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An electronic newsletter for real estate professionals

From the desk of:

The Real e-ditor

Summer is the busy season for the real estate industry here in Southeast Michigan. As soon as the weather turns hot and balmy, and we're distracted by little league games, golf outings and company picnics, that's when the real estate market heats up, and we end up burning the candle at both ends. And is it just me, or, has our market indeed heated again up this summer? Interest rates remain remarkably low, inflation is tame, and activity seems stronger now than it has all year. In fact, Investor's Business Daily reported on July 15 that June retail sales were up, in part, based on a 4.8% surge in auto sales and, on July 18, IBD reported that industrial production surged in June in part due to "hefty" auto output. Even the University of Michigan's consumer sentiment index rose .5% in June.

Detroit put on a fine spectacle for Major League Baseball's All Star Game. Just walking around downtown, I was struck by how friendly people were, including Detroit's ubiquitous police force, and how clean things looked. While in Chicago on business last week, bragging that our City had hosted a flawless All Star Game, I felt proud to call myself *a Detroiter*.

With all this activity and good-vibe in mind, we have packed this issue of Real e-State with more information than usual, featuring articles that affect all of us whether on our day off (*Walking a Fine Line: Who Owns the Beach*), at home mowing the grass (*Is Your Castle Safe? Supreme Court Expands Public Use*) or in our daily business activities (*New Bankruptcy Law Affects Commercial Landlords* and *New Regulations Will Govern Due Diligence*).

So, as they say, let's make hay while the sun shines. Hopefully that's just what you're doing, too because before you know it, summer will be over, the weather will cool and the kids will go back to school. Then the question will be: how to keep the quickened pace of our Metro Detroit real estate market humming along through the end of the year? With the All-Star Game behind us, perhaps the upcoming Superbowl will keep enough positive energy focused on Detroit to allow us all to do just that.

A perfect summer day is when the sun is shining, the breeze is blowing, the birds are singing, and the lawn mower is broken.

~James Dent

WALKING A FINE LINE: WHO OWNS THE BEACH?

BY: DANIELLE M. SPEHAR

Many of us in the State of Michigan spend at least some of our day dreaming about relaxing near one of our approximately 11,000 inland lakes or any one of the Great Lakes that surround our State. Seventy percent of the shoreline in Michigan is private property. For the fortunate few that own waterfront property, the dream may include watching beautiful sunrises or sunsets from a deck or from inside their waterfront home. For the rest of us, the dream may include a quiet walk along the beach either alone or with a special someone. But where does public ownership of the waterway end and private ownership begin? Can a waterfront homeowner erect a fence to the water's edge to prevent beach combers from walking past? We might never know the "legal" answer to these questions if everyone just got along. However, as in every other facet of our daily living, there will be people who just can't get along and therein lies the problem.

What began as a dispute between neighbors has escalated to a case pending before the Michigan Supreme Court that will impact virtually everyone who lives or vacations in Michigan. On March 8, 2005, the Michigan Supreme Court heard oral arguments in the case of *Glass v. Goeckel*. Simply stated, the issue being considered by the Court is who owns or controls the portion of Great Lakes' beaches below the historic high water mark that extends to the waters edge. This area is known as the bottomlands, and has grown larger recently due to historically low water levels. It should be noted that Michigan property law distinguishes between the Great

Can a waterfront homeowner throw someone off of their property and refuse to allow them to walk the shoreline?

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NEW BANKRUPTCY LAW AFFECTS COMMERCIAL LANDLORDS

BY: MICHAEL S. LEIB

On April 20, 2005, President Bush signed into law the long awaited Bankruptcy Abuse Prevention and Consumer Protection Act of 2005.

There were important changes in the business arena, including changes that directly affect landlords when a tenant files bankruptcy.

The "2005 Act" received a great deal of publicity for changes in consumer bankruptcy laws. However, there are also important changes in the business arena, including some changes that directly affect landlords when a tenant files for bankruptcy.

Upon filing for bankruptcy, Section 365 of the Bankruptcy Code required that a debtor/tenant assume or reject an unexpired lease of nonresidential real property within 60 days. As a matter of practice, the 60 day period was routinely extended by order of the court and often over the objection of the landlord. Landlords did not have any certainty as to when the property might be available for lease or when a debtor would be required to make a final decision to either assume or reject the lease.

The changes to Section 365 in the 2005 Act provide more certainty for landlords. Now, effective for cases filed on or after October 17, 2005, a debtor/tenant has 120 days after the case is filed to assume or reject an unexpired lease and the court may extend that period for an additional 90 days upon the request of the tenant or landlord. Rent must be

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New Regulations Impose Tougher Standards Environmental Due Diligence

BY: KASTURI BAGCHI

In order to avoid strict liability for clean up of hazardous substances on commercial properties pursuant to the 2002 Brownfield Amendments to the Comprehensive Environmental Response Compensation and Liability Act ("CERCLA"), the federal environmental cleanup law, a landowner must take several precautions, including the performance of an "all appropriate inquiry" investigation ("AAI") of the property. Presuming an AAI investigation discloses no historical releases of hazardous materials, except in the case of a bona fide purchaser, a landowner may invoke one of the following three defenses to strict liability:

⇒ The innocent landowner defense in which a party buys property "without knowing or having reason to know of contamination on the property."

⇒ The bona fide prospective purchaser defense, in which a party buys property after enactment of the 2002 Brownfield Amendments, "knowing or having reason to know of contamination on the property provided that such party establishes by a preponderance of evidence that contamination occurred prior to acquisition."

⇒ The contiguous property owner defense in which an owner of property "is not the source of contamination" but their property is "contiguous to or otherwise similarly situated to, a facility that is the source of contamination found on their property."

The AAI process is being defined at the direction of Congress by the United States Environmental Protection Agency ("EPA"). the EPA published draft regulations on August 26, 2004 which can be located at 40 CFR Part 312 (2004). Final regulations are expected to be issued later this year.

Since 1993, the generally recognized standard for the conduct of environmental investigations has been the ASTM (American Society for Testing Materials) Standards. How does the environmental due diligence process under AAI differ from the ASTM standards to which we have become accustomed? The draft rules suggest three major differences.

DEFINING THE ENVIRONMENTAL PROFESSIONAL

First, the draft AAI rules define "environmental professionals" more specifically and stringently than the ASTM standards. While the latter makes no mention of the quantity or quality of training or experience, in 40 CFR Section 312.20, the EPA sets forth specific licenses, years of experience for environmental professionals, and/or training that an environmental professional must have to be qualified to perform an AAI. To temper these qualifications, the tasks to be undertaken during the AAI process may be delegated to someone who is not an "environmental professional" as long as "such person is under the supervision or responsible charge of a person meeting the definition of an environmental professional…." This compromise enables individuals who are not "environmental professionals" to participate, thereby keeping the AAI process affordable.

DECLARATIONS BY THE ENVIRONMENTAL PROFESSIONAL

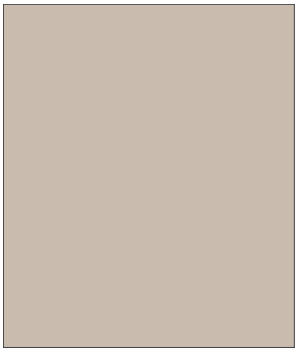
The second distinction between the AAI and the ASTM standards are the declarations required to be made in the AAI report. Pursuant to 40 CFR 312.21(d), the environmental professionals must declare that they meet the criteria of an environmental professional and that they have the qualifications to perform the AAI in accordance with the EPA rules. The EPA notes that these are declarations and not certifications. This distinction is critical because the EPA does not want such statements to imply any warranty or guarantee of the AAI report thereby potentially increasing the cost of insurance for environmental professionals.

"The immediate concern is to check the credentials of your environmental consultant…"

FAR GREATER SCOPE OF INQUIRY

The third and perhaps most critical difference is that the AAI rules impose a greater depth of inquiry than the ASTM standards. Unfortunately, the rules sometimes do not provide guidance as to how to comply with these heightened performance standards. Here are some examples:

⇒ As in the ASTM standards, the environmental professional must interview the current owner and occupant of the property. But the AAI rules also require the environmental professional to interview current and former facility managers, past owners or occupants. If the property is abandoned together with evidence of potential unauthorized use or uncontrolled access, interviews must be taken of one or more owners or occupants of neighboring properties "from which it appears possible to have observed uses". Missing from the AAI rules are the required content of the interviews. The only thing that guides the environmental professional is the vague standard that these interviews must yield information "necessary to achieve the objectives and performance factors" of the AAI rules.



⇒ Another departure from the ASTM standards is that the environmental professional must review historical documents and records such as aerial photographs, fire insurance maps, title documents and land use records as far back "as it can be shown that the property contained structures or from the time the property was first used for residential, agricultural, commercial, industrial or government purposes." No specific definition of what constitutes a structure is provided. This means that searches may have to go back prior to 1940, which is the ASTM benchmark.

⇒ On top of longer historical searches, environmental professionals must also consider "commonly known or readily ascertainable information within the local community" which may compel closer scrutiny of the following sources: current owners or occupants of neighboring properties or adjacent properties; local and state government officials and others with knowledge of the subject property; newspapers; websites; community organizations; local libraries or historical societies.

⇒ Environmental liens must also be considered pursuant to the AAI standard. Since such liens are typically disclosed in title insurance as encumbrances on property, such an inquiry does not re-

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IS YOUR CASTLE SAFE? SUPREME COURT EXPANDS PUBLIC USE

BY: MARTIN B. MADDIN

The Fifth Amendment of the Constitution prohibits the government from taking private property unless the owner is justly compensated and the land is taken for "public use." In *Kelo v. New London* (04-108), homeowners filed suit after the city announced plans to condemn their property for redevelopment, which purportedly would create jobs, increase tax revenue and revitalize the area. 2005 WL 1469529 (U.S.Conn). Notably, the homeowners' property is not blighted and the property is being transferred to a private developer. Nevertheless, the U.S. Supreme Court reaffirmed the power of local government to condemn private property for economic development, even by a private developer, because the city carefully formulated a development plan. Id.

The city's economic development plan satisfies the "public use" requirement because the Court has historically defined "public use" broadly, and because the Court followed "its longstanding policy of deference to legislative judgments . . . ." Id. Relying on prior case law, the Court deferred to the city's judgment that the whole "area at issue was sufficiently distressed to justify a program of economic rejuvenation . . . ," thereby justifying the Court's dismissal of the homeowners' challenge that the condemnation is unconstitutional because their own properties were not blighted. Id. Additionally, even though the New London redevelopment plan was not for use by the general public, the Court "long ago rejected any literal requirement that condemned property be put into use for the general public." Id. Finally, "[p]romoting economic development is a traditional and long accepted function of government and the Court refused to conclude that "public ownership is the sole method of promoting the public purposes of community redevelopment projects." Id.

"public ownership is [not] the sole method of promoting the public purposes of community redevelopment projects."

The Court emphasized that nothing precludes states from imposing stricter "public use" requirements than required by federal law. Id. In fact, in 2004, the Michigan Supreme Court ruled that seizing private property for economic development purposes violates the Michigan Constitution, even though the development contributes to the health of the general economy. *Wayne County v. Hathcock,* (2004). It remains to be seen whether other states will follow Michigan's lead or Michigan will ultimately acquiesce to the reasoning of the Supreme Court in *Kelo v. New London*.

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quire the expertise of an environmental professional. Purchasers can obtain such results on his or her own and deliver the information to the environmental professionals.

⇒ Visual on-site inspections are mandatory. It is recommended by the EPA that the inspection not be delegated by the environmental professional. If an "unusual circumstance" arises because of physical limitations, remoteness or lack of access, an on-site inspection will not be required provided that the AAI report contains the following: visual inspection by another method such as aerial imagery or inspection from the property line or public road; documentation of efforts to gain access and why such efforts were not successful; and "documentation of other sources of information regarding releases or threatened releases…[such as] comments by the environmental professional on the significance of the failure [to inspect]…with regard to the ability to identify conditions indicative of releases or threatened releases…." Please note that an "unusual circumstance" does not arise by the mere refusal of a seller to voluntarily provide access.

⇒ In order to identify the migration of contaminants, the proposed AAI rules require visual inspections of adjoining properties from the subject property's boundary line, public right of way, or even aerial imagery where necessary to achieve the objective of the AAI process. The visual inspection must focus particularly on areas "where hazardous substances may be or may have been stored, treated, handled or disposed." As in the case of on-site inspections, adjacent property observations are also compulsory except in the event of "unusual circumstance".

⇒ The shelf life of an AAI report is shorter than an ASTM Phase I. An AAI report is valid for one year prior to the purchase date of the property, but any interviews, lien searches, and visual inspections cannot be more than 180 days old. If the AAI report is more than one year old, an entire new AAI report must be prepared. A Phase I based on ASTM standards that is over a year old may be used if appropriate updates are made.

⇒ To the extent there are gaps in the data, the AAI report must disclose them and their impact on the ability of the environmental professional to identify releases or threatened releases.

PRACTICAL IMPACT

How do these differences between AAI and ASTM impact buyers and sellers of commercial real estate?

⇒ The immediate concern is to check the credentials of your environmental consultant, to assure that they qualify as an "environmental professional."

⇒ With the more extensive scope of inquiry and the need for qualified environmental professionals, the cost of an AAI based Phase I Assessment is likely to increase, as will the time period needed to perform them. Interestingly, the EPA predicts that the average cost increase per AAI report compared to an ASTM based report will not exceed $50.00, and that the average increase in paperwork burden will be one hour. Only time will tell if the EPA correctly estimated the increase in costs and preparation time.

THREE MAJOR DIFFERENCES

- **More stringent definition of environmental professional**
- **Required declarations by environmental professional**
- **Greater scope of inquiry of history and use of property**

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We never know the worth of water till the well is dry.

~Thomas Fuller

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Lakes and inland lakes and streams. Inland waterfront property owners hold title to the beds to the center of the water body in pie-shaped wedges. Therefore, even after the Supreme Court rules in Glass, we may only know the answers to these questions with respect to properties located on the Great Lakes.

Joan Glass, the Plaintiff in the case, owns property across the street from Lake Huron. She has an easement to access the lakefront. The Defendants, Richard and Kathleen Goeckel, own property fronting on Lake Huron. Glass essentially lost her case in May 2004 when she asserted that the 15 foot wide access easement that benefited her property established her legal right to walk to the beach and that well-established public trust and common law allowed her to walk along the waters edge because the Court of Appeals held that, although the State owns the land up to the highwater mark, owners of waterfront property have exclusive use of that land and can exclude others from their property or require others to stay in the water. The rule of thumb which arises from the Court of Appeals' decision is that to avoid a claim of trespass, beach walkers must walk in the water. Glass has appealed to the Michigan Supreme Court, which is expected to decide the dispute sometime in July 2005.

The argument between property owners and beach walkers is not limited to these parties, of course. The outcome of this case will have far reaching effects. In fact, many groups filed Friend of the Court briefs weighing in on the argument both at the appellate and the Supreme Court level, including Save Our Shorelines, the Michigan Chamber of Commerce, the National Federation of Independent Business Legal Foundation, the Michigan Bankers Association, Michigan Hotel, and the Motel & Resort Association. Conservative property rights groups such as Save Our Shorelines assert that property owners should have the right to say who may and who may not come onto their property. Environmental protection groups, such as the Michigan Land Use Institute, oppose the Appellate Court decision as "another step in its [Save Our Shorelines'] three-year drive to gain unrestricted private ownership of Great Lakes shoreline, including the lakes' 'bottomlands'".

Whether you are a private waterfront property owner or a beach walker may color your opinion as to how the Supreme Court should rule in *Glass*. On the one hand, property owners pay a heavy premium for waterfront land and they continue to pay a high price in the form of extraordinarily high taxes. On the other hand, a beach walker may feel that historically the State of Michigan has held title to 3,200 miles of Great Lakes shoreline in trust for the public use up to the highwater mark and, therefore, he or she should be permitted to continue to enjoy the benefits afforded to all members of the public for over 100 years.

Regardless of how the Supreme Court rules, it is unfortunate that the case had to proceed this far. In fact, the Goeckels noted that most waterfront property owners do not mind people walking peacefully along the water's edge (including on their property) and they themselves enjoy beach walking on other people's lake front property. After the Supreme Court renders its decision, we may all have to modify our vacation plans, if "no trespassing" signs and fences become the rule along our Great Lakes shoreline.

Look for future issues of this newsletter analyzing the impact of the Supreme Court's ruling.

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paid in the interim. Any further extensions are not permitted by the 2005 Act unless the landlord agrees. As a matter of practice, this change may require tenants to take an earlier look at the economics and importance of leases. For example, where leases contain below market terms and the space is important to the reorganization effort of the debtor, the debtor must move more quickly to assume the lease. If the lease contains above market terms and the space is not material to debtor's reorganization efforts, then the lease may be more quickly rejected. Difficulty will arise where the debtor cannot yet determine how important lease space is to reorganization efforts and, perhaps, the lease rate is at market terms. In such cases, the debtor may assume such leases and then later find out the assumption was premature.

When a lease is assumed after a bankruptcy petition is filed, and then the debtor/tenant is forced to reject the lease, damages arise to the landlord in the form of an administrative expense. While there is nothing new about an administrative expense arising from a lease previously assumed and then rejected post petition, the 2005 Act provides for a cap on such administrative expense damages, perhaps recognizing that the more rigid period within which to assume or reject a nonresidential lease could lead to premature assumptions. Section 503(b)(7) now provides that a lease, previously assumed and then rejected post petition, creates a damage claim capped at 2 years of monetary obligations following the later of the rejection date or the date of actual turnover of the premises to the landlord, without reductions except, however, for sums "received or to be received from a entity other than the debtor…". It remains to be seen what "to be received" means and there will be ample opportunity for lawyers to litigate the meaning of that phrase.