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Regulation of High Volatility Commercial Real Estate Loans

By Norma J. Williams, Esq., Williams & Associates

Effective January 1, 2015, U.S. banks must comply with a Final Rule (the "Rule") adopted by the Federal Reserve Board, the Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation ("the Agencies"). The Rule affects commercial real estate loans that finance or have financed the acquisition, development or construction ("ADC") of real property. The Rule addresses banks' capital adequacy requirements for ADC loans classified as High Volatility Commercial Real Estate ("HVCRE") loans. The Rule is based on the standards of an international banking supervision committee of which the U.S. is a member ("BASEL III"), and was adopted to comply with requirements imposed on banks under the Dodd-Frank Wall Street Reform and Consumer Protection Act.

If an ADC loan is classified as HVCRE, the bank will have to assign a risk rating of 150% to it (as compared to 100% for a non-HVCRE loan) and must therefore retain 50% more risk-based capital on its balance sheet to cover that HVCRE exposure. While the Rule became effective on January 1, 2015, it also applies to loans that existed before that date.

An ADC loan will be classified as an HVCRE exposure unless, prior to conversion to permanent financing, it finances a) one-to-four family residential property; b) community development investments, as defined in the statutes; c) the purchase or development of agricultural land; or d) commercial real estate loans that meet each of the following requirements (collectively, the "Requirements"):

1) The loan-to-value ("LTV") ratio is less than

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The Evolving Use of License Agreements in Real Estate-Related Transactions

By S.H. Spencer Compton, First American Title, & Diane Schottenstein, Law Offices of Diane Schottenstein

A 1917 YALE LAW REVIEW article described license agreements as "Chameleon-hued",1 a reference to their versatility and adaptability to so many circumstances. In today's fast paced economy, in addition to their traditional applications, license agreements create the parties' sometimes subtle temporary relationships, rights and obligations in shared work space environments, pop-up stores and even artisanal food halls curated by celebrity chefs. The use of a license agreement may also reflect a landlord's desire to avoid the increasingly burdensome framework inherent in the landlord/tenant relationship. Owners and users of real estate need to understand the many potential applications of a license agreement.

Traditionally, licenses agreements have been used to provide rights to install and maintain communication towers and antennae, display signs, run concession stands at sporting events and other venues, gain access during construction, and use parking spaces and storage areas.

For over a century, license agreements have been used to document the concept of a shop within a shop. For example, in a department store cosmetics section, many or all of the brands will display their products in close proximity to those of other brands, yet each brand retailer is a separate and distinct business operation. The respective rights and obligations of the store owner and the licensee are memorialized in a license agreement. This is also the case with designer shops in stores such as Bloomingdale's, Saks Fifth Avenue or Macy's. The designer will sell its products pursuant to a license agreement, and the department store will have the right to terminate the license if, for example, the licensee's branding is no longer compatible with that of the store or if certain sales targets are not met. Often the licensee will invest large sums to fixture and fit out its designated area to capitalize on its exposure in the department store and the department store will want them to remain as long as both parties are profiting from the relationship.

How is a license different from a lease or an easement? According to Friedman on Leases, "a lease is a conveyance of exclusive possession of a specific property for a term less than that of the grantor usually in consideration of the payment of rent, which vests an estate in the grantee." Generally, a lease provides for an exclusive right to use the space for a set period of time. Considerable legislation and case law in each state now define the obligations of a landlord and tenant created by a lease arrangement. In contrast, Friedman goes on to explain that a license merely makes permissible acts on the land of another that would otherwise lack permission. Critical elements of a license are (i) that it is terminable at will, and (ii) it does not grant the licensee an estate in the land.2

In determining whether an agreement is a lease, a license or an easement, courts will also consider whether the granted use is non-exclusive, whether the owner retains certain controls over the property, and whether the owner provides services essential to the licensee for the use of the property. A license is distinguishable from an easement which, like a license, permits the use of the owner' property or restricts the owner from certain uses of it property; however, unlike a license, an easement transfers to the easement holder an interest that encumbers the property and affects title. Easements are classified as appurtenant to the property in which event they benefit the holder and are transferable with the transfer of the property or personal to the holder of the easement in which event they do not run with the land. Unless otherwise specified, an easement is presumed to be permanent and non-exclusive, and is generally transferable.

A property owner may prefer a license over a lease because it is easier to remove a licensee than to remove a tenant. With a lease, there can be an expensive, litigious and highly technical gauntlet of legal process to remove a tenant. While the eviction winds its way through court, the landlord can face cumbersome delays, lost income, large tax expenses, lost opportunities to obtain a new responsible tenant, and burdensome legal fees. Even if a lease specifically states that a landlord may use self-help, it is a risky proposition. Section 853 of the New York Real Property Actions and Proceedings Law provides that if a tenant is ejected from real property by force or other unlawful means, the tenant may recover treble damages from the landlord and may be restored to the property if ejected before the end of the lease term.

By contrast, it is well settled that a licensor may revoke a license "at will" and can use "self-help" to remove a defaulting licensee, thus foregoing the arduous gauntlet required to regain possession of leased property. Under a license, the licensee has no estate in the property and has no right to possession. Unless expressly contradicted in the license agreement, common law principles generally apply and the licensor has the absolute right to use peaceable self-help to remove a licensee from a licensed premises. However, even though it is easier to remove a licensee than it is to remove a tenant, certain laws apply. New York Real Property Actions and Proceedings Law Section 713, which generally relates to summary holdover proceedings where no landlord-tenant relationship exists, applies to an action against a licensee if the license has expired or been revoked and would therefore require the sending of a ten day notice to quit.

Where the distinction between a license and a lease becomes blurred, there can be uncertainty as to how a court might characterize the license agreement despite how it is labeled. Besides the title of the document, a court will look at the elements of the agreement and the equities of the situation in it decision making. In American Jewish Theatre Inc. v. Roundabout Theatre, Inc. 610 N.Y.S. 2d 256, 257 (N.Y. App. Div.1994), the Supreme Court, Appellate Division, First Department wrote "[w]hat defines the proprietary relationship between the parties is not its characterization or the technical language used in the instrument but rather the manifest intention of the parties. The nature of the transfer of absolute control and possession is what differentiates a lease from a license or any other arrangement dealing with property rights. Whereas a license connotes use or occupancy of the grantor's premises, a lease grants exclusive possession of designated space to a tenant, subject to rights specifically reserved by the lessor. The former is cancellable at will, and without cause." Here, the plaintiff theatre

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or equal to the applicable maximum LTV ratios mandated by the Agencies, as follows:

a. Raw land – 65%;
b. Land Development – 75%
c. Construction - commercial, multifamily and other non-residential – 80%;
d. Construction - 1 to 4 family dwellings – 85%; and
e. Construction - improved property – 85%
(the "LTV Requirement");

2) The borrower must contribute capital to the project in the form of cash or unencumbered readily marketable assets (or have paid development expenses out of pocket) of at least 15% of the property's appraised "as completed value" ("Borrower Capital Contribution Requirement"); and

3) The borrower must contribute the capital in 2) above before the bank advances funds under the credit facility and that capital and all capital internally generated by the project must be contractually required to remain in the project throughout its life, which life ends only when the credit facility is converted to permanent financing, is sold or is paid in full ("Timing Requirements").

COMMENTS AND CLARIFICATION BY THE AGENCIES

LTV Requirement — Based on the perception and practices of banks which generally require LTV ratios equal to or greater than those mandated, the LTV Requirement has received the least comment. The LTV Requirement is satisfied (or not) at loan closing and subsequent changes in property value cannot change an HVCRE classification.

Borrower Capital Contribution Requirement — The Borrower Capital Contribution Requirement has generated extensive discussion. The Agencies responded in frequently asked questions ("FAQs")[1] in which they clarified that the borrower cannot use the following to satisfy the Borrower Capital Contribution Requirement: a) a pledge of other real property owned by the borrower (even if unencumbered); b) the amount of purchasers' deposits in a condominium project; c) the proceeds of a junior mortgage on the property; or d) cash received from grants. The FAQs stated that the borrower can use the following to meet the Requirement: a) cash used to acquire land; and b) soft costs paid by the borrower, such as brokerage fees, marketing expenses or costs of feasibility studies, including reasonable market based fees paid to borrower-related parties.

Timing Requirements — The Timing Requirements have perhaps generated the most extensive comments. In the FAQs, the Agencies clarified that a) the appreciated value of land cannot be used to remove an HVCRE classification; b) an HVCRE classification continues until a loan is converted to permanent financing in accordance with the bank's normal lending practices; and c) the Rule requires retention in the project of both the initial capital contribution and later generated internal capital.

OTHER CLARIFICATIONS IN THE FAQS

The FAQs also clarified that loans used solely to acquire land on which no construction is intended are HVCRE unless they qualify as permanent loans; that U.S. Small Business Administration 504 loans are not automatically exempt from HVCRE classification; and that a loan on a multi-purpose property that will contain both commercial real estate and exempt 1-4 family residential can be classified as HVCRE only to the

[1] Office of the Comptroller of the Currency. Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Frequently Asked Questions on the Regulatory Capital Rule, March 31, 2015.

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Horror Stories: "Haunted" and "Stigmatized" Real Property

By John Murray, Vice President-Special Counsel, First American Title

From ghoulies and ghosties and long-leggety beasties and things that go bump in the night, Good Lord, deliver us — *Cornish Prayer*

"HAUNTED" HOUSES

My wife and I were watching a program on TV several years ago with some friends of ours, about a couple that bought a house that was supposedly haunted and later found out the sellers knew of the abnormal activity. Someone with us said to me, "Couldn't you sue them for not disclosing that a house is haunted?" I said, "Well, probably not successfully because you'd have to 'prove' that the house is/was in fact, haunted, and I don't know how you'd do that -- but you might be able to rescind the transaction for willful failure to disclose, depending on the factual circumstances." This led me to research the issue (after all, it was only a few weeks before Halloween!), upon which I uncovered the following

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company brought an action for injunctive relief that could only be afforded to a tenant in the context of a rental dispute. Because the plaintiff had a six month fixed right to use the space that was not revocable at will, the court found that, even though the agreement between the parties was labelled a license, the relationship was a leasehold one.

In a more recent case, Nextel of N.Y. v. Time Management Corp. 746 N.Y.S.2d. 169 (N.Y. App. Div. 2002), the Supreme Court, Appellate Division, found that a roof top cellular agreement was a lease not a license because the agreement contained provisions typical of a lease and conferred rights well beyond those of a holder of a license or a temporary privilege.

Further, it seems the courts will look at the equities of a situation to come to its decision. In Blenheim LLC v. Il Posto LLC, 827 N.Y.S. 2d 620 (N.Y. Civ. Ct. 2006), the Civil Court of the City of New York found that a provision in a lease giving a restaurant a license revocable at will to use a vault space could not be revoked at will. The Court concluded on the facts of the case that the landlord knew that the tenant needed the vault for its compressors, hot water heaters and elevator machine equipment and, as such, the use of the vault space was necessary and essential for the use of the space as a restaurant and was therefore appurtenant to the lease between the parties and thus irrevocable. Accordingly, where a license is viewed as coupled with an interest or where there is reliance on the license, a court might equitably rule that there should be greater protections for the user.

Most recently, in February 2014, in Union Square Park Community Coalition, Inc, v. N.Y. City Department of Parks and Recreation, 8 N.E. 3d 797 (N.Y. 2014), the New York Court of Appeals affirmed an Appellate Court decision that found that a fifteen-year agreement between the N.Y. Department of Parks and Recreation and a restaurant was a license and not a lease. Here, even though the document was entitled "License"; it had a fifteen year term and a payment structure that resembled a lease. Although in this case the use of the indoor pavilion was exclusive, the outdoor space was available to non-restaurant patrons except in certain designated areas where liquor was served. In addition, in the agreement, the Department of Parks and Recreation retained the right to terminate the relationship at will on twenty five (25) day written notice as long as its reasons were not arbitrary or capricious.

In examining the distinction between a license and a lease, the New York Court of Appeals stated: A document is a lease if it grants not merely a revocable right to be exercised over the grantor's land without possessing any interest therein but the exclusive right to use and occupy the land. It is the conveyance of absolute control and possession of the property at an agreed rental which differenctiates a lease from other arrangements dealing with property rights (Feder v. Caliguira, 171 N.E. 2d 316 (N.Y. 1960). A license, on the other hand, is a revocable privilege given to one, without interest in the lands of another, to do one or more acts of a temporary nature on the lands. (Trustees of Town of Southampton v. Jessup, 56 N.E. 538 (N.Y. 1900); see also Lordi v. County of Nassau, 246 N.Y.S. 2d 502 (N.Y. App. Div. 1964), aff'd without opinion, 199 N.E. 2d 155 (N.Y. 1964). Generally, contracts permitting a party to render services within an enterprise conducted on premises owned or operated by another, who has supervisory power over the method of rendition of the services, are construed as licenses. That a writing refers to itself as a license or lease is not determinative; rather the true nature of the transaction must be gleaned from the rights and obligations set forth therein. Finally a broad termination clause reserving to the grantor the right to cancel whenever it decides in good faith to do so is strongly indicative of a license as opposed to a lease, Miller v. City of New York, 203 N.E. 2d 478 (N.Y. 1964).

Although its analysis of the law was not so novel, the Union Square decision may indicate a critical turning point since it underscores the willingness of the Court of Appeals to find a license rather than a lease, even though: (i) the term was fifteen years, (ii) the user was required to invest $700,000 in capital investments that were not refundable upon termination, (iii) the annual fees were substantial starting at $300,000 and increasing to $450,000 or more if percentage rent was greater, and (iv) the owner was required not to be arbitrary and capricious in exercising its at will termination right. Further, in deciding Union Square, the Court of Appeals ignored its earlier precedent in Miller v. City of New York, 203 N.E. 2d 478 (1964), where, under similar facts, it found that an agreement by New York City's Parks Commissioner allowing a private corporation to use a golf-driving range was a lease not a license.

As the referenced cases indicate, there can be benefits to characterizing an agreement as a license agreement rather than a lease, but the instrument must be drafted carefully and, caveat emptor: the title of the agreement may not be dispositive. Courts seem apt to find a document is (i) a lease, if it is for an exclusive use for a set period of time and (ii) a license, if it for a non-exclusive use which is terminable at will. Further, there may be an element of equity which influences the courts' decision. Skilled real estate lawyers will assess which form of agreement — license or lease — will best serve their respective clients' needs.

Since one indicia of a license is a broad licensor termination right, a licensee may resist its use where a significant financial commitment is needed to prepare the space for its use. However, licensors are increasingly using creative financing arrangements whereby they agree to return an unamortized portion of the licensee's installation investment upon termination to encourage the use of a license rather than a lease. Licensors are agreeing to these provisions where they want the flexibility of an absolute right to terminate the license for any reason (such as the ability to pursue a development deal).

What developing trends lend themselves to license agreement arrangements?

Traditionally, "Pop up" stores have been used for seasonal Halloween or Christmas outlets and designer sample sales. However, today, social media has made it easier and less expensive than ever to advertise the availability of pop up space. Web sites such as thestorefront.com connect property owners who have short term retail space to rent with artists, brands and boutiques in need of temporary quarters, something in the nature of airbnb. Lately, national brands and known entities have been using "pop up" spaces: Kate Spade opened one to launch a new line, Kanye West had a pop up space at 355 Bowery in New York City to sell tickets, hats and bags in connection with a concert tour, and tech giants Google and Microsoft have opened temporary locations to capitalize on the holiday rush. These pop up stores provide a landlord income while it seeks a more permanent tenant, waits for longer term rents to rise, or, perhaps, works through a zoning change. Pop up tenants can add positive visibility or buzz to a location, increasing its desirability. When entering into a license agreement for a pop up store, a property owner should be careful not to hinder its pursuit of a more profitable long term tenant or, in a mall setting, violate existing tenants' exclusive uses or other rights. Likewise, the owner should keep in mind that a pop up occupant may not be as vested in the location as a tenant with a lease and may be less concerned with running a quality operation or being a good neighbor. In all events, liability insurance should be in place because accidents can happen even if the pop up use is only for a few days.

License agreements provide an attractive flexible short term use option for a specific limited purpose whereby a retailer can experiment with a location or create a splash in a heavily trafficked area that it could not afford otherwise. Because there is typically not a large fit out investment, users are agreeable to the licensor's right to terminate at will upon notice. In fact, in certain circumstances, there might not even be a grant of a specific space to the user. For example, in a retail context, the pop up space can be integrated into another non-exclusive use such as where an art gallery agrees to place a certain number of pictures on its walls or a cigar vendor has the right to have a concession stand at a hotel.

Another growing use of license agreements is in shared space situations. With the popularity of temporary work arrangements, a user may not even be devised a specific work space and could have nonexclusive rights to use a conference room, reception area, and available secretarial services (for an extra fee). The user need not make a long term commitment to the space nor invest in outfitting an office since it typically comes furnished. The owner gets optimal use of its space and the ability to charge for a la carte services. Depending on the facts and circumstances, these arrangements may be appropriately characterized (and documented) as licenses. Where the occupant does not have exclusive use of a particular office space for a set period and the agreement is terminable upon thirty days' notice, it seems unlikely the transaction would run awry of any court-imposed license/lease distinction.

Food halls are increasingly popular today, in particular, those where a celebrity chef "curates" a food court. For example, it has been reported that Anthony Bourdain is opening Bourdain Market at Pier 57 on the Hudson River by the Meatpacking District3. The build-out may include a Singaporestyle open area hawker market with moveable stalls selling a variety of inexpensive foods surrounded by a communal eating space. In a food hall, the curator sells different vendors the right to use a designated portion of the space. The curator typically retains the right to change the vendor mix (upon reasonable notice) and the food vendor gets profits and positive exposure without investing in fixturing and promoting a traditional restaurant. Again, since occupancy can be terminated at will after notice and the use is not exclusive, a license agreement seems to be the right legal vehicle.

CONCLUSION — We live in a fast changing world where information is exchanged via social media at hyper-speed and flexible short term associations are increasingly important. Like a chameleon in the jungle, the license agreement is an often overlooked instrument that can be adapted to a myriad of different transaction types to create win/win situations for the parties. ◂

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information.

Courts have not limited disclosure obligations in residential (and even commercial) transactions to the presence of physical defects. The duty to disclose has been extended to include nonphysical defects that detrimentally affect property values. For example, in a widely discussed and analyzed case, *Stambovsky v. Ackley*, 572 N.Y.S. 2d 672 (N.Y. App. Div. 1991), the court held that the seller had a duty to disclose that the house was reputed to be haunted. According to the court, the buyer had no reason to inquire about the apparition and could not have discovered its presence through a reasonable inspection. The court reasoned that because both local and national publications had reported the alleged hauntings at the house, the defendant was estopped to deny the existence of the apparitions. The court concluded that "as a matter of law, the house [was] haunted." Id. at 256. The court noted that the reported haunting lowered the resale value of the property, and ruled that while the doctrine of caveat emptor prevented an action for damages, an action for rescission was appropriate because the seller had taken advantage of the buyer's lack of knowledge regarding the house's reputation, and had in fact "created and perpetuated a condition about which he [was] unlikely to even inquire." Id. at 260.

See generally Ronald Benton Brown and Thomas H. Thurlow III, Buyers Beware: Statutes Shield Real Estate Brokers and Sellers Who Do Not Disclose That Properties Are Psychologically Tainted, 49 OKLA. L. REV. (1996), wherein the authors note that: In 1995, the New York Legislature passed its statute protecting transferors of psychologically impacted property and their agents who fail to disclose the fact . . . Around the time of the law's passage, news stories reported that New York was passing a "haunted house" statute. However, nothing in the statute refers to haunted houses. The law is simply a psychologically impacted property statute that is similar to statutes in other jurisdictions Some states, not including New York, have borrowed the language of Stambovsky for their psychologically impacted property statutes. They specifically include any "act or occurrence which had no effect on the physical structure of the real property." The New York statute does not include this language. Id. at 640.

The author has been informed of a situation in Wisconsin that was reported to the Wisconsin Board of Realtors, where the broker was told that the walls of the listed house "bled." As is common in most states, Wisconsin's real-estate license law requires brokers to disclose a "haunting" only if it has an effect on the physical condition of the property. Given the alleged "physical" effect on the house, that particular "haunting" was required to be disclosed.

The California Association of Realtors is bound by the disclosure requirements of CAL. CIV. CODE § 1710.2, which states that the death or manner of death of an occupant of real property need not be disclosed if it occurred more than three years prior to the date the transferee offers to purchase, lease, or rent the real property, or that an occupant of that property was infected with the AIDS virus, unless the transferee or prospective transferee makes a direct inquiry regarding deaths on the property. Many brokerage firms have disclosure forms that specifically inquire about deaths on the real property.

Some states even require home sellers to disclose "stigmas" affecting a property, including, e.g., proximity to homeless shelters and the scene of a

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extent of the commercial real estate.

LOAN DOCUMENTATION

While contractual requirements are mentioned only in connection with the Timing Requirements, loan document provisions addressing all of the Requirements is recommended and it has become a best practice to include them. The Rule's requirements would be covered in representations and warranties, covenants, closing conditions, cost recovery, events of default, and other appropriate provisions.

DISCUSSION SUBSEQUENT TO THE FAQS/COMMUNITY BANKS

While the FAQs resolved a number of questions, others still exist including the scope of construction activity, the definition of cash and readily marketable assets and whether mezzanine debt or preferred equity can satisfy the Capital Contribution Requirement. Further clarification regarding the allowability of appreciated land value to satisfy the Capital Contribution Requirement and reconsideration of the Rule's requirement for retention of all internally generated capital have also been requested in discussions between the Agencies and groups including the Mortgage Bankers Association, the group whose inquiries led to the FAQs, and others. Congressional hearings on Bank Capital and Liquidity Regulations were held in June, 2016. Additional revisions and guidance on the Rule should be expected.

While much of the discussion on the Rule has been with regard to its applicability, community banks have largely taken the position that they should be entirely exempt on the grounds that a) BASEL III was intended to apply only to the largest banks; b) community banks play an important role in providing capital to local communities; and c) the Rule reduces credit availability and increases costs for potentially job-creating projects. Several pieces of legislation that purports to mitigate the effect of BASEL III on smaller banks have been introduced and should be watched.

CONCLUSION

An ongoing topic of discussion with significant implications for commercial real estate lending, the risk-based capital rules deserve the commercial real estate industry's full attention, especially as ADC lending needs have continued to grow in many parts of the country. ◀

Exchanging Foreign Real Estate

By Mary Kay Kennedy, First American Exchange Company, and Julie Baird, First American Exchange Company

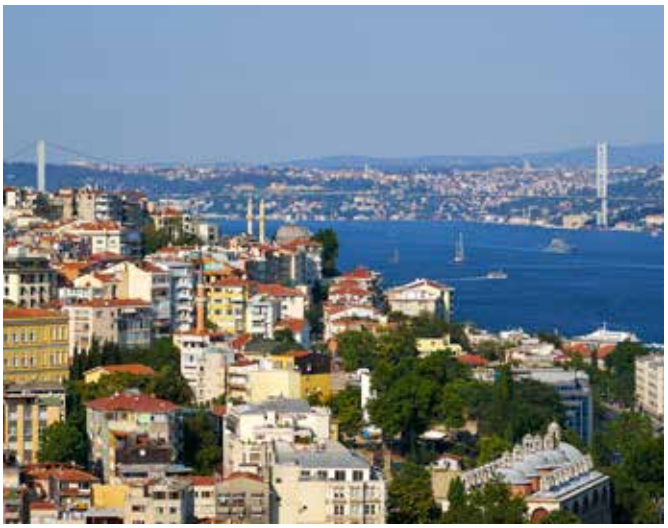
Is it possible to exchange real estate in the U.S. for real estate located in another country? Internal Revenue Code Section 1031(h)(1) says that real estate located in the United States and real estate located outside of the United States are not like kind. In order to trade properties in a 1031 exchange, the relinquished and replacement properties must be like kind; therefore, you cannot trade real estate located outside the U.S. for real estate located in the U.S. For exchange purposes, "United States" includes all 50 states and the District of Columbia.

The Regulations and several Private Letter Rulings have expanded this general rule. In certain circumstances, you can trade U.S. real estate for real estate located in Guam, the Northern Mariana Islands, or the U.S. Virgin Islands. Regs. § 1.932-(g)(1)(ii)(E); § 1.935-(c)(1)(ii)(E); Ltr. Ruls. 9038030,200040017.

What can you do?

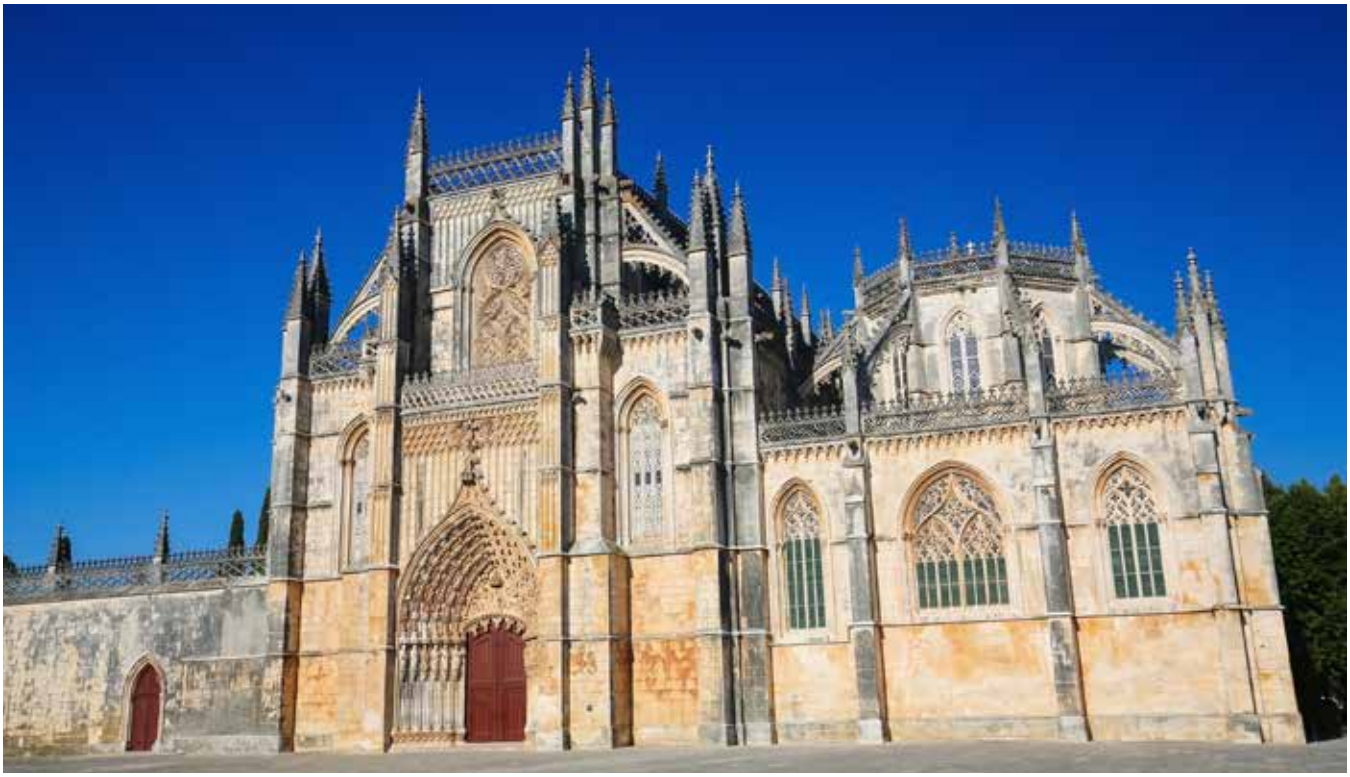
- You can trade real estate located in any state in the U.S. for real estate located in that same state or any other state in the U.S.
- You can trade foreign real estate for foreign real estate.

There can be complications when trading foreign real estate, such as converting different currencies. However, as long as you trade foreign real estate for foreign real estate, you should be able to do a 1031 exchange because the properties will be like kind. ◂



Repurposing Old Schools and Churches for Charter Schools

By Vivian de las Cuevas-Diaz
Attorney - Partner at Holland & Knight LLP



The number of charter schools has increased rapidly across America's urban areas during the last decade. In the 2015-2016 school year, there were approximately 6,800 charter schools in 43 states and the District of Columbia with nearly 3 million students. In 2015 alone, about 400 new charter schools were opened throughout the country. Charter schools are a relatively new phenomenon – Minnesota was the first state to pass a charter school law in 1991. Charters are public-private hybrids – they are publicly-funded but privately-operated and tuition-free for all students. These schools operate more or less independently of local school officials with fewer rules and regulations. However, they receive less funding from the local school districts than traditional public schools. In most states, charter schools receive a fixed amount per pupil. A 2012 study by the Center for Education Reform found that 60% of charter school students received free or reduced lunch, a proxy for low-income status, and 60% of students were members of racial minorities.

FINDING SUITABLE FACILITIES

In spite of their rapid growth, the search for adequate educational facilities is daunting for many charter schools. In most major cities, land prices and building costs represent a significant obstacle for these schools. To alleviate the cost of building new facilities, many charter schools and affiliated entities have purchased old buildings, including abandoned churches and former schools, and repurposed them.

In Philadelphia, Independent Charter School West (ICS West) opened this fall after repurposing the church building and school campus of the Most Blessed Sacrament. The Catholic school had been closed since 2002 and the church closed in 2007. ICS West plans to use the church sanctuary as a gymnasium and cafeteria. In Washington, D.C., the nonprofit St. Paul on Fourth Street – managed by the Charter School Incubator Initiative – has developed an innovative plan to provide building facilities to charter schools and affordable housing for teachers in the city. In June, the nonprofit purchased a Y-shaped building in the Brookland neighborhood for $14.7 million. The complex will house an apartment building with reserved residential units for teachers and two charter schools. The building, which originally served as study and residential space for priests and seminarians attending Catholic University, will retain many of its original

features. In Tacoma, Washington, where voters recently approved a ballot initiative to bring charter schools to the state, the century-old building that once housed Rogers Elementary School, reopened in the fall of 2015 as Destiny Charter Middle School. The building, leased by the nonprofit Green Dot Public Schools, underwent a full renovation after being vacant and abandoned.

Benefits of Repurposing

Repurposed church and school buildings present significant financial and logistical advantages to charter schools. Charter schools are able to save on construction costs by renovating and repurposing existing buildings. Furthermore, these properties can generally be used as schools without requesting or with a simple, short zoning change, special use permit or variance.

Turning abandoned public school buildings into productive use as charter schools can also have significant benefits to local communities. Decades of urban decay have led to declining enrollment in many urban schools throughout the country. Instead of operating some of these schools below capacity, some school districts have chosen to close many schools, leaving school districts with vacant school buildings. Abandoned school buildings are an important concern because they can potentially decrease property values, bring blight, and represent a drain on local school board resources. To address these issues, some public policy experts urge school districts to sell or lease their abandoned school buildings to charter schools.

Some urban school districts have taken proactive steps to disinvest themselves from abandoned school buildings. In Detroit, the school district has generated more than $16 million in public school land sales. The district has sold more than 40 schools and leased an additional 45. In Atlanta, seven former public schools have been repurposed as charter schools. After Hurricane Katrina devastated New Orleans, Louisiana passed legislation replacing failing public schools with district-run charter programs and partnerships. Today, a majority of school children in New Orleans attend charter schools.

In Washington, D.C., school board authorities have partnered with privately-operated charters in hopes of revitalizing failing public schools. The District of Columbia Public Charter School Board (PCSB) is charged with approving charter schools, overseeing charter schools in operation, and revoking school charters if they fail to meet their performance

goals. While charter schools operate autonomously in the District, the PCSB holds schools responsible for satisfying specific guidelines and meeting the goals articulated in their charter agreements. These public charter schools now educate half of the students in the District.

The Archdiocese of Miami has also turned to charter schools in an effort to save struggling urban parishes. Facing dwindling incomes and declining enrollment in many parish schools, the Archdiocese decided in 2008 to suspend all parish subsidies at the end of that year. Without the subsidy many parishes in low-income communities faced the possibility that their schools would close. In response, several pastors and local church leaders decided to close seven Catholic schools and allow charter schools to open in the newly empty buildings.

One pastor, Father Jose Luis Menendez of Corpus Christi parish – a community of largely low-income, Latino, immigrant families – decided to partner with Academica, a charter school support organization with a network of over 120 charter schools in six states. Fr. Menendez selected Academica because of the organization's strong track record of charter school success and shared educational focus on character development. In order to prevent religious entanglement with the secular public school system and allow the church to access the school's facilities, both sides agreed to enter into an academic facilities license instead of a traditional lease. Under this arrangement, the parish is able to evict the charter school upon a 30 days' notice coupled with the repayment of six months of fees. Furthermore, the licensing agreement allows the charter school to operate during typical school hours but allows the church to use the school facilities after school and on weekends. This arrangement has allowed the parish to continue using its former school building for weekend and after school religious education classes independently of the charter school.

The rapid growth of charter schools in the last decade has placed pressure on local school districts and Catholic parishes to respond to the increased demand for charter school education and address the problems of declining enrollment in many urban schools. In response to these challenges, school districts and churches have partnered with charters through innovative agreements that sell, lease or license existing and abandoned school buildings to charter school operators. These charters are renovating and repurposing these old buildings for productive use in cities across the country. ◂

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violent crime. See generally Marc Ben-Ezra and Asher Perlin, Stigma Busters; A Primer on Selling Haunted Houses and Other Stigmatized Property, 19 JUN PROB. & PROP. 59, (May/June 2005). The authors state, at p. 60, that at least 21 states have statutes addressing stigmatizing issues in one way or another.

With respect to rental properties, see Rent.com, Rent in Peace: Avoiding Common Rental Horrors (2009), available at http://www.rent.com/press-room/media/Rent+com+RIP+InfoFlash+FINAL-+9+17+09.pdf. (noting survey results indicating that 31 percent of renters would not live in a "haunted" rental unit even for "a million bucks").

There also is a website, http://www.diedinhouse.com/, which advises visitors that: DiedInHouse.com is the first of its kind, web-based service that helps you find out if anyone has died at any valid US address. A DiedInHouse.com Instant Report saves you time and money, by instantly providing you with valuable information that may impact your decision to purchase or rent a house.

DUTY OF OWNER OR OPERATOR OF "HAUNTED HOUSE" TOURIST ATTRACTION

There are also cases dealing with the duty of an owner or operator of a "haunted house" type of tourist attraction where patrons pay money to be scared by the events at the property. See, e.g., Griffin v. The Haunted Hotel, Inc., 242 Cal. App. 4th 490 (2015). In this case the plaintiff, Scott Griffin ("Griffin") purchased a ticket to a tourist attraction described by the court as "The Haunted Trail, an outdoor haunted house type of attraction where actors jump out of dark spaces often inches away from patrons, holding prop knives, axes, chainsaws, or severed body parts." Id. at 493. When Griffin believed he had passed the exit to the Haunted Trail, he was confronted unexpectedly by a "final scare," i.e., an actor who possessed a chainsaw (with the chain removed). Griffin became frightened and began to run. The actor chased after him, and Griffin fell and injured his wrist. Griffin then brought an action against Haunted Hotel alleging negligence and assault. The trial court granted Haunted Hotel's motion for summary judgment, and the California appellate court affirmed, ruling that the trial court's ruling was correct under the "primary assumption of risk" doctrine in California.

The appellate court ruled that Haunted Hotel did not breach any duty to Griffin, and did not unreasonably increase the risk of injury beyond the inherent risks or act recklessly under the circumstances. The appellate court also held that subjective awareness is not required or relevant under the primary-assumption-of-risk doctrine, and that there were numerous disclosures and disclaimers regarding what patrons could expect and the risks involved. The appellate court noted that Haunted Hotel's website featured actors in ghoulish costumes holding chainsaws, and that the ticket Griffin purchased stated, "This attraction contains high impact scares" and is "not suitable for people with heart conditions." The appellate court also noted that, "The chainsaw-wielding actors are the most popular feature of the Haunted Trail," and were prominently mentioned in both radio and television advertising for the attraction. Id. at 494. The appellate court further noted that at least 250,000 individuals had visited the Haunted Trail in its 14 years of operation, and only 15 of them fell while running from the chainsaw-wielding actor -- and none of them had been injured. The appellate court commented that, "As the trial court aptly noted, [W]ho would want to go to a haunted house that is not scary?" Id. at 500. The appellate court reasoned that "an inherent risk of a fright-event such as the Haunted Trail is patrons will become frightened and run," Id. at 505, and stated that, "At bottom, his [Griffin's] complaint here is Haunted Hotel delivered on its promise to scare the wits out of him." Id. at 508.

See also Galan v. Covenant House New Orleans, 695 So.2d 1007, 1008 (La. Ct.App. 1997), holding that, in a case with facts remarkably similar to the Griffin case (including a chainsaw-carrying actor jumping out to scare patrons "one last time"), the defendant had not breached any duty to the plaintiff. The court concluded that: Patrons in a Halloween haunted house are expected to be surprised, startled and scared by the exhibits but the operator does not have a duty to guard against patrons reacting in bizarre, frightened and unpredictable ways. Id. at 1009.

Some liability insurers have taken note of cases such as Griffin and Galan, supra, and have developed specific exclusions from coverage for incidents such as occurred in these cases. See, e.g., Western World Ins. Co. v. Markel American Ins. Co., 677 F.3d 1266 (10th Cir. 2012). In this case, which involved a tourist attraction called the Bricktown Haunted House ("Haunted House") in Oklahoma City, Oklahoma, an employee working on the evening shift at the ticket booth fell down an elevator shaft. As the court noted, "Haunted Houses may be full of ghosts, goblins, and guillotines, but it's their more prosaic features that pose the real danger." Id. at 1267. The employee recovered from his injuries, and sued the operator of the Haunted House for various torts. The operator then looked to Western World Insurance Company ("Western World") and Markel American Insurance Company ("Markel") to defend the lawsuit under two separate insurance policies, one with Western World and one with Markel. The court noted that, "no doubt wary of liability arising from its occult operation, Brewer [the operator] had attended well to its insurance needs." Id. at 1268. The court stated that: For its part, Western World had thought far enough in advance to exclude from its haunted house coverage "any claim arising from chutes, ladders, …naked hangman nooses,…trap doors…[or] electric shocks. But it hadn't thought to exclude blind falls down elevator shafts. Id. at 1268

Western World admitted liability under its policy and then defended, and eventually settled, the injured employee's claim. It then sued Markel for half the cost of the settlement amount after it refused to contribute toward the settlement. The court ruled that the "reasonable expectations of the insured" doctrine and the language in both of the insurance policies controlled, and that Markel was not entitled to summary judgment based on the language in its policy. This case highlights the fact that if a liability insurer has specifically excluded certain anticipated risks from coverage under a policy with respect to a "haunted house," it likely will not be responsible for coverage or payment under the policy if such an event actually occurs. But isn't this exactly why the owner or

operator of a "haunted house" tourist attraction would purchase a general liability policy, i.e., to provide such insurance coverage?

FAILURE TO DISCLOSE MURDER, SUICIDE, OR FORMER BURIAL GROUNDS

Sellers have also been held liable for failing to disclose the fact that the house had once been the site of a murder (or multiple murders). For example, in Reed v. King, 145 Cal. App. 3d 261 (Cal. App. 3d Dist. 1983), the court found that defendants' failure to disclose the fact that murders had occurred in the house was material to the real estate contract and permitted the buyer to rescind the contract. The following is an excerpt from the court's decision: The murder of innocents is highly unusual in its potential for so disturbing buyers they may be unable to reside in a home where it has occurred. This fact may foreseeably deprive a buyer of the intended use of the purchase. Murder is not such a common occurrence that buyers should be charged with anticipating and discovering this disquieting possibility. Accordingly, the fact is not one for which a duty of inquiry and discovery can sensibly be imposed upon the buyer. Reed alleges the fact of the murders has a quantifiable effect on the market value of the premises. We cannot say this allegation is inherently wrong. Id. at 267-68.

But what standards would apply to determine if a potential purchaser would believe a specific occurrence has a significant impact on the value of the property? What if the buyer has cultural or religious objections?

In Milliken v. Jacono, 103 A.3d 806 (Pa. 2014), the Pennsylvania Supreme Court held, as a matter of first impression, that purely psychological stigmas are not material property defects under the state's Real Estate Seller Disclosure Law ("RESDL", which pertains to physical or structural problems with a property) that sellers must disclose to buyers. A murder-suicide involving the prior owners of the residential property had occurred at the property, but this was not disclosed by the current owners to the purchaser. But the court noted that "The murder-suicide was highly publicized in the local media and on the internet." Id. at 807. The court ruled that the seller's failure to disclose this prior event did not constitute fraud, negligent misrepresentation or a violation of Pennsylvania's Unfair Trade Practices and Consumer Protection Law because it did not have a significant adverse impact on the value of the property or constitute an unreasonable risk to people on the property. The court noted the difficulty in fashioning an appropriate remedy for such a claim, such as rescission of the contract and repayment of the buyer's costs (as requested in this case), or assigning a monetary value to a subjective psychological stigma. Interestingly, the court noted in a footnote that "[the buyer] understandably asserted claims against her own real estate agent and broker, which were "Settled, Discontinued and Ended." Id. at 811, n.7.

See also Susan Funaro, Ghoul Disclosures: Must Home Sellers Disclose Paranormal Activity? available at https://www.legalzoom.com/articles/ghoul-disclosure-must-home-sellers-disclose-paranormal-activity (Oct. 2010), where the author notes studies showing that houses where murder or suicide have occurred can take 50% longer to sell and can lower the selling price as much as 35%.

Christine Alice Corcos, in her article entitled "Who Ya Gonna C(s)ite?" Ghostbusters And The Environmental Regulation Debate, 13 J. LAND USE & ENVTL. LAW 231, 272 (Fall 1997), provides the following interesting information with respect to the effect on a home's value where the residence has been constructed over former burial grounds: Another theme portrayed in movies is that of hauntings substantially reducing the value of suburban neighborhood property constructed over former burial grounds . . . A sympathetic real estate attorney points out that even though the homeowners have a good case, they are unlikely to prevail at trial, and appeals will be costly. Eventually, the owners abandon the property after unsuccessfully suing their real estate agents for "abuse of corpse."

CONCLUSION

As evidenced by the cases and commentary in this article, the doctrine of caveat emptor is generally alive and well with respect to "haunted" and "stigmatized" real property, at least with respect to an action for damages as opposed to rescission of the sale of the property. There are numerous state statutes that deal directly with the issue of what must be disclosed to a purchaser of a residence, but they differ greatly and can be vague when it comes to the disclosure of alleged "psychological" or "emotional" issues or defects that may affect the value of the property, as opposed to its physical condition. It probably would not be wise for a seller of such a property to boast to friends and neighbors about the unsavory reputation of the property; then deliberately withhold such information when seeking a prospective purchaser. Perhaps the rule should be, "Once you claim it's haunted, you can't go back." On the other hand, if a prospective purchaser is by nature squeamish about buying a house that may be "haunted" or "stigmatized," then it would be wise to specifically ask the seller (and, if applicable, the seller's real estate agent) about any "emotional" or "psychological" issues at the property past or present, such as murders, suicides, and alleged paranormal activity. But the existence and relevance of such matters are often in the eye of the beholder, and any clear-cut description or definition of such "defects" often can be difficult. Perhaps applying the strict rule of caveat emptor to a purchase contract involving a "haunted" house brings to mind visions of a psychic or medium (and perhaps a wall x-ray technician) routinely accompanying the structural engineers, electricians and other home inspectors on a pre-closing inspection.

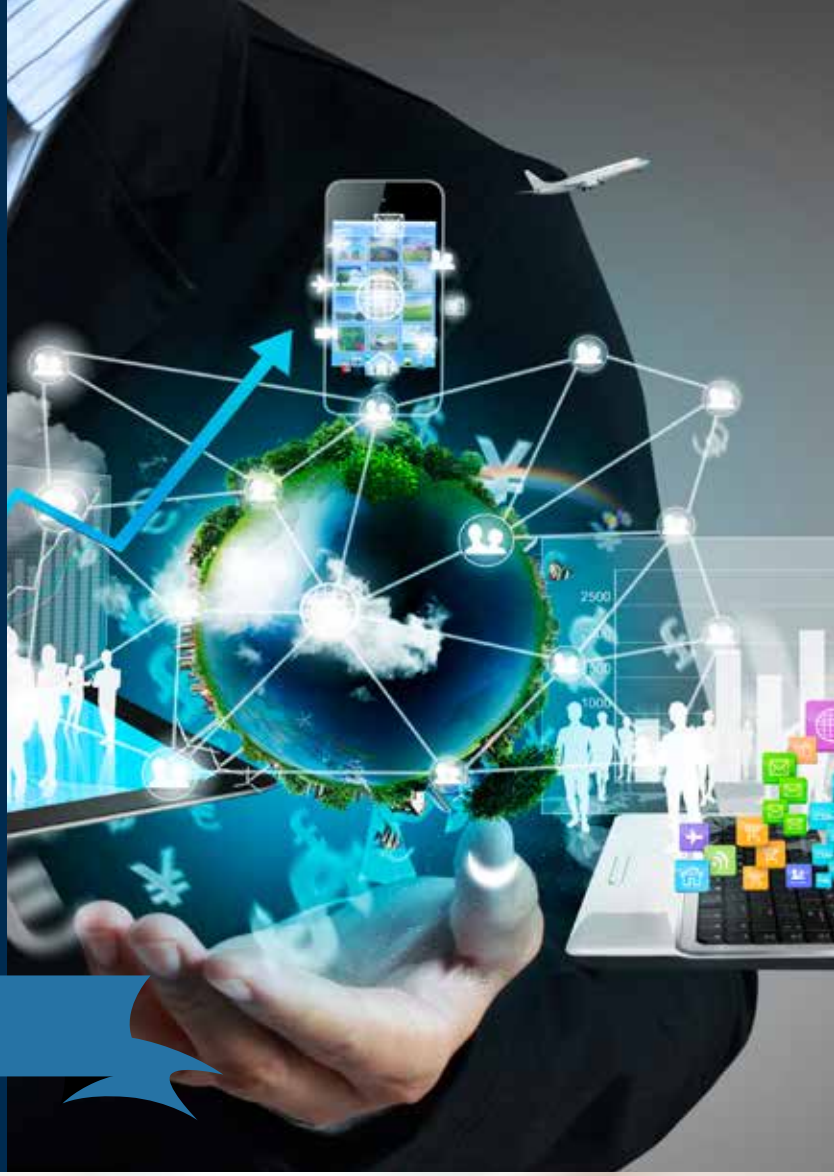
With respect to legal actions against owners/operators of real property that advertise the supernatural or frightening aspects of the property and charge admission to visitors, the rule of caveat emptor applies with even more force, especially if the advertising (including a website) advises prospective patrons of the potential hazards and "scary" features of the attraction. After all, when one pays to be scared, frightened, and surprised, that is exactly what to expect. Owners and operators may feel secure that in any event they can look to their general liability insurance policies for coverage, and ultimate payment, of any successful claims against them. But as illustrated by the holding in Western World Ins. Co. v. Markel American Ins. Co., supra, this will only be true if the policies have not excluded from coverage the specific matter that is the basis of the claim. ◂

Caught in the Web

We're excited to announce the launch of our new National Commercial Services website. The content is organized to take you on a journey through the transactional lifecycle allowing you immediate access to solutions specific to your needs. It also helps you to get to know your local offices a bit better and provides the same great resources and information you've come to trust from First American.

Head over and check it out.

www.firstam.com/ncs



Mark Your Calendar

ALIS — The Americas Lodging Investment Summit
The Americas Lodging Investment Summit
www.alisconference.com • January 23 - 25 • Los Angeles, California

NMHC — National Multifamily Council
2017 NMHC Annual Meeting
www.nmhc.org • January 24 - 26 • San Diego, California

MBA — Mortgage Bankers Association
CREF/Multifamily Housing Convention & Expo
www.mba.org • February 19 - 22 • San Diego, California

PREA — Pension Real Estate Association
2017 Spring Conference
www.prea.org • February 23 - 24 • New York, New York

ICSC — International Council of Shopping Centers
RECon: The Global Retail Real Estate Conference
www.icsc.org • May 22 - 25 • Las Vegas, Nevada

ULI — Urban Land Institute
ULI Spring Meeting
www.uli.org • May 2 - 4 • Seattle, Washington

ICSC — International Council of Shopping Centers
RECon: The Global Retail Real Estate Conference
www.icsc.org • May 21 - 24 • Las Vegas, Nevada

NAIOP — Commercial Real Estate Development Association
Commercial Real Estate Conference 2017
www.naiop.org • October 10-12 • Chicago, Illinois

The Lodging Conference
The Lodging Conference 2016
www.lodgingconference.com • September 26 - 29 • Phoenix, Arizona

PREA — Pension Real Estate Association
27th Annual Investor Real Estate Conference
www.prea.org • October 16 - 18 • Chicago, Illinois

MBA — Mortgage Bankers Association
Annual Convention & Expo
www.mba.org • October 22 - 25 • Denver, Colorado

ULI — Urban Land Institute
ULI Fall Meeting
www.uli.org • October 23 - 26 • Los Angeles, California