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# US Regional Real Estate

## Alabama

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# 2021

# ALABAMA

## Law and Practice

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## 1. GENERAL

### 1.1 Main Substantive Skills

Knowledge of federal, state and local law, the changes to those laws, and local forms and customs, is essential in successfully and efficiently practicing real estate law. Alabama land records are handled on a county-by-county basis, and laws are interpreted accordingly.

Many Probate Offices have implemented technological improvements to improve filing, record-keeping, and access to recorded documents, but these developments can vary significantly between different counties. Successful transactions often involve extensive negotiations. Closing commercial deals involves "standard" forms and requirements for both state law compliance and title insurance.

### 1.2 Most Significant Trends

#### Trends in 2020

The COVID-19 pandemic was the dominant force and issue in 2020 for real estate in Alabama. Although the repercussions of COVID-19 on commercial real estate have been significant, the overall impact was not as dramatically negative as initially feared.

The strictest of the governmental closures and major use and occupancy restrictions in Alabama lasted for approximately three months. Alabama began relaxing these closures and restrictions by Governor Ivey's executive order beginning in May 2020. This meant that many of the initial forbearance agreements and extensions that dominated March and April 2020 did help developers, landlords and tenants weather some of the heavier state and local lockdowns. Unlike certain other areas where major restrictions lasted six to 12 months, the period was shorter in Alabama, which allowed counterparties to reach reasonable extensions.

Although hospitality and entertainment-related real estate ventures struggled for much of 2020, and office and retail projects have been adversely affected by the trend of temporary work-from-home plans and various local and state restrictions related to retail and dining operations, Alabama's residential and vacation home markets were relatively strong, and warehouse, industrial and multifamily developments in the state have continued to find willing financing and investors.

#### Significant Deals in 2020

Recent business and government announcements as well as large in-progress construction will likely generate additional real estate investment in 2021. Major companies with existing industrial and distribution hub facilities in Alabama, such as Mazda Toyota, Mercedes-Benz and Amazon, recently announced plans for additional Alabama operations.

In Birmingham, the nearly complete Protective Stadium, which will host UAB football and ceremonies for the 2022 World Games, should spur other real estate activity north of downtown. Two former hospital sites in Birmingham are in the midst of re-purposed development, and The Hardwick and ongoing Parkside District projects are among other notable, planned Birmingham construction.

Huntsville remains the hottest market, and its selection as the preferred location for the headquarters of the US Space Command will almost certainly lead to additional real estate opportunities.

### 1.3 Impact of New US Tax Law Changes

In February 2021, Governor Ivey signed into law Act 2021-1, which, among other things, exempts numerous federal responses to COVID-19 that would have otherwise been taxable under Alabama law. For example, the act excludes or

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exempts from Alabama income grants, stimulus and advance refund payments made under the CARES Act and clarifies that cancellation of indebtedness income from the forgiveness of Paycheck Protection Program (PPP) loans is not taxable under Alabama law.

Act 2021-1 also made several changes to Alabama corporate tax, including changing the multistate apportionment formula to single sales factor; retroactively decoupling from the Tax Cuts and Jobs Act (TCJA) amendments made to IRC Section 118 with respect to tax incentives; and, rather than decoupling entirely, applies IRC Section 163(j) in a somewhat unique fashion.

In addition, Act 2021-1 established the Alabama Electing Pass-Through Entity Tax Act, allowing pass-through entities to elect for taxation at the entity level rather than the owner level at the highest individual income tax rate. This law was primarily a workaround to the USD10,000 “SALT cap” deduction enacted as part of the TCJA.

## 2. SALE AND PURCHASE

### 2.1 Ownership Structures

Many commercial transactions utilize a single-purpose and single-asset LLC. The member(s) of such single-purpose entities often include joint ventures, limited partnerships, or other LLCs formed for the particular real estate investment opportunity, but many lenders require fee title to the underlying commercial real estate to be held by a newly formed, single-purpose LLC. Tenancy in common agreements are utilized by some investors.

### 2.2 Important Jurisdictional Requirements

A conveyance of real property generally must be written and signed by all parties, with witnesses to the signatures (Alabama Code 1975 Section

35-4-20), and contain a valid property description. Conveyance instruments must provide the instrument preparer’s name and address (Section 35-4-110), list the grantor’s marital status and conveyed property’s homestead status (Section 35-4-73), and provide ad valorem tax notice, typically using Real Estate Sales Validation Form RT-1 (Section 40-22-1).

Residential conveyances require special disclosures, but generally there are no special laws regarding the transfer of real property based on use. However, the parties to a transaction or locality rules may require additional provisions (eg, waivers of claims or restrictions on use) to be included in the deed or in a separate document recorded with the deed at closing. However, buyers should still take additional precautions to ensure the property’s proposed use complies with relevant local rules (see **2.8 Permitted Uses of Real Estate under Zoning and Planning Law**).

### 2.3 Effecting Lawful and Proper Transfer of Title

Transfer of title is generally effectuated by a deed, usually taking the form of a general warranty deed, statutory warranty deed (pursuant to Alabama Code 1975 Section 35-4-271), or a quitclaim deed. In commercial transactions, the most common form of deed is the statutory warranty deed. Other forms of conveyancing and/or transfer or occupancy instruments include ground leases, leases, judicial decrees vesting title to real property, foreclosure deeds, tax deeds, sheriff’s deeds, and deeds in lieu of foreclosure.

Conveyancing instruments must be recorded in the office of the judge of probate for the county in which the property resides (Alabama Code 1975 Section 35-4-50). Alabama uses a hybrid “race-notice” system where a purchaser takes priority over all prior purchasers of which they

have no notice at the time they record their conveyance – see, eg, *Nelson v Barnett Recovery Corp*, 652 So 2d 279, 281 (Alabama Court of Civil Appeal 1994).

## 2.4 Real Estate Due Diligence

In commercial transactions, due diligence typically involves a review of title and survey matters, physical property inspection, financial and other property records inspection and review of relevant zoning, permitting, or platting requirements; it may also include examination of the property's environmental condition. Lawyers are typically assigned review and/or cure of title and survey matters, and are often involved in addressing permitting and platting requirements and resolution of environmental matters (if applicable). The allocation of attorney versus client responsibility continues to vary considerably based on the client's size and needs.

## 2.5 Typical Representations and Warranties for Purchase and Sale Agreements

Purchase and Sale Agreements (PSAs) may vary from those providing for the sale of property in its "as-is, where-is" condition with no representations, to PSAs containing significant representations and warranties, such as the following:

- the seller's ownership of title;
- the seller's authority to sell the property;
- that no violations of law are present on the property;
- that the property has no tenants in possession (except as noted);
- the seller's warranty to satisfy mechanic's liens;
- environmental matters;
- zoning and permitting status; and
- the absence of pending litigation and condemnation.

Alabama law provides for an implied warranty of fitness and habitability for the sale of new residential property, but the doctrine of caveat emptor generally applies – *Sims v Lewis*, 374 So 2d 298, 303 (Alabama 1979).

A buyer's customary remedies for a seller's misrepresentation are based on the contract's terms. The seller's liability for such a breach can be negotiated and is often capped at a specific dollar amount, varying based upon the underlying transaction.

## 2.6 Important Areas of Law for Foreign Investors

Foreign companies are not required to register with the state unless they are considered to be transacting business in Alabama (Alabama Code 1975 Section 10A-1-7.01). Foreign companies must, however, comply with all federal laws relating to the transfer of property to a foreign investor, including FIRPTA, etc. Additionally, foreign investors should consider the tax implications of such a transaction when purchasing real estate (see **8. Tax**). Recent changes to CFIUS regulations have had some but not a major impact in Alabama.

## 2.7 Soil Pollution and Environmental Contamination

Alabama's laws generally conform to federal environmental laws. Because environmental statutes often hold the current owner strictly liable for the costs of remediation, commercial real estate buyers and sellers may contractually allocate environmental liability. Buyers and sellers will negotiate the terms of any "as-is" language, indemnification for environmental matters, and any release of environmental claims between the parties.

Negotiated terms vary between contracts, with sellers favoring caps on their liability, and buyers preferring a complete indemnification from

sellers. Additionally, many buyers wish to limit their liability by satisfying the requirements for the “innocent landowner defense” against CERCLA liability (discussed further in **3.8 Lender’s Liability under Environmental Laws**).

## **2.8 Permitted Uses of Real Estate under Zoning and Planning Law**

An interested buyer can request a zoning verification letter from the applicable jurisdiction’s planning department. Some departments will include statements of compliance or non-compliance, but many counties in Alabama do not have the staff capacity to do so. In those cases, if a buyer or its lender requires a compliance certificate, there are consultants available that will provide such a compliance report or certificate for a fee. Local municipalities may enter into a development agreement to facilitate a specific project use, depending on the type of project and the local municipality.

## **2.9 Condemnation, Expropriation or Compulsory Purchase**

In Alabama, governmental taking of property by eminent domain and condemnation actions may occur if the property is taken for a “public use” and payment of “just compensation” is made for such property (Alabama Constitution of 1901, Article XII, Section 235). In addition to state and federal constitutional limitations, Alabama has adopted the Alabama Eminent Domain Code, which sets procedures for eminent domain cases (Alabama Code 1975 Section 18-1A-1 to -311). If a landowner rejects an offer to purchase from the state, the state will file a complaint for condemnation with the probate court for the county where the relevant property is located.

## **2.10 Taxes Applicable to a Transaction**

The deed tax is triggered by any real estate conveyance, and is typically allocated to the purchaser, unless otherwise agreed by the parties. The purchase of an interest in a property-owning

company is not considered a conveyance of real estate, and therefore does not trigger the deed tax. The deed tax is USD0.50 for every USD500 (rounded up) of the conveyed property’s value. If a mortgage is recorded simultaneously with the deed, a credit is provided by statute, such that the deed tax due is calculated on the value of the real property not securing the mortgage only (Alabama Code 1975 Section 40-22-1(c)).

For example, if a property is purchased and sold for USD2 million and the deed is recorded simultaneously with a mortgage of USD1.5 million secured by the property, the deed tax would be calculated only against the USD500,000 portion of the property’s value not already subject to the mortgage tax. Statutory deed tax exemptions exist for certain instruments made for agricultural purposes (Alabama Code 1975 Section 40-22-4), farm loans (Alabama Code 1975 Section 40-22-5), and certain conveyances by religious organizations (Alabama Code 1975 Section 40-22-5.1).

## **2.11 Rules and Regulations Applicable to Foreign Investors**

Under Alabama law (in addition to FIRPTA), upon the sale of any real property, the transferor must withhold 3% (if the buyer is an individual) or 4% (if the buyer is an entity) of the purchase price or, if the gain recognized on the sale is less than the purchase price and the seller provides the buyer with an Affidavit of Seller’s Gain (see Alabama Department of Revenue Form NR-AF2), the buyer may withhold 3% or 4% of the amount of the gain (Alabama Code 1975 Section 40-18-86). Transferors may be exempt from these withholding requirements under Alabama Code 1975 Section 40-18-86(d), see **8. Tax**.

### **3. REAL ESTATE FINANCE**

#### **3.1 Financing Acquisitions of Commercial Real Estate**

In Alabama, the acquisition of commercial real estate is generally financed with indebtedness secured by a mortgage lien on acquired property. Depending on the type of real estate, financing may be available through bank debt, conduit loans, or government-sponsored enterprises such as Fannie Mae or Freddie Mac.

#### **3.2 Typical Security Created by Commercial Investors**

In Alabama, a purchaser or developer of commercial real estate generally grants a mortgage to secure borrowed funds used to acquire and/or develop the real estate. Most commercial lenders also incorporate a security agreement into the mortgage (in addition to separate UCC filings made locally and in the borrower entity's domicile state) to cover personal property attached to or used in connection with the mortgaged real estate and proceeds. Lenders can also collateralize (with additional agreements and filings) the borrower's entity interests or stock and/or deposit accounts.

#### **3.3 Regulations or Requirements Affecting Foreign Lenders**

Financial institutions that are not domiciled in Alabama may be required to qualify to do business in Alabama, and may be liable for filing tax returns and payment of annual privilege tax (under Alabama Code 1975 Sections 40-14A-21 to 40-14A-29) and excise tax (under Alabama Code 1975 Sections 40-16-1 to 40-16-8) if the financial institution is doing business in Alabama within the meaning of the laws.

#### **3.4 Taxes or Fees Relating to the Granting of Enforcement of Security**

Under Alabama Code 1975 Section 40-22-2, mortgage recording tax is generally USD0.15

per USD100 of the loan amount secured by the mortgage. Mortgages with open-end or revolving indebtedness have two options for paying the recording tax:

- if the mortgage does not state the maximum principal indebtedness, the taxpayer must pay a recording tax on the actual amount initially advanced, annually report the amount of indebtedness secured by the mortgage and pay tax on additional advances made; or
- the more common approach is to pay the recording tax based on the maximum principal indebtedness stated in the mortgage, regardless of the cumulative amount actually advanced.

There are mechanisms such as obtaining tax orders from the Alabama Department of Revenue for allocating recording tax for mortgages covering property in multiple counties or states. Additionally, a nominal per-page recording fee will be collected at the time of recording.

#### **3.5 Legal Requirements before an Entity Can Give Valid Security**

Other than general contract law principles and granting a mortgage in proper form for recording with the required information included in the document (such as proper execution, witness or notary acknowledgement, and a proper description of the collateral), there are no specific legal rules or requirements applicable solely to entities. On most transactions, it is recommended to obtain a lender's title insurance policy insuring the mortgage.

#### **3.6 Formalities When a Borrower Is in Default**

In Alabama, a mortgage must be recorded in order to maintain priority over subsequent liens granted on the property. Alabama Code 1975 Section 35-10-1 to -98 deals with the requirements for foreclosure in Alabama. Also, it should



be noted that there is a homestead exemption pursuant to Alabama Code 1975 Section 6-10-2 and a one-year statutory right of redemption under Alabama Code 1975 Section 6-5-248(b).

### **3.7 Subordinating Existing Debt to Newly Created Debt**

Existing secured debt can be subordinated to newly created debt if the parties execute and record a subordination agreement.

### **3.8 Lender's Liability under Environmental Laws**

Unless the lender is deemed to be a "partner" in the transaction, it cannot be held liable under environmental laws for merely holding security (ie, a mortgage) on real property, unless it directly causes the pollution or contamination. Nonetheless, most lenders in Alabama typically require an environmental indemnity agreement from the borrower and one or more beneficial owners.

If the lender forecloses and becomes the property owner, the only way to qualify for liability exemptions under the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA) for existing contamination is to conduct all appropriate inquiries (AAI) according to the ASTM E1527-13 standards in a timely manner prior to the date the loan is made. AAI investigations must be conducted no more than one year prior to the loan closing.

Any report more than one year old is of no value in establishing an innocent purchaser defense under CERCLA. In addition, certain portions of the AAI investigation are only good for 180 days. Consequently, any AAI report more than 180 days old should be updated prior to the loan closing. If AAI is not performed or is not performed in a timely manner, then a lender can be liable once it takes possession of the property for contamination it did not cause.

In addition to AAI, most mortgage lenders in Alabama require the borrower (and other indemnitors) to agree to indemnify the lender against potential environmental liability. This is typically accomplished either in the mortgage or a separate environmental indemnity agreement.

### **3.9 Effects of Borrower Becoming Insolvent**

Lenders should consider the general principles of US federal bankruptcy law. Typically, loan documents will include provisions dealing with a borrower's potential bankruptcy (eg, making a borrower or related party's bankruptcy an event of default under the mortgage), but such provisions are of limited or no value in a bankruptcy proceeding.

#### **Borrowers Filing Bankruptcy Petitions**

When a borrower files a bankruptcy petition, there is an automatic stay of all actions against a borrower's property, including foreclosure. If a security interest is foreclosed prior to the bankruptcy filing, then, in the absence of some defect in the foreclosure process, the foreclosed property does not become part of the borrower's bankruptcy estate and the lender is free to exercise its state law rights regarding the property, including taking possession. Even in that scenario, a lender may be forced to ask the bankruptcy court for permission via a motion for relief from the automatic stay to oust a borrower who remains in possession of the property. In addition, the foreclosing lender may have an unsecured claim (a deficiency claim) to assert against the borrower in bankruptcy.

Alternatively, if a secured lender fails to foreclose its lien prior to a borrower's bankruptcy filing, the lender will be forced to participate and assert its rights in the borrower's bankruptcy case. Typically, a lender will file a proof of claim and, depending on which bankruptcy chapter the borrower files under (eg, Chapter 7 (liquida-

tion), or Chapter 11 or 13 (business or consumer reorganization, respectively)), will participate in the confirmation process as to the borrower's proposed plan of reorganization. While in bankruptcy, the lender may assert the rights granted to it under the relevant loan documents; however, those rights are tempered by the Bankruptcy Code.

### **Petitioning the Court**

Prior to taking many actions that would otherwise be allowed outside of bankruptcy, a lender must petition the court for relief from the automatic stay. In addition, as to non-residential property that is not a borrower's homestead, a lender's secured lien can be "valued" – ie, bifurcated into secured and unsecured portions after a valuation hearing with the bankruptcy court. Likewise, a wholly unsecured junior lien may be "stripped off" the property and treated as completely unsecured in certain circumstances.

### **Defaults**

Outside of bankruptcy, a borrower's insolvency will ordinarily lead to a default under the terms of the relevant loan documents and subsequent foreclosure of the secured collateral. In the commercial context, and depending on the commercial loan and property's size and characteristics, a borrower's insolvency might lead to a receiver being appointed under Alabama law; see Alabama Code 1975 Section 6-6-620 to -628.

### **3.10 Taxes on Mezzanine Loans**

There are no taxes related to mezzanine loans.

## **4. PLANNING AND ZONING**

### **4.1 Legislative and Governmental Controls Applicable to Design,**

### **Appearance and Method of Construction**

Local municipal corporations (cities and towns) may enact zoning laws and regulations through the creation of a comprehensive zoning ordinance, which must be compatible with the enabling statute (Alabama Code 1975 Section 11-52-1 et seq). Zoning laws generally designate areas into business, industrial, and residential districts, and control the type, character, kind, and use of structures and improvements in such designated zones or districts (Alabama Code 1975 Section 11-52-70). County governments may also enact zoning ordinances and building codes for flood-prone areas outside of municipalities (Alabama Code 1975 Section 11-19-3).

Private restrictive covenants in the property's chain of title may also create similar controls on the development of property or refurbishment of an existing building.

### **4.2 Regulatory Authorities**

Local zoning laws are passed by the local municipal planning commission and must be consistent with the local comprehensive plan, in accordance with Alabama Code 1975 Section 11-52-3. Zoning laws typically control the permitted shape, proportion and dimensions of lots and structures located thereon, the use of such structures and setback requirements, as well as the use of parcels in designated zones or areas.

For certain redevelopments (such as brownfield developments), the Alabama Department of Environmental Management may have recorded restrictions on use, development, etc, into the chain of title of a property.

### **4.3 Obtaining Entitlements to Develop a New Project**

Developers typically begin by engaging certain consultants like architects and civil engineers, and begin contacting the local planning depart-

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ment for guidance on the permitting process, as some municipalities advise developers to hold a pre-application review meeting to streamline applications. Developers should first review the applicable zoning laws for the project and obtain approval from the local zoning official/department before moving forward to apply for a building permit.

Depending on the project’s size and complexity, a developer may be required to obtain approval from the municipality’s planning, zoning, engineering, traffic engineering, inspection, water pollution control, natural resources, or legal departments (among others) before obtaining building permits. If a project requires a change to the zoning code, vacation of road, etc, public hearings are held and third parties are permitted to comment and object during such public hearings. Local non-attorney professionals (civil engineers, etc) may be able to provide guidance on local customs to help navigate this process.

#### **4.4 Right of Appeal against an Authority’s Decision**

The process of appealing a decision regarding an application for permission to develop a property will vary based on the project and jurisdiction, and interested parties should consult the relevant state and local laws.

#### **4.5 Agreements with Local or Governmental Authorities**

The process of obtaining permits and approvals varies among different local governmental authorities and utility companies. Planned unit developments are sometimes used or required by a local government to facilitate the development of a project. Interested parties should consult the relevant local authority for further details.

#### **4.6 Enforcement of Restrictions on Development and Designated Use**

The first governmental enforcement mechanism to restrict development or designated use of a specific property is for a local planning department to refuse to issue a building permit. After issuance of a building permit, restrictions on development or designated use are enforced by an inspector named by the designated zoning official/administrator. The zoning official/administrator is generally authorized to appoint inspectors and seek assistance from other municipal departments to determine if a violation has occurred.

Private parties may also place restrictions on the development or use of real property by the creation of a restrictive covenant that runs with the land. The Alabama Supreme Court has recognized that “[a] covenant is an agreement or promise of two or more parties that something is done, will be done, or will not be done. In modern usage, the term covenant generally describes promises relating to real property that are created in conveyances or other instruments”; *Collins v Rodgers*, 938 So 2d 379, 385 n 15 (Alabama 2006).

In the real property context, restrictive covenants are generally memorialized by:

- restrictive language in a conveyance instrument;
- an express Declaration of Covenants, Conditions, and Restrictions created by a single property owner; or
- an Agreement for Covenants, Conditions, and Restrictions agreed to by two or more property owners, all of which may be recorded in the probate office of the county of the encumbered property.

Such private restrictive covenants may be enforced by the parties to the covenant or the

successor in title to such a party. However, Alabama does follow a “general rule that restrictive covenants are not favored in the law and, therefore, that they will be strictly construed, with all doubts resolved in favor of the free and unrestricted use of land and against the covenants”; *Whaley v Harrison*, 624 So 2d 516, 518 (Alabama 1993).

## 5. INVESTMENT VEHICLES

### 5.1 Types of Entities Available to Investors to Hold Real Estate Assets

Alabama law authorizes the formation of corporations, general partnerships (GPs), limited partnerships (LPs), limited liability companies (LLCs), and real estate investment trusts (REITs) for the purpose of holding real estate.

The most frequently used ownership entities in Alabama are LLCs and LPs (including limited liability limited partnerships). Generally, LLCs are preferred to LPs as investment vehicles because none of an LLC’s owners (“members”) are liable for the entity’s debts and obligations, while an LP is required to have at least one partner (the “general partner”) who is liable for such debts and obligations. LLCs also have a potential tax basis advantage over LPs in qualifying for non-recourse basis treatment for an entity-recourse debt. Alternatively, an LP may be preferable if certain owners are not US citizens and the requirements of their home country’s tax laws would impose additional tax burdens upon them otherwise.

Both LPs and LLCs are usually preferred over corporations (other than REITs, as described below) because corporate income is taxed at the corporate level, and then the dividends paid to the corporate owners (“shareholders”) are taxed again.

Corporations that own real estate often do so in connection with their trade or business (eg, factories).

Other entity types can be used to hold real estate assets as well, such as S-corporations and general partnerships, but their use is infrequent due to taxation and liability concerns, respectively. REITs are corporations or business trusts that elect REIT status, allowing them to pass-through income to their owners, like LPs and LLCs; however, because of the complex qualifications required of REITs under the US tax code, investments in REITs are normally limited to large income-producing assets or portfolios of assets. Many REITs are formed as Maryland corporations.

### 5.2 Main Features of the Constitution of Each Type of Entity

With respect to LPs and LLCs, almost all features of their operations are negotiated among the partners or members in an LP’s limited partnership agreement or in an LLC’s limited liability company agreement, including how and by whom decisions are made and how the economics are divided. Major decisions typically require the consent of the partners or members and often include:

- a sale or refinancing of the principal asset;
- certain major leases;
- construction matters, such as budgets and hiring of contractors; and
- decisions affecting the continuation of the entity, such as merger, termination and bankruptcy.

These agreements also establish the priorities of economic distributions and the payment of agreed-upon fees among the partners or members, and provide how and when additional capital may be called from the partners or members. It is important that these agreements properly

address income tax considerations, because the allocation of economic benefits and tax liabilities of ownership must comply with detailed regulations under the US tax code or risk having unintended tax outcomes. Finally, both types of agreements will generally have provisions allowing for certain owners to buy the interests of other owners, or to have the assets sold under certain circumstances.

### **Corporate Statutes and Judicial Decisions**

Many activities of corporations, including REITs, are governed by Alabama corporate statutes and judicial decisions. In closely held corporations, the owners (shareholders) may enter into a shareholders' agreement which establishes, among other things, how votes are cast and how interests in the corporation may be bought and sold or otherwise transferred. Economic distributions within corporations are generally less flexible than distributions within LPs and LLCs. Each share in the same class of ownership shares is entitled to the identical economic distribution as each other share in that class. In order to allocate economics in a corporation differently among shareholders, multiple classes of shares must be created with different priorities of payments and claims on a corporation's distributions.

### **5.3 Tax Benefits and Costs**

If an entity is a pass-through entity for federal income tax purposes, it also will be a pass-through entity for state income tax purposes in Alabama, but it will need to file an appropriate state tax form to facilitate direct taxation of the owners of the entity. Alabama imposes an income tax on corporations but does not separately tax REITs.

The mere ownership of real estate in Alabama does not require the entity to qualify or register to do business in Alabama, but this generally applies to the ownership of undeveloped land.

Common attributes of active ownership, such as development and leasing of real estate in Alabama, require an entity organized elsewhere to qualify to do business in Alabama. An annual business privilege tax is levied in Alabama for the privilege of being organized under the laws of Alabama or doing business in Alabama.

The privilege tax is reported to the Alabama Department of Revenue on an annual report, which is a simple statement confirming basic information about the entity. The privilege tax is currently USD100 per year, and the initial tax return is due within two-and-a-half months of the initial formation, organization or incorporation of the entity.

Accounting costs for non-tax state filings will not, as a rule, be significant as those filings typically do not contain significant financial information. On the other hand, tax filings and the accounting costs related to those filings will be more significant and will depend on the complexity of the particular company and the amount and nature of its assets and income.

## **5.4 Applicable Governance Requirements**

### **LP Governance**

The governance structure of LPs is set out in the agreement of limited partnership and generally provides that most decisions are made by the general partner. Alabama law allows certain voting rights for the limited partners without jeopardizing their status as limited partners; however, one of the reasons that limited partners do not have liability for the obligations of an LP is that they generally do not have control of the day-to-day activities of the partnership.

### **LLC Governance**

In an LLC, there are two types of governance structures. One is the "member-managed" structure where the members are responsible for

managing the limited liability company. How the members make decisions – by majority, super-majority or unanimous vote depending on the nature of the decision and the relative weight of each member’s vote – is set forth in the limited liability company agreement.

The other structure is a “manager-managed” limited liability company in which a person or entity (who may or may not be a member) is designated as the manager with decision-making rights as set forth in the limited liability company agreement. The members who are not managers often retain the right to consent to certain major decisions. A manager can be one person or several persons each having the ability to act independently or being required to act – similar to a board of directors of a corporation – by majority, super-majority or unanimous vote, depending on the nature of the decision and the relative weight of each member’s vote as set forth in the limited liability company agreement.

### **Corporation Governance**

For corporations, including REITs, governance is set forth in their articles of incorporation and their bylaws. The articles of incorporation are a filed, public document containing certain statutorily required information, such as the name, registered office and registered address of the corporation. The bylaws govern how shareholders vote for the members of the board of directors, how the board elects officers, the duties of the officers, the frequency of shareholder meetings, the frequency of board of directors’ meetings, and other routine matters.

In most corporations, all day-to-day decisions are made by the officers without the approval of owners who are not officers. Certain decisions outside the normal course of business will be made by the board of directors, again without input from owners who are not part of the board. Unless an owner is a director or officer, its only

governance right is to periodically vote for members of the board, or in connection with certain statutorily required matters, such as merger transactions.

## **6. COMMERCIAL LEASES**

### **6.1 Types of Arrangements Allowing the Use of Real Estate for a Limited Period of Time**

A real property’s fee owner may grant a leasehold estate or license to permit others to occupy and use the owner’s real property for a limited timeframe. Leasehold estates allowing a tenant to occupy and use real estate without buying it outright are generally categorized into:

- a tenancy for years;
- a periodic tenancy; or
- a tenancy at will or at sufferance.

A tenancy for years is a leasehold estate “limited to endure for a definite and ascertained period, fixed in advance”; *Waldrop v Siebert*, 237 So 2d 493, 494 (Alabama 1970).

A periodic tenancy is one where the lease has no stated duration and periodic rent is reserved or paid; *Gulf Coast Realty Co, Inc v Prof’l Real Estate Partners, Inc*, 926 So 2d 992, 1007 (Alabama 2005). In Alabama, if no time for termination is stated, the law construes the term to be from December 1st to December 1st (Alabama Code 1975 Section 35-9-3).

A tenancy at will or at sufferance is a lease “for an indefinite and uncertain term”, and is sometimes called a tenancy from month to month; *Melson v Cook*, 545 So 2d 796, 796 (Alabama Civil Appeal 1989). If a lease is specified as a tenancy at will, it may be terminated by either party at will by giving ten days’ notice in writing (Alabama Code 1975 Section 35-9-3).

## 6.2 Types of Commercial Leases

There are no formal, legal distinctions between different types of commercial leases; however, commercial leases are generally divided between "net" leases and "gross" leases. In a net lease, a landlord charges its tenant a base rent plus additional rent for "pass-through" items like common area maintenance, insurance costs, advertising, etc, which pass-through items will vary based on the terms negotiated by the parties.

In a gross lease, a landlord charges its tenant one flat fee for rent and the landlord is responsible for the property's maintenance costs; however, such maintenance costs are typically accounted for in the amount of the gross lease's base rent. Furthermore, certain categories of commercial leases such as shopping center leases or oil and gas leases often contain specialized terms that are unique to the subject matter involved.

## 6.3 Regulation of Rents or Lease Terms

There are no restrictions on the type or amount of rent charged under a commercial lease in Alabama. A lease term may not be longer than 99 years (Alabama Code 1975 Section 35-4-6). If any portion of a lease term is longer than 20 years, the lease or a lease memorandum must be recorded within one year of signing, or the portion of the term exceeding 20 years is invalid (Alabama Code 1975 Section 35-4-6).

Residential leases are generally more regulated than commercial leases, and are subject to the Alabama Uniform Residential Landlord and Tenant Act (Alabama Code 1975 Section 35-9A-101, et seq). For example, under a residential lease, a landlord may not charge a tenant for certain fees – landlord's attorneys' fees, costs of collection, etc (Alabama Code 1975 Section 35-9A-163).

## 6.4 Typical Terms of a Lease

Lease terms range from less than one year up to 99 years, depending on the terms of a specific lease.

Landlords typically maintain structural components of leased real estate, while tenants are often required to maintain the leased premises and those systems and improvements serving the leased premises in good working order, though the extent of such maintenance responsibilities varies widely.

Monthly rent payments are typical, but the parties may agree to different terms.

## 6.5 Rent Variation

The rent payable may vary between different payment periods during the term, based on the lease's terms, typically increasing as time passes during the term.

## 6.6 Determination of Changes in Rent

Changes and increases in rent will be determined by the terms negotiated by the parties in the lease.

## 6.7 Payment of VAT

There is, typically, no governmental tax collected on rent paid to a landlord. However, transfer taxes are due when a lease (or memorandum of lease) is recorded in the public records in an amount equal to the tax consideration. Tax consideration = (term of lease in months) x (monthly rent) x (percentage from lease percentage chart)/1000.

The foregoing lease percentage chart is held by the probate court of the county where the property is located, is based on the lease's term, and varies in amount from county to county. Tax consideration is rounded up to the nearest USD500 (Alabama Code 1975 Section 40-22-1(c)). Furthermore, some municipalities charge revenue-

based license fees for entities doing business within the municipality, and the rental of property is a category of business that requires the payment of such annual fees.

### **6.8 Costs Payable by Tenant at the Start of a Lease**

Costs paid by a tenant at the start of a lease vary by the transaction and the parties' negotiation. Tenants may pay the first month's rent, a security deposit, broker's fees, or other landlord administrative fees at the start of a lease, in addition to rent.

### **6.9 Payment for Maintenance and Repair**

Net commercial leases often pass through operating expenses (including common area maintenance and repair) to the tenant, in accordance with the lease's terms, typically prorated among the tenants of a specific property based on the amount of square footage leased by each tenant at said property. Gross commercial leases typically require the landlord to pay for common area maintenance and repair, though these costs are also typically priced into the rent paid by the tenant.

For a residential lease, the landlord is required to "keep all common areas of the premises in a clean and safe condition", along with other requirements for the leased premises' working order and condition (Alabama Code 1975 Section 35-9A-204).

### **6.10 Payment for Services, Utilities and Telecommunications**

Net commercial leases often include utilities and telecommunications services serving an entire property (not just an individual tenant's leased premises) in the operating expenses that are charged to tenants on a pro rata basis, while gross commercial leases may include the costs of such services, utilities and telecommunica-

tions in the rent charged to the tenant. If such utilities or services are separately metered and service only a single tenant's leased premises, that tenant is often responsible for the payment of such services.

### **6.11 Insuring Real Estate That Is the Subject of a Lease**

Payment of insurance premiums insuring leased real estate is typically done by a landlord, but such costs are often passed through to tenants as an operating expense in net commercial leases. Insurance coverages vary by property, but many commercial landlords carry general liability, casualty, flood, and fire insurance, as well as coverage for bodily injury, property damage, lost rents, etc.

### **6.12 Restrictions on the Use of Real Estate**

Landlords may limit the way commercial tenants use leased real estate, and often prohibit tenants from using the leased premises for certain exclusive uses negotiated with other parties. Applicable zoning laws and private restrictive covenants in the property's chain of title may impose further restrictions on tenant uses, though leases often require compliance with all applicable laws and restrictive covenants.

### **6.13 Tenant's Ability to Alter or Improve Real Estate**

The terms of a lease will dictate whether or not a tenant is permitted to alter or add improvements to real estate during the lease. Often, tenants may receive a tenant improvement allowance to induce signing the lease, requiring that a landlord either installs certain improvements on the premises or reimburses tenant for its costs related to the same.

Often, a lease requires a tenant to obtain the landlord's written approval for materials, plans, contractors, etc, involved in such improvements



before starting the construction or installation of such improvements. Furthermore, trade fixtures may generally be removed by a tenant, but the tenant may be held liable if they damage the underlying real property in the process of removal; *LaFarge Bldg Materials, Inc v Stribling*, 880 So 2d 415, 419 and 424 (Alabama 2003).

## 6.14 Specific Regulations

The Alabama Uniform Residential Landlord Tenant Act (Alabama Code 1975 Section 35-9A-101 et seq) governs any rental agreement ("all agreements, written or oral, and valid rules and regulations adopted under Section 35-9A-302 embodying the terms and conditions concerning the use and occupancy of a dwelling unit and premises") related to the rental of any dwelling unit (a "structure or the part of a structure, including a manufactured home, that is rented as a home, residence, or sleeping place by one or more persons") to a tenant ("a person entitled under a rental agreement to occupy a dwelling unit to the exclusion of others"); Alabama Code 1975 Sections 35-9A-141(13), (4), and (16).

This statute includes additional rules and regulations for both landlords and tenants in the residential context. Non-residential real estate leases may include specific restrictions related to the category or use of the leased premises, but such leases are generally not subject to specific regulations or laws, due to the use or category of the underlying leased premises.

## 6.15 Effect of Tenant's Insolvency

Leases often contain language stating that a tenant's insolvency or the filing of any bankruptcy petition (voluntary or involuntary) constitutes a default under the lease. However, if the lease remained in force at the filing of a bankruptcy petition, the leasehold estate is considered an asset of the tenant, which is protected by the Bankruptcy Code's automatic stay.

## 6.16 Forms of Security to Protect against Tenant's Failure to Meet Obligations

In addition to requiring a tenant to provide a security deposit under the lease, a lease may provide that a tenant grants the landlord a security interest in the furniture, fixtures, equipment, inventory, etc, located at or related to the leased premises. The landlord may file such a security agreement with all rights granted under the UCC or other applicable statutes.

A landlord may also require the tenant to deliver a letter of credit or personal guarantee for costs related to any default by a tenant under the lease. However, for residential leases, liens or security interests of a residential landlord in a tenant's household goods are not enforceable unless perfected before January 1, 2007 (Alabama Code 1975 Section 35-9A-425).

Commercial landlords are also granted statutory liens over crops grown on rented land (Alabama Code 1975 Section 35-9-30), and for the goods, furniture, and effects of a tenant or subtenant for rent due (Alabama Code 1975 Section 35-9-60).

## 6.17 Right to Occupy after Termination or Expiration of Lease

Generally, a tenant does not have the right to continue to occupy the leased premises after the expiry or termination of a commercial lease. When a tenancy is for a certain period of time and the term expires under the lease, the tenant is bound to surrender possession, without the landlord providing notice to quit or demand of possession (Alabama Code 1975 Section 35-9-8).

If a landlord has terminated the lease for a breach or default, the landlord must give the tenant notice of termination at least ten days prior to terminating a commercial lease (unless

the lease provides for additional time) (Alabama Code 1975 Section 35-9-6).

If the tenant does not deliver possession of the leased premises after demand as described above, the landlord may pursue an unlawful detainer action in the district court of the county where the premises is located (Alabama Code 1975 Section 6-6-330). The landlord's complaint must be served on the tenant at least six days before the hearing date (Alabama Code 1975 Section §6-6-332).

If the district judge rules in favor of the landlord, the court files a writ of execution, which requires the sheriff to restore the premises to the landlord (Alabama Code 1975, Section 6-6-337). The tenant may file an appeal of the judge's ruling within seven days, and a trial on the appeal is scheduled within 60 days of the date of the appeal (Alabama Code 1975 Section 6-6-350).

The landlord's right to possession will not be delayed by a tenant's appeal, and can only be prevented if the tenant pays all rent payable before the landlord regains possession by a writ of possession (Alabama Code 1975 Section 6-6-351).

### **6.18 Right to Terminate Lease**

Provided the remedy is included in the commercial lease, in Alabama, a landlord is typically allowed to terminate the lease for failure to pay rent or other amounts due under the lease in a timely manner, for default under the lease (sometimes after a required opportunity to cure), for violation of applicable laws, and for other terms specified in the lease.

For residential leases in Alabama, by statute, a landlord may terminate a lease by delivering written notice to the tenant specifying the acts or omissions causing the breach in the following cases:

- the tenant's material non-compliance with the lease;
- the tenant's intentional misrepresentation of a material fact;
- the tenant's material non-compliance with any of its statutory obligations; or
- the tenant does not pay rent when due (Alabama Code 1975 Section 35-9A-421(a) and (b)).

If the breach arises from unpaid rent or other curable breaches, the lease shall terminate within seven business days of receiving the notice if not remedied by the tenant, as specified in the statute. Other breaches are not curable, including intentional misrepresentation of a material fact and certain acts on the premises (eg, possession of illegal drugs or criminal assault); Alabama Code 1975 Section 35-9A-421(a), (b) and (d).

### **6.19 Forced Eviction Residential Lease**

For a residential lease, the landlord must give the tenant seven business days' notice of default; if the default is not cured, the landlord may file an unlawful detainer action, notice of which must be posted at the leased premises. The tenant then has seven days from the posting of notice to file an answer. Assuming the tenant does not answer, the landlord may file for a writ of execution with the district court for the county where the leased premises are located, which will be issued to the county sheriff, and it may take several weeks to actually serve and evict the tenant.

In total, the process can take several months or longer, based on the case's specific circumstances; see Alabama Code 1975 Section 35-9A-461. The terms of a specific lease may require the landlord to provide more time or comply with other additional notice requirements beyond those in the code.

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## Commercial Lease

For a commercial lease, the landlord must give the tenant ten days’ notice of default (or more, if required under the lease); if the default is not cured, the landlord may file an unlawful detainer action, notice of which must be posted at the leased premises. The tenant then has 14 days from the posting of notice to file an answer. Assuming the tenant does not answer, the landlord may file for a writ of execution with the district court for the county where the leased premises are located, which will be issued to the county sheriff, and it may take several weeks to actually serve and evict the tenant.

In total, the process can take several months or longer, based on the case’s specific circumstances; see Alabama Code 1975 Sections 6-6-310 to 6-6-353. The terms of a specific lease may require the landlord to provide more time or comply with other additional notice requirements beyond those in the code.

## 6.20 Termination by Third Party

Pursuant to its terms, a lease may be terminated by a third party in the case of a condemnation, or a foreclosure on the part of a lender that pre-dated the lease. In the event that the leased premises are condemned, “the lessee is entitled to share in the total award only in proportion to [its] interest” (State Highway Department v Lawford, 611 So 2d 285, 288 (Alabama 1992)), and if the fee owner is satisfied with the award for its interest in the property, but the leasehold owner is not, the circuit court can order a separate trial for the leaseholder on appeal – State v SouthTrust Bank of Baldwin City, 634 So 2d 561, 563-564 (Alabama Civil Appeal 1994). Payment is based on the fair market value of the leasehold interest.

## 7. CONSTRUCTION

### 7.1 Common Structures Used to Price Construction Projects

The type of pricing structure used for projects depends on several factors, including the current economic climate, owner desires, financing concerns, and public entity status. In commercial construction projects, there are typically more guaranteed maximum or “fixed price” contracts than open-ended “cost plus” contracts, while “fixed price” contracts are used almost exclusively in the public works sector.

### 7.2 Assigning Responsibility for the Design and Construction of a Project

In addition to what the parties would negotiate into written agreements for services, Alabama law requires a registered architect to sign off on plans for the design and construction of a project (Alabama Code 1975 Section 34-2-32). For projects of USD50,000 or greater, a contractor must be licensed by the Alabama Licensing Board for General Contractors (Alabama Code 1975 Section 34-8-9).

If there are engineering requirements, a licensed engineer must be consulted and the plans must be approved by that engineer. In addition, most trades are required to be licensed by their respective governing authority, such as plumbers/gas fitters (Alabama Code 1975 Section 34-37-1, et seq) and electrical contractors (Alabama Code 1975 Section 34-36-1, et seq). The project’s owner will typically employ an architect and engineer to work with a general contractor to conceptualize the project, and the general contractor then delegates subcontracts as necessary, often without being subject to owner approval, unless the owner contractually retains that right.

### **7.3 Management of Construction Risk**

Owners and general contractors frequently utilize insurance policies and indemnification agreements in their contracts with each other and in particular with their subcontractors. Under Alabama law, contribution among joint tortfeasors is unavailable, so the only method to obtain contribution is to contractually oblige the counterparty to indemnification. Waivers are generally acceptable, and both interim and final lien waivers are highly recommended.

Each payment on a pay application should be accompanied by an interim lien waiver, and the final payment (including retainage) should be accompanied by a final, unconditional lien waiver and hold harmless agreement. Furthermore, limitations or caps on liability can be negotiated into the contract between an owner and the general contractor, in addition to provisions requiring the contractor to post payment and performance bonds from a reasonably acceptable surety.

### **7.4 Management of Schedule-Related Risk**

Delays in construction should always be addressed in the contracting documents. While a "penalty" is not available, the contract can provide for an agreed upon "liquidated damages" provision providing for a certain amount allocated for each day, week, or month that the project is behind schedule, or for each milestone missed. Delay damages can be accounted for as a "back charge" to the contractor to be deducted from payments due.

As additional security for paying material suppliers or remedying defects and delays in construction, owners and general contractors are entitled to hold back retainage; see Alabama Code 1975 Section 8-29-3. An owner or general contractor may retain 10% of payments to the general contractor or subcontractor, respectively; Alabama Code 1975 Section 8-29-3(i) and (j).

The retainage may only be taken from the first 50% of the payments for completion, after which "no further retainage shall be withheld"; Alabama Code 1975 Section 8-29-3(i) and (j). Some construction contracts do incentivize work to be performed ahead of schedule or at a cost below budget.

### **7.5 Additional Forms of Security to Guarantee a Contractor's Performance**

Depending on the project's size, payment and performance bonds are the most common form of security to guarantee a contractor's performance on a project. As a general rule, the larger the project, the more likely it is for an owner to require more expensive security on a project. Public works are required to be bonded (see Alabama Code 1975 Section 39-1-1), but there is no requirement for any security or bonding to be posted by a contractor on private work.

This is left to the contracting parties, who may employ whatever means they feel are necessary to provide adequate protection. The most common method is for the owner to require both a payment and a performance bond from a reputable surety. Other layers of security, such as letters of credit or personal guarantees, may be negotiated into the relevant contract if risk is increased.

### **7.6 Liens or Encumbrances in the Event of Non-payment**

Any contractor, laborer, material supplier, or other party who contributes work to the property that improves the property is eligible for a materialman's lien (see Alabama Code 1975 Section 35-11-210, et seq). The work provided must be a lasting improvement, not temporary. For example, an architect's work in providing plans would be lienable, whereas a surveyor's work would not; *Wilkinson v Rowe*, 98 So 2d 435 (Alabama 1957).

If the lienor's work is commenced prior to the "creation" of a mortgage on the property, the lien will take priority over the mortgage – otherwise, the lien will be junior to the mortgage (Alabama Code 1975 Section 35-11-211). Liens may be removed from the property by transferring the lien to a bond using the statutory framework found in Alabama Code 1975 Section 35-11-233.

## 7.7 Requirements before Use or Inhabitation

Each governmental jurisdiction has a building inspector's office, which must issue a certificate of occupancy prior to the project being inhabited. Each governmental jurisdiction establishes and adopts standards for construction in its respective jurisdiction. Inspections are typically required to be conducted, and passed, prior to moving on to each phase of the work.

## 8. TAX

### 8.1 Sale or Purchase of Corporate Real Estate

#### Recordation Tax

Alabama imposes a recordation tax upon the filing of a deed or similar instrument conveying an interest in real estate with the county probate court where the real property is located (Alabama Code 1975 Section 40-22-1, et seq); the tax is USD0.50 per USD500 (rounded up) of value for the property conveyed. The obligation for paying the recording tax is upon the buyer because the buyer is the party who tenders the deed for recording.

However, the parties do commonly negotiate that economic burden in real estate sales contracts. Under Alabama law, a deed or other instrument conveying such property must include a Real Estate Sales Validation Form (RT-1) provided to the county probate court at the

time the instrument is presented to the probate court for recording. This form must include either proof of the actual purchase price, if the property is being sold, or the actual value of the property (which may be evidenced by a licensed appraisal or the assessor's current value for the property).

#### Income Tax

Alabama imposes an income tax that is similar to the federal income tax system (Alabama Code 1975 Section 40-18-1, et seq). The maximum Alabama marginal income tax rate on taxpayers other than C corporations is 5%. The maximum Alabama marginal income tax rate on C corporations is 6.5%. The seller must report the gain on the sale of the real property on its annual income tax return. Unlike the federal income tax law, Alabama's income tax law does not contain a preferential rate for long-term capital gains.

#### Withholding of Income Tax

In addition, Alabama imposes a withholding of income tax in connection with the sale by non-Alabama resident taxpayers (Alabama Code 1975 Section 40-18-86). No withholding is required if the seller is an Alabama resident or a "deemed" Alabama resident, provided the seller provides a duly completed affidavit confirming such residency (AL Form NR-AF1).

Certain limited types of transactions are exempt from non-resident withholding under Section 40-18-86 (AL Form NR-AF3). If the seller is not an Alabama resident and if the transaction is not an exempt transaction, then the buyer is generally required to withhold either 3% (where the buyer is an individual) or 4% (where the buyer is an entity) of the purchase price.

However, if the gain recognized on the sale is less than the purchase price, and the seller provides the buyer with an Affidavit of Seller's Gain (see AL Form NR-AF2), then the buyer may withhold 3% or 4% of the amount of the gain.

If the amount to be withheld, as based on the purchase price or the gain, is greater than the net proceeds of the transfer, then only the net proceeds need to be withheld and remitted by the purchaser. Generally, the net proceeds of the sale are the net payments to the transferor as shown on the closing statement, but "net proceeds" may be calculated in other statutorily prescribed manners.

### **8.2 Mitigation of Tax Liability**

If the property being conveyed is located in more than one county in Alabama, there is a procedure to obtain an order from the Alabama Department of Revenue to allocate the value of the property being conveyed among the relevant counties so that the proper recording tax in each county can be determined.

### **8.3 Municipal Taxes**

Each municipality is permitted to impose an annual business license tax on business conducted within its taxing jurisdiction, including from the business of leasing real estate. The business license ordinances imposed by municipalities in Alabama vary based on jurisdiction.

### **8.4 Income Tax Withholding for Foreign Investors**

Alabama has two withholding regimes related to income taxes attributable to non-Alabama resident taxpayers, including non-US taxpayers.

#### **Income Tax Withholding Regime**

The Alabama income tax withholding regime related to sales of Alabama real estate is addressed in Section 40-18-86 of the Alabama Code, as summarized above. In addition, non-Alabama resident owners of pass-through entities such as partnerships or S corporations are subject to a composite payment regime under Section 40-18-24.2 (relating to partnerships and other "Subchapter K entities") and Section 40-18-176 (relating to S corporations).

### **Composite Payment Regime**

Under the composite payment regime, the pass-through entity files and directly remits taxes to the Alabama Department of Revenue with respect to the allocable pass-through income of the non-Alabama resident taxpayer, including the share of gain from the sale of real estate by the pass-through entity.

### **8.5 Tax Benefits**

Alabama provides income tax benefits (such as depreciation deductions) under Alabama's income tax law, which are generally consistent with the federal income tax system.

In certain circumstances, Alabama law provides for tax incentives with respect to certain qualifying investments in the state, such as the creation or expansion of industrial or research facilities, various jobs credits, data processing centers, the relocation of corporate headquarters, investments to rehabilitate certain historic structures, and other qualifying projects. The potential incentives may include abatements related to income tax, state and local sales and use tax, state and local ad valorem tax, and state recording taxes.

However, in order to qualify for such incentives, the taxpayer must file the required applications and reports and be approved by the proper governmental authorities in Alabama, and the approved investment must comply with additional compliance requirements. A summary of Alabama's taxes and tax incentives can be found on the website of the Alabama Department of Revenue.

### **8.6 Key Changes in Federal Tax Reform**

In general, Alabama conforms to federal income tax law on a rolling basis (ie, automatically), and therefore Alabama's income tax laws largely incorporate the recent federal income tax law changes. For taxpayers other than C corpora-

## **ALABAMA** LAW AND PRACTICE

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tions, most (but not all) of the federal tax provisions affected by the recent federal tax reform legislation are also incorporated by reference into Alabama’s income tax system. Importantly, however, individual taxable income is not automatically coupled with its federal counterpoints.

Due to Alabama’s automatic coupling for C corporations but not for individuals, Alabama’s income tax law treats the types of taxpayers differently.

See **1.3 Impact of New US Tax Law Changes.**

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**Dentons Sirote PC** has a real estate team comprised of 19 attorneys, located throughout the state of Alabama, serving clients across the United States and adept at handling the myriad of needs pertaining to real estate developers and investors, including assisting clients in procuring capital and credit, often combining con-

struction, permanent, mezzanine and tax credit facilities with equity participations. The team also handles zoning and other land use matters, as well as litigation and controversies, including eminent domain, design and construction, environmental regulatory enforcement, ejectments and dealing with insolvent counterparties.

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## Trends and Developments

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### Trends in the Real Estate Industry

#### *Introduction*

Overall, 2020 was not a normal year, with COVID-19 impacting real estate throughout the USA.

According to the US Bureau of Economic Analysis, the United States has only seen 40 negative quarters in the past 70 years, with the negative first quarter of 2020 revealing the initial economic component of the pandemic. Real GDP in the second quarter of 2020 declined by 31.4 negative percentage points, the most severe quarterly shrinkage since World War II. After that sharp economic shock, GDP recovered strongly, although not fully, with a 33.1% increase in the third quarter, which was the largest quarterly increase since the 1940s.

The same economic whiplash that was reflected in these US GDP numbers was felt in Alabama's real estate industry, and this chapter will summarize how COVID-19 and more general real estate trends have shaped the market in this state over the past year.

#### *General COVID-19 trends*

Compared to many other states, Alabama's major use and occupancy restrictions were short-lived. Starting in late spring 2020, Governor Kay Ivey lifted or reduced the stouter mandates, opening the state for business with certain social distancing requirements by summer 2020. As a result, COVID-19's impact on real estate in Alabama, particularly on segments such as retail and hospitality, was likely less pronounced than the impact that COVID-19 had in some states.

Because Alabama was essentially reopened by summer 2020, the landlords, tenants, developers, borrowers, lenders and other market participants who were able to reasonably work out short-term extensions, amendments, forbearance agreements and other standstill arrangements early in the COVID-19 pandemic were often able to move forward in 2020 without as much disruption as may have been initially feared. From February through to April 2020, there was a tide of legal work for real estate counterparties (eg, lenders and borrowers) to issue notices and negotiate amendments and extensions. This increase in requests and calls for work focused on force majeure clauses, Alabama common law applications of impossibility and frustration of purpose, and potential remedies for the same, as well as bankruptcy protections and creditors' rights. Once the CARES Act was signed into law in late March 2020, there was also a flood of legal work and requests from real estate clients to understand and apply for PPP loans.

Positives aside, the economic uncertainty facing residential and commercial tenants, including potential tenant bankruptcy filings, has been a major concern for landlords, given 2020's economic downturn. In some sectors, businesses have found it impracticable to continue normal obligations, likely leading to a surge of breach-of-contract litigation. Reasons given will be force majeure and the common law doctrine of "impossibility".

The COVID-19 pandemic has been unique because, rather than an imbalance between supply and demand, the public health crisis has

resulted in a temporary reduction of demand, and the ability to use past data to forecast the future is more limited than ever. However, the assumption from many in the industry is that an economic recovery is well underway and that the vaccination push will assist with a return to more normal times.

## *Multifamily*

Though the apartment sector has faced adversity during the pandemic, this area also has long-term strength going for it. Families' net incomes have increased by 10% over the past five years, and, consequently, high-end apartments have been built at a rapid pace across Alabama's major metro areas. Nearly half of the millennial generation is in its 20s, and the even-larger Gen Z is right behind it. These demographics, coupled with empty nesters, will be sure and important sources of demand for multifamily units in the coming years, despite COVID-19's impact.

In Huntsville, vacancies have increased recently, though this was mostly due to new properties being built and churned out. (As would be expected, vacancy rates in mid-2020 were at a historical low; people were staying put during the pandemic). Congruently, property managers were raising rent in Huntsville at one of the fastest rates in the country. There are fewer vacancies than ever before, despite the high price points.

## *Annual sales and property markets*

Annual sales volume set a record in 2020, with nearly USD500 million in assets trading. Toyota and Mazda continue to announce new job possibilities in 2021, along with Google, Aerojet Rocketdyne, and Polaris, fueling Huntsville's real estate growth. The projection is that vacancies will rise considerably above the national average, above three percentage points, in the next two to three years, before settling down again. This is because of the new units being constant-

ly churned out, and the pandemic did not stop all growth.

Although Huntsville has been the fastest growing of Alabama's primary metro areas, multifamily real estate, both new developments and existing properties, continues to be hot in other Alabama markets. That said, even with this segment of the real estate market remaining relatively strong, COVID-19 has certainly hit some tenants and landlords much harder than others, and eviction moratoria and rent relief programs have been two of the dominant COVID-19-related multifamily issues during the pandemic. In situations where tenants have suffered financial hardships due to COVID-19, the Federal Emergency Rental Assistance program has helped multifamily landlords and tenants work together with respect to delinquent rent. However, many owners of Class A properties have not had enough delinquencies and tenants in need of full-scale assistance for the program to be applicable to them.

## *Job growth*

In the Alabama markets where there has been good job growth, credit has been readily available throughout the past year for development and new construction of units. Throughout the state, financing has also not been an issue for multifamily investors seeking to buy existing apartments. Therefore, despite the pandemic, there was a decent volume of closings in 2020. LIBOR continues to be used to price many loans, and the upcoming LIBOR sunset has triggered new provisions allowing lenders to select replacement rates. Borrowers have had very little leverage to make changes to such provisions, meaning that lenders have been successfully ensuring that they will have substantial leeway to select replacement rates and the process accompanying that change.

For new construction, higher costs for lumber and other materials have had a noticeable

impact. However, because workers in the housing industry were deemed essential and Alabama's lockdowns were relatively short term, many projects have been able to proceed and/or be completed with limited or no delay.

## **Suburbs**

Suburbs were already in a resurgence prior to the pandemic, but COVID-19 has accelerated this boom. Half of all recent home purchases were in the suburbs, while only 13% were in a central city.

The suburban revival is buoyed by slow timelines to completely return to office spaces. The resulting outcome makes sense: if more people are staying at home in their suburbs, they're more likely to shop and support businesses in their immediate areas. The average work-from-home employee saves nearly 28 eight-hour days in terms of lost productivity. Just as businesses followed the labor force into cities, some are likely to follow them into the suburbs, particularly given the lower rents and commute times.

Though millennials are no longer the youngest generation in the workforce, they are still a vital source of talent and the focus of HR professionals. They also remain the largest group in the workplace, with the power to set and maintain trends and request change, particularly accommodation for work-from-home flexibility and co-working solutions. The number of young home buyers will peak at 24 million in a few years, and their home buying decisions are disproportionately based on convenience and proximity to work; in other words, the decision on where to purchase a home is in direct relationship to the location of their jobs. And, despite rumors, millennials are buying homes, just at a later age than their parents; the median age for home buying is 33, and in many markets, it is less expensive to purchase a house and make mortgage payments than it is to pay rent – or, if mortgage

payments are a few hundred dollars higher, at least buyers feel that they are making a long-term investment.

Coupled with these eager young home buyers are those who are finally recovering from the Great Financial Crisis, resulting in a pent-up demand for quality homes in convenient locations. It's a seller's market, as anyone who has recently tried to purchase a home likely knows.

As the fastest-growing city in Alabama, Huntsville's major companies like Google, NASA, and Boeing are continuing to recruit educated workers, particularly from the 24–34-year-old demographic, into the local real estate market. This demographic has held home ownership rates steady, especially those with household incomes of greater than USD100,000.

## **Office**

Change for office work that was already in motion has been accelerated, and the pandemic may have hastened Alabama's recent decline in this sector. As is to be expected, the movement of office properties on the market was minimal. The rebirth of the suburbs that was already underway has been advanced by the pandemic, while central business district (CBD) rent premiums (although still significant) have continued a downward trend. The increase of work-from-home jobs could translate into increased vacancies and place downward pressure on rentals, and more companies may be seen renting in the suburbs as opposed to the CBD. According to the US Bureau of Labor Statistics, many of the jobs that were eliminated during the COVID-19 recession should return, particularly as more than 60% of Americans surveyed by the Gallup Panel have now worked from home, opening opportunities for jobs that have been reworked to fit a remote setup.

Office absorption has continued decreasing, reaching 41.3 MSF near the middle of 2020. While office space completions have leveled out and are nowhere near the high in 2002, the pipeline is still substantial and should see an uptick in the next year or two. Work-from-home or hybrid office schedules may persist post-COVID-19, but the trend towards office-using professional services (as opposed to those who work in manufacturing industries) has been growing, and, in the next ten years, one-quarter of all jobs are expected to be office using, which will catalyze the market again.

### *Suburbs and office space*

Perhaps surprisingly, the US suburbs account for approximately two-thirds of office space inventory and occupancy, with the past two years showing better leasing performance. Though vacancy has historically been higher in the suburbs, the gap between the CBD and suburbs had shrunk to a mere 35 basis points just prior to the pandemic. Annual growth rates for the suburbs have held steadier in the past five years than the rates for the CBD. Vacancy rates peaked in mid-2010, but rates declined faster in the suburbs than in the CBD. In fact, vacancy rates for the latter have increased over the past 18 quarters. From 2005–15 – just ten years – the CBD rent premium more than doubled.

The Birmingham office market, for example, ended Q3 of 2020 with a net absorption totaling negative 66,300 square feet and a vacancy rate of 9.5%. Leasing activity slowed as companies continued to feel financial pressures from the pandemic. Yet Cigna signed a lease renewal for the Chase Corporate Center, and Morgan and Morgan signed a 7800 square foot lease at “The Bird’s Nest,” so business hasn’t ceased altogether. Despite rising vacancies and softening demand, owners continue to raise rents at a fast pace, representing above-average growth for Birmingham and continued year-over-year

improvement, though that particular market is still trailing behind historical averages.

When reopening office spaces, building owners and managers should educate themselves and stay up to date on the newest regulations to avoid potential liabilities. Specifically, the CDC has directed building owners to review the guidance from the Building Owners and Managers Association (BOMA), which assembled a task group from across North America to develop best practices for owners and managers planning re-openings. BOMA recommends that owners meet with their risk managers and insurance brokers to review policies and coverage and assess new liability risks resulting from the COVID-19 pandemic.

### *Guidance for businesses and employers*

The CDC has also provided Interim Guidance for Businesses and Employers, which offers guidelines and recommendations for employers to protect their workers and clients. Owners and managers should also check their local and state requirements. For liability and safety purposes, it is wise to create a written COVID-19 workplace health and safety plan and communicate it to all tenants and staff. Specifically, the CDC has referenced the guidance provided in ASHRAE Standard 180-2018, Standard Practice for the Inspection and Maintenance of Commercial Building HVAC Systems. The best insurance building owners can have is to schedule and document an inspection of HVAC systems.

As businesses and buildings continue to reopen, employers and owners face the risk of claims from those who allege they were exposed to COVID-19 on their premises. Employers should take note that the virus, regulations, and laws are evolving in all respects and should remember that it is better to be safe than sorry. Alabama has passed laws limiting liability for COVID-19

exposure, while immunity legislation is pending at the federal and some state levels.

Current and potential real estate investors should carefully study each particular law, as they vary greatly regarding the types of businesses covered and the extent to which local health department guidance must be followed to qualify for immunity. Office owners and managers will want to review the new construction start-up guidance, particularly for HVAC systems that have been shut down or put on setback, and possibly consult with legal counsel to cover all of their bases.

#### *Employee safety*

Because employers are responsible for creating a safe and healthy workplace under OSHA, it is advisable that owners conduct a thorough hazard assessment of the workplace for any risks associated with COVID-19 transmission. Examples include assessing an open floor plan, size of restroom spaces, employees using one copy machine, and so on.

Managers and building owners have the monumental task of implementing employees' safety while continuing to maintain productivity, a strain that may be too great for some and result in the non-opening of buildings, or at least a delay in opening. Employers are encouraged to minimize the number of employees present at each worksite, modifying and adjusting seating to increase space between employees, establishing designated areas for pickups and deliveries, and limiting interactions, especially in common spaces. Disinfection requirements vary across localities but can be quite stringent, straining building owners' resources and abilities. If one employee in the building falls ill with COVID-19, it is the building operator's responsibility to notify all other tenants and occupants immediately.

Owners are also required to keep records of visitors and reports of symptomatic employees, along with a log of building cleanings and their scope. In the context of these COVID-created changes to the office landscape, another tenant and landlord trend worth mentioning is the increasingly common push for CAM and operating expense reconciliations with additional charges being passed through for office building expenses related to COVID-19 investments and extra cleaning requirements. These CAM and operating expense reconciliations have generated legal work, as landlords have needed to find ways to fairly account for pandemic expenses and the corresponding uptick in many tenants' proportionate share of operating expenses.

#### *Office space economy*

Generally speaking, high-priced office markets have held steady, evidenced by the asking rents in 2020 matching 2019 asking rents. Full recovery is anticipated to take 12 to 18 months, falling in the second half of 2022. Economists project that the office sector will improve, but it will take longer than other sectors. With all of that in mind, Alabama's office market has stayed comparatively steady.

In March 2020, most office workers in Alabama did shift to a work-from-home arrangement. However, office workers have tended to go back to the office earlier in Alabama than the national trend. This has been especially true for small-to-mid-size employers and local businesses, as some larger and national employers in Alabama have kept many of their office-working employees at home for a more extended period of time. In other words, office utilization in 2020 and early 2021 has almost certainly been higher in Alabama than in some other states.

Nonetheless, because Alabama has experienced varying levels of office building use, a trend of the past year has been blend and extend lease-

ing with some tenants seeking a reduction in the square footage of their leased premises.

## *Industrial*

Prior to the pandemic, e-commerce was gaining market share over traditional retail. The virus only accelerated this already-present trend during stay-at-home and lockdown orders. Online sales accounted for 16% of all US retail sales in 2019; that percentage jumped to over 20% during the height of the pandemic and has remained high since. Consequently, the acceleration in online sales has boosted the demand for industrial logistics spaces, of which the occupancy rate has hovered at 95% in the USA.

For example, Gateway Properties, LP, purchased an expansive property in the St. Clair County submarket for USD21 million. The largest lease deal in Q3 of 2020 involved Amazon leasing space in the Birmingham Food Terminal. However, with a lack of new constructions and the inflated cost of building supplies, investors are finding it harder to make their preferred deals.

Industrial spaces have only experienced a mild hit, with demand for these spaces holding relatively well during the pandemic. A notable trend during this time has been an uptick in legal work related to the rezoning and development of new warehouse and industrial projects with sale-leasebacks being used as a financing vehicle.

## *Traditional retail*

Traditional retail has suffered quite a bit, especially considering the stay-at-home orders and the resultant uptick in e-commerce. Retail spaces mimicked the trends in office vacancies. Looking at Birmingham as a microcosm for retail trends in the state, Q2 of 2020 showed a negative net absorption rate, marking the largest drop in over a decade, yet rent growth remained favorable for owners, with asking rates up 1.4% over the previous four quarters. Asking rent

rates remained up for Q3, while vacancy rates were hovering around a historical low of 2.7%. Encouragingly, one of the largest deals in Q3 of 2020 was the purchase of three Mapco gas stations in Montgomery and Birmingham, and the Dollar General in Parrish was sold for USD1.7 million. In Birmingham, most new deliveries on retail stores have only come as build-to-suit projects for established chains, while the little guys have been pushed out even more quickly by the pandemic.

Outdoor centers have fared much better during the crisis than enclosed malls because the direction of retail was already moving from isolated stores to community integration. There have been strong demands in the area from budget retailers who can more easily slide into suburban spaces. The enclosed mall spaces provide opportunities to rethink the properties' potential: many suburban malls can be converted into office and professional spaces.

For retailers without a traditional outdoors presence, it has not been atypical for leases to be amended to permit more outdoor use. Overall, as has been a national trend, the retailers that have been the most creative in adjusting to COVID-19 have tended to fare reasonably well compared to more flat-footed operations. The same has been true in the restaurant industry. For the most part, landlords have been supportive of these business changes, some of which may continue beyond COVID-19.

## *Tourism and entertainment*

The tourism, retail, entertainment, and health-care sectors fared poorly during the pandemic. Unsurprisingly, tourism has suffered one of the biggest blows from the pandemic and will be much slower to recover than other segments. Alabama's Gulf Coast is heavily reliant on tourism, so the decline in tourists has had a ripple effect on many businesses and individuals in

that part of the state. On top of COVID-19, the 2020 hurricane season was a particularly bad one for the Gulf Coast. Elsewhere in Alabama, restrictions on leisure and recreational activities, crowd limitations, and temporarily closed museums have very much slowed hospitality and entertainment real estate operations. However, Alabama and out-of-state tourists have been returning in recent months and the businesses that have survived should be nicely positioned to take advantage of a population that is getting vaccinated and very much beginning to return to pre-pandemic travel and leisure norms.

As an attempt to lessen COVID-19's economic toll, standstill agreements have been commonplace for hotels and other tourism and entertainment real estate ventures. Considering that there has been less "use" of hotels, another device used by some hotel operators has been the crafting of agreements allowing for a delay of the use of FFE reserves.

### **Construction**

Some major issues emerged for the future of construction during the pandemic. Stay-at-home and shelter-in-place restrictions limited the building of last year's commercial operations. Additionally, the cost of building materials rose exponentially this past year, so there may be fewer new builds and more repurposed buildings in the coming year.

Force majeure provisions are being invoked to address the unexpected delays associated with the pandemic, with specific reference to the impact of the pandemic on the project at issue, including temporary restrictions related to construction, government shutdowns of administrative offices, delays in approval, and lack of inventory available. Broadly speaking, existing force majeure provisions have been a widely discussed legal topic during the past year as many of these provisions do not directly address pandemics.

Relatedly, real estate and construction attorneys have spent considerable time in recent months both reviewing existing contracts and drafting or editing pandemic-aware force majeure language for new construction contracts, purchase and sale agreements, leases, loan agreements and other contractual documents.

In practice, real estate owners will need to continue considering COVID-19 safety compliance and prompt payment of contractors, emphasizing regular communications between all involved on a building project, and coordinating with material suppliers to avoid unnecessary delays, all of which create additional work and stress for owners. Due to pandemic-related construction delays, there may be an uptick in mediations and arbitrations; litigation attorneys should be prepared to deal with the increased flow by updating their knowledge on ever-evolving compliance laws. Will some of the potential buyers of office buildings be scared away by these regulations? Will current building owners throw in the towel and simply sell? These are certainly possibilities.

### **Conclusion**

The possibilities ahead of us depend on many factors: whether COVID-19 sticks around and continues to infect large segments of the population, whether the vaccines continue to prove effective and a large enough number of people participate, whether consumer optimism rebounds sufficiently, and whether and for how long certain use restrictions remain in place. Economically, the early months of the COVID-19 pandemic included the most severe global recession during the post-World War II era, with US employers cutting 22 million jobs in March and April 2020 alone. But after that major recession and the Q2 lockdowns, the global and US economy began picking up again. Whatever economic data analyzed – retail sales, road traffic, restaurant bookings, mortgage applications, oil consumption – at least a partial rebound from



## ALABAMA TRENDS AND DEVELOPMENTS

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the low levels observed in Spring 2020 will be shown. Further, besides the retail and entertainment sectors, many markets either weren't hit that hard or are recovering quickly. The types of real estate likely to benefit from accelerations brought on by COVID-19 include data centers, internet-related real estate, life sciences, and real estate in the suburbs.

Moody's Analytics cites the end of 2022 as the latest possible time that there may be a return to the 2019 level of GDP. Encouragingly, the US Bureau of Labor Statistics predicts the recovery from the COVID-19 recession in three years, compared to the six and a half years it took to stabilize after the Global Financial Crisis. The upside will be a flurry of activity in new real estate strategies when the pandemic is fully controlled.

**Dentons Sirote PC** has a real estate team comprised of 19 attorneys, located throughout the state of Alabama, serving clients across the United States and adept at handling the myriad of needs pertaining to real estate developers and investors, including assisting clients in procuring capital and credit, often combining con-

struction, permanent, mezzanine and tax credit facilities with equity participations. The team also handles zoning and other land use matters, as well as litigation and controversies, including eminent domain, design and construction, environmental regulatory enforcement, ejections and dealing with insolvent counterparties.

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