COUNTRY COMPARATIVE GUIDES 2023

The Legal 500 Country Comparative Guides

United States

REAL ESTATE

Contributor

Clifford Chance

Ness Cohen

Office Managing Partner, New York & Chairman of Clifford Chance's Real Estate practice in the Americas | ness.cohen@cliffordchance.com

Eddie Frastai

Partner | eddie.frastai@cliffordchance.com

Jeanne Roig-Irwin

Partner | jeanne.roig-irwin@cliffordchance.com

Kris Ferranti

Partner | kris.ferranti@cliffordchance.com

Jon Newman

Partner | jon.newman@cliffordchance.com

This country-specific Q&A provides an overview of real estate laws and regulations applicable in United States.

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UNITED STATES
REAL ESTATE

1. Overview

The U.S. Constitution sets forth a system of federalism where governmental power is divided between the national (or federal) government and the governments of individual states. Each state also has its own constitution, which further divides governmental power between the state and local governments. For this reason, legislation affecting the acquisition, disposition, use, financing, and taxation of real estate can be found at each of the national, state, and local levels of government. Each state in the U.S., other than Louisiana (which employs a civil law system), follows a common law regime which evolves through both case law (e.g., court decisions) and legislation, and laws can vary greatly from state to state. In following the common law tradition, U.S. courts generally allow parties engaging in transactions relating to commercial real estate the freedom to set the terms of those transactions by contract, subject to regulations relating to the public interest (e.g., environmental, tax, counter-terrorism).

2. What is the main legislation relating to real estate ownership?

There is no main legislation relating to commercial real estate ownership across the U.S. As explained in Q1 above, the U.S. Constitution sets forth a system of federalism which divides governmental power between the national (or federal) government and the governments of individual states. Each state also has its own constitution which, in turn, divides governmental power between such state and the municipalities located within such state. The laws relating to commercial real estate ownership are generally governed by state law though federal law will also apply as to some aspects.

3. Have any significant new laws which materially impact real estate investors and lenders come into force since December 2022 or are there any major anticipated new laws which are expected to materially impact them in the near future?

Two laws are likely to materially impact real estate investors: (i) the Corporate Transparency Act which is a relatively new U.S. federal law and (ii) the Interests of Foreign Countries law in the State of Florida (each as described below). We also bring your attention to the new emissions laws described in the response to Question 21 below.

(1) The Corporate Transparency Act was adopted by U.S. Congress in 2021 and requires non-exempt entities with involvement in the U.S. to report information regarding their beneficial ownership to the U.S. federal government. The agency tasked with enforcing this law is the Financial Crimes Enforcement Network (FinCEN) and it released the final version of the regulations in September 2022. These regulations are set to go into effect on January 1, 2024. Pursuant to the regulations, unless qualifying for an exemption, entities that are formed in the U.S. or formed outside the U.S. but registered to do business in the U.S. are required to submit to FinCEN information regarding any beneficial owners who own or control more than 25% of such entity or otherwise exercise substantial control over the same, (x) within one year after formation or registration to do business in the U.S. for entities in existence prior to January 1, 2024, (y) within 90 days after formation or registration to do business in the U.S. for entities formed in 2024, and (z) within 30 days after formation or registration to do business in the U.S. for entities formed in 2025 and thereafter. Entities created on or after January 1, 2024, will also need to report certain information with respect to the individual(s) that formed the entity. The regulations, however, contain a number of exemptions to these reporting requirements which are likely to apply to many large real estate investors and operators including, without limitation, banks, broker-dealers, registered investment companies and advisers, insurance companies, pooled investment vehicles and large operating companies. Prior to forming any entity in the U.S. or registering any entity formed outside the U.S. to do business in the U.S., one should confirm whether a

filing will be required pursuant to the Corporate Transparency Act.

(2) The "Interests of Foreign Countries" act (codified at Fla. Stat. Ann. §§ 692.201-205) took effect on July 1, 2023. This law, among other things, restricts certain individuals and entities associated with China, Russia, Iran, North Korea, Cuba, Venezuela and Syria from owning real property in Florida. The act labels these individuals and entities as "foreign principals" and the countries as "foreign countries of concern." These parties are prohibited from owning agricultural land and any interest in real property within ten miles of any military installation or other critical infrastructure, with the toughest laws against foreign principals associated with China, who are completely prohibited from purchasing or acquiring any interest in real property in Florida. There are limited exceptions for natural persons from foreign countries of concern. Purchasers of real estate in Florida are now required to execute a new affidavit certifying that they are not a foreign principal or that the transaction otherwise complies with the law. Under the act, foreign principals are required to register their properties with the Florida Department of Economic Opportunity by December 31, 2023, including restricted properties acquired prior to July 1, 2023, and permitted properties acquired on or after July 1, 2023. The consequences of non-compliance with the act include civil and criminal liability for any party to an applicable transaction, including forfeiture of the property to the State of Florida. The Florida act is under a legal challenge (per the Shen v. Simpson case) under the argument that the law violates the Equal Protection Clause, the Due Process Clause, the Fair Housing Act and the Supremacy Clause of the U.S. Constitution; this case is still being adjudicated.

The Florida act is only one example of laws that restrict foreign ownership of land. Currently, foreign ownership of land is restricted in 24 U.S. states, with 11 of those states enacting laws in 2023. While there is currently no federal law restricting foreign ownership of U.S. land, bipartisan support for it is growing in Congress, particularly as it relates to ownership of farmland and agricultural land.

Due to the legal challenges, the uncertainties in the breadth of the act itself and the reporting requirements, prior to having any foreign investors from the relevant countries purchase real estate in the U.S., one should confirm whether they would be subject to this law or other similar laws in the U.S.

4. How is ownership of real estate proved?

There is no uniform land registration system across the U.S. to verify ownership of real property. Instead, recording systems have been adopted on a state-by-state basis, and each county (or "parishes" or "boroughs" in Louisiana and Alaska, respectively) within each state has its own recorder's office for evidencing ownership and other interests in real property. While there are similarities among the rules of each such recording system and recorder's office, such rules vary by county, and it is therefore important to ensure that any instruments that are intended to be recorded comply with the rules of the applicable recorder's office.

In order to confirm ownership of real property in the U.S., it is therefore necessary to perform a title search of the real estate records in the county where the applicable property is located. Electronic access to such records varies by county and, if available, such records are typically only available from and after a certain date, and therefore, a search of the physical records of the applicable recorder's office is almost always necessary. It is important to note, however, that with few exceptions, a search of a county's real estate records does not guarantee that the owner appearing of record in such search is actually the owner of the property.

As such, prospective purchasers or lenders in U.S. real estate transactions routinely engage a title insurance company to perform a title search on their behalf and, at the time of closing, purchase insurance from a title insurance company to cover the ownership of the property and the state of title thereof. Once engaged, the title insurance company will examine the real estate and other records and produce a title report which discloses, among other things, the record owner, as well as any interests to which such record owner's title is subject, such as leaseholds, mortgages, easements, restrictive covenants, and other liens and encumbrances.

It is important to note, however, that a title report by itself is not an insurance policy and therefore cannot be relied on in a legal sense; it merely provides an indication as to what the title insurance company believes is the state of title. As such, prospective purchasers and lenders in U.S. real estate transactions almost always purchase title insurance (the cost of which is paid for once at the time of the closing and, in the case of a loan, is paid for by the borrower), which insures that title to the property is in the name of the insured (or the borrower, in the case of a loan policy), and provides coverage against, among other things, any defects, liens or encumbrances on title, other than those noted in the policy. The principal benefit of purchasing a title insurance policy is to cover claims that threaten or impair the insured's interest in the real property, and, in such instance, the title insurance company will pay or dispose of the claim in accordance with the terms of the policy. A title insurance policy also covers against the risk of forged documents and, in most jurisdictions, matters that arise between the date of closing and the date that the applicable instrument is recorded in the real estate records. The premium for title insurance is based on the amount of coverage purchased (along with the cost of additional coverage, as applicable) and is negotiable in some states and is fixed by statute in other states.

5. Are there any restrictions on who can own real estate?

In general, there are very few restrictions on who can own real estate or interests therein.

The federal government (specifically the Committee on Foreign Investment in the United States ("CFIUS")) has the authority to review transactions (including real estate transactions) that could result in control of U.S. real estate by a foreign person. CFIUS has the ability to require that a transaction be cancelled, that a foreign person divest itself of real estate or other asset(s), or require that certain mitigation measures be adopted to limit foreign control of such real estate or other asset(s) if it determines that doing so is in the best interest of U.S. national security. The majority of U.S. real estate transactions do not require CFIUS filings. Some parties to a transaction, however, elect to make a voluntary filing, in order to receive comfort that CFIUS will not later require divestiture or the imposition of mitigation measures. In recent years, the influence of CFIUS has increased and it has also reviewed and intervened in a larger percentage of transactions.

As noted in the response to Question 3 above, several states restrict the right of non-U.S. persons from certain countries to own real estate, or interests therein, in the U.S.

6. What types of proprietary interests in real estate can be created?

The main proprietary interests in real estate that can be created are:

- *Fee Estate:* where the owner owns the real property, typically in perpetuity. The fee estate commonly includes the land, the development rights relating to airspace above the land, and any buildings or other improvements on that land, but the parties are free to agree to other arrangements. For example, a fee estate could include only land and airspace with certain defined limits or could only include an interest in land or airspace.
- *Leasehold Estate:* where the tenant is granted a lease of an agreed area for a fixed term. With very few exceptions, there is no minimum or maximum term, and the lease can include renewal rights. In some cases, a lease is granted in the entirety of the fee owner's estate, often referred to as a ground lease. Ground leases are typically for significantly longer terms than leases of a portion of a property. The tenant under a ground lease will typically seek to record a memorandum of the ground lease in the real estate records in order to put all interested parties on notice with respect to the tenant's interest in the property, and protect its interest from being subordinated to the rights and interests of subsequent purchasers of the property or interests therein. Subject to the terms of the lease, the tenant can, in turn, grant a lease of all or a portion of its premises (for a period not to exceed the term of its lease), which is referred to as a sublease.
- *Tenancies in Common:* where a property is owned by more than one person (each referred to as a "co-tenant"), with each co-tenant having an undivided interest in the entire property. A co-tenant's ownership interest in the property is reflected as a percentage and the ownership percentage among co-tenants need not be equal. Each co-tenant, however, has the same right to possess the property as the other co-tenants, regardless of ownership percentage. The parties to such arrangement often enter into a "tenancy in common agreement" which outlines their respective rights and responsibilities with respect to the applicable property.
- *Condominium Ownership:* a type of fee estate where land and improvements are split into a number of units. Each unit is a distinct property and includes an undivided interest in the overall property's common elements. The condominium regime allows multiple owners to own and use distinct portions of a property while collectively sharing ownership of the common facilities of the property, for which each unit owner is responsible for paying a proportionate share of expenses (referred to as common charges). Unit owners typically have the right to sell, mortgage, lease or alter their unit, however, such rights may be limited in some way by the agreements

creating and governing the condominium.

- *Cooperative Ownership:* where a corporation owns the property, and individual owners own shares of such corporation and are granted a "proprietary lease" demising a particular unit of the property. The number of shares of the corporation that each owner holds is typically proportionate to the size of the unit leased to the cooperative shareholder. Similar to condominium ownership, cooperative shareholders have shared rights to use the property's common elements, for which each owner is responsible for paying a proportionate share of maintenance expenses. Cooperatives, however, often impose restrictions on the sale of units (which is effectuated through a sale of shares and an assignment of the proprietary lease) as well as restrictions on the rights of a cooperative shareholder to alter its unit. The use of cooperative ownership structures are most commonly found in the Greater New York metropolitan area and the midwestern region of the U.S.

7. Is ownership of real estate and the buildings on it separate?

Not unless otherwise agreed. Buildings and other improvements are included in a transfer of the land unless otherwise specifically provided. For example, it is possible to carve out a specified block of airspace and the buildings structures within it from a transfer of a fee estate or the grant of a lease. Doing so is unusual other than in the context of ground leases, and potentially problematic, as it can affect the marketability of the property, and where it is necessary or desirable to do so, this is typically achieved by granting separate leasehold interests or subjecting the fee interest to a condominium structure.

8. What are common ownership structures for ownership of commercial real estate?

Commercial real estate is typically owned by corporations, trusts, partnerships, limited liability companies or limited partnerships. Tax concerns, personal liability of the investors, management concerns, and transferability of ownership interests are all factors to be considered in selecting the appropriate entity through which to own the property.

A corporation (i) is managed by its board of directors, (ii) continues in existence regardless of the death, bankruptcy or sale of interests of any shareholder, with few exceptions for certain tax reasons, and (iii) generally protects shareholders from personal liability for the corporation's obligations. By default, a corporation is treated as a "C" corporation for U.S. federal income tax purposes. Profits of a "C" corporation are taxed at the corporation level and, if dividends are distributed to shareholders, also taxed at the shareholder level, thus limiting its attractiveness to investors. Under certain circumstances, a "C" corporation can elect to convert to an "S" corporation, which is only subject to one level of tax. Among other limitations, however, a shareholder of an "S" corporation may only be an individual who is a U.S. citizen or resident alien, an estate or certain types of trusts.

The primary goals shared by investors when selecting a vehicle to own commercial real estate – avoiding double taxation and limiting liability to the amount invested – can be achieved in many cases through the use of a limited partnership or limited liability company, and in certain jurisdictions, a business trust. In many cases, a Delaware limited liability company is used mainly because such an entity achieves both of these objectives, is easy to form and operate, and Delaware's laws are well developed and provide for a great deal of flexibility. Another entity that achieves the goal of avoiding double taxation and limitation of liability is a real estate investment trust (a "REIT"). If the proper election is made, a REIT can be in the form of a limited liability company, a partnership, a corporation or a trust. Provided an entity qualifies as a REIT, it generally is not taxed on its otherwise taxable net income and gains to the extent that it distributes such income and gains to its shareholders. Rather, shareholders of a REIT are generally subject to tax on such distributions so that an investment through a REIT is typically subject to a single level of tax and not the double level of tax that generally applies to "C" corporations. In order to qualify as a REIT, an entity must satisfy certain requirements with respect to its ownership, operations, income, and assets. If an entity's status as a REIT is terminated because it fails to meet the applicable REIT requirements and does not satisfy certain relief provisions, the terminated REIT will be taxed in the same manner as a "C" corporation.

9. What is the usual legal due diligence process that is undertaken when acquiring commercial real estate?

For transactions involving the purchase of commercial real estate, the investor's lawyer would typically review, as part of due diligence, and/or assist with commissioning, the following:

- the real estate records and other state and

city governmental records through a title report prepared by a title insurance company;
- a survey of the land and improvements located thereon;
- a zoning report or zoning letter;
- an environmental report (commonly referred to as a "Phase I" environmental site assessment);
- leases (if the property is subject to leases – though the extent of this review will depend on the nature of the property and why the investor is purchasing the property); and
- any other material contracts relating to the property.

The due diligence process performed by the investor's lawyer can take several weeks (particularly as some of the key searches can take a number of weeks to be produced) and is relatively expensive as most sales are on an "as-is" basis. As such, sellers give limited representations regarding leases, services contracts, and some other property related matters but do not generally give purchasers warranties regarding title to the property, the condition of the property or its compliance with laws. In certain cases (such as where the seller is selling complex or numerous properties via a competitive bid process), the seller may decide to assemble many of the relevant due diligence materials in order to accelerate the sale process, ensure that all bidders are provided with substantially the same information, and avoid the same due diligence activities from being carried out several times (which could disrupt tenants at the property or the seller's employees).

In many cases, the purchase and sale agreement will provide for a due diligence contingency period which is when most of the legal and non-legal due diligence will take place. During that period, the investor has the right to terminate the purchase and sale agreement for any or no reason and, in such event, will receive a return of any deposit monies previously tendered. When market conditions favor the seller, however, such due diligence contingency periods are typically shorter or may even be eliminated.

In the case where a property is sold by way of a transfer of the direct or indirect ownership interests of the property owner rather than the property itself, additional due diligence is performed in respect of the relevant entities that are to be purchased. In such transactions, the seller would typically give representations and warranties on the constituent entities in addition to the limited set of representations and warranties relating to the property itself.

10. What legal issues (if any) cannot be covered by usual legal due diligence?

Generally, a purchaser would take title to real property subject to matters of which it is actually aware as well as those for which it is on constructive notice. Constructive notice attributes knowledge to a person or entity of those things that would be known if a search were carried out by a reasonable person even if such person or entity did not in fact carry out such search or have actual knowledge of the result thereof. While in the typical due diligence process lawyers commission and review most of the searches that would otherwise result in constructive notice, there are some searches that are not performed by lawyers. For example, matters that would be apparent from a physical inspection of the property would be imputed to a purchaser.

11. What is the usual process for transfer of commercial real estate?

Transaction Steps	Seller	Purchaser	Comments
Letter of Intent (the "LOI")	· Hire a broker or self-market the asset for sale. · Depending on the market and level of interest in the asset, the seller's broker may solicit bids from interested purchasers which may then go through one or more rounds of bidding until a potential purchaser is selected. · Review the LOI from purchaser and negotiate same. · Prepare and aggregate due diligence materials (title documents and property information, including leases, financial information, service contracts, existing third-party reports) for distribution to potential purchasers. Prior to such distribution, it is common for sellers to require that a potential purchaser execute an agreement to keep such information confidential.	· Prepare and negotiate the LOI. · Review and negotiate confidentiality agreement, if applicable. · Review any due diligence materials provided by the seller. · Consider and solicit proposals for financing.	· There is no prescribed form of the LOI but there are industry standard terms. · The LOI is typically not binding except for specifically agreed upon terms such as the existence of a broker, confidentiality and, in some cases, an agreement by the seller to exclusively deal with the purchaser for a specified period. · In some cases (usually where time is short and the deal is relatively straightforward), the parties dispense with the negotiation of an LOI and proceed "to contract". In such a case, the seller will instruct its lawyer to prepare a draft purchase and sale agreement for review by the purchaser and its lawyer. · Increasingly, most of the due diligence materials are hosted on a secure website known as "virtual data rooms".
Purchase and Sale Agreement (the "PSA")	· The seller's attorney to prepare drafts of the PSA and closing documents. · Negotiate the PSA, deed, and other closing documents with the purchaser's lawyer.	· Review and negotiate the PSA and closing documents. · If the purchase is not subject to a due diligence contingency period (see Q9 above), carry out due diligence and commission title report, survey of the property, and other third-party reports. · If the purchase is subject to a due diligence contingency period, then carry out limited due diligence to assist with negotiation of the PSA.	· There is no prescribed form of the PSA but there are industry standard terms. · Most states have specific rules that prescribe the statements to be included for the type of deed to be used as well as rules concerning the form of the deed in order for it to be in recordable form.
Signing the PSA to Closing	· Satisfy any seller conditions to closing. · Obtain any third-party consents or approvals, if applicable. · If the property is subject to financing that is not going to be assumed, then notify lender of the seller's intent to pay off the financing, request a release of the property from the financing or arrange for the assignment of the existing mortgage to the new lender, as applicable. · Prepare closing statement and agree on apportionments.	· Upon signing the PSA, pay deposit into escrow with title insurance company or seller's lawyer. · Finalize sourcing debt and equity capitalization for payment of purchase price. · Satisfy any purchaser conditions to closing. · Review closing statement and agree on apportionments.	· A deposit of not more than 10% of the purchase price (generally a smaller percentage in larger transactions) is typically paid into escrow on signing which will be forfeited by the purchaser if it fails to complete the sale (unless failure was due to the seller's default under the PSA or if the purchaser has a right to terminate the PSA). · Closing statement deals with the apportionment of real estate taxes, rental income, arrears, service contracts, and other expenses. · The deed (and any other documents to be recorded in the real estate records) must be notarized (or if executed outside of the U.S., notarized in a U.S. embassy or consulate office or notarized by a local notary with an apostille).

Closing	· Use of purchase price proceeds to pay off any existing debt that is not being assumed. · Delivery of deed and any other closing documents. · Arrange closing phone call or meeting with escrow agent, seller, purchaser, their respective lenders, and lawyers for "breaking escrow" (i.e., the dating and release of documents and release of funds).	· Pay into escrow balance of purchase price as adjusted by apportionments. · Satisfy purchaser's lender's conditions precedent to induce it to make the loan and execute loan documents. · Execute closing documents. · Attend closing phone call or meeting referred to in the column to the left.	· If closing is "in escrow", all closing funds and documents will be sent to escrow agent to be held by it and then released and distributed upon the satisfaction of specific conditions.
Post-closing	· If not provided at closing, provide purchaser with tenant lease files and any keys to the property. · Close all utility accounts for the property that are in the name of the seller. · Remit any rents received by the seller from tenants that relate to the period from and after closing. · If applicable, file any notices required by any government agencies.	· Send notices of sale executed by the seller to tenants, service contractors, and any other applicable third party. · Transfer (or open new) utility accounts for the property.	· The title insurance company will arrange for recording of the discharge of the seller's mortgage, the deed, and the purchaser's mortgage documents. If the title insurance company is also acting as escrow agent, then it will also arrange for distribution of original sets of closing documents to the purchaser and seller. While the title insurance company might not record the documents on the day of the closing of the transaction, the title insurance company will, in most jurisdictions, insure the purchaser for the gap period between closing and recording. · In cases where some of the amounts that need to be apportioned cannot be determined at the time of closing, those amounts are typically apportioned based on an estimate and then re-apportioned post-closing once those amounts are able to be determined.

12. Is it common for real estate transfers to be effected by way of share transfer as well as asset transfer?

It is far more common for real estate transfers to be effected by way of deed (asset transfer) than by way of share transfer. Generally, unless there is a compelling commercial reason to do so, purchasers prefer to purchase the asset rather than to purchase the shares of the property owner because in a share transfer the property owner's liabilities continue after the transfer. In the case where a transaction is to be effected through a share transfer, additional due diligence needs to be carried out in respect of the applicable entity or entities.

13. On the sale of freehold interests in land does the benefit of any occupational leases and income automatically transfer?

Yes. Nevertheless, in a typical transaction, the seller and purchaser will execute a separate instrument assigning all of the leases that affect the property.

14. What common rights, interests and burdens can be created or attach over real estate and how are these protected?

A wide variety of rights, interests and burdens can be created or attached to real estate, but given the historical nature of real estate law in the U.S. and the adoption of certain vestiges of the arcane laws of England, there are a large number of complex rules that govern them, which can create somewhat arbitrary distinctions around exactly when certain rights, interests or burdens will attach and "run" with the land. Some of these key interests are:

- easements: for example, rights of way over a property;
- restrictive covenants: for example, an agreement not to build more than one house on a plot of land;
- mortgages or other security instruments securing debt obligations; and
- options to purchase, and other rights to purchase, such as rights of first refusal and rights of first offer.

While recording of documents evidencing such agreements is not required in order for the applicable agreement to be enforceable against the grantor, all of the above rights and interests must be recorded in the real estate records in order to ensure that such rights and interests are not subordinated to the rights of a subsequent bona fide purchaser for value who records its interest.

15. Are split legal and beneficial ownership of real estate (i.e. trust structures) recognised

Title to real property may be held in trust, with a trustee holding legal title and the beneficiaries of the trust holding beneficial title. Such a structure is typically implemented for estate planning purposes. Certain states, such as Florida, also have statutory trust structures for the ownership of real property (e.g., the Florida land trust), which provide a similar separation of legal and beneficial title. In such a trust structure, the trustee, with reference to the trust he, she or it is holding for, would appear as the record owner of the property. In the case of a sale of a property by a trust, the title insurance company will require evidence of the trustee's authority to sell the property. Also, some states permit the use of a nominee structure, whereby a nominee would hold the property on behalf of another and may engage in transactions with respect to the property.

16. Is public disclosure of the ultimate beneficial owners of real estate required?

Generally, no. There are, however, requirements to make non-public disclosure of the ultimate beneficial owners of real estate to certain governmental agencies in certain types of real estate transactions. In the federal arena, for example, FinCEN requires that a title insurance company collect and report to FinCEN the identity of all individuals owning 25% or more of the direct or indirect interests of an entity (other than a public entity) that is purchasing residential real estate for more than $300,000 in an all-cash transaction (i.e., without mortgage debt) in any one of 9 major U.S.

metropolitan areas. FinCEN will also require non-public disclosure of certain beneficial owners pursuant to the Corporate Transparency Act as described in Q3 above. In addition, CFIUS (see Q5) may require disclosure of the identity of, among other things, the direct and indirect beneficial owners of a purchaser or investor in U.S. real estate in order to determine the effect a transaction may have on national security.

While most states do not require public disclosure of the beneficial ownership of entities engaged in real estate transactions, some states have begun requiring such disclosure in certain types of transactions. For example, New York recently passed a law requiring that, in the sale of a 1 to 4 family dwelling, a buyer or seller that is a limited liability company (but not a corporation, partnership or other legal entity), disclose its direct and indirect beneficial owners. Note that this disclosure is not publicly filed but would be available to the public through a freedom of information law request. Additionally, Legislation that would require all limited liability companies authorized to do business in New York disclose their ultimate beneficial owners on the public records has been proposed but, as of this writing, has not been passed.

17. What are the main taxes associated with commercial real estate ownership and transfer of commercial real estate?

Taxes imposed on ownership of commercial real estate are:

Income Taxes: U.S. federal income taxes, as well as state and local income taxes in certain states and localities, apply to income arising from the ownership of commercial real estate by both U.S. and non-U.S. tax residents. The rates will vary depending on a number of factors, including the structure through which the real estate is owned (e.g., whether the real estate is owned through a flow-through entity, a “C” corporation or a REIT), whether the direct and indirect owners of the commercial real estate are U.S. tax residents and, if not, the applicability of either an income tax treaty with the U.S. or a U.S. domestic exemption.

Property Taxes (or Real Estate Taxes): In the U.S., the real property tax scheme varies by state and sometimes by local jurisdiction, but generally, local governmental entities are required to comply with the state’s tax laws to assess and collect an annual tax (with the rate varying by locality) on the value of land, structures, and improvements. Usually, the tax imposed is calculated by reference to a stated percentage of the fair market value of the real estate. In most jurisdictions, certain types of property are exempt from real property tax, including properties owned by a not-for-profit organization and properties in specified economic development zones. In addition to real property tax, most state tax schemes provide for the taxation of tangible personal property owned by business entities.

Other Taxes: Certain jurisdictions impose a commercial rent tax on tenants of commercial real estate.

Taxes commonly imposed on the transfer of commercial real estate located in the U.S. are:

Income Tax: U.S. and non-U.S. tax residents are generally subject to U.S. federal income tax, as well as state and local income tax in certain states and localities, on capital gains recognized on the disposition of U.S. real estate. The rates vary depending on a number of factors, including the structure through which the real estate is owned. In addition, non-U.S. tax residents disposing of U.S. commercial real estate are generally subject to a withholding tax equal to 15% of the purchase price (including any debt assumed or treated as assumed in connection with the disposition).

Real Estate Transfer Tax: Many U.S. states (and a number of counties and cities) impose a transfer tax on the sale of a property (or the granting of a long-term lease) based on the purchase price of the property. In addition to direct transfers of property, some states impose a tax on transfers of a controlling interest in an entity that owns property located within the state. Each state and local government sets its own rate of tax and the basis to which that rate is applied.

Mortgage Recording Tax: A number of states and municipalities impose a mortgage recording tax, calculated as a percentage of the face amount of the mortgage (and occasionally varying with the length of the term of the mortgage loan). The tax is typically due at the time the mortgage is recorded and paid by the borrower although the process for the payment of mortgage recording tax and the party responsible for the payment of the same can vary depending on the custom of the applicable state and/or municipality. Some states permit a borrower seeking to refinance a mortgage loan to have the mortgage encumbering its property assigned to its new lender and thus avoid paying mortgage recording tax on the principal then outstanding.

18. What are common terms of commercial leases and are there regulatory controls on

the terms of leases?

Although certain jurisdictions do place restrictions on commercial leases such as limiting the length of their term or prescribing certain required provisions, the terms of commercial leases are primarily established by contract rather than any federal, state or local governmental authority or law.

Term:

Leases must be granted for a fixed period (i.e., they cannot be indefinite). With very few exceptions, there is no required maximum or minimum duration though it is rare for a lease to be longer than 99 years. Typically, commercial leases are between 5 and 15 years.

Renewal rights:

Tenants under commercial leases do not have a statutory right to renew the term of their lease and such right is entirely determined by contract.

Rent:

There are no regulations on the amount of rent charged for a commercial space and, as such, the same is determined by contract. The parties to the lease may agree to a fixed rent throughout the term of the lease or they may agree to rent increases which may be based upon a fixed percentage, tied to a referenced index of inflation such as the Consumer Price Index of the U.S. Department of Labor, or be based upon a fair market value determination (or some combination thereof). The longer the term of a lease, the more likely it is that there will be one or more adjustments of the rent based on fair market value of the property (sometimes with a floor to prevent rent from decreasing). In some retail leases, the rent is either wholly or partly based on percentage rent which is calculated by reference to the tenant's gross sales at the premises.

Permitted Use:

It is typical for there to be regulations limiting the tenant's use of the premises. Leases will also often restrict a tenant's ability to change the use of the premises.

Repair:

There are few laws regarding either party's repair obligations in the commercial context. Parties are therefore free to agree who is responsible for each type of repair. Typically, the landlord is responsible for repairs to the structure and roof of the property as well as systems that serve the building at large while the tenant is responsible for repairs to its space and those systems that exclusively serve its premises.

Operating Expenses:

There are no laws in the commercial context as to what expenses may be passed through to a tenant. Parties are therefore free to agree what items are to be passed through or absorbed by the landlord. Where the lease demises part of a building, the tenant will often be required to reimburse the landlord for a portion of the costs of operating, repairing, maintaining, and insuring the structure of the building in addition to the cost of lighting, heating, cooling and otherwise maintaining the common areas (e.g., reception, stairwells). In a multi-tenant property, each tenant's share of operating expenses is usually calculated based on the relative amount of space leased by such tenant. Tenants often resist the inclusion of expenses that are capital in nature in the calculation of their obligation to reimburse operating expenses.

Assignment:

There are few laws regulating a tenant's right to assign its interest in a commercial lease. Typically, a commercial lease will prohibit a tenant from assigning its interest in the lease without the landlord's consent. These restrictions would generally extend to direct or indirect transfers of ownership interests in the tenant. Further, leases will often provide a landlord with the right to cancel the lease or "recapture" the premises upon a request from a tenant to assign its interest in the lease. Assignment provisions are the subject of a great deal of negotiation and often a landlord will agree to not unreasonably withhold, condition or delay its consent with respect to a request therefor. As part of its negotiation, tenants will seek to have certain transferees pre-approved and exempt from the recapture right (e.g., transfers to affiliates or in the case of a sale or merger of the parent company). An assignor of a lease is not released from liability thereunder absent an affirmative release from the landlord. It should be noted that in the event of a bankruptcy involving a tenant, the bankruptcy court may order the assignment of a lease even where such assignment would violate the assignment provisions of the lease and regardless of whether the landlord has consented to such assignment.

Subleasing:

There are few laws regulating a tenant's right to sublease its premises. Similar to the restrictions on assignment, a commercial lease will generally prohibit a tenant from subleasing its premises without the landlord's consent and also provide the landlord with a right of recapture if a request is made therefor. Just as they do in the case of assignment, landlords will often agree to not unreasonably withhold, delay or condition their consent to a tenant's request to sublease. Care should be taken by a tenant to ensure that a sublease should not expire later than the day before the expiration date of the prime lease in order to avoid the sublease from being re-characterized as an assignment of the prime lease.

Termination Rights:

Each state has laws governing the right of a landlord to terminate a lease and evict a tenant in the case of a default by the tenant of its obligations under a lease. Landlords typically have the right to terminate a commercial lease and evict a tenant through court proceedings if the tenant fails to pay rent and/or other amounts when due or in the case of other breaches by the tenant which remain uncured.

A commercial lease will also usually provide the landlord or tenant with the right to cancel the lease in the case of a material casualty to the premises or a taking of a material part of the premises by eminent domain.

Though less typical, tenants may have the right to terminate its lease early under certain circumstances or at certain times during the term of the lease. In such a case, the tenant may be required to pay a termination fee and provide ample notice to compensate the landlord for the leasing costs it incurred and allow it sufficient time to re-let the premises. Leases for space in shopping centers sometimes contain termination rights in favor of tenants which are exercisable if occupancy at the shopping center falls below a specified threshold or if a specific tenant is no longer operating at the center.

19. How are use, planning and zoning restrictions on real estate regulated?

Governmental Regulations:

Use, planning, and zoning restrictions are enacted and enforced by each municipality (e.g., city, county or town) through statute. Use, planning, and zoning laws affect the use of a property, the standards to which any buildings located on a property must be constructed as well as limits on lot size, building size, height, floor area ratio, number of rooms, parking, and setbacks. If the property is being operated under a permitted use, then such use is considered to be permitted "as of right". Properties which were constructed prior to current use, planning, and zoning restrictions are typically grandfathered into the current code, meaning that they are considered "legal non-conforming" and can remain and, in some cases, be rebuilt to the same extent they were non-conforming following a casualty. An owner of property may apply for a special use permit or variance if compliance "as of right" would cause it undue hardship which, if approved, would allow for additional uses or other non-compliance with applicable regulations.

Although use, planning, and zoning restrictions are primarily shaped by local law, federal law can pre-empt local law.

Private Restrictions:

Use, planning, and zoning restrictions may also be created by contract between owners of interests in real property. These are often found in reciprocal easement agreements and covenants, conditions, and restrictions in connection with planned developments, such as shopping centers and subdivided housing developments where property owners benefit from having the use and characteristics of adjacent properties conform to certain specifications. The agreements "run with the land" and are almost always recorded in the real estate records. Certain municipalities, such as the city of Houston, Texas have historically relied exclusively on private deed restrictions rather than statute in order to regulate use, planning, and zoning restrictions.

20. Who can be liable for environmental contamination on real estate?

Federal and state laws including the federal Comprehensive Environmental Response, Compensation and Liability Act of 1980, commonly known as "CERCLA" or "Superfund", impose liability on parties that own, operate or occupy (or have previously owned, operated or occupied) contaminated property regardless of fault. While parties to a purchase agreement can allocate responsibility for clean up between them, this will not serve to prevent claims from the government under such laws. Purchasers, however, may avoid liability under CERCLA if they satisfy the bona fide prospective purchaser defense. This defense requires that a purchaser conduct "all appropriate inquiry" into the environmental condition of a property prior to its acquisition and exercise "appropriate care" with respect to any environmental condition thereat. To qualify for the defense, the purchaser cannot be affiliated with any other party that is potentially liable for clean-up costs. The standard for "all appropriate inquiry" was promulgated by the U.S. Environmental Protection Agency and generally is the process of evaluating a property's environmental condition and assessing potential liability for any contamination. While there is no one size fits all for "all appropriate inquiry," in the typical case it means commissioning a type of environmental assessment of the property commonly known as a Phase 1 Environmental Site Assessment. “Appropriate care” means that the purchaser took reasonable steps to stop any continuing releases, prevent any threatened future release, and prevent or limit human, environmental or natural resource exposure to any previously released hazardous substance. Most states have comparable defenses under their respective environmental statutes.

21. Are buildings legally required to have their energy performance assessed and in what (if any) situations do minimum energy performance levels need to be met?

As real estate is mainly a state and local level matter, laws regarding energy performance are generally handled on the state or local level of government, not at the federal level. Currently, there are no federal laws requiring an assessment of energy performance for buildings in the U.S. Discussions about carbon emissions and net-zero laws have prominently featured in the national discourse, and a few local governments have taken progressive positions on these matters. With respect to real estate, these laws are generally around carbon dioxide emissions from fossil-fuel combustion attributed to commercial and residential buildings, primarily for heating, hot water, cooking and leaks of compounds from refrigeration and air-conditioning. Laws regarding energy performance in commercial buildings in the U.S. are very new, and have local differences in standards, requirements, and penalties. The success of these laws going forward will probably result in many more jurisdictions enacting such laws. In addition to New York City and Washington, D.C., as summarized below, other jurisdictions in the U.S. have also enacted net-zero laws affecting building emissions; these include, without limitation, San Francisco, California and Denver, Colorado. This is an evolving area in the law. Any client looking to purchase residential or commercial buildings in the U.S. should do an analysis of applicable laws that may affect such buildings.

In New York City, the NYC Climate Mobilization Act (CMA) of 2019 is a group of four local laws (92, 94, 95 & 97) aimed at drastically cutting building carbon emissions, starting with a 40% reduction goal by 2030 and an 80% reduction goal by 2050. New York City also enacted Local Law 33 (Building Energy Efficiency Rating), which requires owners of buildings over 25,000 square feet to obtain the Building Energy Efficiency Rating labels and display them near public entrances by October 31 of each year; buildings that do not post by the deadline are fined $1,250 per violation. The label includes an ENERGY STAR® score and a corresponding A-D letter grade to give New Yorkers a snapshot of the building’s energy performance, and to benchmark it against other buildings. However, Local Law 97 is the most impactful of the enacted laws in that it imposes unprecedented emissions regulations on nearly all residential and commercial buildings in the City over 25,000 square feet. Buildings owned by New York City, rent regulated buildings and buildings owned by religious corporations and places of worship are excluded. Local Law 97 takes aim directly at emissions by defining an absolute limit on emissions based on a building’s use classifications and the amount of floor space dedicated to each classification; a building’s emissions depend on an “emissions factor” applied to each source of energy (e.g., natural gas, electricity or district steam) based on its associated carbon pollution. Under Local Law 97 all building owners must submit their first emissions intensity report for the prior year (2024) by May 1, 2025; the reporting is annual thereafter and must be prepared by a registered design professional. Buildings that do not timely submit an annual report or that release carbon emissions above their occupancy group limit will be fined. If the annual emissions for a building are less than the annual emissions limit for that building, then the building is in compliance. The fine for exceeding the limit will be $268 per metric ton of emissions, and for large buildings that can run hundreds or even tens of thousands of tons over their emissions limit, the fines can run into tens of thousands or even millions of dollars. Note also that the building emissions limits under Local Law 97 are valid from 2024 through 2029, and then become substantially more restrictive in 2030 through 2034, and for each five-year period thereafter. Local Law 97 does allow authorized building owners to meet some of their emissions limits and to reduce penalties by purchasing certain renewable energy credits; however, the eligible credits do not currently exist and are not expected to be available until at least 2026. The city plans to work with some building owners who are at risk of violating Local Law 97 thresholds through a special decarbonization plan which could give such owners up to two additional years to comply with the carbon caps starting in 2024; however, as of now, those buildings taking part in such plans will not be able to utilize renewable energy credits. The New York City Department of Buildings issued a set of final rules and an additional set of proposed rules in September 2023 to guide the ongoing implementation of Local Law 97, including allowing certain building owners to mitigate compliance fines in 2024 if they can demonstrate concrete steps towards decarbonization that will result in them achieving their 2024 targets by 2027 and their 2030 targets on-time by 2030. The rules surrounding Local Law 97 are in flux and are subject to change as implementation of the law goes forward.

Washington, D.C. has also enacted the Clean Energy DC Omnibus Act of 2018, which was amended in 2022 by D.C. Act 24-304 (collectively, the "Omnibus Act"), and the Clean Energy DC Building Code Amendment Act of 2022 (A24-0528) (the "Clean Energy Act"). The Clean Energy Act requires that by the year 2026, all new construction buildings and substantial improvements to covered buildings in Washington D.C. be constructed to a net-zero-energy standard, for which the city must establish new net-zero energy building codes no later than December 31, 2026. The term "new construction" includes an addition to or enlargement of an existing building, and "substantial improvements" means any repair, alteration or addition, the cost of which exceeds 50% of the market value of the structure before the work is started. The Omnibus Act expanded Washington D.C.'s mandatory building performance benchmarking program to include all buildings owned by the District of Columbia of at least 10,000 square feet, and privately owned buildings of at least 50,000 SF, with the threshold decreasing to 25,000 square feet on January 1, 2027 and 10,000 square feet on January 1, 2033 for privately owned buildings. The Omnibus Act mandates that all of D.C.'s energy supply come from tier 1 renewable energy sources by 2032, and by 2041, at least 15% of that energy must come from solar energy generated within D.C. To meet its carbon-neutral goal to reduce greenhouse gas emissions and energy consumption by 50% by 2032, about half of the city's existing buildings over 10,000 square feet will need to boost their energy performance, most likely through building retrofitting, re-skinning, repositioning, and heating, ventilation and air-conditioning (HVAC) system upgrades. New Building Energy Performance Standards have been established, which are at least equal to D.C.'s median ENERGY STAR score for established property types. If a building is found below the standard, it will enter a 5-year compliance cycle (which may under certain circumstances be extended for up to 3 years) to improve its energy performance by 20% or be penalized at the end of the cycle over such 5-year compliance period. For buildings that do not meet the standards, the Department of Energy & Environment will provide pathways to achieve these benchmarks through reductions in energy use intensity and implementing cost-effective energy efficiency measures.

22. Is expropriation of real estate possible?

Yes. Expropriation, known as the power of "eminent domain" or "condemnation" or a "taking," is the power of the federal or state government to take private property for a public purpose in exchange for just compensation. Additionally, private corporations (such as utility companies) may also have eminent domain powers if such powers were delegated by law. Eminent domain can be effected through the taking of a fee interest, easement, leasehold or other real property interest. The Fifth Amendment to the U.S. Constitution requires that any such taking be for a "public purpose" and that the owners thereof receive "just compensation" and the Fourteenth Amendment to the U.S. Constitution affords such owners due process rights including the opportunity to be heard in an impartial judicial setting. Appraisals are commissioned in order to assist with determining the amount of compensation to be awarded to a property owner. Other factors that are considered include business losses and, if applicable, the loss in value to the remainder of the property.

23. Is it possible to create mortgages over real estate and how are these protected and enforced?

Yes, mortgages can be created over real estate (or an interest therein). As a technical matter, however, in some states, the manner in which security is granted over real estate is by deed of trust (rather than a mortgage) where the property owner places the property in trust with a trustee for the benefit of the lender. In the case where the interest to be secured is a leasehold estate, the terms of the lease must first be reviewed to ascertain if the lease is indeed financeable and to ensure that any requirements prescribed by the lease have been satisfied.

In order to perfect the lender's interest in a mortgage, the mortgage must be recorded in the real estate records in the county where the applicable property is located. Once recorded, a mortgage will generally have priority over any future encumbrances and any prior unrecorded encumbrances (except for encumbrances that the lender was aware of or should have been aware of). While a mortgage does not need to be recorded in order to be enforceable, the failure to record generally exposes the lender to have its interest subordinated to a subsequent bona fide purchaser for value that records its interest first. Depending on the municipality where the property is located, the method for recordation (i.e., physical delivery vs. electronic recording) and the volume of documents submitted for recording, the actual recordation of a document may take place on the day of closing or days or weeks after the closing of the transaction. Any delay in the recordation of a mortgage is not typically a practical concern for the lender because the lender will have obtained a title insurance policy for its mortgage loan and the title insurance company will insure the lender for the gap period between closing and recording.

A mortgage is a lien which provides the lender with the power to sell the property owned by the borrower at the time the mortgage was granted. In the case of a default, the lender may exercise such power of sale through the foreclosure of the mortgage. There are two types of foreclosure – judicial and non-judicial foreclosure. The remedy of judicial foreclosure is available in all states, and more than half of the states also permit non-judicial foreclosure. The specific remedies available to a lender and the manner in which a foreclosure is carried out is governed by state law with significant variations. Generally, in a judicial foreclosure, the lender must commence a lawsuit against the borrower to initiate the foreclosure process. The entire process is then run through the court and, as a result, takes longer than a non-judicial foreclosure and allows the borrower to raise defenses as part of the proceeding. In a non-judicial foreclosure (typically permitted in states that employ a deed of trust regime), the lender may proceed with the foreclosure outside of court in accordance with state law. Non-judicial foreclosures are less formal and proceed quicker than a judicial foreclosure. In either case, the borrower will have the right to attend and bid at the auction and the lender will have the right to credit bid the amount of its outstanding indebtedness. If anyone other than the lender is the winner of the auction, then the lender will receive the proceeds from the sale up to the amount of its outstanding indebtedness with any surplus going to junior lienholders or the borrower. If the lender is the winner of the auction, it or its designee becomes the owner of the property. Depending on the state in which the property is located and the terms of the loan, the lender may be able to pursue the borrower or other credit parties for any deficiency.

24. Are there material registration costs associated with the creation of mortgages over real estate?

Yes, in some states. Some states and municipalities impose a mortgage recording tax which is calculated as a percentage of the face amount of the mortgage and is paid by the borrower (see Q17). In all cases, in addition to its own costs, a borrower will be responsible for the lender's title insurance, legal fees, and due diligence costs as well as a *de minimis* recording charge.

25. Is it possible to create a trust structure for mortgage security over real estate?

Yes, except such structures are usually in the form of an agency relationship rather than a trust. Where collateral is pledged, or security interests granted to more than one lender it is common to use a collateral agent to hold such collateral and/or security interests as agent for the lenders. Under this structure, the underlying lenders can change without any changes being required to the mortgage or security documentation and the collateral agent would enforce the security on behalf of the lenders. Also, if such a structure is used, the collateral and security interests held by the collateral agent on behalf of the lenders should not be considered to be part of the collateral agent's estate in the event of its insolvency, though the lenders would likely need to seek approval from the bankruptcy court to unwind the structure or take other action.

Contributors

Ness Cohen
Office Managing Partner, New York & Chairman of Clifford Chance's Real Estate practice in the Americas
ness.cohen@cliffordchance.com


Eddie Frastai
Partner
eddie.frastai@cliffordchance.com


Jeanne Roig-Irwin
Partner
jeanne.roig-irwin@cliffordchance.com


Kris Ferranti
Partner
kris.ferranti@cliffordchance.com


Jon Newman
Partner
jon.newman@cliffordchance.com