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MINIMIZING LEGAL RISKS IN PLANNING AND MANAGING CONSTRUCTION PROJECTS

Planning and managing a large design and construction project is a major commitment of resources, the success or failure of which can impact a company's financial and business success for years after completion.

Fortunately, there are a few basic steps that owners can take to minimize the risks inherent in construction projects such as cost overruns and disputes and help ensure that the project is completed on time and within budget.

DEVELOP A MASTER PLAN FOR THE PROJECT

An Owner should start the project planning process by preparing a Master Plan with the help of qualified design professionals and facility planners. The Master Plan describes the Owner's goals with respect to the purpose and functionality of the project, and how the project advances the strategic plan and overall business goals of the Owner. As part of the process, the Owner should review and assess current facilities and equipment, determine space and technological needs, identify actions necessary for continuing operations during construction (if necessary), and develop and choose from a series of design options, including preliminary costs and time tables, for the project.

PREPARE AND MANAGE A MASTER BUDGET

Next, a detailed Master Budget of anticipated project costs should be prepared. The final Master Budget should be used to track and manage costs throughout the project. Budgeted costs typically include land acquisition costs, architectural and engineering fees, site work costs, construction costs, impact fees, financing fees, legal expenses, furniture costs, and moving and relocation expenses, as well as a contingency for unanticipated cost overruns and change orders that are likely to occur during the design and construction process. As the project is designed and constructed, the Owner can

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ADDRESSING REAL ESTATE AD VALOREM TAXES IN LEASES

With real estate ad valorem taxes for Class A office space in Metro Atlanta typically running between $2.00 and $3.00 per square foot per year, the treatment of taxes in a lease can have a major financial effect on both the landlord and the tenant.

Most frequently, taxes are one of the operating expenses passed through to a tenant. Operating expenses are included in leases either as a straight pass-through in their entirety, or above a "base year" (the initial year the tenant is in the leased space), so that only increases in those expenses are passed to the tenant. Landlords

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track actual costs, and identify areas of potential savings and cost overruns, adjusting the budget line items accordingly.

PREPARE AND MANAGE A MASTER SCHEDULE

In conjunction with preparing its Master Budget, the Owner should prepare a "big picture" time line of the activities and anticipated time periods associated with each activity that will be necessary to deliver the project. The Master Schedule will include not only design and construction activities, but also items such as obtaining necessary permits, closing on construction loans, selecting design professionals, contractors and other outside consultants, delivering furniture and moving equipment and personnel. A properly prepared Master Schedule allows the Owner to identify and reduce the risks of delays in project completion.

SELECT THE RIGHT PROJECT TEAM

The Owner should identify appropriate members of its internal team that will be involved in the project, through design, construction and occupancy, and determine their specific roles and authority levels for making the necessary decisions. With the help of its internal team, the Owner should solicit qualified professionals to submit proposals for performing the design and construction activities by preparing Requests for Qualifications and Proposals. By taking the time to properly evaluate the qualifications and proposals, including personal interviews, the Owner will select design and construction professionals with similar project experience at competitive prices.

DRAFT AND NEGOTIATE DESIGN AND CONSTRUCTION CONTRACTS

There are a number of options to consider when approaching the design and construction components of a project. The chosen method of project delivery (such as Design/Build or Construction Management with negotiated guaranteed maximum price) will determine the types of agreements the Owner will need to prepare and negotiate with the design professionals and contractors. While time consuming, the process of preparing and negotiating the right contracts is critical to ensuring that the expectations of all the parties are understood and properly addressed, thereby reducing the Owner's risk of cost overruns and schedule delays. For instance, the construction contract should outline the procedure for the handling and pricing of change orders during construction.

As with any other business transaction, an Owner can enhance its chances of successfully delivering a project on time and within budget by proper planning for and managing of anticipated risks and by implementing procedures for handling unexpected difficulties. ◆

(Addressing Real Estate Ad Valorem Taxes in Leases, continued from page 1)

draft broad language to capture any charge that could be described as a "tax." Tenants typically negotiate exclusions from tax pass-throughs for taxes related to the landlord's income and for real estate ad valorem taxes that do not relate to the building or to the particular tenant's improvements.

In addition to such exclusions, tenants often try to limit real estate ad valorem taxes with caps or limits on annual increases. Landlords are typically extremely reluctant to agree to such limits because they have no control whatsoever over these increases. If the building is in a municipality that has to raise the millage rate to make up for a budget shortfall, the increase could be in excess of the cap. Also, a healthy real estate market may cause values to rise, with a dramatic increase in the assessment, resulting in taxes rising in excess of the cap.

Some tenants object to paying taxes as part of the monthly payment of operating expenses. Such monthly payments in effect loan money to the landlord because taxes are typically paid in one or two installments, near the end of the calendar

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year. Landlords resist such tenant requests because, among other reasons, the landlord is at risk that certain tenants (especially weaker credit tenants) will not be able to pay the money when due. The landlord will have to pay the taxes to the governmental authority even if the tenant fails to pay landlord.

Landlords sometimes separate the real estate ad valorem tax payment obligation from the rest of the operating expense payment. This happens more often when there is a "base year" or an "operating cost stop" in the lease, especially if the landlord thinks there is a chance that either taxes or the other operating expenses, but not both, will fall. For example, if taxes were not separately charged, and taxes went down by the same amount that other operating expenses increased, there would be no change in the payments to the landlord. But if there were separate tax and operating expense obligations, the tax amount could not go below the tax stop, yet the operating expenses could increase, and the result could be that the payments to the landlord increase.

When a building or project is sold, there may be a reassessment upwards for tax purposes. From the tenant's perspective, operating expenses may rise substantially because of the increase in property taxes. As a result, some tenants request language that the tenant is not responsible for property tax increases arising out of the sale or refinancing of the property. Landlords resist this language for a number of reasons, including the difficulty in determining what the assessment would have been in the absence of a sale or refinance. In Georgia, state law requires that tax assessments be updated periodically to reflect current fair market values.

Other tax issues which are sometimes the subject of lease negotiations include challenges to assessments, exclusions for taxes on the leasehold improvements of other tenants, community improvement district taxes, and sales or other taxes on rent. ◆

A LOOK AT SHOPPING CENTER RECIPROCAL EASEMENT AGREEMENTS

A well-drafted reciprocal easement agreement (REA) is vital to both the initial development and the successful maturation of a shopping center. The REA must balance the developer's need for control over the center with the need for flexibility for future modifications and expansions of the center. The marketability of the outparcels must be maintained while protecting the "front door" of the center. This article offers only a brief review of just a few typical REA provisions.

EASEMENTS

The REA grants and reserves easements for access and parking, for installation, use, maintenance and repair of utility lines, and for storm and surface water drainage and retention.

In order to maintain flexibility to reconfigure parking areas and accessways in the future, the REA should minimize the grant of easements over specific accessways shown on an attached plan. However, the developer must recognize that in some situations, for example certain outparcel configurations, specifically delineated accessways may be required to protect the users.

The REA should give each owner approval rights with respect to the location of utility easements on such owner's parcel, and should permit each owner, at the owner's expense, to relocate the utility easements on such owner's parcel, as long as utility services to other owners are not interrupted.

MAINTENANCE AND OPERATION

Depending upon the size of the shopping center, the maintenance and operation provisions of an REA can be fairly simple or complex, and may even include formation of an association, with issues of voting, budgets and the like. Whether or not an association is formed, the rights and responsibilities

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(A Look at Shopping Center Reciprocal Easement Agreements, continued from page 3)

of in-line tenants are typically controlled by provisions in their leases. The REA may provide for separate maintenance by the outparcel users, but obligate the users to pay a portion of the costs of certain items, such as main accessways and storm water detention pond maintenance.

If no association is to be formed, the REA should impose on owners and users standards of maintenance for landscaping, driveways and improvements. The REA should also permit self-help in favor of the owners of other parcels, plus lien rights (subordinate to security deeds) for the costs so incurred.

Owners should be required to restore or raze improvements within a reasonable time following a casualty, and to maintain landscaping following any such razing or removal.

BUILDING RESTRICTIONS

The REA should contain appropriate building restrictions on outparcels. These may be as simple as building size and height restrictions or as complex as a detailed architectural theme for the center.

If the developer is retaining the right to approve all plans and specifications, the REA should include a detailed outline of the submission process, the address to which they are to be submitted, and a reasonable response time, failing which the plans are deemed approved.

If there is no plan approval requirement, the REA will need to include appropriate restrictions, including height and square footage limitations, limits on the type, number and height of signs, and screening of rooftop equipment and trash receptacles.

USE RESTRICTIONS

The REA should set forth a reasonable and comprehensive list of prohibited uses, possibly including a prohibition against uses not in keeping with a first class shopping center.

INSURANCE

Reasonable insurance limits should be applicable to all parcels within the shopping center, and the liability policies should name the shopping center owner as an additional insured.

ESTOPPEL CERTIFICATE

Make sure the REA includes a provision for estoppel certificates and a reasonable time period for response.

AMENDMENTS TO REA

One of the most important provisions to include in an REA is a provision which allows for less than all of the owners to amend the document as long as the rights of the nonconsenting owners under the REA are not affected. ◆

CRITICAL ISSUES IN LEASE TERMINATION AGREEMENTS

Not every landlord-tenant relationship runs its full course. Lease termination agreements are necessary when a landlord and tenant seek to end their relationship by mutual agreement prior to the stated lease expiration date and not as a result of the exercise of a termination right provided for in the lease.

The lease termination agreement should specify the date on which the termination will take effect. Although this will usually be a fixed calendar date, the termination date may sometimes be based on the occurrence of one or more conditions.

The lease termination agreement should specify what monetary obligations have been fully satisfied and which ones survive notwithstanding the termination of the lease. For example, final reconciliation of pass-through charges owed by the tenant, such as tenant's pro rata share of taxes, insurance premiums and operating costs, may be months away, and both parties will likely want the opportunity to seek adjustment of those costs on a post-termination basis.

The parties will want to address the condition of the premises upon surrender. Although the tenant would prefer to surrender the premises to the landlord in "as-is" condition, the landlord will expect that the lease obligation to surrender the premises in good condition and repair will survive the termina-

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tion of the lease. If the tenant has liability for repair and maintenance of the HVAC system or other utility systems, the landlord may want to have the systems examined by a professional before accepting them in "as-is" condition. In addition, a landlord will want to make sure that tenants whose operations involve hazardous substances remain responsible subsequent to lease termination for environmental liability that cannot be assessed at the time of the lease termination agreement.

The parties should also agree with respect to the disposal and removal of any fixtures, equipment and personal property remaining in the premises and how long the tenant has to remove such property before the landlord is permitted to remove or dispose of it.

The landlord may also want to consider the recovery of a portion of any construction or other allowance which was provided to the tenant.

Most lease termination agreements also contain a mutual release of all claims and liabilities, pursuant to which the landlord and tenant release each other from any and all debts, liabilities and other actions. Obligations provided in the termination agreement to survive termination should be excepted from the mutual release, such as the payment of certain rental amounts, surrender of the premises, environmental liability, and third party claims for personal injury or damage that arose prior to the effective date of the lease termination. Because the lease termination often arises from a dispute between the parties, the mutual release provisions are also an effective way to put a final end to the disagreements between the parties. After the mutual release provisions take effect, neither party can bring a claim against the other for matters which accrued through the effective date of the release as addressed in the termination agreement.

An issue often overlooked in any voluntary lease termination transaction is that where the landlord has financing in place, the consent of the landlord's lender will be required for the early termination of the lease. Otherwise, the termination will not be effective as to the lender.

By addressing the foregoing issues, the landlord and tenant can minimize the post-termination disputes regarding their respective responsibilities. ◆

FCC Ruling Mandates Allowing Installation of Satellite Dishes

An FCC rule effective January 22, 1999 requires that property owners permit apartment dwellers to place certain satellite dishes within the leased premises.

Under the rule, tenants may install satellite dishes wherever they rent space outside of a building, such as a balcony, balcony railing, patio, terrace, yard, garden or any other similar area within the exclusive use or control of the tenant.

The FCC ruling overrides conflicting state or local laws and regulations restricting the placement of such devices as well as lease provisions prohibiting installation of satellite dishes that are less than one meter either in diameter or measured diagonally. However, the ruling does not prohibit property owners from implementing reasonable safety regulations and regulations that protect the building owner's property.

In response to the FCC ruling, apartment owners should consider taking the following steps:

Notify tenants. Property owners should advise tenants that tenants have a right to install certain satellite dishes, but that such rights extend only to certain specified areas within the tenant's premises. Installations should be, and legitimately may be, restricted so that they are noninvasive and do not cause property damage.

Modify Lease Forms. Especially in multi-level apartments, there is the possibility of satellite dishes falling or being blown off balconies and injuring someone on the ground or a lower floor. Property owners may want to consider requiring evidence of liability insurance. Regardless of whether insurance is required, the tenant should indemnify the property owner in the event of an accident involving a satellite dish at the tenant's premises.

The FCC ruling is being challenged by trade groups representing the apartment industry.

RECENT DECISIONS

Pipeline Company Acquired Prescriptive Easement to Pipeline Corridor by Continuous use for over 30 Years

In 1962, Colonial Pipeline began operating an underground petroleum pipeline within a 75-foot-wide corridor that crossed a small portion of land now owned by the Simpsons. Colonial originally determined that the pipeline corridor would not cross the property now owned by the Simpsons, and, therefore, Colonial obtained an easement only from C.H. Humphries, the then owner of property to the north.

The Simpsons purchased their property in 1972, but it was not until 24 years later that the Simpsons and Colonial realized that the pipeline corridor crossed over the Simpsons' property. Colonial filed a court action requesting a ruling that Colonial had acquired prescriptive title to an easement over the Simpsons' property. The Simpsons counterclaimed that Colonial had damaged their property without paying just compensation. The trial court granted Colonial's request, and the Simpsons appealed.

In Simpson v. Colonial Pipeline Co., the Georgia Supreme Court agreed that Colonial obtained prescriptive title to the pipeline corridor easement because Colonial had at all times inspected, cleared, and marked the corridor, and in 1978 even used heavy equipment to install a second pipeline in the corridor. In addition, the Supreme Court determined that the Simpsons' claim for just and adequate compensation was barred by the four-year statute of limitations.

Prescription Does Not Run Against the State or its Subdivisions

Ketchum and Foster, property owners, had a dispute with Whitfield County over a tract of land dividing their properties at the end of an existing public road. Ketchum and Foster claimed their prescriptive title to the disputed tract prevented the County from opening a public road thereon.

The prior owners of Ketchum's and Foster's properties had attempted to expressly dedicate the disputed tract to the County for the purpose of creating a public road, but the description of the tract was ambiguous. However, the deeds to Ketchum and Foster each indicated that the public road forms one of the boundaries for each tract.

The trial court ruled that while the ambiguous description in the deed to the county precluded a finding that the road had been expressly dedicated, an implied dedication had clearly occurred. Ketchum and Foster appealed the trial court's denial of their claim of prescriptive title to the land.

The Georgia Supreme Court (Ketchum v. Whitfield County) upheld the trial court, finding that the description in the deeds from the prior owners, although ambiguous, was sufficient to establish a key to the location of the boundaries intended by the parties, resulting in an express dedication of the property to the County.

The Court went on to state that a County must accept a dedication for the property to become a public road, but that where there is an express dedication, acceptance does not require installing the entire street. Instead, acceptance may be evidenced by any improvements on any part of the tract. Since the County had worked and maintained the existing portion of the public road, the Court found that the County had accepted dedication of the entire tract of land as a

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public road. "The fact that Ketchum and Foster used the disputed tract for their own purposes had no effect because prescription does not run against the State or its subdivisions."

County Not Required to Maintain Abandoned Cemeteries

Members of the Lamkin family filed a petition to compel Pulaski County and its sole county commissioner to preserve, protect, and prevent the desecration of the Lamkin family cemetery under the Georgia Abandoned Cemeteries Act. The Lamkins also claimed that the owner of the property had a similar duty to maintain the cemetery.

The trial court ruled in favor of the County, the commissioner and the landowner and dismissed the claims. The Lamkin family appealed, and the Georgia Supreme Court upheld the trial court.

In Smith v. Pulaski County, the Georgia Supreme Court agreed with the trial court that the language of the Act is permissive, and authorizes, but does not require, that counties preserve and protect abandoned cemeteries. The Court upheld the rulings in favor of the County, the commissioner and the landowner, because the Act had not been implemented by the County.

Right of First Refusal to Buy Property Not Binding on Subsequent Purchasers

In 1987, the Ricketsons purchased a portion of a larger tract of land owned by William Greene, Jr. The closing statement contained a covenant by Greene that, in connection with any future sale of any portion of his remaining property, he would offer a right of first refusal to the Ricketsons. The covenant was not recorded in the real estate records. After the closing, Greene's remaining property was the subject of several transactions, including two security deeds covering the property and a bankruptcy petition. Prior to the execution of the second security deed and the filing of the bankruptcy petition, the attorney for the Ricketsons recorded an affidavit giving notice of the right of first refusal.

The bankruptcy court approved the transfer of all of Greene's remaining property to the bank holding the security deeds in satisfaction of the debt. Shortly thereafter, Greene's father purchased the property from the bank by borrowing the purchase money from the bank and executing a security deed in favor of the bank. Although the Ricketsons submitted an offer to purchase the property during the bankruptcy proceeding, they never sought to enforce their right of first refusal in connection with the purchase by Greene's father.

The next year, Greene's father sold a portion of the property to the Ricketsons pursuant to the right of first refusal.

Subsequently, the bank foreclosed on the remaining property and later sold it to Federal Paperboard. A year after that sale, the Ricketsons sued, claiming that the sale violated their right of first refusal. The trial court ruled that the right of first refusal was a contractual obligation that was personal to Greene and therefore did not bind subsequent purchasers of the land. The Ricketsons appealed.

The Georgia Court of Appeals (Ricketson v. Bankers First Savings Bank, FSB) upheld the trial court, stating that a right of first refusal, even if recorded, does not bind subsequent owners because the refusal right, and the exercise of the right, do not change the nature, value, use, quality, occupation and enjoyment of the property.

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Lender May Not Foreclose on Property Because Borrower Fails to Tender Amount Owed Where Borrower Offers to Make such Tender and had Sufficient Funds to Make Such Tender, but Lender Unambiguously Stated Lender Would Refuse Tender Unless it Included Unearned Interest Claimed by Lender

Prince sold land to Grebel and took back a loan secured by the land. When Grebel defaulted, Prince accelerated the loan and demanded payment of the total indebtedness, less unearned interest, within 10 days or else Grebel would also be liable for attorneys' fees.

Grebel did not make payment within the 10 day period, but he refinanced the debt prior to the scheduled foreclosure sale and offered to pay principal, accrued interest, late fees, and attorneys' fees. Prince rejected the offer, demanding an additional amount of approximately $50,000 in unearned interest.

The day prior to the scheduled foreclosure, Grebel filed an action for a declaratory judgment regarding the amount owed and for a temporary restraining order to stop the foreclosure. In connection with the filing, Grebel deposited with the court the amount he believed was owed. The trial court granted the temporary restraining order that day. However, instead of personally serving a copy of the order on Prince, Grebel faxed notice of the restraining order to Prince's attorney. Even though Prince's attorney informed Prince prior to the sale that "something had happened to try to stop the sale," Prince conducted the sale and purchased the property for an amount sufficient to pay the debt exclusive of the approximately $50,000 of unearned interest which Prince had demanded from Grebel.

Grebel amended his suit to set aside the foreclosure and obtain a contempt order against Prince for proceeding with the foreclosure despite the court order.

The trial court ruled in favor of Prince, finding that Grebel had not actually tendered the amount necessary to pay off the debt (exclusive of the unearned interest), and that Grebel had not properly served Prince with notice of the temporary restraining order. Grebel appealed.

In *Grebel v. Prince*, the Georgia Court of Appeals held Prince in contempt for violating the restraining order, despite the fact that Prince was not properly served, because Prince had actual notice of the restraining order. The Appeals Court sent the case back to the trial court to consider Grebel's demand to set aside the foreclosure sale. The Appeals Court found that a certain and unconditional tender to Prince of the amount owed was not required since Prince's attorney stated that a tender of less than such amount plus unearned interest would be refused if made. In addition, the Court noted that Grebel had deposited with the lower court the amount he believed was owed and that where there is a bona fide controversy over the amount required to satisfy a debt, the debtor should be required to tender only such sums as are admittedly due under the note, not all sums which may be claimed by the creditor as due. ◆

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