LEXOLOGY
Getting the Deal Through

REAL ESTATE 2023

United States – New York

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Dechert LLP

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GENERAL

Legal system

1 How would you explain your jurisdiction's legal system to an investor?

Like every US state except Louisiana, New York is generally a common law jurisdiction with statutes governing specific subjects, as well as related regulations and case law precedents. Injunctions are available to prevent a party from acting but are subject to strict standards and typically difficult to obtain (New York Civil Practice Law and Rules, section 6301). Injunctions are most often granted to prevent irreparable injury; if the party seeking the injunction is likely to win on the merits; or once a matter is fully adjudicated (ie, when an injunction is issued as a final judgment). New York courts may rule in equity under certain circumstances.

Parol evidence may be admissible when necessary to discern an ambiguity in a written contract. Oral contracts are enforceable, although most contracts involving real property in New York must be in writing, including leases for more than one year, conveyances or deeds (New York General Obligations Law, section 5-703). While certain laws that affect New York real estate are national in scope – including, among others, the Fair Housing Act, the Americans with Disabilities Act and certain federal environmental laws – most vary by state and may also vary by county and by municipality.

Land records

2 Does your jurisdiction have a system for registration or recording of ownership, leasehold and security interests in real estate? Must interests be registered or recorded?

New York has a system for recording interests in land, which is promulgated by the New York Real Property Law and operates on a county-by-county basis. Recordings are generally made in the county where the property in question is located and requirements vary by county.

Fee and leasehold interests, among others, can be recorded. Leasehold interests are typically only recorded when they:

- contain an option to purchase a fee interest;
- are for a long term; or
- cover a material amount of space (or an entire property).

Not all interests are required to be recorded, but unrecorded interests will be void against a subsequent bona fide purchaser of a property for valuable consideration who does not have notice of such an unrecorded interest. Buyers of New York real estate typically purchase title insurance to protect against unknown or competing interests in the property.

Registration and recording

3 What are the legal requirements for registration or recording conveyances, leases and real estate security interests?

Execution of a deed is necessary to vest a fee title in a grantee in New York. The conveyance must be in writing, signed by the grantor or the grantor's lawful agent and grant a fee or leasehold interest. The grantor or its authorised agent must sign a deed for it to be valid. Additionally, deeds must be acknowledged, or otherwise proved by the grantor before recording, to be effective against subsequent purchasers and encumbrances (New York Real Property Law, section 243).

New York imposes taxes on the recording of mortgages at a rate of 50 cents per US$100 of debt secured. Some counties and metropolitan areas, notably New York City, have significant additional mortgage recording taxes. A state real estate transfer tax is paid by the grantee at a rate of US$2 for each US$500 of consideration, with additional taxes levied in New York City and certain other counties for residential and commercial property priced above certain value thresholds.

Foreign owners and tenants

4 What are the requirements for non-resident entities and individuals to own or lease real estate in your jurisdiction? What other factors should a foreign investor take into account in considering an investment in your jurisdiction?

There are no requirements that a foreign entity register to do business in New York or obtain a special licence merely to own or lease real estate in New York. However, if an entity does not register in New York, that entity may not bring a lawsuit in New York courts. Some landlords may require increased security deposits or a letter of credit as additional security if the tenant is not a local entity. Foreign investors should pay careful attention to US federal and New York state tax laws (such as section 1312 of the New York Business Corporation Law) in structuring New York real estate investments. Many foreign investors create a US special purpose entity to hold or manage their New York real estate investments.

Certain foreign real estate transactions could be subject to review by the Committee on Foreign Investment in the United States, a US federal inter-agency committee that reviews real estate investments by foreign persons and their effect on US national security.

Exchange control

5 If a non-resident invests in a property in your jurisdiction, are there exchange control issues?

There are no exchange control issues or restrictions on repatriation of capital in New York. However, New York and US federal tax laws will impact any real estate investment and any disposition of real estate by a foreign investor. Foreign investors will attract federal tax liability under the Foreign Investment in Real Property Tax Act from gross rental income, with non-US nationals generally subject to:

- a 30 per cent tax (minus deductions such as mortgage interest and business expenses); and
- for disposition of real estate assets, a 15 per cent tax on realisation of capital gains.

Foreign investors should pay careful attention to US federal and New York state tax laws in structuring New York real estate investments.

Legal liability

6 What types of liability does an owner or tenant of, or a lender on, real estate face? Is there a standard of strict liability and can there be liability to subsequent owners and tenants including foreclosing lenders? What about tort liability?

Liability is generally restricted to:

- breaches of any contracts involving the property, owner or tenant;
- tort claims involving the property, owner or tenant; and
- statutory claims by either state, county or other governmental agencies, often involving health, safety, zoning or building code enforcement.

Strict criminal liability will be imposed for some environmental and health and safety laws, such as leakage of petroleum products or deficient fire safety equipment in multiple dwellings. An example of tort liability, colloquially known as the Scaffold Law, imposes a strict liability standard on owners and contractors of multi-family or commercial buildings for damages caused while using equipment such as scaffolding, ladders or hoists while working on, demolishing or cleaning buildings.

Liability to foreclosing lenders will depend on whether the underlying loan's lender has recourse to the borrower. Such recourse, unless otherwise stated, is typical. Many lenders require, as a condition of the loan, for borrower-affiliated guarantors to assume certain obligations in the event of liability relating to the property. This is often the case for environmental issues, construction project failure, bad boy guarantees (in the event of bad acts by the borrower or certain other parties) or failure to pay taxes. See section 181 of the New York Navigation Law, and sections 240 and 241 of the New York Labor Law.

Protection against liability

7 How can owners protect themselves from liability and what types of insurance can they obtain?

Owners in New York can protect themselves from liability by acquiring property through legally distinct entities, such as limited liability companies (LLCs) and limited partnerships or corporations, and through careful ownership structuring (New York Limited Liability Company Law, section 203; New York Business Corporation Law, section 628). Owners will typically hold the fee or leasehold interest in a single purpose entity created with the limited purpose of holding the owner's interest. Owners can also acquire different types of insurance to protect themselves against claims (eg, title insurance, environmental insurance, and representations and warranties insurance), as well as various endorsements to title insurance policies such as non-imputation endorsements, which insure an entity against imputation by operation of law of the knowledge of its partner, officer, director or employee regarding unrecorded items affecting title.

Choice of law

8 How is the governing law of a transaction involving properties in two jurisdictions chosen? What are the conflict of laws rules in your jurisdiction? Are contractual choice of law provisions enforceable?

The governing law of a transaction is typically chosen by the parties. Absent a choice of law provision, a court will generally apply the law of the forum state. If multiple jurisdictions are involved and the substantive law of each state differs, a court will apply choice of law analysis. Factors considered in a modern contractual conflict of law analysis include:

- the place of contracting;
- the place of negotiation;
- the place of performance;
- the location of the contract's subject matter; and
- domicile, residence, nationality, place of business and place of incorporation of the parties.

Contractual choice of law provisions naming New York are enforceable in transactions with a value of at least US$250,000, provided that it is not a contract for personal services or labour (New York Labor Law, section 5-1401).

Jurisdiction

9 Which courts or other tribunals have subject-matter jurisdiction over real estate disputes? Which parties must be joined to a claim before it can proceed? What is required for out-of-jurisdiction service? Must a party be qualified to do business in your jurisdiction to enforce remedies in your jurisdiction?

The New York state civil court system contains several levels of courts: Courts of Original Instance, Intermediate Appellate Courts and the Appellate Divisions of the Supreme Court,

with the Court of Appeals as the highest court in the state. The trial court with jurisdiction over real estate disputes is the Supreme Court, as it is designated for civil matters involving claims with higher dollar amounts. There are four federal district courts in New York: the Northern, Southern, Eastern and Western Districts. For a federal court to have jurisdiction over a real estate dispute, the parties must have diversity of citizenship and there must be more than US$75,000 at issue. Required parties (parties in which in their absence the court cannot accord complete relief among the existing parties) must be joined to the claim before it can proceed.

In New York, to serve a party that resides outside of New York, the paperwork may be delivered to that party by a process server via first-class post or the serving party may hire a process server that resides in the state in which the defendant resides for them to hand-deliver a copy of the summons and complaint.

A foreign entity (corporation, LLC, non-profit, partnership, etc) must have obtained authority to conduct business in New York to affirmatively access New York state courts. If the entity is not qualified to do business in New York, the action is subject to dismissal in court. See Rule 19 of the Federal Rules of Civil Procedure, section 1312 of the New York Business Corporation Law and section 1001 of the New York Civil Practice Law and Rules.

Commercial versus residential property

10 How do the laws in your jurisdiction regarding real estate ownership, tenancy and financing, or the enforcement of those interests in real estate, differ between commercial and residential properties?

New York laws regarding property ownership are similar for commercial and residential properties. New York imposes a real estate transfer tax on sales of real property or interests when the sale is for greater than US$500. If the seller is not a resident of New York, they must pay taxes on the personal gain or loss from the sale or transfer of those properties and fill out the accompanying tax forms (New York Real Property Actions and Proceedings Law, sections 1303 and 1304). New York has several laws that protect individual consumers and tenants, particularly in the areas of foreclosure, disclosure, equal opportunity, evictions, rent stabilisations and control, as well as more recent laws enacted in light of the covid-19 pandemic.

Planning and land use

11 How does your jurisdiction control or limit development, construction, or use of real estate or protect existing structures? Is there a planning process or zoning regime in place for real estate?

Land use, zoning, construction and development are generally governed by New York county, city and municipal zoning and building codes, rules and regulations. Procedures to obtain permits and variances will differ between counties and between municipalities within counties. Specifically, if the local zoning authority in charge affirms that the intended development complies with the local zoning regulations, the developer may begin their work as of right.

Often, however, newer and larger projects that do not satisfy existing zoning codes must first submit proposals to obtain variances, discretionary approvals or apply for re-zoning, particularly in heavily developed or regulated localities. Every locale has its own process for obtaining such approvals. New York City has the most robust process in the form of the Uniform Land Use Review Procedure, which involves several stages of review.

After a developer applies for a variance, approval or re-zoning, the local zoning authority will either approve or deny the application. In the event of a denial, decisions may be appealed to a local Zoning Board of Appeal (or, in the case of New York City, the Board of Standards and Appeals) within a short amount of time, typically between 30 and 60 days (or, in the case of New York City, a maximum of 30 days).

When zoning non-compliance exists, the first step is generally to informally contact the offending party. If the violation persists, enforcement can either take the form of a civil or criminal penalty. The consequences of failure to comply with zoning requirements may include (in addition to fines and other charges):

- revocation or suspension of related permits;
- denial of future permits until compliance;
- stop work orders; and
- cease-and-desist orders.

Government appropriation of real estate

12 Does your jurisdiction have a legal regime for compulsory purchase or condemnation of real estate? Do owners, tenants and lenders receive compensation for a compulsory appropriation?

New York law (as well as municipal law, all grounded in the US Constitution) provides for taking by eminent domain and condemnation. When real property is taken, owners must receive just compensation, except when the taking constitutes an exception, which varies based on applicable law. Often, during this process, owners will engage in consensual negotiations with the condemning governmental body to ease the process, and maximise compensation and other benefits. Particularly, in circumstances where wrongdoing has occurred, civil and criminal forfeiture rules can apply.

Forfeiture

13 Are there any circumstances when real estate can be forfeited to or seized by the government for illegal activities or for any other legal reason without compensation?

Under New York state law, real estate is only subject to forfeiture without compensation in connection with certain illegal activities. Specifically, real property may be seized if it qualifies as 'proceeds' or is an 'instrumentality' of a felonious crime. Most of these felonies are related to controlled substances, including (but not limited to):

- criminal possession of a controlled substance in the first or second degrees;
- criminal sale of a controlled substance in the first or second degrees; or

- operating as a major trafficker.

See article 13-1 of Chapter 8 of the New York Civil Practice Law and Rules, article 480 of the New York Penal Law, and the New York Organized Crime Control Act.

Bankruptcy and insolvency

14 Briefly describe the bankruptcy and insolvency system in your jurisdiction.

Bankruptcy is generally governed by US federal law. Title 11 of the United States Code is the federal Bankruptcy Code, which covers both voluntary and involuntary bankruptcy proceedings. A bankruptcy proceeding may involve liquidation (Chapter 7) or restructuring (Chapters 11 and 13) of the debtor, or both.

Under article 12 of the New York Business Corporation Law, there are also voluntary and involuntary receiverships available without a federal bankruptcy filing. As soon as a bankruptcy filing occurs, an automatic stay takes effect that halts most proceedings and collection efforts, pending resolution of the bankruptcy itself. The automatic stay also provides an opportunity to value the bankruptcy estate. The trustee's role in a bankruptcy is to collect payments, monitor activity and report to the bankruptcy court. In a New York receivership, the receiver's role is to take or hold real (or personal) property, and collect and sell debts or claims. During a borrower's bankruptcy, lenders cannot begin collecting rents; however, in a non-bankruptcy receivership through New York law, they may do so (through the receiver or trustee).

INVESTMENT VEHICLES

Investment entities

15 What legal forms can investment entities take in your jurisdiction? Which entities are not required to pay tax for transactions that pass through them (pass-through entities) and what entities best shield ultimate owners from liability?

In New York, investment entities can take any form. The most typical forms of investment entities are corporations, limited liability companies (LLCs), general partnerships, limited partnerships (LPs) and limited liability partnerships (LLPs). Tax pass-through entities are LLCs, S-corporations, partnerships and LPs, while other entity forms are taxed on both the entity and personal levels (including real estate investment trusts). Entities that are typically treated as tax pass-through entities can also elect to be taxed as corporations (which may be the case when foreign investors sit above the US entities). The types of entities that provide liability shields are corporations, LLCs, LPs (with respect to the limited partners only) and LLPs (on a partial basis).

Foreign investors

16 What forms of entity do foreign investors customarily use in your jurisdiction?

Foreign investors will tailor their entities to their personal tax needs, which will vary by individual and by country of origin. Most typical will be use of a domestic C-corporation or other entity (eg, partnership or LLC) that has elected to be taxed as a corporation to minimise tax consequences associated with the Foreign Investment in Real Property Tax Act (FIRPTA). This election is due to these entities' pass-through tax structure. FIRPTA requires foreign investors to withhold 15 per cent of the sales price and deposit it directly with the Internal Revenue Service, meaning that foreign investors have additional taxes when investing in real estate unless the real estate is for a personal residence and costs less than US$300,000. Therefore, selecting an entity that is taxed at the corporate level is crucial for foreign real estate investors to offset the FIRPTA tax penalty.

Organisational formalities

17 What are the organisational formalities for creating and maintaining the above entities? What requirements does your jurisdiction impose on a foreign entity? Does failure to comply incur monetary or other penalties? What are the tax consequences for a foreign investor in the use of any particular type of entity, and which type is most advantageous?

Most organisations require filing a specific form with, and paying an associated fee to, the New York Department of State. Each entity must adopt a governing agreement or by-laws and contain specific words in their names indicating their organisational form. New LPs and LLCs must publicise their existence. Corporations and LLCs require their own tax filings and associated annual filing fees. Although entities can be formed in New York, it is generally considered best practice for various reasons to form US entities in Delaware where possible and then, if needed, have those entities qualify to do business in New York.

Foreign entities require a separate application for authority that asks identifying information of the foreign entity. Foreign corporations must file a statement of activities containing tax information or obtain consent from the New York Department of Finance to operate before the application for authority is accepted. Failing to comply may lead to injunctions against the foreign entity conducting business and a revocation of its business licence. Failure to comply with a certificate of authority attracts a penalty of up to US$500 for the first day and US$200 for each subsequent day, not to exceed US$10,000 (New York Codes, Rules and Regulations, Title 20, section 540.6). The person failing to file may be subject to a US$200 penalty or criminal violations under article 9A of the New York Tax Law.

Foreign entities, if engaged in a trade or business within the United States, are generally subject to US federal, state and local taxes on their net income and may be subject to a branch profits tax, which may be reduced or eliminated by a double tax treaty. Foreign entities that are not engaged in a trade or business within the United States are generally subject to a 30 per cent withholding tax on any US source income, which may be reduced or eliminated by a double tax treaty. A foreign investor can generally reduce the US tax consequences and filing obligations by using a domestic C-corporation or other entity (eg, partnership or LLC) that has elected to be treated as a corporation for US tax purposes to

invest in US real estate. FIRPTA requires that a portion of real estate transfer proceeds be withheld to cover potential taxes on the asset's gains, withholding 21 per cent for foreign corporations or trusts rather than 15 per cent for other non-resident sellers. Forming a domestic entity is recommended for property sales.

ACQUISITIONS AND LEASES

Ownership and occupancy

18 Describe the various categories of legal ownership, leasehold or other occupancy interests in real estate customarily used and recognised in your jurisdiction.

Real estate interests are typically comprised of fee interests and leasehold interests. A fee interest is an ownership interest that gives full and permanent title to the property owner, including the right to control the property by allowing for the sale, assignment, subordination and collateralisation of the property. A leasehold interest gives the holder the right to access and occupy the property for a period of time, along with various other customary rights, often requiring prior landlord consent for certain actions, as well as obligations required by the landlord pursuant to a negotiated lease agreement.

New York recognises real property interests of:

- sole ownership;
- tenancy in common;
- joint tenancy;
- joint tenancy with right of survivorship;
- tenancy by entirety;
- condominium ownership; and
- cooperative ownership as interests in real estate.

Condominium ownership is a fee ownership of individual units divided from a larger building (most often a multi-family residential property) and an undivided interest in that property's common elements.

Cooperative ownership is the ownership of one or more shares of stock in a corporation owning real estate, generally entitling the buyer to a long-term proprietary lease of the portion of the real estate occupied by that buyer, with maintenance charges assessed per share. Condominium and cooperative ownership regimes are widely used in New York for both residential and commercial properties.

Space leases for various types of properties (multi-family, industrial, retail, etc) are each similar in structure, but may differ in rent calculation, additional charges assessed (eg, operating expenses and taxes) and in services provided by landlord to tenant. Master leases allowing for a single tenant who sublets to other tenants are common. Ground leases for long periods (treated similarly to fee interests in many ways), incentivising lessees to improve real estate for long-term use, are also common.

Easements (ie, agreed limited use rights without ownership or tenancy) can have many forms and uses, and generally give beneficiaries specific property rights in land that is not owned by those beneficiaries. Easements can be temporary or perpetual and can be expressly contracted or implied through pre-existing use, necessity or prescription. Easements by pre-existing use, according to Beretz v Diehl, require:

- initial unity of title followed by subsequent separation of title;
- continuous use long and obvious enough to manifest an intent for that use to be permanent; and
- that use is necessary for the benefit and enjoyment of the retained property.

Easements by necessity, according to Walt Whitman Rd Assocs v Whitman Capital LLC, require the use to be 'indispensable to the reasonable use for the adjacent property'. Prescriptive easements, according to Masucci v DeLuca, require the beneficiary's hostile, open, notorious, continuous and uninterrupted use for 10 years. A prescriptive easement is comparable to the concept of adverse possession and has a similar test.

Easements in gross involve one property and grant access to specific entities such as utilities. In contrast, appurtenant easements involve two neighbouring properties and run with those properties, running with those properties and thus surviving changes in ownership. Easements can be terminated through abandonment, merger, necessity, demolition, recording acts, condemnation, adverse possession and release. Restrictive covenants burden a property from a certain use or development and may be contracted or enforced through zoning.

Pre-contract

19 | What are the typical pre-contractual steps?

In a commercial context, it is typical and advisable, but not necessary, to negotiate non-binding offer letters, letters of intent or term sheets for the acquisition or lease of a property before the parties proceed to prepare a binding contract. Courts may bind parties to term sheets, letters of intent and offer letters where it is unclear that the parties intended not to be bound. However, courts will generally respect clear language stating that the parties in fact intend not to be bound. Merger clauses are useful to disclaim prior or extra-contractual agreements and bar parties from relying upon such agreements, and are typically included in definitive contracts.

The parties may agree on a specified period of exclusivity during contract negotiations, but in many cases, particularly in New York City and in residential property transactions among individuals, properties remain on the market during negotiations until a contract of sale is fully executed by the parties. Parties often transact off market with or without a broker. Brokers are regulated by New York law and must be licensed in New York under section 440 of the New York Real Property Law. New York real estate brokers currently must be at least 20 years old, have at least two years of experience as a licensed real estate salesperson or three years in real estate generally, meet an experience point system, complete a course and pass a licensing examination.

Contract of sale

20 | What are typical provisions in a contract of sale?

Real estate sale contracts typically include:

- a clear description of the property being sold;
- purchase price and purchase price adjustments;
- prorations, if any, and deposits to be made;
- representations and warranties of both parties;
- title matters benefiting or burdening the property;
- operating covenants of the seller;
- due diligence periods, if applicable;
- rights of title and survey review and objection;
- closing deliveries, including deeds and other conveyance documents;
- closing cost allocations;
- risk allocations in the event of casualty or condemnation; and
- remedies for defaults.

If a due diligence period is contemplated, the contract will provide for a mechanism for the buyer to review the recorded exception documents and other related matters located on title as well as a survey locating such items and to make objections. The buyer may also have the right to access the property to conduct non-invasive environmental, structural and other investigations. Invasive investigations are also typical but are subject to detailed negotiation.

Typical representations and warranties for real property sales include statements regarding:

- good standing, authority and consent to buy and sell, respectively;
- good and marketable title to the property;
- pending litigation involving the property;
- bankruptcy;
- options or rights of first refusal;
- material contracts binding the property;
- leases or licences of property;
- conflicts with other contracts;
- whether seller is a foreign person, trust or corporation;
- that there are no anti-terrorism law violations (or other typical know-your-customer provisions);
- whether parties are acting under the federal Employee Retirement Income Security Act;
- insurance policies;
- pending tax proceedings; and
- violations of law (including environmental law).

Survival of representations and warranties as well as anti-sandbagging clauses may also be included.

Liability for taxes, utilities and other property expenses can be allocated through specific negotiations but are typically bifurcated based on the parties' period of ownership. Tax years vary based on the property's county (in New York County, the tax year starts on 1 July each

year). Sellers typically bear risk of loss until closing occurs both with and without contract specifications unless the purchaser acquires possession of the property prior to closing, is otherwise at fault or the loss is unrelated to property damage.

Environmental clean-up

21 Who takes responsibility for a future environmental clean-up? Are clauses regarding long-term environmental liability and indemnity that survive the term of a contract common? What are typical general covenants? What remedies do the seller and buyer have for breach?

If no risk is otherwise apportioned among the parties, buyers will bear hazardous waste clean-up costs regardless of their responsibility for the waste, although they may sue responsible parties such as sellers and brokers who fail to disclose reasonably discoverable environmental contamination for reimbursement. New York enforces unambiguous environmental indemnification agreements between private parties, but a minority of states do not, so parties should be aware of choice of law provisions. Survival provisions defining or extending the periods of indemnity or representations are common, but not ubiquitous. Even under long-term survival provisions, buyers cannot be wilfully ignorant of an environmental concern and receive indemnity, creating an implied limitation to the period of indemnity.

Sellers often covenant to provide buyers with environmental audits or assessments before closing, at the seller's cost. Mortgagors may similarly covenant that all construction or development permits obtained and anticipated uses comply with environmental law. Tenants may covenant to comply with environmental matters during their occupation of the property.

Although not typical, sellers may and do indemnify purchasers for acts occurring prior to sale, but sellers will typically cap their indemnification exposure to specific events or limited to specific amounts. Buyers may negotiate clauses allowing recission if an assessment reveals contamination before closing or deducting clean-up costs from purchase prices. Indemnification clauses frequently require buyers to enable sellers to meet their obligations and provide immediate notification of contaminations to the seller as a condition to indemnification. Buyers may also seek monetary expectation or (if shortly after closing) recission in court for misrepresentations or the seller's responsibility for environmental law violations.

Lease covenants and representation

22 What are typical representations made by sellers of property regarding existing leases? What are typical covenants made by sellers of property concerning leases between contract date and closing date? Do they cover brokerage agreements and do they survive after property sale is completed? Are estoppel certificates from tenants customarily required as a condition to the obligation of the buyer to close under a contract of sale?

Property sellers with existing leases affecting the subject property typically include a description of the applicable leases along with a representation that:

- such a list is complete in all material respects;

- correct copies of all such leases have been or will be provided to the purchaser;
- no defaults exist under any lease (except as otherwise disclosed), all leases are in full force and effect, and all leases are written and not oral;
- the seller has the exclusive right of possession of all portions of the property subject only to the rights of tenants thereunder;
- the seller has no knowledge of any claims of adverse possession;
- there are no commissions due or coming due in the future to any broker or other third party;
- all fixtures attached now and later are landlord's property; and
- existing tenants will continue to comply with:

    - the terms of their leases;
    - the landlord's right to perform existing tenant's covenants at the tenant's expense;
    - subletting rights;
    - rights of first offer;
    - assignment and subletting procedures;
    - assignment and sublease profit sharing;
    - existing defaults;
    - closing certifications of rent rolls and financial contracts;
    - brokerage fee allocations (usually paid by the seller, but may be allocated with respect to future events, such as lease extensions and renewals);
    - completed or future improvements as individually negotiated; and
    - whether current operating contracts are taken as is or otherwise.

During the contract period prior to closing, the seller generally covenants:

- to operate the property in the ordinary course and in substantially the same manner as prior to the contract period;
- not to cancel, modify or extend any lease or operating agreement (of a certain agreed upon value) without the buyer's consent;
- not to sell or create a lien on any part of the property; and
- not to enter new leases or service contracts without the buyer's consent.

Pre-closing covenants generally survive closing for an agreed-upon period. As a closing condition, the seller typically agrees to deliver completed estoppel certificates from tenants on either a pre-approved form or in a condition acceptable to the buyer.

Leases and real estate security instruments

23 Is a lease generally subordinate to a security instrument pursuant to the provisions of the lease? What are the legal consequences of a lease being superior in priority to a security instrument upon foreclosure? Do lenders typically require subordination and non-disturbance agreements from tenants? Are ground (or head) leases treated differently from other commercial leases?

Leases are customarily made subordinate to all ground leases affecting the property as well as to all present and future mortgages and assignment of leases and rents affecting the property. Most leases contain a self-operative subordination clause as well as a tenant

obligation to deliver any instrument required by the landlord under the lease or any other applicable lease, or the holder of any mortgage or any of their applicable successors-in-interest to evidence such subordination. If a lease is superior in priority to a security instrument, the lender may not have the right to take possession of the property during a foreclosure, and the tenant in possession cannot be dispossessed by foreclosure and may continue to possess the premises until lease expiration. Lenders commonly require subordination and non-disturbance agreements from tenants to ensure that the security instrument takes priority over the lease in the event of a foreclosure.

Fee mortgages may be subordinated to ground leases to ensure that in the event of an uncured default, the leasehold mortgage lender has the right to foreclose on the leasehold interest, take and readily enforce a leasehold mortgage, preserve the ground lease and its value, and exercise certain other considerations such as maintaining control of any casualty and condemnation proceeds. Because ground leases contain long terms and are treated similarly to fee interests, a ground lease subordination and non-disturbance agreement typically focuses on the parties' rights and obligations regarding the ground lease and any mortgage or other lien against the property by the tenant subordinating its leasehold interest to the lender's mortgage.

Delivery of security deposits

24 What steps are taken to ensure delivery of tenant security deposits to a buyer? How common are security deposits under a lease? Do leases customarily have periodic rent resets or reviews?

Security deposits are a standard practice in New York commercial leasing. Security deposits typically consist of a cash or letter of credit, or both, component. The security deposit, along with the payment of the first month's rent, is typically due at or shortly after lease execution. Landlords may also allow for the posting of a cash security deposit in lieu of a letter of credit until the letter of credit is delivered and the cash is returned to the tenant. Security deposit amounts may increase or decrease during the lease term.

In the context of a real estate purchase, the seller will typically deliver to the buyer, as a part of its due diligence requests, a list of all security deposits being held by the landlord for existing tenants. The buyer will typically require tenant-executed estoppel certificates delivered by the seller at or prior to closing, confirming the amount and form of the security deposits being held, and will require that all security deposits be delivered to the buyer at or prior to closing. The seller typically delivers cash security deposits to the buyer via a wire transfer through their underlying bank account or by a credit to the purchase price shown on the settlement statement issued by the escrow agent charged with holding all funds and distributing them at closing in accordance with the relevant escrow provisions of the purchase agreement or stand-alone escrow agreement. Letters of credit are either reissued as a replacement letter of credit or physically delivered to the buyer at or prior to closing of purchase. Because of the administrative burden of letter of credit transfers, the delivery to the buyer may become a post-closing seller obligation.

Most commercial leases contain annual rent escalations based on the prevailing market escalation rate. Some leases contain periodic rent review or reset clauses to ensure that the rent remains consistent with market rates. In some cases, a rent review or reset clause

may require an adjustment to the security deposit, while in other cases the security deposit will remain unchanged. Another common mechanism is a reduction (burndown) of the cash security deposit or the letter of credit amount. More common on larger leases, the burndown provision provides for a reduction in the amount of the security deposit as the remaining term on the leases is reduced over time, provided that the tenant is not otherwise in default under the lease.

Due diligence

25 What due diligence should be conducted before executing a contract? Is any due diligence customarily permitted or conducted after contract but before closing? What is the typical method of title searches and are they customary? How and to what extent may acquirers protect themselves against bad title? Discuss the priority among the various interests in the estate. Is it customary to obtain government confirmation, a zoning report or legal opinion regarding legal use and occupancy?

Due diligence requirements will vary depending upon various factors (including buyer budgets, availability of information and available time). A buyer will typically make thorough tours of a property and conduct diligence relating to property-specific documents, including:

- existing title insurance policies;
- surveys;
- architectural plans;
- leases;
- brokerage agreements;
- maintenance contracts;
- casualty and liability insurance policies;
- existing notices of legal violations;
- rent rolls;
- tenant-by-tenant operating expenses;
- income and expense and operating statements;
- historical leasing information;
- historical capital expenditures;
- rental arrearage reports;
- budgets;
- tax appeals;
- utility bills; and
- environmental reports.

A buyer may also negotiate access rights to conduct additional physical, non-invasive studies, tests or inspections of the property after the parties are under contract but before closing (or pursuant to a separate access agreement), including:

- zoning and land use investigations;
- non-invasive soil, groundwater and vapor inspections; and
- non-invasive engineering and geotechnical inspections of the land.

Invasive testing may be negotiated if the non-invasive reports indicate a need for further information. Sellers are typically reluctant to permit invasive testing.

A lender in connection with the financing of an acquisition may, in addition to the above, also consider reviewing the borrower's or any guarantor's financial statements, organisational documents, good standing certificates regarding the borrower and, if applicable, each guarantor as well as appraisals of the real property. Lenders may also order their own environmental or engineering reports, or both, regarding a property.

A common title search is a 40-year search regarding previously recorded deeds, liens, judgments, encumbrances and other claims of ownership, and is a common tool for buyers to discover and attempt to cure title defects. Moreover, buyers may obtain title insurance to protect themselves against any title defects. Buyers may at times be able to negotiate for an indemnity to survive for a period of time after closing or for the seller to provide an escrow holdback of a portion of the purchase price in connection with title defects or breached seller representations. Priority amongst parties is subject to a race-notice statute, meaning that the first to record a title instrument without notice of competing claims will maintain priority over other, potentially prior, interests. Additionally, the buyer may be asked to have a zoning report or opinion prepared to address such permitted use as well as documents from the relevant local jurisdiction confirming such use. See section 291 of the New York Real Property Law.

Structural and environmental reviews

26 Is it customary to arrange an engineering or environmental review? What are the typical requirements of such reviews? Is it customary to get representations or an indemnity? Is environmental insurance available?

It is customary to arrange for both an engineering review and an environmental review, often performed by separate service providers. A Phase 1 Environmental Site Assessment is conducted by an environmental inspector to discern whether any hazardous substances were reported or located on the site. A Phase II Environmental Site Assessment may be necessary if it is determined that further investigation is required involving potential environmental issues. Additionally, an engineering report may be conducted to address any structural deficiencies, including roofs, utilities, drainage and mechanical systems. A buyer could ask the seller to provide certain representations or an indemnity regarding compliance with environmental or site-specific issues, or may request that an escrow or purchase price holdback be established to mitigate cost risks with respect to any discovered violations or deficiencies. However, most sellers will reject such requests (or agree to make only very limited statements) and instead insist that the buyer conduct its own due diligence to gain comfort regarding potential risks. Notably, environmental insurance may be available.

Review of leases

27 Do lawyers usually review leases or are they reviewed on the business side? What are the lease issues you point out to your clients?

Whether lawyers review leases and management agreements is determined on a transaction-by-transaction basis and generally governed by the purchaser's budget. It is common for

lawyers to review leases. It is less common for lawyers to review management agreements because they are typically terminated at acquisition closing. Management agreements are typically required to be subordinate to financing security instruments.

Depending on cost, lawyers may be asked only to review the material leases in connection with the transaction, which may be identified or otherwise determined based on factors such as rent amount, square footage or location. Typically, lease reviews will focus on:

- economic terms;
- initial alteration work to be performed by the landlord;
- a tenant improvement allowance and related construction items if the tenant is performing the initial buildout;
- ongoing services and covenants of the landlord;
- operating expenses, utilities and taxes;
- extension and renewal options;
- expansion options;
- purchase options;
- rights of first offer and refusal;
- guaranties;
- security deposits;
- holdover penalties;
- insurance requirements;
- casualty and condemnation;
- assignment and subletting restrictions;
- available remedies; and
- mortgagee protection provisions.

Other agreements

28 What other agreements does a lawyer customarily review?

The documents reviewed by a lawyer will vary based on the type of transaction. However, in connection with the purchase and sale of commercial real estate, lawyers will typically review brokerage agreements, letters of intent, purchase and sale agreements, title and survey documents, loan documents, operating agreements, material third-party service contracts and other material agreements affecting the property, including, if applicable, condominium documents and reciprocal easement agreements.

Closing preparations

29 How does a lawyer customarily prepare for a closing of an acquisition, leasing or financing?

To prepare for a closing of an acquisition, leasing or financing, lawyers for each party to the transaction will work to ensure that:

- the operative documents are finalised, executed and fully compiled with;
- all signature pages are in the possession of the receiving party or the escrow agent;

- all necessary funds have been received (either directly by the landlord in the case of a lease or by the escrow agent in the case of an acquisition or financing); and
- all other required documentation, which will vary based on the type of transaction (but may include organisational documents, authorisations and consents, opinions, third-party reports, title insurance policies, assignments and guaranties, among others) have been finalised and delivered prior to or at the time of closing.

To verify authorisation to close a transaction, a lender in the case of a financing or the escrow agent in the case of an acquisition may require the representatives from each party who are duly authorised to enter into the transaction (or their attorney as agent) to confirm in writing that the documents are in final form, the closing funds may be distributed and the transaction may be consummated. Prorations to the final settlement statement including adjustments for prepaid taxes, third-party fees, commissions and offsets, among others, are prepared at closing and reviewed and signed off on by the applicable parties. The timing between the signing of the contract and closing will vary based on each transaction (ranging from a sign-and-close, in which the signing and closing occur simultaneously, to long executory periods necessary to account for the completion of all conditions precedent to closing). Though the parties may agree to endeavour to close the transaction on a date certain, if this date becomes mutually unrealistic for various reasons, amendments or other modifications will be made to the operative agreement to account for any such delays.

Closing formalities

30 Is the closing of the transfer, leasing or financing done in person with all parties present? Is it necessary for any agency or representative of the government or specially licensed agent to be in attendance to approve or verify and confirm the transaction?

The closing of the transfer is typically conducted via escrow by an independent third-party escrow agent who will hold and distribute all funds and fully compiled execution documents at closing, at the parties' direction. The parties will typically deliver all required counterpart signatures to the escrow agent along with a detailed escrow instructions letter via courier prior to closing. Copies of signature pages are typically acceptable other than for documents that require notarisation or those that are being recorded in the public records. Any document that will be recorded in the public records that is not being filed electronically must typically be an original wet ink signature pursuant to the guidelines of the applicable county recording office. Closings may also be consummated in-person, but this practice became increasingly less common prior to the covid-19 pandemic and is even more uncommon in its aftermath. If the closing is done in person, a representative from each party should be in attendance. If any local, state or federal government agency is a party to or otherwise has an interest in the transaction, there may be additional closing requirements, but this will occur on a case-by-case and agency-by-agency basis.

Contract breach

31 What are the remedies for breach of a contract to sell or finance real estate?

Both parties are entitled to obtain remedies when the other party breaches the contract. If a seller is unable to sell the property in good faith, a buyer is limited to recovering its

payment and reasonable expenses associated with attorney's fees, title searches and other out-of-pocket costs and damages. Alternatively, if the seller wilfully breaches the contract, a buyer may be entitled to recover their benefit from the bargain, which is calculated at the difference between the market value of the property and the contract price, in addition to other damages.

A buyer may also obtain specific performance of the seller's contractual obligation. To obtain specific performance, it should be expressly and clearly agreed upon by the parties in their contract. Notably, however, specific performance is an equitable remedy and will be considered on a case-by-case basis. If the buyer does not proceed with purchasing the property, a seller may claim damages, but contracts will typically limit the seller's remedy to retaining the buyer's earnest money deposit as liquidated damages. In most cases, the parties' contract negotiations will result in the expansion or narrowing of remedies on a case-by-case basis.

Breach of lease terms

32 What remedies are available to tenants and landlords for breach of the terms of the lease? Is there a customary procedure to evict a defaulting tenant and can a tenant claim damages from a landlord? Do general contract or special real estate rules apply? Are the remedies available to landlords different for commercial and residential leases?

Termination, acceleration of rent, eviction and ejectment are typical remedies for a breach of a lease. The landlord also has the option to draw down a security deposit. Lease remedies are generally specified in the lease agreement itself. Tenants can only claim damages if the landlord has breached the terms of the lease. Often, leases provide for limitation of tenants' remedies to claim damages against a landlord. In New York, a landlord can file for eviction in landlord–tenant court in accordance with the rules and procedures of such a court or can file an ejectment action in state court under the theory of general contract law. If there is an individual or corporate parent guarantor who guaranties the underlying lease obligations, the landlord can file a breach of contract claim against such guarantor in State court as well. In certain jurisdictions, including New York, the landlord has the duty to mitigate tenant damages by using commercially reasonable efforts to ready the premises for occupancy and show the space to prospective tenants. Self-help is a remedy that is available to landlords in some jurisdictions, although this has largely fallen out of favour.

Remedies available for residential leases are much more extensive and favourable to tenants. In residential leases, the remedies available to landlords are generally limited by state laws and may include eviction, recovery of unpaid rent and the ability to make repairs and charge the tenant for those repairs if the tenant breaches the lease agreement.

See sections 227-e and 701 of the New York Real Property Law.

FINANCING

Secured lending

33 Discuss the types of real estate security instruments available to lenders in your jurisdiction. Who are the typical providers of real estate financing in your country? Are there any restrictions on who may provide financing?

New York utilises both a deed of trust and a mortgage form. However, a mortgage is the most common security instrument used to create a lien on real property to secure indebtedness. Deeds of trust are rarely used in New York. Mortgages grant liens on real estate and New York operates under a lien theory of mortgage, which grants the lender a lien, while the borrower retains legal and equitable title. Enforcement is through New York statutory law (foreclosure) for both types of security instruments.

Lenders in New York are of varied types and natures. There is no restriction on who can be a lender, but lenders are typically required to be licensed. The most typical types of loans are acquisition loans, construction loans, bridge loans and permanent loans. Acquisition loans are used to finance the acquisition of unimproved or improved real property. Construction loans are utilised to develop or significantly renovate real property and have short-term maturities. Bridge loans are short-term loans used in connection with an acquisition or to pay off construction loans when a permanent loan cannot be obtained immediately. Permanent loans are longer-term loans that are obtained for stabilised properties.

See section 254 of the New York Real Property Law and section 340 of the New York Banking Law.

Leasehold financing

34 Is financing available for ground (or head) leases in your jurisdiction? How does the financing differ from financing for land ownership transactions?

Financing is available for ground leases in New York. To qualify for leasehold financing, the lease will typically have a remaining term of at least 35 years. For a ground lease to be financeable, it should contain a standard set of leasehold mortgagee protective provisions (eg, notification to lender of tenant defaults and other events, lender rights to cure tenant defaults, control of casualty insurance and condemnation proceeds, lender's right to a new lease with the landlord upon tenant default). Lenders will also require an estoppel certificate from the landlord (confirming, among other things, the lease document, the lease's economic terms and the absence of defaults), and potentially a subordination, non-disturbance and attornment agreement. Lenders typically should verify that either the ground lease or a memorandum thereof (ie, a short summary of the certain lease terms) has been recorded in the land records of the county where the property is located, providing notice to third parties of the ground lease. Lenders may also require that any mortgages on the landlord's interest in a ground leased property are subordinated to the ground lease itself.

Form of security

35 What is the method of creating and perfecting a security interest in real estate?

A security interest in real estate is created and perfected by recording a mortgage or deed of trust against that real estate in the office of the clerk of the county in which such real estate is located. Additionally, liens against certain personal property that has been incorporated into the real estate itself may be created. Such personal property is referred to as a 'fixture'. Such a lien on fixtures will be created using a security agreement, describing the fixtures and recording a notice (a fixture filing) in the office of the clerk of the county in which such real estate is located. Lenders will often incorporate the security agreement and fixture filing into the mortgage itself.

See section 291 of the New York Real Property Law, and sections 9-501 and 9-502 of the New York Uniform Commercial Code.

Valuation

36 Are third-party real estate appraisals required by lenders for their underwriting of loans? Are there government or industry standards for appraisals? Must appraisers have specific qualifications or required government or industry certifications? Who is required to order the appraisal?

Nearly all lenders in New York will require the delivery and review of a third-party real estate appraisal before originating a loan. This requirement will apply regardless of whether the lender is statutorily required to obtain that appraisal. New York requires appraisers to be certified by the state for all mortgage loans over US$250,000. There is no requirement for who is to order the appraisal, but loan officers are heavily restricted in contacting appraisers.

New York commercial real estate appraisers typically base their appraisals on three different valuation approaches: the cost approach; the direct sales comparison approach; and the income capitalisation approach. To calculate a value, appraisers utilise factors such as:

- the land value;
- the replacement (or reproduction) cost of the improvements;
- the accrued depreciation;
- the value by the sales of comparable properties and rentals;
- expenses, interest rates, capitalisation rates and vacancy rates;
- existing land use regulations;
- neighbourhood trends;
- physical adaptability of the property; and
- probable supply and demand as evidenced by current market conditions.

Most appraisers acceptable to lenders will hold an MAI membership designation.

See section 590-B of the New York Banking Law and Title 3, section 80.7 of the New York Codes, Rules and Regulations.

Legal requirements

37 What would be the ramifications of a lender from another jurisdiction making a loan secured by collateral in your jurisdiction? What is the form of lien documents in your jurisdiction? What other issues would you note for your clients?

Foreign banking corporations that do not maintain offices in New York can issue loans in New York that are secured by mortgages or deeds of trust on New York real property without any specific permissions, approvals or licences. New York has a mortgage recording tax for the registration and recording of real property liens with the tax payable at the state level, as well as a separate tax payable in certain counties.

Mere assignment of a mortgage by a lender does not trigger additional taxes. A foreign lending entity may also wish to qualify to do business in New York to avoid a borrower's claim that the lender's failure to qualify to do business in New York prevents that lender from commencing foreclosure action in New York.

See section 200 of the New York Banking Law and section 1401(e) of the New York Tax Law.

Loan interest rates

38 How are interest rates on commercial and high-value property loans commonly set? What rate of interest is legally impermissible in your jurisdiction and what are the consequences if a loan exceeds the legally permissible rate?

If the interest rate for a commercial or high-value property loan is fixed for the loan term, the lender will commonly utilise US Treasury (swap) rates as a benchmark in addition to a spread (expressed in basis points) on top of the benchmark to create the all-in interest rate. If the interest rate for a loan will float during the loan term, the lender will commonly utilise the one-month secured overnight financing rate.

New York's general usury ceiling is 16 per cent per year. The criminal usury rate in New York is a rate in excess of 25 per cent per year. The usury limitations vary based on type of property and transaction. The exceptions to the general usury laws include, among other things:

- loans of US$250,000 or more, except when secured primarily by a mortgage on a one- or two-family residence;
- loans to corporate borrowers, except when the corporation was formed to own a one- or two-family residence;
- federally pre-empted first residential mortgage loans made by a federally regulated lender; and
- junior mortgage loans made by New York chartered banks, trust companies or mortgage brokers.

These exceptions do not apply to criminal usury. The criminal usury rate ceiling of 25 per cent and the criminal penalties for exceeding it do not apply to loans of US$2.5 million or more. New York's civil and criminal usury statutes include origination fees, points and other

discounts, and all other amounts paid or payable, directly or indirectly, by any person to or for the account of the lender in consideration for making the loan or forbearance, except for categories of fees and charges set forth in the applicable New York codes and regulations, which are:

- sections 5-501(1), 5-501(6)(a) and 5-521 of the New York General Obligations Law;
- sections 14-a(1), 14-a(7), 103(4-a) and 590-a(1) of the New York Banking Law;
- sections 190.40 and 190.42 of the New York Penal Law; and
- Title 3, sections 4.2 and 4.3 of the New York Codes, Rules and Regulations.

Loan default and enforcement

39 How are remedies against a debtor in default enforced in your jurisdiction? Is one action sufficient to realise all types of collateral? What is the time frame for foreclosure and in what circumstances can a lender bring a foreclosure proceeding? Are there restrictions on the types of legal actions that may be brought by lenders?

Foreclosures in New York are judicial, which means that the lender must foreclose by commencing an action in the New York state court system. Foreclosure begins with the lender filing a summons and complaint with the court (and serving that summons and complaint on the borrower), and filing notice of a pending claim in the public real estate records against the underlying property. In the event of a loan default, lenders have the choice under New York's election of remedies statute to either:

- enforce the note or guaranty and obtain a money judgment; or
- pursue an action in equity to foreclose on the mortgage.

New York's one-action rule bars lenders from bringing simultaneous actions to recover on the same mortgage debt once a foreclosure has commenced (New York Real Property Actions and Proceedings Law, section 1301). A borrower has the right of redemption, allowing it to redeem the real property up until the foreclosure sale has occurred (New York Real Property Actions and Proceedings Law, section 1301(3)).

Loan deficiency claims

40 Are lenders entitled to recover a money judgment against the borrower or guarantor for any deficiency between the outstanding loan balance and the amount recovered in the foreclosure? Are there time limits on a lender seeking a deficiency judgment? Are there any limitations on the amount or method of calculation of the deficiency?

Lenders must seek a deficiency judgment within 90 days of consummation of a foreclosure sale. The lender makes a request for a deficiency judgment at the same time it files a motion for an order confirming the sale. The deficiency is limited by the property's fair market value, which the court determines. The deficiency judgment amount is the borrower's total debt less the market value as determined by the court or the sale price of the property, whichever is higher. The lender may obtain a deficiency judgment only if the debtor

is personally served the summons or the debtor enters an appearance in the foreclosure action. See New York Real Property Actions and Proceedings Law, section 1371.

Protection of collateral

41 What actions can a lender take to protect its collateral until it has possession of the property?

Temporary receivership is an option that a lender may take to protect its collateral. Upon motion of a judgment creditor, the court may appoint a receiver who may be authorised to administer or collect rents, or improve, lease, repair or sell any real or personal property in which the judgment debtor has an interest, or to do any other acts designed to satisfy the judgment. If a receiver has been appointed, a court making an order directing payment or delivery of property shall direct that payment or delivery to be made to the receiver rather than to a sheriff. A receiver is an officer of the court and will not solely represent the interests of the lender. Moreover, a junior lender taking possession of property before foreclosure may be exposed to liability from senior lienholders. Also, a receiver appointed by a New York state court does not have the authority to oversee out-of-state assets and cannot sell the property. See section 5228 of the New York Civil Practice Law and Rules.

Recourse

42 May security documents provide for recourse to all of the assets of the borrower? Is recourse typically limited to the collateral and does that have significance in a bankruptcy or insolvency filing? Is personal recourse to guarantors limited to actions such as bankruptcy filing, sale of the mortgaged or hypothecated property or additional financing encumbering the mortgaged or hypothecated property or ownership interests in the borrower?

Security documents may provide recourse to all of the borrower's assets under New York law. However, commercial borrowers will typically try to limit recourse to the underlying collateral in the event of a foreclosure action, commonly referred to as a non-recourse loan. Alternatively, a single-purpose entity borrower will be formed that owns only the loan collateral. A guarantor's recourse liability is typically governed by the guaranty agreement. Personal recourse to a guarantor will typically be limited to certain non-recourse carveouts, such as fraud, bankruptcy, non-payment of taxes and other bad acts. However, in certain circumstances, the guarantor may subject themselves to additional recourse such as environmental liability as well as principal or interest (or both) repayment. For example, in construction loans, it is common for a guarantor to agree to a completion guaranty with respect to the property, obligating the guarantor to cause construction to be completed if the borrower defaults. See section 1371 of the New York Real Property Actions and Proceedings Law.

Cash management and reserves

43 Is it typical to require a cash management system and do lenders typically take reserves? For what purposes are reserves usually required?

A cash management system is standard for commercial loans. Cash management systems ensure that the lender can obtain and control a property's rental income in all circumstances, as opposed to a mere assignment of leases and rents, which a lender would also receive in any event. Lenders typically take reserves for a variety of purposes, but the amount and replenishment requirements will depend on a number of factors, including the size of the loan, the loan-to-value ratio, the credit of the borrower and the quality of the collateral. Reserves are typically required for payment of interest (where the property is not cash flowing or in a construction loan scenario), taxes, insurance, capital maintenance and future tenant improvements.

Credit enhancements

44 What other types of credit enhancements are common? What about forms of guarantee?

Depending on the creditworthiness of a borrower, interest reserves and cash collateral are typical credit enhancement forms. Lenders may also institute reserves for:

- real estate taxes;
- insurance premiums;
- tenant improvement and leasing commission costs;
- capital expenditure costs; and
- furniture, fixtures and equipment with respect to hotel property loans.

Lenders may also require collateral (eg, mortgage on other properties owned by the borrower's organisation or other types of hard collateral) if the borrower's credit is questioned. Lenders may require that guarantors covenant to maintain specific net worth and liquidity amounts in the guaranty agreement.

Completion guaranties are considered customary for construction loans. Payment guaranties are substantially less common, being used mostly in circumstances where there is more risk associated with the borrower. Most lenders require guarantors to execute a non-recourse carveout guaranty for bad acts of the borrower, the guarantor and their affiliates. Such guaranties have been upheld numerous times. Enforcement of guaranties and indemnities typically begin with a demand on the guarantor made by the beneficiary. If the guarantor fails to immediately comply, enforcement would take place by bringing a lawsuit in New York state or US federal courts in accordance with the terms of the guaranty agreement.

Loan covenants

45 What covenants are commonly required by the lender in loan documents?

Lenders commonly require borrower covenants regarding:

- legal existence and good standing;
- compliance with laws and zoning requirements affecting the property;
- continued maintenance and use of the property;
- that the borrower will not commit waste;
- payment of taxes on the property;
- maintaining required insurance policies;
- properly managing and maintaining the property;
- giving prompt notice of litigation or default;
- agreeing to cooperate with the lender in any related judicial proceedings;
- performance under the loan agreement;
- reporting on financial metrics of the borrower or guarantor, or both;
- restrictions on leasing and other agreements;
- restrictions on further encumbrances;
- restrictions on changing the property's zoning or other legal characteristics;
- compliance with applicable laws and regulations; and
- restrictions on altering the property or performing construction.

Different asset classes may require additional covenants on a case-by-case basis (eg, hotel and resort properties will have several additional covenants around the property's ongoing operations and construction loans will have far more detailed criteria for performance of construction).

Financial covenants

46 What are typical financial covenants required by lenders?

Common financial covenants include a cash management system and termination or replacement of the property manager. Typically, one or both of these covenants may be triggered by a low debt service coverage ratio, low debt yield or other financial triggers (typically agreed to on a case-by-case basis). However, a failure to satisfy these covenants is not always an immediate event of default in itself. Such covenants can often be cured by improving the applicable financial metric. Financial reporting requirements are a separate covenant for which failure to satisfy could result in an event of default or a monetary penalty. It is unusual to require ongoing appraisals, but the lender typically reserves the right to request updated appraisals from the borrower periodically in line with market standards or after an event of default has occurred.

Secured movable (personal) property

47 What are the requirements for creation and perfection of a security interest in movable (personal) property? Is a 'control' agreement necessary to perfect a security interest and, if so, what is required?

The New York Uniform Commercial Code allows the creation and attachment of liens against personal property generally by a security agreement. An authenticated security agreement, which clearly states the intent to create a lien on the collateral, will create an effective security interest in most types of personal property if value has been given and the agreement reasonably describes the collateral. Perfection generally requires filing a New York Uniform Commercial Code financing statement with the New York Secretary of State for most types

of personal property, although fixtures require a fixture filing in the real property records at the county level to be perfected. Additionally, certain other types of personal property, such as investment property for example, must be perfected by taking physical control of the collateral.

See sections 9–201, 9–108, 9–310, 9–502 and 9–314 of the New York Uniform Commercial Code.

Single purpose entity (SPE)

48 Do lenders require that each borrower be an SPE? What are the requirements to create and maintain an SPE? Is there a concept of an independent director of SPEs and, if so, what is the purpose? If the independent director is in place to prevent a bankruptcy or insolvency filing, has the concept been upheld?

It is typical for lenders in New York to require the borrower entity to be a single purpose entity (SPE). SPEs are typically created by forming an entity (most often a limited liability company) in Delaware. SPE covenants are typically found both in the loan documents and the borrower's operating agreement, and the lawyer will work to ensure that the covenants are consistent in both documents. Independent directors are also commonly required for New York commercial real estate loans because they ensure that any bankruptcy-related decisions require the vote of an independent party and could prevent an insolvent parent company from forcing an otherwise solvent SPE into bankruptcy proceedings. Such use of independent directors to ensure bankruptcy remoteness is widely used and was upheld by the Southern District of New York in *In re: General Growth Properties*.

UPDATE AND TRENDS

International and national regulation

49 Are there any emerging trends, international regulatory schemes, national government or regulatory changes, or other hot topics in real estate regulation in your jurisdiction?

On 23 November 2022, the Financial Conduct Authority announced the cessation of US LIBOR will occur in June 2023. SOFR has been selected as the generally accepted market alternative to LIBOR, although there are a large number of current loans still based on LIBOR. Additionally, Senate Bill S7231A, currently before the New York Senate, would cause the recording of mezzanine debt and preferred equity to be treated the same as a mortgage recording, including subjecting it to the same recordation taxes.

The covid-19 pandemic changed the commercial real estate industry dramatically and it is likely that the impact of the commercial eviction moratorium introduced by Senate Bill S50001 will be carried forward into the foreseeable future.

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