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Real Estate 2024

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USA – New York: Law & Practice

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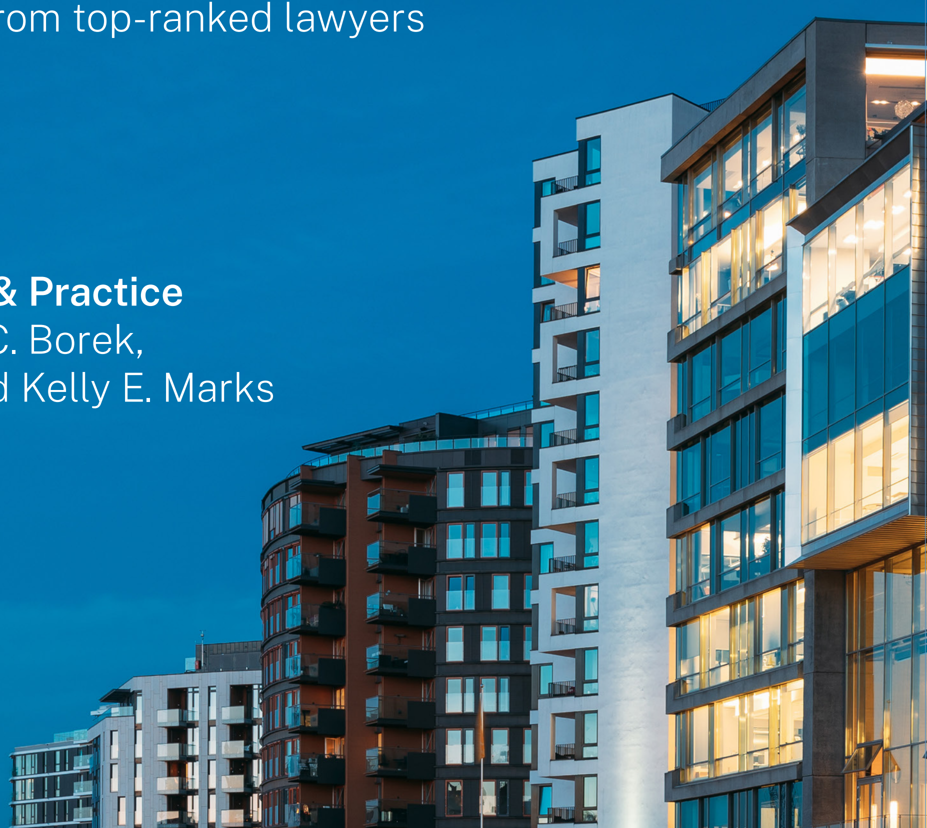

USA - NEW YORK

Law and Practice

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Phillips Lytle LLP is a preeminent law firm with a highly recognised real estate practice consisting of 50 attorneys with a broad range of expertise. With offices across New York State, as well as offices in Chicago, IL; Washington, DC; and Ontario, Canada, Phillips Lytle has handled many high-profile real estate development projects. The firm has nationally recognised experience across numerous areas, including those involving institutional lenders, corporations, REITs, private developers, public utilities, municipalities, individuals, and others in connection with large and small commercial, industrial, office, professional, retail and residential projects. The practice includes national, high-volume, high-technology representation in the telecommunications, lending and foreclosure areas, as well as nationwide multilocation retail leasing and portfolio sales. Areas of expertise include commercial leasing, construction compliance (including MWBE requirements) and litigation, land use, permitting and zoning, project development, real estate finance, real estate litigation and workouts, tax, and title insurance.

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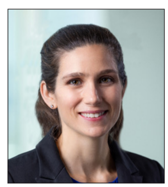

Erin C. Borek is a partner at Phillips Lytle LLP and member of its Real Estate Industry Team. She concentrates her practice in the area of civil litigation, with a focus on construction and commercial litigation matters, including breach of contract claims, payment disputes, lien foreclosures, delay claims and commercial torts. Erin frequently presents to various construction groups on a variety of topics including municipal contracts, the Prompt Payment Act, minority- and women-owned business enterprise requirements and evolving case law concerning industry-specific contractual terms and obligations. She is a member of the National Association of Women in Construction.

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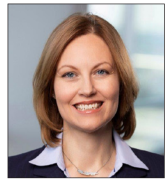

Kelly E. Marks is a partner and tax attorney at Phillips Lytle LLP practising in partnership and corporate tax, REIT tax, and the taxation of mergers and acquisitions, private equity deals, joint ventures, and equity compensation, with expertise in New York State tax law. She has provided tax advice in connection with asset, stock, and equity sales; stock offerings and private placements; and executive compensation. Kelly, who is a member of the Bar Associations of New York State and Erie County, also has experience providing tax advice on real estate transactions and joint ventures.

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1. General

1.1 Main Sources of Law

Real estate law encompasses a broad range of skills and practice areas. To adequately represent a client, a real estate attorney must understand the nature of the client's business and the client's willingness to take risks.

A real estate practitioner must understand the myriad of potential issues that may arise for a given real estate project (typically within tax, finance, corporate, securities, environmental, energy and land use, bankruptcy, government relations, insurance, and construction, among others) and have access to the breadth and expertise necessary to effectively represent clients on all relevant issues. To that end, most matters require a team approach, with lawyers who have differing expertise. In addition, practitioners must be resourceful and have the ability to communicate and negotiate effectively. Current trends typically do not impact the skills required to practice real estate law; however, one must remain aware of them to effectively assist clients in moving their real estate projects forward.

1.2 Main Market Trends and Deals

The dominant trend in real estate in 2024 remains rising interest rates and economic uncertainty, especially in an election year. The pipeline of new development projects has slowed significantly as higher rates and somewhat flat demand make it harder for projects to "pencil out." If rates continue to rise, or remain stagnant, there could be significant impacts on over-leveraged commercial owners. Industrial properties continue to grow at a steady rate as the amount of e-commerce grows and federal stimulus targets expansion of US-based manufacturing capabilities. Brick-and-mortar retail is slowly making its comeback post-pandemic. Consumers have adjusted to and embraced online shopping, but a stronger desire from people to make physical connections with brands and products is leading to improvements in in-store experiences for consumers. Developers continue to try to get creative to breathe new life into traditional shopping malls by converting them into mixed-use lifestyle centres with a focus on residential, restaurants, and other experiential features. Similarly, the outlook for dated commercial office space is trending towards residential conversion. Restaurants and hospitality continue to rebound as more and more people are getting back to normal and travel increases. Looking ahead, the big question is how the real estate-related trends that the pandemic accelerated will evolve over time. The "work-from home" model appears to be holding strong, and the impact on the commercial office space and dependent retail/restaurant sectors remains unclear. Employers are either getting creative in order to entice workers back to the office, or simply mandating new rules about required office presence.

1.3 Proposals for Reform

New York State Governor Kathy Hochul recently signed new legislation aimed at ending New York State's dependence on fossil fuels. The state's pending ban on natural gas is one of many steps to achieve the proposed goal of creating zero-emission buildings and reducing greenhouse gas emissions by 40% by 2030 and 85% by 2050 from 1990 levels. The natural gas ban will be effectuated through amendments to the State Energy Conservation Construction Code and the State Uniform Fire Prevention and Building Codes ("Codes"). Specifically, the natural gas ban legislation amends the Codes to prohibit the installation of fossil-fuel equipment and building systems, including plumbing, heating, electrical, lighting, insulation, ventilation, air conditioning and refrigeration that uses fossil fuels, in:

- new one-family residential buildings of any height beginning 31 December 2025;
- new multi-family residential buildings not more than three stories in height beginning 31 December 2025;
- new multi-family residential buildings more than three stories in height beginning 31 December 2028; and
- new commercial buildings beginning 31 December 2028.

Residential construction will seemingly be most affected by the ban, but how much homeowners and commercial building owners will pay for electrified alternatives will depend in part on the availability of alternative technologies – such as heat pumps to replace fossil-fuelled heating and cooling – and whether the state can remove the existing cost and permitting barriers to promote development of alternative energy sources. Hesitation on future new commercial development projects has already begun, with developers wary of unanticipated utility costs associated with an outdated electrical grid that will need improving to handle the new requirements.

2. Sale and Purchase

2.1 Categories of Property Rights

The most prevalent forms of ownership are individual and joint ownership through legal entities, such as limited liability companies, limited partnerships, corporations, or trusts. Currently, these legal entities remain the primary owners of commercial real estate, especially limited liability companies due to their flexibility with tax treatment and structuring the company. Typically, investors in commercial real estate take title through an entity, or series of entities, owned and controlled by the individual owners.

Residential real estate owned by more than one person may take title as tenants-in-common, joint tenancy with the right of survivorship, or tenancy by the entirety for married couples.

2.2 Laws Applicable to Transfer of Title

Generally, parties are able to buy and sell real estate without complying with any jurisdictional requirements. Only certain types of parties or real property are subjected to state or local regulation; eg, certain charitable corporations must obtain the permission of the Supreme Court of the State of New York or the New York State Attorney General before transferring real property.

Similarly, a party seeking to purchase a residential home that is in default on a mortgage loan must comply with the New York State Home Equity Theft Prevention Act. Properties that are suffering from environmental contamination may require the selling party to notify the New York State Department of Environmental Conservation or subsequent parties in title of the existence of the contamination or any restrictions placed upon the real property.

2.3 Effecting Lawful and Proper Transfer of Title

Transfer of title is effectuated by the delivery and acceptance of a deed, in recordable form, to the subject real property. To be in recordable form, a deed must be signed, be acknowledged by a notary, and contain an adequate description of the property. While delivery and acceptance of a deed is sufficient to transfer title to real property, the deed must be recorded in the county clerk's office and the applicable taxes and fees paid to perfect the transfer.

This final step is important because New York State is a "race-notice" jurisdiction. This means a party can simultaneously issue two deeds to two separate parties for the same real property. The party that wins the "race" to the applicable county clerk's office and has their deed recorded first will be the owner of the real property, provided that such party had no knowledge of the other deed.

2.4 Real Estate Due Diligence

Depending on the complexity of the acquisition, purchasers of real estate typically engage third parties such as attorneys, institutional lenders, real estate brokers, appraisers, engineers, surveyors, architects, general contractors, title insurance/search companies, accountants, insurance agents, environmental consultants, zoning research companies, representatives from local municipalities, and other third parties. Sophisticated purchasers often communicate directly with the above-referenced third parties. Contracts for the purchase and sale of real property typically provide the purchaser a specific time period in which to conduct all real estate due diligence.

Purchasers engage attorneys to coordinate with and review the work of the above-referenced third parties. Attorneys are also responsible for examining abstracts of title, instrument surveys, and other title documents to ensure the purchaser is receiving good and marketable title to the property.

Although purchasers are responsible for conducting due diligence and choosing to proceed with the real estate transaction, sophisticated purchasers are increasingly relying on the opinions and expertise of third parties to determine whether various aspects of the real estate are satisfactory for its end use.

2.5 Typical Representations and Warranties

While representations and warranties in a purchase and sale contract can vary greatly, in commercial transactions, the following representations and warranties are common:

- authority and capacity to execute the agreement and perform the obligations under the agreement;
- no pending or threatened lawsuits against the parties or the subject real property;
- no pending or threatened eminent domain or condemnation proceedings against the real property;
- no pending or threatened changes in the assessed valuation or tax rate applicable to the real property;
- no pending or threatened changes in the zoning classification of the real property;
- no known environmental defects with the real property or any actions being taken by any agency with respect to the environmental condition of the real property; and
- the existence and good standing of all permits and certificates necessary for legal use or occupancy of the real property.

In commercial transactions, there are generally no representations or warranties provided for under state or local law. This is not true of residential transactions. For instance, with respect to newly built homes, each sale is subject to certain warranties regarding the quality of construction under the Housing Merchant Implied Warranty.

For pre-built homes, sellers are required to make certain disclosures with respect to the condition of the real property in a Property Condition Disclosure Statement. These forms require the owner to represent certain facts, including general historical, environmental, mechanical, and structural information with respect to the property.

There are generally no common representations and warranties driven by the COVID-19 pandemic. One exception is a representation regarding a seller having a loan or other benefits through the federal Paycheck Protection Program (or related program) and whether such loan is still outstanding or has been properly forgiven and/or discharged. However, as time has passed since the COVID-19 pandemic, this type of representation is only of limited relevance.

Remedies and Protections

The remedies against a seller that breaches a representation are typically defined in the contract, including termination of the purchase agreement, specific performance, and monetary damages for out-of-pocket costs incurred by the purchaser owed to attorneys and third parties engaged to assist with purchaser's due diligence. Sellers typically seek to limit their post-closing liability for representations and warranties by negotiating into the contract a "sunset provision" on their survival. The typical "sunset provision" ranges from six months to one year. However, depending on the transaction and relationship of the parties, the "sunset provision" may run significantly longer. In addition, it is not uncommon in a commercial transaction for a seller to limit its liability for a breach of the representations and warranties. Typically, post-closing liability is capped at 1% to 5% of the purchase price. Such limitations on the length and extent of liability allow a seller to distribute closing proceeds and dissolve entities with knowledge of the maximum potential post-closing liability.

The statutory protections that exist in residential transactions also include remedy provisions, such as payment for actual damages if covered by warranty or if the misrepresentations prevented the purchaser from learning the truth before purchasing the real property.

It is not customary to utilise representation and warranty insurance in New York.

2.6 Important Areas of Law for Investors

There are several areas of law that are important for an investor to consider when purchasing real property in New York. Federal and state tax law is important for an investor to consider to determine the tax consequences of any transaction. In addition, it is important for an investor to have an understanding of New York Business Corporation Law, Partnership Law and/or Limited Liability Company Law so that the investor can properly determine which type of entity should be used to acquire title to real property. Finally, to confirm that the property is acceptable for the use contemplated by the investor, it is important for the investor to have an understanding of federal and state environmental law as well as local zoning and land use rules and regulations. If the real property is residential rental property, it is also important for an investor to have an understanding of New York landlord-tenant laws.

2.7 Soil Pollution or Environmental Contamination

As an owner or operator of a real estate asset, the buyer could be held strictly, jointly, and severally liable for preexisting soil pollution or environmental contamination pursuant to state and federal laws. Therefore, typical allocations of environmental risk in purchase and sale agreements are tailored to the intent of the parties, the site conditions, and the actual or potential presence of contaminants of concern.

Under the federal Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA), current owners and operators of a property are, except in limited circumstances, strictly liable for all response and remediation costs regarding hazardous wastes and substances that were released on a property, unless a statutory defence is established. These include acts of God or war, acts of third parties, and landowner liability protections, such as the innocent landowner defence, bona fide prospective purchaser defence, and contiguous property owner defence.

If the buyer spends money to clean up the contamination caused by others, there are contribution claims available under state and federal laws.

2.8 Permitted Uses of Real Estate Under Zoning or Planning Law

A buyer can ascertain the permitted uses of a parcel of real estate by undertaking an analysis of the applicable zoning map and code to identify the zoning district of the parcel in question and the uses permitted by right in that district, as well as the uses permitted upon issuance of a special use permit. In addition, a buyer should review the applicable zoning code to determine the associated bulk requirements. Further background is often available in a municipality's land use/comprehensive plan. See **4.6 Agreements With Local or Governmental Authorities**.

2.9 Condemnation, Expropriation or Compulsory Purchase

Governmental taking through eminent domain or condemnation is a possible risk in this jurisdiction. While there is only a slight risk that a governmental taking will occur, it appears more prevalent along rights of way to accommodate roadway-widening projects or the installation of public utilities.

The governmental taking process in New York State is codified in the New York Eminent Domain Procedure Law, and allows for condemnation by the filing of an appropriate map with the applicable county clerk (at which time the property set forth in the map vests in the governmental agency), or filing of petition to condemn, which seeks an order allowing the filing of an acquisition map. The title vests in the condemning party upon the filing of the acquisition map.

The condemning party is required to pay just compensation (defined as the fair market value of the property) to the former owner of the property that was acquired through condemnation.

2.10 Taxes Applicable to a Transaction

For the transfer of real estate, a transfer tax is due to the New York State Department of Taxation and Finance, and is paid to the applicable county clerk upon recordation of a deed. In order to record a deed, a transfer tax return (form TP-584) must be presented to the county clerk. The state transfer tax is USD2 for every USD500 of consideration paid or the fair market value of the real property. Local municipalities may also impose a separate transfer tax, which varies by county.

Transfer tax and the cost of filing a form TP-584 are customarily seller expenses, although this can be negotiated. Additionally, the "Mansion Tax" – imposed on the conveyance of residential real property where the consideration is USD1 million or more – has a tax rate of one percent of the consideration paid, customarily paid by the purchaser. Transfers of real property in New York City may be subject to additional taxes.

New York Tax Law was recently amended to provide that when the purchaser fails to pay the tax, the seller is required to pay. When the seller is required to pay the additional tax because the purchaser failed to pay, the additional tax becomes the joint and several liability of the seller and the purchaser.

A transaction of shares in a property-owning company also triggers a transfer tax obligation if the grantee, or a group of grantees acting in concert, acquires a controlling interest (50% or greater) from one or more grantors. Section 1402 of the New York Tax Law regulations provides a safe harbour for acquisitions of a controlling interest completed outside of a three-year period. The transfer tax is calculated by utilising the consideration paid for the shares or the grantor's pro rata share of the fair market value of the real property owned by the property-owning company.

Standard Exemptions

There are certain standard exemptions, including conveyances:

- to the federal or state government, or their agencies or political subdivisions;
- to secure a debt or other obligation;
- to confirm, correct, modify, or supplement a prior conveyance;
- made as gifts;
- that are only intended as a change of identity;
- given in connection with a tax sale;
- by deed of partition;
- made pursuant to the federal Bankruptcy Act;
- that only consist of certain contracts to sell, or options to purchase, real property; or
- not deemed a conveyance within the meaning of New York Tax Law.

2.11 Legal Restrictions on Foreign Investors

Regulations issued since passage of the Foreign Investment Risk Review Modernization Act of 2018 expose even noncontrolling foreign investments to potential CFIUS review if the investment conveys certain minimal rights in property within one of the listed proximities to specified national security installations or infrastructure. In view of the substantial penalties should CFIUS later determine a filing should have been made, as well as CFIUS' authority to block an investment or even order divestiture, filing for such review by simple declaration or more detailed notice, if applicable, would seem advisable.

Investors from "excepted investor states" (currently Australia, Canada, New Zealand, and the United Kingdom) are exempt from filing for noncontrolling investments provided the investor meets the detailed criteria of relationship to the "excepted" state outlined in the regulations. Even for these states, however, the usual rules apply for acquisition of controlling interests.

3. Real Estate Finance

3.1 Financing Acquisitions of Commercial Real Estate

Commercial real estate acquisitions are typically financed through commercial real estate loans from institutional lenders, customarily secured by a mortgage. In addition, commercial mortgage loans are usually further supported by guarantees of payment from the borrower's individual principals. For new construction, borrowers can apply for a construction loan mortgage.

In addition to mortgage loans, purchasers of commercial real estate may obtain mezzanine financing to finance amounts beyond what is loaned by the institutional mortgage lender. Mezzanine loans are secured by a pledge of the borrower's equity interest in the entity which owns the property. Developers also raise funds to purchase real estate by selling equity in exchange for cash contributions.

3.2 Typical Security Created by Commercial Investors

Typically, the security interest created in connection with a mortgage loan is a first-in-priority mortgage lien on the real property. If permitted by the lender, one could borrow additional money from the same or a different lender secured by a mortgage, which would be subordinate to the first mortgage. The security interest is created upon recordation.

The mortgage lender may also choose to file a Uniform Commercial Code (UCC) Financing Statement to create a security interest in any fixtures located at the property or to perfect a security interest in other non-real estate assets of the borrower.

With respect to mezzanine financing, the mezzanine lender may perfect its security interest by filing a UCC Financing Statement in the state of formation of the borrower entity. In addition, the mezzanine lender may require the borrower to opt in to Article 8 of the New York UCC, which changes the characterisation of the pledged equity interest to a "security" under Article 8, as opposed to a "general intangible" under Article 9. In order to perfect its security interest in this manner, the mezzanine lender would require the borrower to deliver original certificates of equity interest.

3.3 Restrictions on Granting Security Over Real Estate to Foreign Lenders

The Bank Secrecy Act governs the obligation of financial institutions, including lenders, to engage in strict compliance and reporting measures with regard to the prevention of possible money laundering, terrorism finance, or sanctions violations in international funds transfers or guarantees. Institutions must conduct extensive diligence of the parties to such transfers, routinely report all details, and file immediate reports of suspicious activity.

It is worth noting that CFIUS continues to expand and modify its list of installations and infrastructure subject to the special requirements discussed above; moreover, several pending Congressional measures would, if enacted, expand the types of property acquisitions (especially in the agribusiness area) subject to investment review, and even prohibit certain parties from such investments. In addition, in the last year a number of state legislatures have adopted laws restricting such investments by purchasers from certain "adversary" nations and mandating review. Extensive diligence into the then-current state of both federal and state restrictions is recommended for prudent counsel when advising prospective foreign investors in such transactions.

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

Mortgage recording taxes vary based on the county where the property is located, but generally range between 0.75% and 1.25% of the loan amount. The county clerk will also charge a fee to record the mortgage and accompanying loan documents or the filing of UCC Financing Statements, the costs of which vary widely based on the type of mortgage or other document being recorded, and the length of the document.

3.5 Legal Requirements Before an Entity Can Give Valid Security

Generally, an entity can give a valid security interest over real estate assets provided it owns the real estate and has complied with its charter documents and applicable law. In addition, certain charitable entities may also be required to obtain the permission of the Supreme Court of the State of New York or the New York State Attorney General before granting a security interest in real estate assets.

3.6 Formalities When a Borrower Is in Default

In New York, a mortgage is used to create a security interest in real property. A mortgage is perfected upon its recording in the local county clerk's office.

Prior to enforcement, it is a customary requirement in a commercial mortgage for a lender to be required to send a notice of default and provide the borrower with an opportunity to cure the default. If the mortgage is considered a "home loan" under New York law, then an additional 90-day statutory notice is required to be sent before a foreclosure of a mortgage can commence.

The length of a mortgage foreclosure action may vary greatly depending on the jurisdiction within the State of New York, the type of mortgage involved and the litigiousness of the parties.

Once commenced, a commercial mortgage foreclosure action may take as little as one year to complete. Conversely, in the City of New York, it is estimated that a standard foreclosure of a home loan will take approximately six years.

Generally, the administrative laws and orders that restricted mortgage foreclosure actions during the COVID-19 pandemic have been lifted or removed. As a result, lenders are now routinely exercising their foreclosure rights. However, an administrative order was issued in 2022 that requires mandatory settlement conferences in commercial division cases. Previously, New York law only required settlement conferences in the foreclosure of home loans.

3.7 Subordinating Existing Debt to Newly Created Debt

It is possible for existing secured debt to become subordinated to newly created debt in any circumstances, but ideally you want to take several steps in your documentation to avoid pitfalls.

3.8 Lenders' Liability Under Environmental Laws

Lenders are generally exempt from liability under federal and State environmental laws as long as the lender does not take title to, or "participate in the management" of, a contaminated property. Requiring a borrower to take action to address contamination, or renegotiating the terms of the secured interest, does not generally equate to "participating in the management" and will not subject a lender to liability. However, decision-making control over day-to-day activities or the environmental compliance of the site (ie, hazardous waste management), controlling expenditures, or taking title to the property may make a lender liable.

3.9 Effects of a Borrower Becoming Insolvent

When a security interest is created and a foreclosure action is commenced prior to the filing of a bankruptcy by the borrower, the mortgage lien is generally secure and will typically survive the bankruptcy unless discharged by payment during bankruptcy. However, attempts to enforce the mortgage or pursue the foreclosure action are generally stayed unless and until the automatic bankruptcy stay is lifted.

Once a foreclosure sale occurs, the debtor's rights of redemption will expire. If a borrower files bankruptcy after a foreclosure sale, the real property is generally considered to be outside the borrower's bankruptcy estate and the title may be transferred to a winning bidder, notwithstanding the pendency of the bankruptcy and corresponding automatic stay.

3.10 Taxes on Loans

On 22 January 2021, New York State Assembly members reintroduced legislation which would require the recording of, and payment of recording tax on, mezzanine debt and preferred equity investments related to the real property, whenever a mortgage is recorded with respect to the property. This legislation, however, was not enacted.

4. Planning and Zoning

4.1 Legislative and Governmental Controls Applicable to Strategic Planning and Zoning

Governmental authority over planning and zoning is derived from the state's police power to promote the health, safety, and welfare of its citizens. This authority has been delegated to local municipalities through the General City Law, Town Law, and Village Law, which authorise municipalities to exercise control over local zoning pursuant to the police power. The Municipal Home Rule Law and the Statute of Local Governments provide additional independent authority for municipalities to adopt local zoning laws that are not inconsistent with state law. Local zoning laws must also be in accordance with a municipality's comprehensive plan. While there may be regional approaches to particular land use issues, typically, each municipality has its own zoning laws and there is little consistency between differing municipalities.

4.2 Legislative and Governmental Controls Applicable to Design, Appearance and Method of Construction

A municipality's zoning code sets forth development criteria and regulations with respect to appearance and construction of structures. In addition, there may be supplemental/overlay design guidelines dependent on the parcel's location within a specific neighbourhood or historic district. Compliance with design, appearance, and method of construction is normally handled through the site plan review process with the municipal planning board. This process should be consistent with the applicable zoning enabling law (General City Law, Town Law, and Village Law).

4.3 Regulatory Authorities

The local municipal government is typically responsible for regulating development of individual parcels within the municipality, with input from municipal planning boards. The municipal zoning code provides a framework for decision-making in connection with the development of property, which is based upon the community's preferences. In addition, the municipality's land use plan bridges the municipality's comprehensive plan and zoning code by recommending the appropriate type, intensity, and character of development.

4.4 Obtaining Entitlements to Develop a New Project

New projects or major refurbishments typically require approvals from local municipal boards after a formal filing is made, and a public hearing is held. Compliance with the State Environmental Quality Review Act is often included in this process. Third parties or members of the public may appear at public hearings regarding the proposal, and the municipality may consider the opinions of the public in connection with its determination.

Requests for variances require application to the municipal zoning board of appeals. Rezonings generally require an application to a municipal board for a zoning amendment, which is often referred to the municipal planning board for its review and recommendation.

4.5 Right of Appeal Against an Authority's Decision

Often, a municipality will have a specific section in its municipal code for appealing a relevant authority's decision. An appeal will begin with an adverse determination by a code enforcement officer and is normally heard by the zoning board of appeals. Once all municipal avenues have been exhausted, an aggrieved party is provided the right to appeal further in the State Supreme Court.

4.6 Agreements With Local or Governmental Authorities

Agreements with local governments, authorities, or utility suppliers are not generally necessary to obtain permits or approvals for development projects; however, they can be required in some instances, commonly in cases of incentive zoning agreements and reimbursement agreements. Incentive zoning offers rights to a developer in exchange for public benefits to the community. Rezoning of property is negotiated between the developer and municipality.

Some municipal zoning codes contain provisions for Planned Unit Development that allow municipalities to provide flexibility with respect to underlying code requirements for certain innovative and unique projects. In addition, reimbursement agreements allow a municipality to hire certain professionals/consultants, and require the applicant to cover all fees associated with the same. However, such fees may only be lawfully imposed if they are reasonable, necessary, and not simply for the convenience of the local board.

4.7 Enforcement of Restrictions on Development and Designated Use

Restrictions on development and designated uses are typically enforced through certain bulk provisions in the zoning code regulating height, density, lot coverage, minimum/maximum parking requirements, setbacks, and similar considerations. Restrictions may also be enforced through conditions to zoning approvals. Proposed development is evaluated by the municipality's planning/zoning department, and existing development is monitored through the municipality's code enforcement officer/building department. Violations can be generated through citizen complaints or permitting and routine inspections, and fines can be assessed.

5. Investment Vehicles

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

There are several types of entities available to investors to acquire and hold real estate, including, but not limited to, limited liability companies, corporations, and partnerships. Limited liability companies are the most commonly used entity type to acquire real estate because they are typically characterised by flexible organisational governance, they offer limited liability protection to all members, and members can define their contractual obligation in the company's operating agreement to tailor it to reflect their business agreement and financial arrangements.

5.2 Main Features and Tax Implications of the Constitution of Each Type of Entity

Corporation

A corporation is an association of shareholders formed under the New York Business Corporation Law that is a legal entity separate and distinct from its shareholders with the capacity for perpetual existence to:

- acquire, hold and dispose of property;
- sue or be sued; and
- have such other powers as may be conferred upon it by law.

Owners of a corporation are shareholders, who typically do not manage the day-to-day affairs of the corporation. Shareholders elect directors and approve extraordinary transactions and activities of the corporation.

The primary benefit of corporations is that the shareholders are generally not personally liable for the debts and obligations of the corporation, and liability is limited to the assets of the corporation. Directors and officers are generally not liable to shareholders or the corporation for their actions or inactions with respect to the corporation, provided that they act in a manner that is consistent with their fiduciary duties of care and loyalty. Corporations may also limit or eliminate the personal liability of directors for their acts and omissions.

However, corporations do not afford the same level of flexibility as do partnerships and LLCs.

Limited Liability Company

An LLC is an unincorporated organisation of one or more persons having limited liability for the contractual obligations and other liabilities of the business. An LLC is a hybrid business organisation that combines the flexibility of governance and economic arrangements of a partnership and a corporation. The primary benefit of an LLC is that it offers its members the limited liability protection akin to shareholders of a corporation, is taxed like a partnership (except for a single-member LLC or unless the owners elect corporate tax treatment), and is governed by contract, whereby the operating agreement is the primary document defining the rights of members, the duties of managers, and the financial arrangements among the LLC's members.

Members and managers are generally not liable for debts, obligations, or liabilities of the LLC solely by reason of being a member or manager.

Partnership

A partnership is a voluntary agreement between at least two persons who bring together their money, property, labour, or skills to conduct a business and share profits and losses. In this jurisdiction, commercial real estate is more often held in limited partnerships than general partnerships due to their liability structures. General partners are jointly liable for the debts and obligations of the partnership, while limited partners are not liable for the contractual obligations of a partnership unless they are also general partners or they participate in the control of the business.

The benefit of real estate acquisition through a limited partnership is material for the limited partner, whose liability is restricted to the amount that the partner has contributed to the partnership plus the partner's share of any undistributed income. Whether a general partnership or limited partnership, the partners do not have a separate interest in the property and are therefore obliged to treat partnership property as joint property.

This is often a deterrent to some commercial real estate owners or investors who value the freedom to deal with their undivided interest in the property as would be permitted under a co-ownership arrangement.

5.3 REITs

Real estate investment trusts (REITs) are available in the United States and New York, although typically they are formed under Maryland law. New York follows the federal income taxation of REITs, but subjects REITs to state corporate franchise tax if the REIT is subject to federal income tax. REITs can be publicly traded or privately held, and are available to foreign investors. There are plenty of advantages of using REITs. They provide investors with the opportunity to invest in a diversified estate portfolio; they may provide for more flexibility in terms of tax-efficient sales of real estate by investors looking to exit a real estate portfolio; and, depending on applicable tax rates, income generated by REITs may be subject to less aggregate federal income tax than real estate held through other types of entities. The requirements for qualifying as a REIT are numerous and complex, but the primary statutory requirements are:

- the REIT is managed by one or more trustees or directors;
- the beneficial ownership of the REIT is evidenced by transferable shares or by transferable certificates of beneficial interest;
- the REIT would be taxable as a domestic corporation but for Sections 856 through 860 of the Internal Revenue Code of 1986, as amended (the “Code”);
- the REIT is neither a financial institution nor an insurance company subject to specified provisions of the Code;
- the beneficial ownership of the REIT is held by 100 or more persons;
- at all times during the last half of each taxable year, not more than 50% in value of the outstanding shares of the REIT are owned, directly or indirectly, through the application of certain attribution rules, by five or fewer individuals;
- the corporation makes an election to be taxable as a REIT, or has made this election for a previous taxable year that has not been revoked or terminated, and satisfies all relevant filing and other administrative requirements established by the IRS that must be met to elect and maintain REIT status;
- the REIT uses a calendar year for federal income tax purposes and complies with the record-keeping requirements of the Code and Treasury regulations promulgated thereunder;
- at the end of any taxable year, the REIT has any undistributed earnings and profits that are attributable to a non-REIT taxable year; and
- the REIT meets other tests regarding the nature of its income and assets, and the amount of its distributions.

5.4 Minimum Capital Requirement

New York State does not have a minimum capital requirement to start up any type of entity.

5.5 Applicable Governance Requirements

Corporations

The day-to-day management of a corporation’s activities is the responsibility of the directors of the corporation, who generally delegate such management to officers. Certain significant matters associated with the governance and operation of the corporation may require the approval of the corporation’s shareholders. Corporate governance is dictated by the provisions of the certificate of incorporation, bylaws and statutory law.

Limited Liability Companies

An LLC is presumed to be managed by its members unless the articles of organization provide that the management is carried on by managers. Except as provided in the operating agreement, each member of an LLC is entitled to vote in proportion to the member's share of current profits. The articles of organization of an LLC may provide for classes or groups of members having such relative rights, powers, preferences and limitations as the operating agreement of such LLC may provide. Members in a member-managed LLC, and managers in a manager-managed LLC, who exercise management powers or responsibilities have the duty of care and loyalty.

Limited Partnerships

Limited partnerships are managed by at least one general partner. Limited partnership governance is dictated by the terms of the limited partnership agreement with the limited partnership law setting forth statutory defaults. In order to insulate the limited partners from unlimited liability, the general partner must be solely responsible for the management and operation of the partnership business. The limited partners cannot participate in the management or operation of the business.

A limited partner who does take part in the control, management or operation of the business of the limited partnership, including signing any documents on behalf of the partnership in its own capacity as a limited partner, risks being exposed to unlimited liability.

The Corporate Transparency Act was passed by Congress in 2021 and the law imposes a new beneficial ownership reporting requirement on entities – both newly-formed and ones that are currently in existence. The objective of the legislation is to make it more difficult for bad actors to shield their identity or facilitate illegal transactions through entities which may be opaque to federal governmental authorities in terms of the identity of individuals that own and operate those entities. Unless an exemption for a particular entity is available, effective 1 January 2024, each entity is required to report certain information regarding the entity and individuals that exercise "substantial control" over the particular entity through an information portal maintained by the Financial Crimes Enforcement Network (FinCEN), which is a bureau within the U.S. Treasury Department.

Newly formed entities (ie, entities formed after 1 January 2024) have a limited period of time following formation (90 days in 2024; 30 days in 2025 and thereafter) in which to file their reports if they are not otherwise exempt from the reporting requirements. Existing entities (ie, entities that were formed prior to 1 January 2024) that are not exempt from the requirements have until 31 December 2024 to file their initial beneficial ownership report with FinCEN. More information relating to the reporting requirements, the filing portal, exemptions from reporting (in all, there are 23 exemptions available) and all related information (including the underlying law and regulations) can be found on the FinCEN Beneficial Ownership Information reporting page of its website. On 1 March 2024, in the case of National Small Business United v. Yellen, No. 5:22-cv-01448, a Federal District Court in the Northern District of Alabama ruled the Corporate Transparency Act to be unconstitutional. Subsequent to the ruling, the U.S. Justice Department (on behalf of the U.S. Treasury Department) filed a Notice of Appeal as it relates to the case. FinCEN has essentially taken the position that all other reporting companies (aside from the parties involved in the case) remain obligated to file beneficial ownership information reports with FinCEN pending the outcome of the case.

5.6 Annual Entity Maintenance and Accounting Compliance

New York corporations and limited liability companies have biennial statement fees of USD9 each. These fees are subject to change.

6. Commercial Leases

6.1 Types of Arrangements Allowing the Use of Real Estate for a Limited Period of Time

A lease and a license are two common legal arrangements that allow a person, company, or other organisation to occupy or use real estate that it does not own.

A lease is a contract between a landlord and a tenant whereby the tenant is given the exclusive right to occupy the landlord's property for an agreed-upon time period. A lease is an interest in real property that can be transferred to another, subject to restrictions contained in the lease agreement.

A license is an agreement granting a limited use of a property. A license is not an interest in real property. A license is typically terminable by the licensor, not transferrable, and not exclusive, and may be subject to a right of relocation.

6.2 Types of Commercial Leases

There are several types of commercial leases, as follows.

Net Leases

The tenant pays rent, as well as all or a portion of the operating expenses for the property such as taxes, insurance, maintenance, and utilities. Parties sometimes refer to net leases as single net leases, double net leases or triple net leases. The distinctions are not absolute, but in a triple net lease, the tenant pays all costs and expenses with respect to the real property.

Gross Leases

The landlord provides services and pays the operating expenses for the property, and such expenses are typically factored into the tenant's rent. In addition, the tenant typically pays escalation charges with regard to real property taxes and operating expenses. In Class A office buildings, the tenant typically pays its proportionate share of taxes and operating expenses over the negotiated base year.

In retail leases, the tenant typically pays its proportionate share of such taxes and expenses from the first dollar.

Ground Leases

The landlord leases the land to the tenant. The tenant pays ground rent, covers all costs and expenses, and is responsible for all improvements to the premises. Upon the expiration of the lease, possession of the land and ownership of any improvements revert to the landlord.

6.3 Regulation of Rents or Lease Terms

There is no commercial rent regulation in New York State. The terms of commercial leases are a matter of negotiation between the parties, subject to case law and statutes pertaining to specific issues. For example, statutes provide that a lease cannot contain a waiver of a landlord's responsibility for its negligence.

There are no-going regulations of rents for commercial leases.

Since the COVID-19 pandemic, the definition of force majeure has been scrutinised as to whether or not the provision refers to pandemics such as the COVID-19 pandemic. Landlords and tenants often have differing opinions and practices with regard to the treatment of pandemics and force majeure under a lease.

6.4 Typical Terms of a Lease

The term of a typical commercial lease is five to ten years. However, the term of a typical ground lease is 30 to 100 years.

The tenant is typically responsible for maintaining and repairing the space it occupies, whereas a landlord is typically responsible for repairing and maintaining the common areas, the structure, the exterior of the building and surrounding property.

Rent payments are typically made on a monthly basis, although in a ground lease, rent may be paid annually or quarterly.

6.5 Rent Variation

Rent typically increases either annually or once every three or five years, usually by a predetermined amount, depending on the terms of the lease.

6.6 Determination of New Rent

Increases in rent under a commercial lease are typically determined by negotiation prior to entering into a lease. Increases can be expressed in terms of a fixed dollar amount, a per-square-foot amount or a formula based on, for example, the Consumer Price Index.

6.7 Payment of VAT

Value-added tax, or other taxes or governmental levies, are typically not payable on New York rent. An exception is the New York City Commercial Rent Tax (CRT) that is imposed on the rent paid by tenants of commercial property located south of the centreline of 96th Street in Manhattan. Generally, the CRT applies to tenants whose gross annual rent is at least USD250,000.

The tax rate is 6% of the base rent. However, all taxpayers are given a 35% base rent reduction, effectively reducing the number of taxpayers that are subject to the CRT, as well as reducing the tax rate to 3.9%. In addition, a tax credit is given to those tenants whose annual base rent is between USD250,000 and USD300,000 before the 35% reduction.

6.8 Costs Payable by a Tenant at the Start of a Lease

In a net lease, the tenant is responsible for constructing or remodelling any existing improvements, and for the payment of all associated expenses. In a gross lease, landlords often deliver the space with mechanical services stubbed to the premises, or sheetrocked in “white box” condition, and give the tenant a negotiated allowance for the construction of improvements.

Alternatively, the landlord may be responsible for building out the space to meet the tenant’s needs. This is known as a “turnkey” lease. Such leases may include a cap on the landlord’s construction costs, with the tenant responsible for excess costs.

6.9 Payment of Maintenance and Repair

Landlords are typically responsible for paying for the maintenance and repair of common areas used by several tenants, such as lobbies, elevators, parking lots and gardens. However, tenants are often responsible for reimbursing the landlord for their pro rata share of operating expenses. Sometimes reimbursement commences from the first dollar and sometimes over a base amount, depending on negotiations and the structure of the lease.

Ground leases are triple net leases whereby the tenant covers all expenses for maintenance and repair obligations.

6.10 Payment of Utilities and Telecommunications

Telecommunications and utilities are typically paid for by the tenants. Each tenant's space is either metered or submetered for electricity, or the tenant reimburses the landlord for electric costs pursuant to a formula.

The charges for heating, ventilation and air conditioning (HVAC) depend on how the property is engineered. Each tenant may have its own cooling system, or the tenants may be served by a building-wide cooling system during business hours and subject to significant charges for after-hours HVAC. Tenants may also control supplemental HVAC systems to provide overnight cooling, typically for IT and telecom installations.

Tenants should determine the availability of telecommunication services and the availability of any particular providers, including distributed antenna systems during the selection of a property to lease.

6.11 Insurance Issues

The landlord and tenant each have to insure their respective interests in the real estate, subject to the terms negotiated and included in the lease. Negotiated issues include whether rent abates because the space becomes unusable, for example, due to a pandemic or other force majeure, and who is required to maintain business interruption insurance.

The COVID-19 pandemic resulted in the renegotiation of many leases. For example, many tenants extended the term of their lease in exchange for a reduction of the rent during the period of the pandemic.

6.12 Restrictions on the Use of Real Estate

A landlord can impose restrictions on a tenant's use of the real estate via the permitted use provision, which typically lists specific permissible and prohibited uses of the space, and allows the landlord to declare a default and exercise available remedies if the tenant engages in an unpermitted use. The tenant's use can also be restricted by local zoning laws, as well as building and health regulations. Retail leases often also grant exclusive uses to tenants, which are limited to the tenant's specific product line.

6.13 Tenant's Ability to Alter and Improve Real Estate

Tenants are typically permitted to alter or improve the real estate during the lease with the landlord's approval, and landlords generally allow cosmetic alterations without prior approval. A lease usually contains a limit on the cost and type of alterations a tenant can make without the landlord's approval.

6.14 Specific Regulations

Commercial Leases

Commercial leases are generally governed by the agreement between the parties. However, there are laws and licensing requirements that are specific to particular uses, such as the operation of hotels, restaurants, banks, etc.

A new issue frequently overlooked by tenant attorneys in New York City is Local Law 97, which was passed as a part of the Climate Mobilization Act in 2019. Local Law 97 requires the reduction of greenhouse gas emissions in most buildings over 25,000 square feet by 40% in 2030 and 80% by 2050. With its first compliance period in 2024, the law's carbon emission limits become increasingly stringent over a series of compliance periods, with owners facing potential penalties for exceeding limits. While compliance rests with the buildings' owners, emissions from tenants' energy consumption play a part in compliance. At the onset of negotiating a letter of intent, landlords and tenants should discuss the extent to which the tenant has to contribute to the cost of improving the building to meet the new law. During the lease negotiation, landlords and tenants should clearly discuss and understand any building performance standards that the landlord has set or other building rules and requirements applicable to energy efficiency and the reduction of greenhouse gas emissions.

Residential Leases

The regulations and laws that apply to residential leases were overhauled by the Statewide Housing Stability and Tenant Protection Act of 2019 (HSTPA). In addition, some residential tenancies are protected by older rent control laws. The key provisions of the HSTPA include the following:

Rent Regulation

Some residential buildings are subject to rent stabilisation regulations that establish caps on the amount of rent landlords can charge and the amount of increases they can impose. In addition, some residential tenancies are protected by older rent control laws. The HSTPA has made it more difficult for landlords to "deregulate" units subject to such regulations, as follows.

Luxury deregulation and vacancy allowances

Prior to the HSTPA, apartments with rents above a certain threshold could be deregulated upon vacancy or when the tenant's income rose to a certain amount. Also, landlords could increase rent by up to 20% each time a unit became vacant, and earn longevity bonuses, which allowed them to increase rent by 0.6% multiplied by the number of years since the last vacancy. The HSTPA repealed these allowances.

Sunset provision

The HSTPA repealed the sunset provision, which was the date by which the legislature had to renew rent regulation laws to prevent their expiration.

Rent control

Under the HSTPA, rent for rent-controlled units can only be increased by the lesser of 7.5% or the average of the previous five increases approved by the Rent Guidelines Board.

Co-op and condo conversions

Landlords could previously deregulate stabilised apartments as part of the condo or co-op conversion process. The HSTPA imposed significant limitations on this by eliminating the eviction-plan option, and increasing the required purchase percentage for non-eviction plans from a minimum of 15% sales to third parties to a minimum of 51% sales to current occupants.

Capital improvements

Before the HSTPA, landlords could recoup costs of Major Capital Improvements (MCIs) to buildings and Individual Apartment Improvements (IAIs) to apartments through rent increases. These increases have been significantly curtailed.

MCI increases are based on the cost of the improvements and apportioned on a per-unit basis. Before the HSTPA, owners of buildings with 35 or fewer units could recoup their costs over an eight-year amortisation period, while owners of buildings with 36 or more units had nine years. Annual rent increases were capped at 6% in New York City and 15% in the rest of New York State. The HSTPA imposed a 2% Statewide cap, lengthened the amortisation period to 12 years, and made the rent increases temporary, requiring them to be removed after 30 years.

The HSTPA limited the number and cost of IAIs to no more than three within a 15-year period, at a maximum aggregate cost of USD15,000. As with MCIs, the rent increases are now temporary and must be removed after 30 years.

Duty to mitigate

If a residential tenant vacates before the lease expires, the landlord has a legal duty to find a new tenant before they can seek to collect rent from the vacating tenant. There is no such duty for commercial landlords. Landlords must now take reasonable and customary actions to re-rent vacant units, whether regulated or unregulated, at the lower of fair market value or the rate agreed to in the lease.

In addition, residential tenants are now statutorily entitled by law to a sanitary and safe apartment pursuant to the warranty of habitability.

On 22 December 2021, the HSTPA was modified as to the application of the following to co-operatives:

- the provisions limiting security deposits and advances;
- the requirement for the landlord to give notice if a lease renewal is not offered or if a renewal is offered at an increase to rent equal to or greater than 5%;
- the limitations/prohibitions on fees charged at the beginning of a tenancy;
- the limitations on the payments, fees or charges for the late payment of rent;
- restrictions on what may be sought in a summary proceeding;
- the requirement for an additional five-day notice by certified mail if maintenance is not timely received; and
- the provision prohibiting the collection of attorneys' fees in a summary proceeding.

Tax incentives for residential development

Section 421-a of the Real Property Tax Law has over the years provided certain tax incentives for developers to build "affordable" residential units, in the form of real property tax abatements for a certain number of years following completion of construction. This law is controversial, has been modified several times, and currently is only available to projects that commenced construction between 1 January 2016 and 15 June 2022 that are to be completed on or before 15 June 2026. This law is under continuing discussion and debate. It is unclear if the tax incentives will be renewed, and the form and terms of any such renewal are uncertain.

6.15 Effect of the Tenant's Insolvency

The effect of a tenant's insolvency on its lease obligations is governed by the applicable bankruptcy, insolvency, and creditors' rights statutes.

When the tenant files for bankruptcy, an "automatic stay" is imposed that initially restricts the enforcement of remedies or the termination of the lease by the landlord. Thereafter, there are specific requirements under bankruptcy law with respect to whether a lease is to be assumed or rejected.

6.16 Forms of Security to Protect Against a Failure of the Tenant to Meet Its Obligations

Upon the signing of the lease, the landlord typically requires a "security deposit" from the tenant to protect against a default by the tenant.

The amount of the security deposit is a matter of negotiation and may be in the form of cash or a letter of credit. A letter of credit is a document through which the issuing bank promises to pay the security deposit to the landlord.

A letter of credit is generally considered more desirable to a landlord than a cash security deposit because it puts the landlord in a better position in the event of the bankruptcy of the tenant.

6.17 Right to Occupy After Termination or Expiry of a Lease

A tenant typically does not have a right to occupy the relevant real estate after the expiry or termination of a commercial lease. However, commercial leases typically have a "holdover" provision that states that if a tenant continues to occupy the premises after the expiry or termination of the lease, the tenant must pay a multiplier of the rent for the last month of the lease (typically 150% to 200%) and become a month-to-month tenant or a tenant at sufferance. A landlord can only evict a month-to-month tenant upon notice, whereas a tenant at sufferance may be evicted at any time after the expiry or termination of the lease, subject to applicable laws.

In addition, leases may give the landlord the right to impose consequential damages on the tenant for failure to timely vacate.

6.18 Right to Assign a Leasehold Interest

Assignment of leasehold interests are negotiated by landlords and tenants. Typically, tenants are permitted to assign their leasehold interest or sublease all or a portion of the leased premises with the landlord's consent, or to assign to an affiliate or a successor to the tenant by merger, consolidation or acquisition of all or substantially all of the tenant's assets without the landlord's consent. Landlords will want to see financial information regarding the new subtenant and may require tenants to pay the landlord's attorney costs in relation to the consent for the assignment or sublease.

6.19 Right to Terminate a Lease

There are several events that typically give the landlord or the tenant the right to terminate the lease. For example, the lease typically states that if the landlord fails to complete the build-out of the space, the tenant has the right to terminate after a certain date.

The parties typically have a right to terminate in the event of a casualty if the space is not restored within a certain period of time. In addition, a landlord can terminate the lease if the tenant defaults and fails to cure the default, eg, by failing to pay rent.

A tenant may negotiate the right to an early termination of the lease, but such early termination rights are often expensive.

A landlord may negotiate the right to relocate the tenant to other space or even terminate the lease if the landlord wants to redevelop the subject property.

6.20 Registration Requirements

There are no registration requirements to comply with in New York. Memoranda of leases may be recorded in the county's land records. However, not all landlords agree to execute a memorandum of lease because landlords do not want the memorandum of lease encumbering title to the property. Recording fees are paid by a per-page formula and are generally paid by the party requesting and recording the memorandum of lease.

6.21 Forced Eviction

A tenant can be forced to vacate in the event of default or upon the expiration of the lease. For example, a tenant can be evicted for failure to pay rent or for otherwise violating the lease. Such actions are governed by the Real Property Actions and Proceedings Law (RPAPL) of the State of New York.

In residential leases, the HSTPA amended the RPAPL to extend the time periods in non-payment proceedings. The HSTPA eliminated oral demands to vacate and increased the notice period for written demands to 14 days, while also increasing the tenant's time to provide an answer to ten days. In addition, the HSTPA amended RPL Section 235-e to require that tenants be reminded if rent is not received within five days of the due date. Failure to provide such a reminder can be used as an affirmative defence in a non-payment proceeding.

At this point, all rent moratoriums for residential leases have expired.

6.22 Termination by a Third Party

Portions of the leased premises may be taken by the government through eminent domain (condemnation). Condemnation provisions are negotiated by landlords and tenants. Typically, in the event of a condemnation that takes a significant portion of the leased premises such that it is no longer useable for the tenant's purposes, the parties have the option to terminate the lease. Typically, the landlord retains the right to the majority of the claim, and tenants have the right to claim for their fixtures and relocation costs associated with the condemnation. See **2.9 Condemnation, Expropriation, or Compulsory Purchase**.

6.23 Remedies/Damages for Breach

In commercial leases, remedies and damages for a tenant breach and termination of a lease are negotiated between landlords and tenants. There are no statutory or customary limitations on damages a landlord may collect.

Security deposits are negotiated between landlords and tenants. If landlords do hold a security deposit, it can be in cash or letter of credit.

7. Construction

7.1 Common Structures Used to Price Construction Projects

There are several structures used to price construction projects. First, there is a traditional fixed price or lump sum contract in which the contractor (or a construction manager) bears all of the risk for the job and must complete the job for that cost. On the other hand, in a cost-plus contract, the owner pays the contractor its cost plus a fee, making any cost overruns the owner's responsibility. In a guaranteed maximum price (GMP) arrangement, also referred to as a not-to-exceed price, the owner will reimburse the contractor for costs and fees up to a maximum; this offers the owner more protection than a cost-plus contract because the contractor is responsible for any additional costs that exceed the GMP. Finally, in a unit price contract, the contract price is based upon the price of individual units of work, for which the contractor provides a specific price. The owner must compensate the contractor for every unit the contractor completes.

7.2 Assigning Responsibility for the Design and Construction of a Project

In New York, the design of a project must be completed by licensed design professionals, which includes Professional Engineers (PE) and Registered Architects (RA).

Traditionally, construction projects consist of a designer for the design phase and a contractor for the construction phase, a process called design-bid-build. Typically, an architect leads the design phase of a project, employing additional professionals as subcontractors. The contractor manages the construction phase of the project.

However, design-build delivery systems are becoming more popular. In this type of project delivery system, the design and construction services are constructed by a single entity using one contract. This arrangement reduces costs in both design and construction, provides a single point of responsibility, and can greatly shorten the delivery schedule by overlapping the design phase and the construction phase. In December 2019, the New York State Legislature passed a law allowing certain New York City departments to use design-build for public projects.

The third type of project delivery system is called a construction manager at risk (CMAR) method, which is a derivative of the design-bid-build process. However, instead of the designer overseeing the design phase and a contractor overseeing the construction phase, a CMAR acts as a consultant to the project owner during the development and design phases, and then acts as general contractor during the construction phase. The CMAR holds all the contracts for the subcontracts and commits to delivering the project within a guaranteed maximum price.

7.3 Management of Construction Risk

Construction risk is managed by indemnification, warranties, limitations of liability, waivers, insurance provisions and retainage.

Indemnification is limited by New York General Obligations Law Section 5-322.1, which prohibits a party involved in the construction, alteration, repair or maintenance of a building from contracting with another to indemnify or hold it harmless for injuries or damage to property caused by its own negligence, though the party may require indemnification for damages caused by the negligence of parties other than itself.

Warranties are almost always limited in duration by express contract provision. New York General Business Law Section 777-a specifically creates warranties applicable to the sales of new construction homes that include a one-year warranty that the home will be free from defects due to poor workmanship and a six-year warranty that the home will be free from material defects.

Limitations of liability and waivers of damages are limited to the extent that the liability or damages were in contemplation of the parties at the time of entering into the contract, but will not be enforced if they purport to protect a party from liability for conduct that constitutes fraud, gross negligence or willful misconduct. The most common limitation of liability in construction contracts is a waiver of consequential damages. Owners and contractors can also limit risk by including a “no damages for delay” clause in a contract with a downstream party, which prohibits a contractor or subcontractor from asserting claims to recover financially for damages caused by delays, instead limiting relief from delays to time extensions.

Insurance is often used to address the risks occasioned by the limitation on indemnity, and oftentimes owners and contractors will require they be added as an additional insured on the contractor's or subcontractor's commercial general liability policy, respectively.

In addition, an owner may participate in an owner-controlled insurance program (OCIP), which is an insurance policy held by a property owner during the project and covers all liability and losses from the project. Contractors may participate in a contractor-controlled insurance program (CCIP), or wrap-up insurance, which protects the general contractor, its subcontractors and the project owner from liability and losses.

Finally, retainage is used to reduce risk and incentivise contractors or subcontractors to complete a project by withholding a portion of payment until agreed-upon milestones are met. New York recently introduced a new law (New York General Business Law Section 756-c) that reduces the amount of retainage that can be withheld from a contractor or subcontractor on a private construction project to 5% of the contract sum for projects with costs that are equal to or greater than USD150,000. Before this law, parties could agree to withhold "a reasonable amount" of retainage.

7.4 Management of Schedule-Related Risk

Contract provisions require contractors and subcontractors to adhere to schedules prepared by the construction manager or architect on behalf of the owner. Owners can receive compensation for delays if provided for in the contract, most often in the form of liquidated damages. Alternatively, owners can recover actual damages to the extent damages can be proven. While not common, contracts will sometimes provide contractors with cash incentives to exceed scheduling milestones or costs below budget.

7.5 Additional Forms of Security to Guarantee a Contractor's Performance

The most common form of additional security to guarantee a contractor's performance is a performance bond. In most, if not all, public projects and in many private projects, the owner will require the general contractor to post a performance bond.

It is becoming popular for general contractors to use a subcontractor default insurance (SDI), often called "subguard", insurance policy in lieu of a subcontractor performance bond for private projects. Such a policy shifts the burden of losses resulting from a subcontractor's default to the insurance company, and provides coverage for losses or damages sustained in the event of a subcontractor's or supplier's default. Further, the subguard policy covers all subcontractors on a given project, or on an annualised basis for all projects combined. However, the insured (general contractor) maintains the responsibility for determining whether or not the subcontractor will be pre-qualified and thus accepted under the subguard programme. Also, the general contractor is responsible for resolving the subcontractor default issues, although the costs of completing the work are covered.

7.6 Liens or Encumbrances in the Event of Non-payment

Contractors and designers may file liens to encumber property in the event of non-payment pursuant to New York Lien Law. Generally, in New York, a mechanic's lien can be filed at any time during the progress of a project, but no later than eight months after the completion of the contract or the final furnishing of labour or materials. For single-family dwellings, a mechanic's lien must be filed within four months of completion of the contract or the final furnishing of labour or materials. If the work performed requires a license, the claimant must be licensed in order to file a mechanic's lien. The lien must be recorded in the county in which the project is physically located, and the lien is valid for one year from the date of filing, at which point the claimant must either commence an action to foreclose the lien or file to extend the lien by one year.

Pre-existing mortgages typically have priority over a mechanic's lien claim, but a mechanic's lien has priority over advances made by the construction loan lender after the filing of the mechanic's lien.

The owner can discharge a mechanic's lien by depositing with the county clerk a payment equal to the amount claimed in the lien, with interest to the time of the deposit, or by posting a bond equal to 110% of the lien.

7.7 Requirements Before Use or Inhabitation

An owner must obtain a certificate of occupancy stating a legal use and/or type of permitted occupancy of a building before a building may be occupied. A certificate of occupancy has no expiration date.

8. Tax

8.1 VAT and Sales Tax

New York State does not have a value added tax. New York State sales tax only applies to the sale or lease of tangible personal property and selected services. Sales tax does not apply to the sale or purchase of real estate.

8.2 Mitigation of Tax Liability

Parties occasionally use a Consolidation Extension and Modification Agreement to reduce mortgage recording tax. Provided both the existing lender and the new lender agree, the existing lender assigns its mortgage to the new lender, which will then amend the terms of the mortgage for refinance or purchase of the property. A buyer will then pay mortgage tax on the difference between the outstanding balance of the seller's existing mortgage and the buyer's new mortgage, rather than paying tax on the entire amount of the new mortgage.

8.3 Municipal Taxes

In Upstate New York, municipal taxes are typically not paid on the occupation of business premises or on the payment of rent.

8.4 Income Tax Withholding for Foreign Investors

Foreign investors are generally subject to a 30% withholding tax on certain US source income, including real property rental income. In certain cases, an income tax treaty may reduce the withholding tax rate.

The Foreign Investment in Real Property Tax Act requires the purchaser of real property owned by a foreign investor to withhold a 15% tax on the total amount realised on the purchase. Foreign investors in partnerships are subject to a 15% withholding tax on the sale of their partnership interests. Because real estate in the USA is frequently owned through entities treated as partnerships for US federal income tax purposes, foreign investors will have exposure to this tax if they dispose of the equity in a partnership owning real estate.

8.5 Tax Benefits

Benefits include depreciation deductions for taxpayers with respect to improvements made to real property.

In addition, to the extent that the owner of the real estate used in a trade or business financed the acquisition of, or improvements to, the property with debt, the interest is deductible. Generally, the amount of interest that can be deducted is limited to 30% of the taxpayer's adjusted taxable income, but real estate businesses that meet certain requirements can elect to fully deduct their entire interest expense.

Individuals who own real estate directly or through a pass-through entity pay tax on any long-term capital gain recognised at significantly lower rates than other types of income.

Real property owners who hold property for investment, or for use in a trade or business, may dispose of that property in tax-efficient ways not available to other types of property, such as through Section 1031 of the Internal Revenue Code as discussed above.

Historic Tax Credits

Federal and New York State historic tax credits may be available in connection with the substantial rehabilitation of certain historic buildings. If various requirements are satisfied, a taxpayer that holds title to a rehabilitated historic building (or has an ownership in a pass-through entity that holds the title) may claim a nonrefundable federal tax credit equal to 20% of "qualified rehabilitation expenditures" incurred with respect to the building. The federal tax credit is claimed on a pro rata basis over a five-year period beginning in the tax year in which the rehabilitated building is placed in service.

New York State's historic tax credit is available to a taxpayer that is allowed the federal historic tax credit with respect to a historic building located in New York State, provided that the building is located in a census tract at or below 100% of the state's median family income. The state tax credit is currently equal to 100% of the federal tax credit claimed, but does not need to be claimed over a five-year period. Property owners can receive this enhanced state credit of 100% of the qualified rehabilitation expenditure (QRE) up to USD5 million, if the property placed-in-service date is after 1 January 2010 and before 1 January 2030. A credit of 30% of QRE is available for a property placed-in-service date after 1 January 2030, so long as the total QREs do not exceed USD100,000 per structure.

The Brownfield Cleanup Program

The New York State established the Brownfield Cleanup Program (BCP) in 2003 to encourage private sector cleanup of contaminated property, known as Brownfield sites, and redevelopment and reuse of those sites. The program offers certain legal, financial, and tax incentives to encourage this private sector cleanup, redevelopment, and reuse. Provided that a variety of requirements are met, taxpayers that remediate and redevelop Brownfield sites are eligible to receive refundable tax credits against their New York State income tax liability.

Under the current program, the amount of the credit may be between 10% and 24% of eligible costs paid or incurred to clean up and redevelop the site, with certain components capped. The amount and type of tax credits available vary by individual sites depending on location, type of use, and when the site was accepted into the BCP, amongst other factors.

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