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US Regional Real Estate 2022

Alabama: Law & Practice
and
Alabama: Trends & Developments

Adam J. Sigman, Crystal Walls and Nathan Stotser
Dentons Sirote

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ALABAMA

Law and Practice

Contributed by:

Adam J. Sigman, Crystal Walls and Nathan Stotser
Dentons Sirote see p.24



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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 better 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 2021

In 2021, the COVID-19 pandemic was not the dominant force it was in 2020 for real estate in Alabama. The commercial real estate industry welcomed a “back-to-business” mentality following an unprecedented year, which began with an impressive economic return as the commercial real estate market continued to show resiliency.

As new variants of COVID-19 extended the pandemic state, Governor Ivey issued various Safer at Home/Safer Apart Orders along with mask mandates or encouragements; however, there were no required government shutdowns or major use and occupancy restrictions in Alabama. The state’s residential and vacation home markets were strong once again, and dining and retail operations continued to operate with mask requirements or suggestions. While many transitioned back to the office, the work-from-home infrastructure crafted by companies due

to COVID-19 necessities has become a more permanent option than pre-pandemic.

Significant Deals in 2021

Major companies with existing industrial and distribution hub facilities in Alabama, such as Mazda Toyota, Mercedes-Benz, and Amazon, have grown Alabama operations through increased development. Facebook announced an expansion to its Huntsville Data Center, which began serving traffic in 2021. Huntsville’s market continues to grow and will likely lead to additional real estate investment opportunities. Ongoing construction in Mobile will develop six million square feet of manufacturing and distribution space.

In Birmingham, the Protective Stadium, Alabama’s latest major sports venue, opened in the fall and hosted UAB football games and a sold-out 2021 Birmingham Bowl. It will also host the ceremonies for the 2022 World Games. The United States Football League, a professional football association with a spring schedule, announced Birmingham as the host city for the revived league.

With the ongoing addition to Grandview Medical Center, planned Midtown developments, and additional renovation, restoration, and development, including The Hardwick and Birmingham Building Trades Tower, there are many notable projects expected in Birmingham in 2022. These types of announcements and large, in-progress construction will likely generate additional real estate investment in 2022.

1.3 Impact of Recent 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

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.

1.4 Impact of COVID-19-Related Rules and Regulations

Governor Ivey terminated the coronavirus state of emergency in Alabama in 2021, and all restrictions and occupancy limits in the state have generally been lifted. While COVID-19 has clearly advanced trends in real estate, the lingering impact of COVID-19 rules and regulations in real estate will likely be minimal. As an example of trends, remote notarization was first allowed due to COVID-19 logistics, but, in 2021, Alabama adopted the Uniform Real Property Electronic Recording Act. See below.

Electronic Signatures and Filing; Remote Notarization

The Uniform Electronic Transaction Act (UETA) gives electronic signatures legal effect under the statute of frauds and is codified in Alabama Code Sections 8-1A-1 to -20. The Uniform Real

Property Electronic Recording Act (URPERA) allows documents with electronic signatures to be recorded and is codified in Alabama Code Section 35-4-120 to -127.

While Alabama Code Section 36-20-73.1 does not allow online or electronic notarization, it does allow remote ink notarization. Among its requirements, the notary must be physically located in Alabama, the notarial act must be recorded and kept for seven years, and the recording must include the date and time of the act, a record description, and a confirmation of the signatory’s identity.

County recording offices are not required to accept electronic recording, and, therefore, despite the adoption of these laws, parties should verify that the specific recording office accepts electronic signatures and documents notarized remotely and confirm that all parties involved in the transaction approve remotely notarized documents and electronic signatures. There are several electronic liaisons that offer e-recording services. For example, there are 31 counties in Alabama that allow e-recording of documents through Simplifile.

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 that 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) regarding (Alabama Code 1975 Section 35-4-90).

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 an 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 the 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 – see *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 who 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 (liquidation), 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 outside of taxes due on interest and income from the same.

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, such as architects and civil engineers, and begin contacting the local planning department for guidance on the permitting process since 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, such as civil engineers, 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 develop-

ment 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 mem-

bers 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, supermajority 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 1 December to 1 December (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 such as 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, such as 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, although 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 telecommunications 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 the 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 1 January 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 Expiry 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.

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 obligate 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 corporations, 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 counterparts.

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 Recent US Tax Law Changes.

Dentons Sirote has a real estate team comprised of 19 attorneys located throughout the state of Alabama who serve clients across the USA. As part of the global law firm Dentons, these attorneys are 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.

AUTHORS



Adam J. Sigman serves as a shareholder in Dentons Sirote's Real Estate and Corporate and Securities practice groups, representing developers and investors across a broad

spectrum of asset categories, including retail, office, industrial/warehouse, multifamily, healthcare and life sciences, restaurant and hospitality, entertainment and sports, education, and agricultural, ranch, and hunting properties. He also counsels real estate clients in their general corporate, intellectual property, management and operations, and tax planning matters. Adam is a member of the Real Property, Trust and Estate Law (RPTE) section of the ABA and is widely published.



Crystal Walls serves as a shareholder in Dentons Sirote's Real Estate and Corporate and Securities practice groups, representing a broad spectrum of clients in the commercial real

estate industry, including developers, owners, managers, and lenders, in local, regional, and national matters. Her practice also includes public finance, representing municipalities, counties and state agencies in various transactions.

Contributed by: Adam J. Sigman, Crystal Walls and Nathan Stotser, Dentons Sirote



Nathan Stotser is an associate in Dentons Sirote's Real Estate practice group, where he focuses on commercial real estate and commercial lending.

Nathan earned his JD from Samford University's Cumberland School of Law.

Dentons Sirote PC

2311 Highland Avenue South
Birmingham
AL 35205
USA

Tel: +1 205 930 5100
Fax: +1 205 930 5101
Email: marketing.us.dsp@dentons.com
Web: www.dentons.com/sirote

大成 DENTONS SIROTE

Trends and Developments

Contributed by:

*Adam J. Sigman, Crystal Walls and Nathan Stotser
Dentons Sirote see p.34*

Introduction

Overall, 2021 was a bounce-back year as the lingering impact of COVID-19 on real estate lessened throughout the USA. According to the US Bureau of Economic Analysis, the first quarter of 2021 saw a 6.4% increase in real GDP and a 6.7% increase in the second quarter as the nation continued to recover from a historically negative 2020, which included the most severe quarterly shrinkage in real GDP since the Second World War. With a lesser third quarter increase of 2.3%, the GDP again resumed its usual, positive trend in the fourth quarter at an annual rate of 7.0%. This same economic recuperation that was reflected in these US GDP numbers was felt in Alabama's real estate industry.

Construction pricing and supply-chain issues appear to be the dominant leftover force from COVID-19.

Relatedly, this has caused an increase in construction and supply contract disputes. While such disputes are not necessarily getting to litigation, they require a refreshed review of these contracts and dispute/resolution provisions. These issues have made every project very fast-paced and highly pressured.

In addition to real estate development sponsors moving at an incredibly high speed, investor capital seems to be moving as fast or faster. Joint venture equity agreements have been very prominent, with developer completion guarantees included as investor due diligence reduces to keep up with deal velocity.

This chapter will summarize how the lasting effects of COVID-19 and more general real

estate trends have shaped the market in this state over the past year.

General COVID-19 Trends

At the start of 2021, Governor Kay Ivey announced that certain individuals would be eligible to receive the COVID-19 vaccine. As vaccine eligibility expanded to all residents 16 years of age and older in April 2021, Alabama – like the rest of the USA – saw an attempted shift to normalcy. In the same vein, the Governor ended the coronavirus state of emergency in 2021. Although variants, such as Delta and Omicron, were thought to have contributed to spikes in 2021 in the nation and in Alabama, the economy and real estate market continued on an upward trend.

While Alabama's shutdown in 2020 was short-lived compared to many parts of the country, the impact of COVID-19 in 2021 could be felt by the increased demand in the supply chain and contractors. In Alabama's real estate market, the pandemic more often delayed projects and transactions rather than stopped them entirely. This caused 2021 to be extremely busy, as market participants were caught up on older deals and transactions while still starting newer ones. As developers continued to play catch-up, the need for construction materials and labor escalated. In turn, while Alabama is not necessarily experiencing a labor shortage, contractors and subcontractors are as busy as ever, which has caused a natural increase in construction costs and delays.

Multifamily

Although the apartment sector has faced adversity during the pandemic, this area also has

long-term strength going for it. Household net incomes continue to increase, and, consequently, high-end apartments have been built at a rapid pace across Alabama's major metro areas. Much of the millennial generation is still 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 any lingering COVID-19 impact. As people continue to show they love the flexibility of renting, multifamily remains one of the strongest sectors commercially.

In Huntsville, the apartment market continues to surge, boasting a 97% occupancy rate in apartments in the first quarter of 2021. Driven by the technology and aerospace sectors and blended with education and defense, the Huntsville multifamily market remains very popular. Interestingly enough, the cost to rent is actually decreasing in Huntsville, despite its population increasing, and it is difficult to predict whether this could be a trend beginning to spread throughout Alabama. However, as property managers have continued to raise rental rates in Alabama over the years, this slope will have to level eventually.

Repurposing retail properties into multifamily and mixed-use projects has become a new trend post-COVID; this has especially occurred with movie theaters, which suffered during the pandemic and typically have a lot of parking. These redevelopments have triggered an uptick in zoning/entitlements work, disputes (or threatened disputes) with neighbors and municipalities, and private title declarations and easement agreements.

Annual Sales and Property Markets

Sales tax collections in 2021 grew over 17% from the previous year, led by a record-setting November and December. Toyota, Mazda, and Mercedes-Benz, along with Amazon, Facebook,

and others, have grown or otherwise announced expansion plans that would lead to new job possibilities in 2022. By the end of 2021, home costs had grown 18% since September 2020.

Alabama's homeownership rate remains higher than neighboring and other states. Meanwhile, Alabama's rental vacancy rate rises well above the national average at over 12 percentage points. Although new units are constantly being churned out, the pandemic did not stop all growth. While 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 as well.

Job Growth and Lending

In conjunction with the labor shortages in the construction and development process, the amount of online job advertisements in Alabama was 41% more in November 2021 than the previous year. Experts expect the amount of job listings to increase as the economy grows and the unemployment rate shrinks. 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, the volume of closings continued its momentum in 2021. For new construction, higher costs for lumber and other materials have had a noticeable impact. Many projects have had to overcome delays and/or higher-than-usual prices in order to be completed.

The LIBOR sunset at the end of 2021 prompted new provisions throughout the year, 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. LIBOR will remain in the mix until at least 2023, but it will no longer be used to price new loans.

Late 2020 and 2021, we saw an uptick in loan amendments that were priced according to LIBOR to install max flexibility for the lender to select a new benchmark rate. New LIBOR real estate credit facilities also contained lender-flexible provisions to later select a new benchmark rate. In late 2021 and early 2022, we have seen many lenders select the Secured Overnight Financing Rate (SOFR). Being based on overnight transactions, SOFR relies entirely on transaction date, whereas LIBOR is based partially on expert estimations. Neither the amendments nor new loans using the SOFR benchmark caused any notable problems.

Suburbs

In 2021, the seller's market maintained its momentum, especially in the suburbs. If it is any indication, Montgomery and Mobile featured some of the largest increases in housing investments nationally.

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 are 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 main-

tain trends and request change, particularly accommodation for work-from-home flexibility and coworking solutions. The number of young homebuyers will peak at 24 million in a few years, and their homebuying 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. 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 homebuyers are those who are finally recovering from the financial crisis of 2007-2008, resulting in a pent-up demand for quality homes in convenient locations.

As the fastest-growing city in Alabama, Huntsville's major companies such as Google, NASA, and Boeing are continuing to recruit educated workers, particularly from the 24- to 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. Unlike in multifamily, which sees significant turnover from year to year, offices leases are generally much longer and therefore might not immediately portray the lasting impacts of the pandemic. While remote work was already growing in popularity, the pandemic jump-started a new normal for office work that creates an interesting dynamic for Birmingham and other cities

in Alabama. Birmingham's appeal and the general cost of living throughout the state could be enticing to young professionals with permanent remote professions.

Announced in 2021, Landing, a company creating a network of fully furnished apartments, will move its headquarters to Birmingham as it attempts to accelerate growth plans. Landing, in relocating its headquarters from San Francisco to Birmingham, suggests that companies, not just individuals, may be looking to transition to more affordable places for central hubs.

On the other hand, the rebirth of the suburbs, along with 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 central business district. According to the US Bureau of Labor Statistics, more than 80% of the jobs that were eliminated during the COVID-19 recession have returned, opening opportunities for jobs that have been reworked to fit a remote setup.

Suburbs and Office Space

Perhaps surprisingly, the US suburbs have accounted for approximately two-thirds of office space inventory and occupancy since 2002. Undoubtedly, this stems from cheaper land, availability, and a desire for spacious sites. Though vacancy has historically been higher in the suburbs, the gap between the central business district (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 than the rates for the CBD in the past five years. Vacancy rates peaked in mid-2010, but rates declined faster in the suburbs than in the CBD. From 2005 to 2015 – just ten years – the CBD rent premium more than doubled.

The Birmingham office market, for example, ended Q1 of 2021 with a net absorption totaling negative 13,000 square feet and a vacancy rate of 16.9%. 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. While some have predicted that office development will carry on in the future, it's unclear whether this will favor the suburban market or the CBD.

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. 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 adjust, although Ala-

Alabama has passed laws limiting liability for COVID-19 exposure, 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.

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 current 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.

In 2021, according to the American Psychological Association (APA), more than 40% of employees reported burnout from working, and close to two-thirds reported job performance was affected by poor mental health. The APA provides five areas of focus for employers and companies: employee involvement in decision-making; work-life integration; employee growth and development; employee recognition; and health and safety. Employers would be wise to address these areas and show consideration to not only the physical health and safety of employees but also their mental health.

Employee Safety

The pandemic continues to evolve as COVID variants and vaccine effectiveness cause peaks and valleys in cases around the country. Due to this unpredictability, OSHA is reviewing and updating guidelines set forth in 2021. Nevertheless, discussions throughout this article allow for a cautious approach for employers and owners.

Because employers are responsible for creating a safe and healthy workplace under OSHA, it is advisable that owners conduct a thorough haz-

ard 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 had, and still have, the task of implementing employees' safety while continuing to maintain productivity. 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

Throughout the pandemic, Alabama's office market has stayed comparatively steady. In a back-to-business fashion, and despite rises of COVID-19 cases due to virus variants, most

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office workers were back in the office in 2021, or at least had that option. Even larger and national employers in Alabama followed small- to mid-size employers and local businesses in allowing their office-working employees back on campus. In all likelihood, office utilization in 2021 certainly remained higher in Alabama than in some other states.

Nonetheless, because Alabama has experienced varying levels of office building use, a trend over the course of the pandemic has been to blend and extend leasing, with some tenants seeking a reduction in the square footage of their leased premises.

Industrial

Total e-commerce sales in the USA 2021 rose from the previous year, an increase of 14.2%, while maintaining a similar market share of total sales, and we believe Alabama experienced similar increases. This rise is impressive because, despite a return to in-store shopping for many, consumers did not forget the convenience and perks of online shopping. Consequently, the acceleration in online sales has boosted the demand for industrial logistics spaces.

Amazon accounted for around 40% of all US e-commerce in 2021. In Alabama, the online giant anticipates opening three new operations facilities, as well as a new fulfillment center for customer deliveries; these projects will be located in Huntsville, Montgomery, and Birmingham.

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. With the inflated cost of building supplies and

labor shortages, construction continues, but at a slower pace than usual.

Traditional Retail

Alabama's retail sector continued its slide and evolution in 2021. The primary thriving end users are grocery stores, home improvement stores, and dollar stores, as well as outparcel-like fast-casual and fast-food restaurants.

Outdoor centers fared much better during the highs and lows of the pandemic 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. Particularly 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.

Looking at Birmingham as a microcosm for retail trends in the state, the nearly vacant Brookwood Village Mall was purchased by Fairway Investments, based in Birmingham, and Pope & Land Real Estate, based in Atlanta, with plans to redevelop the property. Following that announcement, the Macy's located in Brookwood Village, one of only two in Alabama, announced that it will be closing its doors. The only remaining Macy's in Alabama is located in the Riverchase Galleria in Hoover.

Over the course of the pandemic, it was not atypical for leases to be amended to permit more outdoor use for retailers without a traditional outdoors presence. 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 supported these business changes, some of which are likely here to stay.

Tourism and Entertainment

Tourism is an important industry in Alabama. At the start of 2022, Governor Ivey affirmed as much by announcing a USD1 million funding to help prepare up to 2,000 students to join Alabama's hospitality industry. In a state that saw a vast majority of businesses in the entertainment sector operating generally at full capacity, the industry had a 25% rally in 2021 from the previous year.

Unsurprisingly, tourism, which suffered one of the biggest blows from the pandemic, began to recover in 2021. Alabama's Gulf Coast is heavily reliant on tourism, so the uptick in tourists from the previous year has had a ripple effect on many businesses and individuals in that part of the state. In Birmingham, the new Protective Stadium will be the main venue for the long-awaited 2022 World Games.

Elsewhere in Alabama, restrictions on leisure and recreational activities, crowd limitations, and temporarily closed museums were minimal in 2021. Alabama and out-of-state tourists have taken advantage of a population that is getting vaccinated and, for the most part, returned to pre-pandemic travel and leisure norms. As an attempt to lessen COVID-19's economic toll, asset managers have had to get creative to make use of hotel assets to generate revenue. Hotels may lease extra kitchen or dining space or convert part of their hotels to specifically accommodate healthcare workers. Though full recovery will take some time, hotels are expected to rebound in 2022.

Construction

Some major issues emerged for the future of construction during the pandemic. As prices for steel, lumber, and other materials continued to increase in 2021, so did the length of time on construction projects. In these projects specifically, there is not necessarily a labor shortage; rather, contractors and subcontractors have been so busy that delays are practically inevitable. These factors, coupled with inflation and disruptions in supply chains, have and will continue to have an impact on project timelines. However, although the cost of building materials rose exponentially, the delays of 2020 caused more construction projects in 2021. Multifamily proved to be resilient throughout the USA.

Broadly speaking, pre-COVID force majeure provisions did not directly address pandemics. Although force majeure provisions were invoked throughout the pandemic to address the unexpected delays, the varying authority on this subject left many looking for more specific provisions. Now, force majeure provisions, or even COVID-19-specific sections, are included in new construction contracts, purchase and sale agreements, leases, loan agreements, and other contractual documents.

In practice, real estate owners will need to continue considering safety (including COVID-19) 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 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.

It is also important to note that while climate change is not a huge factor in Alabama real

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estate transactions, we are seeing more climate-friendly amenities included in projects, such as car-charging stations, window and roof updates, and the like.

Conclusion

Though 2021 was closer to business as usual than 2020, it's clear that, rather than going back to normal, we are going back to a new normal. The US economy showed a resiliency against different COVID variants, and businesses and people demonstrated their ability to adapt around mandates or new safety rules and preferences. COVID-19 spurred changes that many predicted would occur, yet not so soon. The types of real estate likely to benefit from accelerations brought on by the pandemic include data centers, internet-related real estate, life sciences, and real estate in the suburbs.

According to CNBC, the US economy in 2021 grew at its fastest rate since 1984. The fourth quarter GDP exceeded experts' predictions, marking a year that, although filled with uncertainties and doubts, had consumers ready to spend if they had the savings to do so. Regardless, uncertainties will always accompany any lingering COVID-19 variants, and a continued economic upturn is uncertain. Still, the real estate market has shown it can and will make up for lost time, and there is no reason to suggest this will not continue in the future.

Dentons Sirote has a real estate team comprised of 19 attorneys located throughout the state of Alabama who serve clients across the USA. As part of the global law firm Dentons, these attorneys are 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.

AUTHORS



Adam J. Sigman serves as a shareholder in Dentons Sirote's Real Estate and Corporate and Securities practice groups, representing developers and investors across a broad

spectrum of asset categories, including retail, office, industrial/warehouse, multifamily, healthcare and life sciences, restaurant and hospitality, entertainment and sports, education, and agricultural, ranch, and hunting properties. He also counsels real estate clients in their general corporate, intellectual property, management and operations, and tax planning matters. Adam is a member of the Real Property, Trust and Estate Law (RPTE) section of the ABA and is widely published.



Crystal Walls serves as a shareholder in Dentons Sirote's Real Estate and Corporate and Securities practice groups, representing a broad spectrum of clients in the commercial real

estate industry, including developers, owners, managers, and lenders, in local, regional, and national matters. Her practice also includes public finance, representing municipalities, counties and state agencies in various transactions.

*Contributed by: Adam J. Sigman, Crystal Walls and Nathan Stotser, **Dentons Sirote***



Nathan Stotser is an associate in Dentons Sirote's Real Estate practice group, where he focuses on commercial real estate and commercial lending.

Nathan earned his JD from Samford University's Cumberland School of Law.

Dentons Sirote PC

2311 Highland Avenue South
Birmingham
AL 35205
USA

Tel: +1 205 930 5100
Fax: +1 205 930 5101
Email: marketing.us.dsp@dentons.com
Web: www.dentons.com/sirote

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