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USA Regional Real Estate

Delaware

Young Conaway Stargatt & Taylor, LLP

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Law and Practice

Contributed by Young Conaway Stargatt & Taylor, LLP

Contents

1. General	p.5	4. Planning and Zoning	p.9
1.1 Main Substantive Skills	p.5	4.1 Legislative and Governmental Controls Applicable to Design, Appearance and Method of Construction	p.9
1.2 Most Significant Trends	p.5	4.2 Regulatory Authorities	p.9
1.3 Impact of New US Tax Law Changes	p.5	4.3 Obtaining Entitlements to Develop a New Project	p.9
2. Sale and Purchase	p.5	4.4 Right of Appeal Against an Authority's Decision	p.9
2.1 Ownership Structures	p.5	4.5 Agreements with Local or Governmental Authorities	p.9
2.2 Important Jurisdictional Requirements	p.5	4.6 Enforcement of Restrictions on Development and Designated Use	p.9
2.3 Effecting Lawful and Proper Transfer of Title	p.6	5. Investment Vehicles	p.9
2.4 Real Estate Due Diligence	p.6	5.1 Types of Entities Available to Investors to Hold Real Estate Assets	p.9
2.5 Typical Representations and Warranties for Purchase and Sale Agreements	p.6	5.2 Main Features of the Constitution of Each Type of Entity	p.10
2.6 Important Areas of Law for Foreign Investors	p.6	5.3 Tax Benefits and Costs	p.10
2.7 Soil Pollution and Environmental Contamination	p.6	5.4 Applicable Governance Requirements	p.10
2.8 Permitted Uses of Real Estate Under Zoning and Planning Law	p.7	6. Commercial Leases	p.10
2.9 Condemnation, Expropriation or Compulsory Purchase	p.7	6.1 Types of Arrangements Allowing the Use of Real Estate for a Limited Period of Time	p.10
2.10 Taxes Applicable to a Transaction	p.7	6.2 Types of Commercial Leases	p.10
2.11 Rules and Regulations Applicable to Foreign Investors	p.7	6.3 Regulation of Rents or Lease Terms	p.10
3. Real Estate Finance	p.8	6.4 Typical Terms of a Lease	p.11
3.1 Financing Acquisitions of Commercial Real Estate	p.8	6.5 Rent Variation	p.11
3.2 Typical Security Created by Commercial Investors	p.8	6.6 Determination of Changes in Rent	p.11
3.3 Regulations or Requirements Affecting Foreign Lenders	p.8	6.7 Payment of VAT	p.11
3.4 Taxes or Fees Relating to the Granting of Enforcement of Security	p.8	6.8 Costs Payable by Tenant at the Start of a Lease	p.11
3.5 Legal Requirements Before an Entity Can Give Valid Security	p.8	6.9 Payment for Maintenance and Repair	p.11
3.6 Formalities When a Borrower is in Default	p.8	6.10 Payment for Services, Utilities and Telecommunications	p.11
3.7 Subordinating Existing Debt to Newly Created Debt	p.8	6.11 Insuring Real Estate that is the Subject of a Lease	p.11
3.8 Lender's Liability Under Environmental Laws	p.8	6.12 Restrictions on the Use of Real Estate	p.11
3.9 Effects of Borrower Becoming Insolvent	p.9		

6.13 Tenant's Ability to Alter or Improve Real Estate	p.11	8. Tax	p.13
6.14 Specific Regulations	p.11	8.1 Sale or Purchase of Corporate Real Estate	p.13
6.15 Effect of Tenant's Insolvency	p.12	8.2 Mitigation of Tax Liability	p.14
6.16 Forms of Security to Protect Against Tenant's Failure to Meet Obligations	p.12	8.3 Municipal Taxes	p.14
6.17 Right to Occupy After Termination or Expiration of Lease	p.12	8.4 Income Tax Withholding for Foreign Investors	p.14
6.18 Right to Terminate Lease	p.12	8.5 Tax Benefits	p.14
6.19 Forced Eviction	p.12	8.6 Key Changes in Federal Tax Reform	p.14
6.20 Termination by Third Party	p.12		
7. Construction	p.12		
7.1 Common Structures Used to Price Construction Projects	p.12		
7.2 Assigning Responsibility for the Design and Construction of a Project	p.12		
7.3 Management of Construction Risk	p.13		
7.4 Management of Schedule-related Risk	p.13		
7.5 Additional Forms of Security to Guarantee a Contractor's Performance	p.13		
7.6 Liens or Encumbrances in the Event of Non-payment	p.13		
7.7 Requirements Before Use or Inhabitation	p.13		

Young Conaway Stargatt & Taylor, LLP has six experienced commercial real estate attorneys in Wilmington, Delaware, providing a full range of services related to complex and sophisticated commercial real estate transactions in Delaware, Maryland and Pennsylvania, including: acquisition, development and financing of commercial real estate projects and condominium regimes; preparation and structuring of leases; easements; tax assessment appeals; legal opinions; review of title and survey matters; issuance of title insurance; obtaining land development approvals in

all Delaware counties and local municipalities; and dealing with environmental issues, including brownfield redevelopment projects. As part of a Delaware-based firm of over 100 lawyers, the real estate team frequently collaborates with other attorneys who specialize in real estate litigation, taxation, corporate and alternative entities, insurance, and bankruptcy. The real estate attorneys frequently represent major players in Delaware real estate and finance, such as The Buccini/Pollin Group, Inc., WSFS Bank, Verizon Wireless and Handler Corporation.

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1. General

1.1 Main Substantive Skills

As the laws and regulations impacting commercial real estate and the players involved grow more complex every year, the main substantive skills required of real estate lawyers are multiple and varied. The drafting of intricate legal documentation that takes into account such laws and regulations, and the needs and requirements of lenders, outside investors, local government agencies and developers (as well as the necessity to take a practical approach) is essential. In land use matters, the ability to negotiate necessary approvals while remaining sensitive to the many constituencies that influence them is needed. For many transactions, strong working relationships with the government agencies, lenders, and investors involved is key. Real estate law in 2019 requires a team approach, with members of the team being fluent in tax and environmental law, as well as corporate, alternative entity and bankruptcy matters. Recent trends that have impacted most on these skills are the new challenges and opportunities from changes in federal tax law, as well as changing regulations applicable to lenders and common interest community developers.

1.2 Most Significant Trends

The most significant trends in the Delaware commercial real estate market over the last twelve months have included continued robust sale of new single family residential construction in western Sussex County due to an influx of retiree purchasers from other states; very active construction in the hotel and hospitality industry; and large mixed-use residential, retail and office developments in the City of Wilmington and New Castle County. The most significant deals have included the redevelopment of the historic DuPont Building on Rodney Square, including the creation of office and hotel condominium units handled by our firm; the construction of a new arena in Wilmington to be used by the local semi-professional basketball affiliate of the Philadelphia 76ers and for after-school athletic programs and activities, the financing of which was handled by our firm; refinancing of the Midtown Apartments, a multi-use complex in Wilmington, also handled by our firm; and the construction of multiple Wilmington riverfront hotels, with which our firm was involved in several aspects.

1.3 Impact of New US Tax Law Changes

The recent federal tax law changes have resulted generally in making more capital available for real estate development and construction. Delaware is well positioned to be a leading state for the employment of Opportunity Zone benefits for several reasons. First, the State of Delaware has developed other tax incentive programs that dovetail nicely with Opportunity Zones, creating layers of equity such as downtown development zone tax credits and state historic tax credits. Additionally, due to the need of projects to be held by single-purpose entities to take full advantage of

opportunity zone benefits under the currently-proposed tax regulations, Delaware's series limited liability company laws make the redevelopment of existing projects in opportunity zones easier. Amendments to the Delaware Limited Liability Company Act effective August 2019 create the ability to register series LLCs, eliminating lender issues with perfecting liens and security interests in series LLCs used for Opportunity Zones. On the state tax level, recent changes in filing requirements involving Delaware's nonresident withholding tax have caused significant problems for real estate developers. Our firm has assisted with proposed legislation to eliminate tax withholding for new construction builders who pay taxes on a quarterly basis.

2. Sale and Purchase

2.1 Ownership Structures

Most real estate-owning entities use the structure of a limited liability company, though virtually any type of entity ownership structure is available in Delaware. Delaware continues to be a leader with respect to legislation permitting series within limited liability companies that can hold segregated and insulated assets and liabilities. The ability to register series LLCs (effective from August 2019) is expected to result in much greater use of series LLCs for real estate-owning entities.

2.2 Important Jurisdictional Requirements

Delaware title transfers are subject to a transfer tax of 4% (2.5% to the State of Delaware and 1.5% to the county or municipality in which the property is located) applied to the value of the property conveyed. See **8.1 Sale or Purchase of Corporate Real Estate**, below for further information.

Delaware has nonresident withholding taxes that apply to title transfers, although business entities created in other jurisdictions that have been duly qualified to do business in the State of Delaware are not considered foreign and are exempt from the tax.

There are no special state transfer laws or regulations that apply to specific types of real estate, except for sales of unimproved parcels of land, for which there is a required purchase contingency for the ability to install approved onsite disposal systems, the availability of a water supply, and to evaluate local zoning ordinances (25 Del. C. §§ 313, 315).

Private transfer fees (fees payable upon the transfer of an estate in real property for the right to make or accept the transfer of title of the real estate) created after July 27, 2010 are prohibited and void (25 Del. C. § 319).

Contracts for the sale of residential homes are required to be accompanied by certain disclosures pursuant to a home sales condition report, in a form produced by the Delaware

Real Estate Commission. Additionally, buyers of residential homes for which there are non-voluntary assessments payable to homeowner or condominium associations must, prior to sale, receive either a public offering statement or resale certificate, depending upon the size of the community, the size of the assessments, and when the homeowners or condominium association was established. If a new home is exempt from the requirement of delivery of a public offering statement or resale certificate, then the seller must provide disclosure of obligations in the chain of title that create financial obligations for the buyer (25 Del. C. § 317A).

2.3 Effecting Lawful and Proper Transfer of Title

Transfer of title to real estate is effectuated by the execution and delivery of a deed, typically a special warranty deed (25 Del. C. § 101). The deed must be acknowledged by a person authorized to approve acknowledgments in Delaware, usually a notary public (25 Del. C. §§ 122, 123). The deed itself does not need to be recorded to be effective between its parties. To establish priority against other parties the deed must be recorded in the Office of the Recorder of Deeds for the county in which the land is located, and has priority from the time that it is recorded (25 Del. C. §§ 153, 154). Delaware is considered a 'race' jurisdiction for purposes of priority.

2.4 Real Estate Due Diligence

Buyer due diligence for the purchase of real estate in Delaware is similar to other jurisdictions. Title searches must be performed to ascertain the condition of title to the property, and the chain of title of ownership reviewed for defects. Almost every Delaware buyer purchases an owners' title insurance policy. Only a licensed Delaware attorney may issue title insurance or conduct a real estate title transfer closing. Title insurance is typically issued by the attorney for the buyer, as agent for a title insurance company. A licensed Delaware attorney must disburse funds for a transfer of title and/or payoff of a Delaware mortgage through that attorney's settlement escrow account. The degree to which other real estate due diligence is conducted by the client or outsourced varies depending upon the sophistication of the buyer and the complexity of the real estate transaction. For commercial real estate purchases, most buyers do obtain Phase I Environmental Site Assessments prepared by qualified environmental inspectors that meet the requirements of the US Environmental Protection Agency's 'All Appropriate Inquiry' Standards.

2.5 Typical Representations and Warranties for Purchase and Sale Agreements

Typical express representations and warranties contained in Delaware commercial purchase and sale agreements include warranties of marketable title, due authorization, warranties with respect to leases, environmental matters, liens and taxes, and brokerage commissions. Express and implied warranties in Delaware are made by declarants and dealers for homes subject to the Delaware Uniform Common

Interest Ownership Act (25 Del. C. § 81-414). For residential real property, required disclosures must be provided to buyers at the time a property is offered for sale or when the purchase agreement is signed. Under the Delaware Buyer Property Protection Act, sellers of residential real property must disclose all material defects that are known at the time the property is offered for sale or known prior to the time of settlement, in writing (6 Del. C. § 2572), and provide a notice of radon dangers and disclosure of radon testing (6 Del. C. § 2572A). At the time of offer to purchase, the seller's disclosure of real property condition report on the form prescribed by the Delaware Board of Realtors must be provided (6 Del. C. §§ 2573, 2578). Additional disclosures are contained in the public offering statement or the resale certificate required for certain communities containing homeowners and condominium associations.

Remedies for misrepresentations by sellers are commonly specifically agreed to in the purchase and sale agreement. Buyers also have typical remedies at common law and in equity, although by statute the buyer is not to have a cause of action against a seller or real estate agent for material defects in the residential real property disclosed prior to the offer to purchase.

The limitations on a seller's liability for breach of representations and warranties in Delaware are often negotiated and dependent upon the relative bargaining power of the buyer and seller. Many contracts limit liability to matters that arise or are discovered by the buyer within the one-year period immediately following settlement.

2.6 Important Areas of Law for Foreign Investors

Important areas of law or regulations for foreign investors to consider when purchasing real estate in Delaware are similar to those in other US jurisdictions. The real estate transaction loss will be subject to the Foreign Investment in Real Property Tax Act and the requirements of the United States Department of Commerce Bureau of Economic Analysis. Foreign investor sellers may be subject to the Delaware non-resident state withholding tax.

2.7 Soil Pollution and Environmental Contamination

As is the case in other United States jurisdictions, under federal environmental laws owners and operators of real estate in Delaware are potentially responsible parties for soil pollution or environmental contamination of real property even if they did not cause the pollution or contamination. However, as is the case in other jurisdictions, owners and operators have a defense to this liability if they can show that they conducted all appropriate inquiry into the prior ownership and use of the property prior to the date of acquisition pursuant to 42 USC § 9601 (35)(B)(i) and no contamination was discovered. The current standard for proving all appropriate inquiry remains ASTM E1527-05. The Delaware Hazardous

Substance Cleanup Act parallels the federal provisions of the Comprehensive Environmental Response, Compensation, and Liability Act. Liability can be imposed upon any person who owned or operated a real estate facility at any time, any person who owned or possessed a hazardous substance and who by contract, agreement or otherwise engaged for disposal or treatment of a hazardous substance at the facility, any person who generated, disposed of or treated a hazardous substance at the real estate facility, and so forth (7 Del. C. § 9105). Under the state act, persons who are operators or owners and who can establish that at the time the facility was acquired or operated they had no knowledge of any release or imminent threat of release of hazardous waste are also protected from liability if they demonstrate they carried out all appropriate inquiries, again meeting the procedures of the American Society for Testing and Materials known as Standard E1527-97 and Standards E1527-00. However, unlike the federal law, there is no bona fide prospective purchaser protection from environmental liability in the state law should contamination be found during the 'all appropriate inquiry' investigation. In that case, the state law requires the purchaser to enter into either a prospective purchaser agreement or a Brownfield Development Agreement in order to avoid the strict liability that will otherwise apply. Additional specifics apply under the statute (7 Del. C. § 9105(c)(2)). If the State of Delaware has incurred remedial costs in connection with environmental cleanup of a property, they may obtain a lien on the property and certain other properties owned by the same owner. The allocation of risk between purchaser and seller for environmental liabilities under purchase and sale agreements varies due to bargaining position of the parties; however, the typical approach is to have the seller represent that the property complies with environmental laws and regulations, as of the closing date, with such warranty to survive closing for a specified period.

2.8 Permitted Uses of Real Estate Under Zoning and Planning Law

Buyers should obtain zoning certification letters from the applicable county, city or town with land use zoning authority where the real estate is located with respect to the permitted zoning classification, and review the applicable code provisions regarding permitted uses within the applicable classification. The degree by which the governmental authorities will certify zoning and land use compliance varies by jurisdiction. Many Delaware jurisdictions will charge a fee for the issuance of a zoning certificate.

Specific development agreements with relevant public authorities are often entered into in connection with the approval of record development plans for real estate projects or in connection with rezonings.

2.9 Condemnation, Expropriation or Compulsory Purchase

Government taking of land through condemnation is possible throughout Delaware and is accomplished in accordance with state statutes governing such proceedings (10 Del. C. § 6101 et seq). All condemnation proceedings within the State of Delaware commence by filing a complaint in the Superior Court in the county where the property is located, which contains the statement of the authority for the taking, the use for which the property is to be taken, description of the property, the interest to be acquired and designation of defendants that are joined as owners. The amount of just compensation to be paid for such taking is established at trial. It is typical in Delaware for landowners to enter into agreements under which they voluntarily convey property under threat of condemnation for agreed-upon compensation. The risk of a taking is entirely dependent upon the location of the property. Takings in Delaware are primarily pursued for road improvement projects of the Delaware Department of Transportation.

2.10 Taxes Applicable to a Transaction

Delaware realty transfer taxes typically apply for the purchase and sale of real estate, currently total 4% of the amount of consideration paid or imputed in the transaction, and are typically shared equally between the buyer and the seller. The same transfer taxes apply to transfers of ownership interests in property-owning entities, through a conveyance or series of conveyances of intangible interests (including mergers and other indirect exchanges). However, if the beneficial owners of real property prior to conveyance or series of conveyances of interest own 80% or more of the beneficial interest in the real estate following the conveyance or conveyances, such transfers are not subject to tax. There are many exemptions to the realty transfer tax, a partial of list of which includes:

- mortgages, conveyances between certain family members, certain conveyances to trustees, nominees or straw parties, certain conveyances to entities where the grantor or grantee owns an interest in the entity in the same proportion as the grantor's or grantees' ownership in the real estate being conveyed (subject to certain limitations);
- conveyances to lenders in lieu of a foreclosure if a bona fide mortgage is genuinely in default; and
- conveyances without consideration to organizations exempt from tax under Section 501(c)(3) of the Internal Revenue Code.

Although commercial leases are not subject to the transfer tax, leases of residential property under term of more than five years are subject to the tax.

2.11 Rules and Regulations Applicable to Foreign Investors

There are no specific Delaware rules or regulations that apply to foreign investors acquiring real estate; however, many fed-

eral laws apply to such acquisitions, including those highlighted in **2.6 Important Areas of Law for Foreign Investors**, above.

3. Real Estate Finance

3.1 Financing Acquisitions of Commercial Real Estate

Acquisitions of commercial real estate in Delaware may be financed by many sources, including local and regional banks, private equity funds, insurance companies, pension funds and in commercial mortgage-backed securities transactions. In the area of affordable housing, the Delaware State Housing Authority administers housing development fund loans and home loans. Other special financing vehicles for affordable housing may be available from county and local governments, and from member banks of the Federal Home Loan Bank of Pittsburgh. Acquisitions of large real estate portfolios are generally financed using CMBS funds. Small business administration loans made through participating lender institutions are also common. In Delaware, most real estate is owned by privately held companies; there is not a significant difference in financing real estate owned by publicly held companies.

3.2 Typical Security Created by Commercial Investors

The type of security interest created by commercial real estate investors borrowing funds to acquire and develop real estate in Delaware takes the form of a mortgage lien, and also a security interest in related non-fixture personal property under the Delaware Uniform Commercial Code. Delaware is a 'lien theory' mortgage jurisdiction.

3.3 Regulations or Requirements Affecting Foreign Lenders

There are no special state regulations or requirements affecting foreign lenders in Delaware, except for licensing requirements. A party that is not lending money as authorized by another Delaware or federal law, and that is not a banking organization, federal credit union, or insurance company that makes more than five loans in any 12 month period, must become a licensed lender under 5 Del. C. § 2202.

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

There are no transfer taxes, mortgage taxes or documentary taxes on mortgages in Delaware.

3.5 Legal Requirements Before an Entity Can Give Valid Security

Assuming due authorization and good standing status, there are no legal rules or requirements which must be complied with in Delaware before an entity can give valid security over

its real estate assets, such as financial assistance rules or corporate benefit rules.

3.6 Formalities When a Borrower is in Default

There are no special debtor protections in Delaware that must be overcome before a lender may enforce its rights against real estate, except in the case of owner-occupied one- to four- family residential properties, in which case a foreclosure may not be filed until 45 days after a notice of intent to foreclose is provided in a required form with an accounting of the mortgage obligation (subject to certain exceptions). The ordinary method of foreclosure is to sue at law by a writ of scire facias sur mortgage in the Superior Court of the county in which the mortgaged property is located. The action is commenced by filing a praecipe and complaint with the Prothonotary of the Superior Court. Upon issuance of the writ, it is served (together with the complaint) and returned in the same manner as an original summons and the case proceeds in the same manner as any other civil action. Upon entry of judgment, execution is by a writ of levavi facias directed to the proper officer, who subjects the mortgaged property to public sale. No additional procedures must be taken (beyond the initial recordation of the mortgage) to give the mortgage priority over interests of other creditors, though such creditors must receive notices in the foreclosure action. However, priority of the mortgage from time of recording extends only to debts and to amounts specified in the recorded mortgage. Such priority does extend to all future modifications of the mortgage except for those modifications that expressly increase the maximum principal amount specified in and secured by the mortgage.

3.7 Subordinating Existing Debt to Newly Created Debt

Existing secured debts may be subordinated to newly created debt in any circumstances, either by:

- entering into a subordination agreement between the debt holders that is recorded in the Office of the Recorder of Deeds in and for the county where the real property is located; or
- the creation of a purchase money mortgage.

A purchase money mortgage (given by a purchaser to a seller for securing future payment of the purchase price) has priority over any other liens or judgments against that mortgagor, even if they predate the purchase money mortgage.

3.8 Lender's Liability Under Environmental Laws

A lender which has not itself contributed to contamination of a property that forecloses and purchases the property at foreclosure, and seeks to sell, re-lease or divest itself of the properties at the earliest practicable, commercially reasonable time, on commercially reasonable terms, taking into account market conditions and legal and regulatory require-

ments, avoids liability under the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA) and the Delaware Hazardous Substance Cleanup Act via the 'secured creditor exemption,' (7 Del C. § 9105(c)(3)). In order to keep this protection, the lender should have the property appraised and listed for sale within a matter of months after the foreclosure. If such lender does not meet the requirements for the exemption, it can be held liable for the contamination.

3.9 Effects of Borrower Becoming Insolvent

If the borrower is insolvent, mortgages created by the borrower in favour of a lender during the insolvency, or conveyances following the foreclosure during the insolvency, could be challenged. If the mortgage is granted to the lender within the 90 day look-back period from the filing date of a federal bankruptcy action or a preference action under Delaware law, the mortgage could be challenged and set aside as a preference. Title transfers of the property made while the transferor is insolvent without receiving reasonably equivalent value can be challenged as a fraudulent transfer under bankruptcy or the Delaware Uniform Fraudulent Transfer Act (6 Del. C. § 1301 et al).

Although not tested by Delaware case law, lenders seek to protect themselves from bankruptcy risks by providing in loan documents that otherwise nonrecourse loans become recourse upon the filing of bankruptcy, and may require organizational documents of borrowers to obtain consent from a lender-appointed director or member to file bankruptcy.

4. Planning and Zoning

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

The design and appearance of new and refurbished buildings is most heavily regulated in New Castle County, as its Code not only regulates monotony in standard subdivision and development approvals, it requires architectural enhancements in matters where discretionary approvals are sought and links such approvals to the architectural elements proffered by an applicant.

4.2 Regulatory Authorities

Local jurisdictions (municipalities and counties) regulate zoning and subdivision development approvals within their respective boundaries. The Delaware Department of Transportation regulates connections to state-owned roads. The regulation of stormwater management will vary by jurisdiction within the state, with the Delaware Department of Natural Resources and Environmental Control's designated agencies taking the lead in each instance.

4.3 Obtaining Entitlements to Develop a New Project

As with all land-use matters in the state of Delaware, the process of obtaining entitlements to develop a new project or complete a major refurbishment varies by jurisdiction. In most instances, however, public hearings will be part of the process for most major land development proposals. The weight of such participation is most significant in New Castle County, where the zoning and subdivision code contains multiple provisions that either encourages or mandates such participation.

4.4 Right of Appeal Against an Authority's Decision

In New Castle County, the zoning and subdivision code contains administrative avenues that must be pursued prior to initiating any challenge to the decision or interpretation made by the county's administrative officials. For the remaining jurisdictions, challenges may be pursued in either the Court of Chancery or Superior Court depending on the decision sought to be challenged and/or the statutory scheme governing the method of appeal.

4.5 Agreements with Local or Governmental Authorities

Most jurisdictions do not require such agreements prior to entering the land use process. Instead, such agreements are required prior to completing the process and recording the final plan. Notable exceptions to this are sewer capacity, which typically requires a letter from the local sewer agency confirming capacity exists prior to commencing the process, and municipal annexations, which typically require confirmation that municipal utilities can accommodate the new territory.

4.6 Enforcement of Restrictions on Development and Designated Use

New Castle County is the most vigilant. Record plan inspections are conducted two years after the project has received its certificate of occupancy to confirm that the project was completed and maintained in accordance with the approved plan. If a violation is uncovered, the violation must be repaired or the plan must be formally modified.

5. Investment Vehicles

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

In Delaware, the preferred type of entity most commonly used to acquire real estate is the limited liability company. However, virtually any other type of recognized entity is available and can hold real estate assets. This includes Delaware corporations, religious corporations, close corporations, general partnerships, limited partnerships, limited liability limited partnerships, unincorporated non-profit

associations and statutory trusts. Title to real estate may also be held by a series created within a limited liability company or, beginning August 1, 2019, by a Delaware-registered series of a limited liability company.

5.2 Main Features of the Constitution of Each Type of Entity

Limited liability companies have become the preferred ownership entity in Delaware due to the insulation of members of the company from liability and the option of pass-through of taxes to members, bypassing taxes at the entity level. The flexibility of the Delaware Limited Liability Company Act with respect to structure and management is another advantage. In Delaware the names persons holding membership interests in the company are not required to be made a matter of public record.

Delaware corporations have the advantage of the most well-established and business-friendly corporate law in the country. Disadvantages are required corporate formalities and taxation at the entity level. The fiduciary duties of a corporation's board and officers to owners of the corporation are very limited in Delaware.

General partnerships have the disadvantage of not protecting their partners from liability for actions of the partnership, but are not subject to franchise tax or annual filing requirements with the State of Delaware.

Statutory or 'business' trusts are most commonly used for the organization of real estate investment trusts. Statutory trusts offer contractual flexibility similar to limited liability companies and also require less observance of formalities than corporations. The statutory trust itself is not deemed to be a 'person' and therefore not a 'debtor' under the federal bankruptcy code. In Delaware, a series may also be established within the statutory trust.

5.3 Tax Benefits and Costs

Corporations are an unattractive ownership structure for income-producing real estate due to the double taxation at the corporate level and the stock/membership owner level (unless they are able to elect IRS Subchapter S treatment for pass-through tax treatment on earnings). Limited liability companies are not taxed at the company level unless they so elect, offering the benefit of pass through tax treatment.

5.4 Applicable Governance Requirements

The governance requirements of limited liability companies in Delaware are extremely flexible and the provisions of the limited liability company operating agreements can specify myriad management structures and owner-member powers (or a lack thereof). There are no generally required formalities needed for limited liability companies other than the annual registration filings with the Delaware Secretary of State. Delaware partnership law also provides a great deal

of flexibility in 'freedom of contract' with respect to entity governance. Delaware corporations do require ownership by members, or stockholders, and management by a board of directors, with day-to-day operations carried out by officers. However, there can be an identity of interests among these various parties. Corporations must hold annual meetings and make annual filings with the Delaware Secretary of State.

6. Commercial Leases

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

There are several structures under which a party can occupy and use real estate for a limited period of time without obtaining full fee simple ownership. A lease for a term of years is the most common vehicle. Leases generally provide for exclusive use by the tenant and specify whether the lease can be assigned, or divided up by sublease for various periods of time or as to portions of the premises. License agreements also allow use of a property on a non-exclusive basis. Life estates in land, including life estates for the period of another person's life, are also recognized. This allows use by one or more persons of a property until death of one or both of them, with the reversionary interest going back to the grantor or a third party. A fee simple determinable estate, where the fee simple interest terminates and the property reverts to the grantor upon the happening of a stated condition, is also permitted.

6.2 Types of Commercial Leases

In Delaware, commercial leases vary in terms of the provisions that they contain based primarily on the property or asset type (for example, office, warehouse, residential, cell tower, and so forth). Office leases are more likely to contain lease expansion and contraction provisions. Retail leases will often contain percentage rent, co-tenancy and exclusive use provisions.

6.3 Regulation of Rents or Lease Terms

The amount of rent payable is not regulated for Delaware commercial leases. Rent provisions regarding lease renewals and holdover tenancies are negotiated and specifically stated in the lease. Commercial landlords that purchase utility service from a public utility for the tenant and meter the tenant's use may not charge an amount that exceeds the amount the tenant would be billed by the public utility if directly metered by the utility (25 Del. C. § 6101). Every verbal and written agricultural lease in which no term is expressed is deemed to have a term of one year ending on the December 31 next occurring after the commencement date unless the lease is entered into after September 1, in which case the lease terminates on the second December 31 following lease commencement (25 Del. C. § 6702).

6.4 Typical Terms of a Lease

The terms of commercial leases are not regulated in Delaware and are a matter of contract negotiation. The length of lease term varies greatly as to the type of property, particulars of the property, and whether the lease is a ground lease or a space lease. Maintenance and repair of the real estate is also allocated between landlord and tenant by contract, and varies greatly. As a rule of thumb, in pad site leases and single-occupant properties the entire building and structure are typically maintained by the tenant; with space leases the landlord is typically responsible for structural maintenance and the tenant for interior maintenance. The maintenance responsibility as to HVAC is negotiated and may be allocated either to the landlord (especially if the useful life of the equipment exceeds the term of the lease) or to the tenant (in the case of a longer lease term). The frequency of rent payments in space leases typically is monthly; for ground leases rent is more often paid in less frequent installments.

6.5 Rent Variation

Whether rent remains the same as long as the lease lasts is also a matter of negotiation. Typically there is an annual increase in base rent built into a commercial lease, either based on cost of living adjustments or fixed percentage increases.

6.6 Determination of Changes in Rent

If rent is to be changed or increased, the amount of the increase is a product of negotiation. Increases based on the percentage change in the consumer price index for all urban consumers, US city average is a typical escalator index or formula for the increase, but this can vary widely. Rent 'reset' clauses updating rent to current market rates upon the exercise of extension options are common, using appraised rent values from a qualified appraiser acceptable to landlord and tenant or from multiple appraisers (one each selected by landlord and tenant, sometimes with a third selected by the other two).

6.7 Payment of VAT

Rent is subject to the Delaware gross receipts tax imposed on landlords (30 Del. C. § 2301(e)(6)).

6.8 Costs Payable by Tenant at the Start of a Lease

The costs other than rent typically payable by a tenant at the start of a lease are subject to negotiation. The tenant usually is responsible for paying the cost of tenant improvements to the space, regardless of whether the landlord's or tenant's contractor performs these improvements. However, often the tenant is able to negotiate a tenant improvement allowance from the landlord, by which the landlord agrees to pay all or a portion of the cost of the improvements when they are completed. The amount of the tenant improvement allowance paid by the landlord is usually compensated for by an increase in the amount of rent payable by the tenant over time.

It is typical for a tenant under a lease of a condominium unit to pay for any realty transfer tax that is imposed on the lease.

6.9 Payment for Maintenance and Repair

In Delaware the maintenance and repair of common areas is typically paid for by the landlord, but the landlord often charges, as additional rent to each tenant, the tenant's proportionate share of such maintenance and repair costs, based upon the tenant's proportionate share of leasable square footage in the multi-tenant property.

6.10 Payment for Services, Utilities and Telecommunications

Under most Delaware leases, all services and utilities in multi-tenant properties are separately metered and paid for directly by tenants to the providers. However, if the leased premises is not separately metered with respect to a utility, the tenant often pays the proportionate cost of the service based on the square footage leased.

6.11 Insuring Real Estate that is the Subject of a Lease

Common practice is for the tenant to pay the cost of the landlord's commercial property/casualty insurance for the entire property, based on tenant's proportionate square footage leased in the case of a multi-tenant property, through the form of expense reimbursements/additional rent. Special form coverage is normally obtained. It is typical for the tenant to obtain liability insurance for the leased premises and personal property insurance for business contents in the leased space at tenant's expense. The landlord also typically maintains general liability insurance coverage for common areas, charged back as additional rent based on the tenant's proportionate share of the property.

6.12 Restrictions on the Use of Real Estate

There is no limit on the restrictions that can be imposed by the landlord on how the tenant uses the real estate. There are no regulations or laws restricting use under leases other than zoning and land use regulations.

6.13 Tenant's Ability to Alter or Improve Real Estate

There is no limit on the provisions that can be negotiated with respect to tenant alterations and improvements. Typically, landlord consent will be required for tenant alterations or improvements and typically the landlord will either have approval rights over the contractor performing the work or will require the work to be performed by the landlord's contractor.

6.14 Specific Regulations

In Delaware the only category of real estate for which there are specific regulations or laws is residential. The Delaware Residential Landlord/Tenant Code contains numerous pro-

hibited and required lease provisions and disclosures (25 Del. C. § 5101 et seq).

6.15 Effect of Tenant's Insolvency

If a tenant becomes insolvent under Delaware insolvency laws, then the tenant's goods that are on the demised premises are liable for the rent of such premises for the current or preceding year, but limited to one year only (10 Del. C. § 7324). The tenant's insolvency has the effect of vesting in the insolvency proceeding trustee the rights under the lease.

6.16 Forms of Security to Protect Against Tenant's Failure to Meet Obligations

Forms of security typically used to protect against the tenant's failure to meet its obligations can include security deposits (typically limited in amount to two months' rent, although there is no limit on this for commercial leases), or irrevocable standby letters of credit.

6.17 Right to Occupy After Termination or Expiration of Lease

In Delaware the express terms of the lease typically specify the rights and rents that apply to holdover tenants that remain after expiration or termination of the commercial lease. For residential leases only, the Delaware Residential Landlord/Tenant Code provides that the tenant pays the landlord a sum not to exceed double the monthly rental, computed and prorated on a daily basis, for the holdover period. If the tenant fails to vacate the premises upon expiration of the lease term, the landlord brings an action for summary possession in the Justice of the Peace court (25 Del. C. § 5701 et seq).

6.18 Right to Terminate Lease

In Delaware commercial leases, the rights of tenants to terminate the lease are extremely limited and exist only in unusual circumstances specifically negotiated by the tenant. However, in residential leases there are many conditions, under the provisions of the Delaware Residential Landlord/Tenant Code, that give a tenant the right to terminate the lease. Landlords can typically terminate the lease upon the breach of any contractual provisions in the lease by the tenant.

6.19 Forced Eviction

In Delaware tenants can be forced to vacate leased premises in the event of default prior to lease expiration by the landlord filing an action for summary possession in the Justice of the Peace court where the leased premises is located (25 Del. C. § 5701 et seq). To briefly summarize the process, the landlord first files a complaint for possession with the court. The court then attempts to serve process upon the tenant using the sheriff or, if the landlord files a motion for appointment of a special process server, a special process server consistent with the Justice of the Peace civil court rules. The court schedules a hearing once the notice of hearing, complaint

and proof of service are filed with the court. The tenant has the right to file an answer in writing or by raising defenses orally. The court then tries issues of fact raised (if any) and enters a judgment. The length of this process depends on whether a defense is tendered and in which Delaware county the real property is located.

6.20 Termination by Third Party

In Delaware, it is not typical for a third party to have the right to terminate a lease (such as the government or a senior lender). Such termination right will not arise unless it was specifically negotiated.

7. Construction

7.1 Common Structures Used to Price Construction Projects

The pricing structure will depend on a variety of facts and circumstances based on the type of the project (ie, new construction, renovations or additions) and can be a stipulated sum, a cost of work plus a fee with a guaranteed maximum price, or a cost of work plus a fee with no guaranteed maximum price. Most professionals will typically utilize standardized contract documentation software that provides for a variety of pricing structures, as well as provisions to address administrative related costs and expenses that are typically charged as additional costs.

7.2 Assigning Responsibility for the Design and Construction of a Project

New construction projects will typically require the engagement of:

- a civil engineering firm to determine and address the availability of utilities, stormwater design, geotech and other site-related considerations;
- a land use attorney for assistance with zoning and subdivision regulations; and
- an architectural firm for construction plans.

Depending on the size and complexity of the project, there will likely also be a construction manager acting as an adviser to the owner or as the general contractor. Renovation and expansion projects will typically require a civil engineering firm, an architectural firm and, depending on the nature and age of the existing improvements, an environmental firm. The contract documents will generally provide the scope of services and responsibilities of the various parties involved, including schedules that outline milestone dates and substantial completion deadlines. The construction manager, in conjunction with the architect, will typically provide a full range of basic services including a preconstruction phase that develops a construction management plan, an evaluation of the owner's proposed schedule and construction budget requirements, cost estimates and bid packages.

Construction phase services will typically commence with the award of the contracts for the project and involve on-site administration, management and related services as needed to coordinate activities among the various contractors and subcontractors as provided under the contract documents.

7.3 Management of Construction Risk

It is typical to require the construction manager and individual contractors to carry, as applicable (depending on the type of project), comprehensive general liability, automobile liability, workers' compensation at statutory limits, professional liability and umbrella or excess liability insurance coverages at such amounts negotiated by the parties. Insurance coverages and amounts are often dictated by the lender providing the construction financing for the project. The typical construction contract documents will require the contractor to provide the owner with certificates of insurance naming the owner as an additional insured on comprehensive general liability, automobile liability and umbrella or excess liability policies. Warranties related to workmanship for a limited time period after completion of the work are customary. Provisions providing for the recovery of consequential or punitive damages are atypical but provisions providing for monetary penalties for delays in achieving substantial completion of a project are quite common.

7.4 Management of Schedule-related Risk

This is typically addressed in the contract documents by providing for liquidated damages on a per diem basis for each day or designated period in which the contractor does not achieve substantial completion or fails to meet certain milestones. Other contract provisions may include the owner's right to offset costs and expenses incurred against amounts due the contractor, or obligating the contractor at its sole cost and expense to provide additional labor and/or overtime to meet designated milestones.

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

This will often depend on the type of project as well as the type of financing. Certain financing that is obtained through the issuance of governmental bonds typically requires performance bonds and/or payment bonds. Certain financing through the Department of Housing and Urban Affairs (HUD) for the construction of apartment complexes will require escrows for working capital and operating deficits during construction and prior to stabilization, usually secured by letters of credit.

7.6 Liens or Encumbrances in the Event of Non-payment

Mechanic lien rights of contractors or others entitled to assert a mechanic's lien are set forth under 25 Del. C. Chapter 27. Prospective waivers of mechanic's lien rights are against public policy and unenforceable under 25 Del. C. §2706. There are specific time frames and filing requirements

that must be followed. It is possible for a mechanic's lien to become superior to a construction loan for work performed before the recording of the security interest by the lender. The customary practice is for the lender to obtain partial releases from any contractor who may have performed work prior to the lender's construction loan. The owner or any party in interest (such as a lender) may upon a petition to the Superior Court under 25 Del. C. §2729 to post a sum equal to the amount of the claim or other approved security such as a letter of credit with the Court to bond over the potential lien which results in the claim being discharged as a lien against the property.

7.7 Requirements Before Use or Inhabitation

The requirements for the issuance of the necessary building permits and other applicable authorizations will vary depending on the issuing jurisdiction's building code, housing-related ordinances and applicable zoning, subdivision and land use statutes, codes, ordinances and regulations. The initial steps typically involve the submission of sealed construction and lines and grades plans for review and approval, verification of properly licensed contractors, establishing erosion and sediment controls for the site, and approval of construction entrance designs. Numerous inspections are typically performed during the construction process including inspections after foundations are constructed, after the installation of electrical, plumbing and HVAC improvements, and after overall building construction. Depending on the jurisdiction, these inspections may be performed by state, county or local personnel or approved third party vendors, including the state fire marshal's office. Such inspections are required before the issuance of temporary or final certificates of occupancy.

8. Tax

8.1 Sale or Purchase of Corporate Real Estate

In general, the transfer of fee simple title to real estate in Delaware is subject to a 2.5% state transfer tax and either a county or municipality transfer tax of 1.5%, for a total of 4% of the value of the property being transferred.

If beneficial ownership in real estate in Delaware is transferred through a conveyance of intangible interests in an entity, then the transfer is subject to the transfer tax, subject to certain limited qualifications set forth in 30 Del. C. §5401.

In addition, any transfer of title or possessory interest for a term of more than five years in a condominium unit subject to the Delaware Unit Property Act; any transfer of title or possessory interest of any lessee or other person in possession of real estate owned by the State of Delaware or a political subdivision thereof, and any transfer of a leasehold or possessory interest in residential property under a lease for a term of more than five years, is also subject to the transfer

tax. Other leases, regardless of duration, including ground leases, are exempt from transfer tax pursuant to 30 Del. C. §5401.

The value of the property to which the tax applies is based on the amount of actual consideration associated with the transfer, which includes any assumed ground rents, liens, or other encumbrances, provided that, in the case of a transfer for an amount less than the highest appraised value for local real property tax purposes, 'value' shall mean the highest such appraised value unless it can be demonstrated that fair market value is less than the highest such appraised value. To prevent parties from computing realty transfer taxes on artificially low purchase prices for new construction, realty transfer taxes are also imposed on the value of construction contracts entered into either prior to the date of the deed transfer or within one year from the date of transfer (collected at building permit issuance).

There are certain exemptions to the state portion of the transfer tax set forth in 30 Del. C. §5401. New Castle County and Sussex County each have a comparable list of exemptions with respect to their 1.5% transfer tax. Kent County recognizes the state exemptions with respect to its 1.5% transfer tax.

In general, the transfer tax is apportioned equally between the grantor and grantee, absent an agreement to the contrary or an exemption pursuant to 30 Del. C. §5401.

Delaware does not have a mortgage recordation tax.

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8.2 Mitigation of Tax Liability

The mitigation of transfer tax on the transfer of real estate in Delaware will depend on whether the transaction qualifies for any of the various exemptions set forth in 30 Del. C. §5401.

8.3 Municipal Taxes

See **8.1 Sale or Purchase of Corporate Real Estate**, above.

8.4 Income Tax Withholding for Foreign Investors

Income tax withholding for a foreign investor will vary depending on the facts and circumstances specific to the particular investor.

8.5 Tax Benefits

Tax benefits from owning real estate will vary depending on the facts and circumstances specific to each party to each specific transaction, including, but not limited to, consideration of the taxpayer's basis in the asset and other tax relevant considerations, such as depreciation, capitalized costs and deductions.

8.6 Key Changes in Federal Tax Reform

The impact of recent federal tax reform on a real estate investor will vary depending on the facts and circumstances specific to the particular investor.