



Shopping Center Legal Update

The legal journal of the shopping center industry



■ In Practice

To Build or Not to Build: The Myriad Issues Facing Developers With Approved Development Sites in Today's Market	2
The Benefits and Pitfalls of LEED 2009: The Greening of Retail	7
The Landlord's Bankruptcy: How to Prepare for It and What to Expect	10
Vested Rights Case Favors Developers and Serves a Cautionary Tale	14
Next Steps: The Green Movement Presses Forward	16
The Rite-Aid Scare—Is This Really the End of the 'Compare-and-Save' Ad?	19

26

■ Of Interest

Cases	22
<i>Americans With Disabilities Act</i>	22
Assignment / Assumption	22
Bankruptcy	22
Condemnation / Eminent Domain	23
Contracts	24
Landlord and Tenant	24
Signs	25
Taxation	25
Zoning	25
Legislation	26

■ From Canada

■ In Depth

Are Continuous Operation Clauses in Leases Enforceable?	27
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To Build or Not to Build: The Myriad Issues Facing Developers With Approved Development Sites in Today's Market

George J. Kroculick*

Duane Morris, LLP

Philadelphia, PA

"I bought properties inexpensively and made a lot of money. I began to think it was easy." *Donald Trump*

Flashback: 2005

During the last decade, the real estate market was booming and everyone was looking to get a piece of the action. Housing starts and sales were robust. Accordingly, developers were looking to push projects into the pipeline as quickly as possible. By and large, the projects were residential in nature or had been spurred on by other residential development taking place in the area.

Property prices were inflated, but financing was not an issue. Lenders were more than willing to finance anything and everything relating to real estate. In fact, the primary obstacle to development was locating a suitable site and managing the approval process. Though the approval process was time-consuming and expensive, the sentiment of many was that it was all worth the effort.

Fast-Forward: 2008

The real estate bubble has burst. Unsold home inventories are high, and sales are declining. Bankruptcies, foreclosures and unemployment are on the rise. The credit crunch is in full force and effect. The domino effect of falling real estate values and tightened lending has resulted in a severe recession.

Present Day: Developers in Limbo

Everyone recognizes that the market today is not the same market from two or three years ago. The real estate market is not as deep as many had anticipated or hoped. As a result, the product a developer had expected to be able to sell is still on the market. For many in the residential market, the product may no longer be viable or may only move at a significantly reduced cost. Certainly, residential projects are taking much more time to move. For those in the commercial sector, forecasts are bleak and tenants are hard to come by. The lending market has impacted everyone.

Developers who started their development approval process between 2005 and 2006 have likely obtained all their approvals, but have not gotten around to putting a shovel in the ground. These developers are now faced with the decision of whether to build or not to build in an uncertain economy. For the harder hit developers, the decision may have been made for them, as financing for the projects has dried up. Many developers are simply unable to either complete many of their ongoing projects or to start work on other projects due to a severe credit crunch. Lenders are not interested in construction financing. For others, the decision will be a measure of the market for the product and their expectations for a turnaround in the market. In some areas of the United States, market values have declined to such a degree to render a project economically

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infeasible. Regardless, those developers still standing will have to assess the progress of their construction. They will have to analyze the percentage of the project sold and the price(s) received, whether the land has been paid for, and whether construction financing is secure. If the project includes any large-scale residential portion, a developer may have to think long and hard if it is worth it to try and wait out the current market downturn.

Among many mid-to-large-scale developers that may still have access to financing, the consensus has been to delay their projects. That is, they have sought to refrain from building where possible, as these developers have likely been more concerned with unloading existing inventory on already-developed projects. A developer cannot sit on a project forever, however. The approvals that a developer spent hundreds of thousands of dollars (if not more) and several years to obtain have a fixed shelf life. By law, many of these local approvals are set to expire.

Consequently, more and more developers are faced with a dilemma: Should they: (i) abandon their projects altogether, eating whatever costs they have sunk into the approval process? (ii) Alter or amend the scope of their projects? (iii) Seek extensions on their approvals with the hope of waiting out the current economic tsunami? Whatever a developer decides, it will come at a cost. This article discusses some of the factors involved in the decision, including recent legislation addressing permit extensions.

I. Abandoning the Project: Loss of Time, Money and Effort Invested to Date

- A. *Cost of Market Studies.* The developer had to analyze whether such a venture would be profitable once it was constructed.
- B. *Cost of Informal Meetings.* For larger-scale developments, the developer may have also taken steps to gauge the political climate facing the project to determine if there were any potential obstacles. This might have entailed discussing plans, or conducting informal meetings with various officials or the public in general.
- C. *Cost of Property Acquisition and Carrying Costs.* In addition, once the property was purchased, there were likely significant carrying costs. These can often be some of the most significant costs for a developer and include mortgage payments and taxes.
- D. *Cost of Formal Approval Process.* Assuming that approvals were eventually obtained, authorization was likely subject to the approvals of other outside agencies. These may have included utility easements, access permits, storm water approvals, waste or sewerage authority approvals, county approval, etc. Relatively few of the costs associated with the approval process can be recouped once a project is abandoned.
- E. *Loss in Value of the Property.* The approvals contribute value to the property. This contributory value is lost once a developer abandons a project and lets the approvals lapse.
- F. *Impacts to Financing Agreements.* Financing agreements may not permit a borrower to abandon the project without the consent of the lender.
- G. *Selling the Project at a Loss.* As an alternative to abandoning the project altogether, a developer might be able to sell a project.
- H. *Multiple Losers.* Not only does a developer lose if a project is abandoned, but the contractors, the lenders and the towns hoping for such development also potentially lose. Once a project is terminated, substantial financial loss has been incurred already. Contractors and consultants will not only lose out on work, but also may struggle to settle outstanding invoices. The lender may lose the value of its collateral or be forced to take over a project. Towns with abandoned projects, on the other hand, may be left with fallow sites and fewer tax dollars.

II. Altering or Amending the Project

The economy has slowed, and consumer demand has weakened. Everyone is being asked to do more with less, including developers. Plans developed before the economic downturn may not apply now. As a result, developers may have to reschedule the focus of their proposed projects where possible. This could include scaling back development or adjusting time tables for construction.

For example, where a large-scale development was approved, a developer may be able to construct various portions in phases instead of all at once. In this manner, the developer can focus on those phases with the most current potential and may be able to generate some cash therefrom.

Nonetheless, a change to an approved plan will likely require approval from the local planning or zoning board. This, of course, will entail additional costs to a developer, including the cost of revised plans and hearings before the public body. Moreover, the makeup of a public body that was once receptive to your plan may have changed. Accordingly, they may have a different view on your development or may see an opportunity to exact further contributions from a developer. What is more, if the changes are significant, the local law may require the developer to begin the development process anew.

By and large, however, local towns should be receptive to minor amendments, given the current economic climate. In many instances, towns that have been equally burdened by the economic downturn would prefer to have a smaller-scale development take place rather than have land sitting vacant.

III. Seeking Permit/Approval Extensions

Many real estate development businesses are struggling to survive in the current economy. Each day, they look for good news on home sales figures, only to find very little comfort. Moreover, the permits and approvals they likely spent hundreds of thousands of dollars to obtain are set to expire. Consequently, these developers with approved sites, who are likely looking to cut costs, have to weigh whether or not to sink additional costs into a site that may not turn a profit. Additionally, they have to look to determine whether their financing agreements require them to maintain the approvals.

Local development approvals and permits generally have an expiration date. If the developer does not take action within the time frame governing the approval, it faces losing the approvals. Though each unit of local government has its own distinct procedures regarding zoning and development approvals, most have a means for extending existing approvals.

The extension process, nonetheless, will likely entail additional fees to apply for a permit/approval extension or re-permitting as well as appearances before the local governing body to review the application. Though such extension applications should not be as complicated as the original approval process, the fees associated with the process can quickly mount up on any given project. As discussed above, boards change, and a project once viewed with favor may now raise concerns. Accordingly, a developer that is not ready to abandon a project should look at the potential for any project alterations in connection with the extension process.

IV. Have the Permits or Approvals Been Extended by Law?

Due to the current economic climate, several governing bodies have adopted legislation that deals with the automatic extension of certain approvals. Below is an analysis of a few of those statutes:

New Jersey: The Permit Extension Act of 2008

On Sept. 6, 2008, the New Jersey Legislature passed the *Permit Extension Act of 2008*. N.J.S.A. 40:55D-136.1 *et seq.* (*Permit Extension Act*). The *Permit Extension Act* tolls the expiration of certain New Jersey State, county and municipal land development approvals from Jan. 1, 2007, to July 1, 2010—the “Extension Period” as defined under the *Act*. N.J.S.A. 40:55D-136.3.

The *Permit Extension Act* covers a broad range of state, county, and municipal permits and approvals, including permits granted pursuant to the *State Uniform Construction Code Act*. N.J.S.A. 40:55D-136.3. With regard to covered approvals, the *Permit Extension Act* provides:

For any government approval in existence during the extension period, the running of the period of approval is automatically suspended for the extension period, except as otherwise provided hereunder; however, the tolling provided for herein shall not extend the government approval more than six months beyond the conclusion of the extension period. Nothing in this act shall shorten the duration that any approval would have had in the absence of this act, nor shall this act prohibit the granting of such additional extensions as are provided by law when the tolling granted by this act shall expire. [N.J.S.A. 40:55D-136.4 *Existing government approval; extension period.*]

Exceptions to the *Permit Extension Act* *Specifically*

The *Permit Extension Act*, however, specifically lists a number of permits that are not tolled under the *Act*. The exceptions include permits issued for projects located in environmentally sensitive and protected areas, as such areas are designated under the State Development and Redevelopment Plan, as well as portions of other areas, such as the Highlands and the Pinelands. Further, the *Permit Extension Act* does not affect permits and approvals issued or controlled by the Federal government.

Miscellaneous Provisions

In addition to the specific exceptions listed under the *Act*, there are several miscellaneous provisions, including but not limited to the following:

The act does not take away the power of the commissioner of the Department of Environmental Protection to revoke or modify a permit or approval where the specific terms of the approval grant such power. N.J.S.A. 40:55D-136.4(d).

The act is not intended to guaranty the sufficiency of sanitary sewer capacity. Where a developer has obtained an approval for connection to a sanitary sewer system, the approval remains contingent upon the availability of sufficient capacity. However, the Permit Extension Act does reserve priority for developers that have obtained sanitary sewer approval over those who have not received approval prior to the enactment of the act. N.J.S.A. 40:55D-136.4(e).

A municipal approval for residential development is not protected where, subsequent to the expiration of the permit but prior to Jan. 1, 2007, an amendment has been adopted to the master plan and the zoning ordinance to rezone the property to industrial or commercial use. N.J.S.A. 40:55D-136.4(f).

Florida: SB 360—Growth Management

More recently, Florida passed legislation that would extend certain development approvals. On June 1, 2009, Florida's Governor Charlie Crist signed SB 360 Growth Management. The statutory extension was crafted "[i]n recognition of 2009 real estate market conditions" with the intent of assisting those in the real estate, construction and lending industries. Among other provisions, this bill allows economic development projects to stay "in the pipeline" by extending the validity of development permits and environmental permits for two years following its date of expiration.

The bill covers, with certain exceptions, any permit issued by the Department of Environmental Protection or a water management district having an expiration date of Sept. 1, 2008, through Jan. 1, 2012. The extension also includes "any local government-issued development order or building permit." Generally, to perfect the statutory extension, the holder of a valid permit or other approval eligible for the statutory extension must notify the authorizing agency of the permit or approval in writing no later than Dec. 31, 2009, "identifying the specific authorization for which the holder intends to use the extension and the anticipated time frame for acting on the authorization."

Virginia: HB2077 additions to Virginia Code § 15.2-2209.1

In response to the current economic downturn, the General Assembly of the Commonwealth of Virginia, through HB 2077, added to Virginia Code § 15.2-2209.1 a provision extending the expiration period for certain site development plans and permits that were approved before Jan. 1, 2009. Such plans and permits will be extended to July 1, 2014, and may be extended even further, dependent upon local governing bodies.

Subject to specific exceptions, the new law applies to the expiration date for (i) any subdivision plat, recorded plat or final site plan; (ii) certain special exceptions, special use permits or conditional use permits; and (iii) certain proffers that were valid and outstanding as of Jan. 1, 2009. Nevertheless, the law requires that any performance bonds or other financial guarantees of completion of public improvements are continued for the time of the extension in order to benefit from the extension.

Local Ordinances—Philadelphia, PA, and Portland, OR

In addition to the above state-wide mandated statutory extensions for certain development approvals or permits, several local governing bodies are implementing or have implemented similar provisions. On May 13, 2009, the City of Philadelphia passed Bill No. 090127, a limited permit extension bill that applies to zoning and/or use registration permits. Namely, such permits shall be extended for one year upon written request of the permittee, so long as certain terms and conditions are met.

On May 20, 2009, the City Council of Portland, OR, adopted a Zoning Code amendment that extends for a limited period the expiration dates of certain land use reviews and related land use actions. This Zoning Code amendment went into effect on May 27, 2009, and was adopted in response to the current economic downturn, recognizing the difficulty that developers and homeowners are having in proceeding to the building permit or land use review phase of their projects. The Zoning Code amendment extends land use decisions that became effective between May 27, 2006, and Dec. 31, 2006. These approvals, which heretofore would have expired if a building permit had not been issued within three years, must now be issued by June 30, 2012. Preliminary plans approved between May 27, 2006, and Dec. 31, 2008, are likewise extended, now providing applicants until June 30, 2012, to submit a final plat application. In addition, certain pre-application conferences and final plat conferences have been extended under the Zoning Code amendment.

V. Your Options

"Every right implies a responsibility; every opportunity, an obligation; every possession, a duty." John D. Rockefeller

Developers with approved sites have certain responsibilities. Developers that let their permits and approvals lapse may face many problems. In addition to eating their substantial investment in the approval process, developers that allow their approvals to lapse face reclassification of loans and/or a decline in real estate values. Still, many developers may seek to ensure the survival of their projects to protect their own financial interests, as well as those of their investors. Nonetheless, developers that are not ready to abandon their projects face additional costs just to preserve their approvals in this uncertain market.

For projects that obtained their approvals and permits several years ago, the clock is ticking. As a result, developers that have delayed construction on approved projects should sit down with their legal and financial advisors as soon as possible. These developers will have to make a decision on whether they can and should abandon a project, or whether they should seek extensions or alterations to their projects. The rules of the game have changed, and developers must adjust accordingly.

***GEORGE J. KROCULICK** practices in the area of real estate law with a focus on eminent domain and highway access management and control, land use and land use litigation, relocation assistance, tax appeal matters, and general commercial litigation. Mr. Kroculick has represented clients before local and county land use boards and has worked on lease litigation matters as well as title disputes. The author gratefully acknowledges the work of **MICHAEL J. MCCALLEY**, an Associate at Duane Morris.