The Court prevented the insurance company from suing the upstairs unit owner who caused the water damage (and who had no insurance).

In *Universal North American Insurance Company v. Bridgepointe Condominium Association*, a case of first impression decided in March of 2018, the Superior Court of New Jersey held that the plaintiff, an insurer that paid under its policy for damages to a unit owned by one of its insureds, was not allowed to maintain its subrogation claim against the condominium association. Judge Gary K. Wolinetz (a former Greenbaum partner) ruled that whether or not a waiver of subrogation provision was included in the policy, the association's by-laws required unit owners to include a waiver of subrogation in their homeowner's insurance policy, and that the waiver was binding on the insurance company.

The opinion makes it clear that insurance companies are on notice of waiver of subrogation provisions in homeowner association documents: "It is also undisputed that Universal knew, or should have known about the Association's Master Deed and Bylaws, including the Waiver of Subrogation Provisions, before it agreed to sell Laspada [a unit owner] an insurance policy." The opinion also reconciles the fact that a Master Deed may be silent on the subrogation issue, with a bylaw provision containing the waiver requirement in favor of the association, which requirement will remain enforceable.

The *Universal* opinion is the first reported case to address the waiver issue in the context of claims against associations head-on. It reinforces the common practice of associations to require that unit owners who suffer casualty damage to their units assert claims against their homeowner insurance policies - and avoid any liability of the association or other unit owners to the insurance carrier for any such claims paid under the policy.