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TENNESSEE

LAW AND PRACTICE:

p.3

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The 'Law & Practice' sections provide easily accessible information on navigating the legal system when conducting business in the jurisdiction. Leading lawyers explain local law and practice at key transactional stages and for crucial aspects of doing business.

Law and Practice

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Butler Snow LLP has one of the largest real estate groups in the State of Tennessee, which has experienced growth in Memphis and Nashville. In Memphis and West Tennessee, the firm's lawyers are not only involved in the majority of large real estate transactions in the area, but are also sought after to handle multi-state deals. Its Tennessee real estate group also has a national real estate practice and regularly represents public and private companies in real estate transactions throughout the USA. In the last year, this group has served as lead real estate counsel for transactions in

Florida, New York, Washington, New Jersey, Illinois, Colorado, Georgia, Kentucky, Ohio, Louisiana, Texas, Missouri, Arizona and Massachusetts. The real estate practice encompasses a broad range of matters, including acquisitions and dispositions; construction and development; financing; leasing and property management; condominiums, co-operatives and timeshares; administrative law and litigation; title insurance; and bankruptcy and insolvency issues

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1. General

1.1 Main Substantive Skills

Real estate law requires not only an understanding of buying and selling real estate, closing processes, real estate title, leasing and finance, but also experience in a variety of other areas that are important to many real estate deals and specific industries. In particular, law firms must have professionals who are familiar with environmental laws, land use and zoning matters, development and construction, joint ventures, complex financing structures, restructurings and workouts. In addition to good analytical, organizational and negotiating skills, effective real estate lawyers must have an understanding of their client's industry and business objectives.

Several current trends have had an impact on the skills required by real estate lawyers, including the popularity of large mixed-use projects and the increasing use of tax credits and other complex financing structures for large real estate projects. Many traditional real estate projects involve primarily the acquisition, sale or development of a single building, parcel or contiguous parcels of real estate by one owner, with financing from a single lender or lender group. By contrast, large mixed-use projects often involve the development of large areas and sometimes multiple blocks of non-contiguous real estate by multiple owners with various lenders and financing structures. These projects frequently have complex land use and entitlement issues and a variety of ownership structures that require greater experience

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with corporate and business laws. Likewise, the increased use of tax credits requires experience with tax law and the structuring of these credits and project financing in a manner compatible with the business interests of the owners, developers and lenders.

1.2 Most Significant Trends

Some of the most significant trends in the Tennessee real estate market have been (i) the popularity of large mixed-use projects, both in urban cores as part of the redevelopment of blighted areas and in suburban areas as stand-alone projects; (ii) the use of tax credits, including historic tax credits and new markets tax credits, in large redevelopment projects; and (iii) a construction boom in Nashville with a number of large office, hotel and residential towers.

The most significant real estate deals in Tennessee include the following:

- the 30-story Bridgestone Americas headquarters in downtown Nashville;
- the USD2 billion expansion of the St. Jude Children's Research Hospital, including a USD412 million research tower, in downtown Memphis;
- the Capitol View project in Nashville, a USD750 million, 32-acre mixed-use development in Nashville;
- the Central Station project in Memphis, a USD75 million, 17-acre mixed-use project in downtown Memphis that involves the redevelopment of historic Central Station and historic tax credits;
- the USD117.64 million acquisition of Fifth Third Center in Nashville;
- the conversion of the Peabody Place shopping mall in downtown Memphis into the 300,000 square foot corporate headquarters for ServiceMaster;
- the USD81 million acquisition of the Hilton Garden Inn in Nashville;
- the USD90 million TraVure development, which includes the headquarters tower for Mid-America Apartments (MAA); and
- the USD114.65 million acquisition of Providence Marketplace in Wilson County, Tennessee.

1.3 Impact of the New US Tax Law Changes

The primary effects from the recent Tax Cuts and Jobs Act (the "new tax act") on real estate investment and development are as follows:

- the allowance for non-C Corporation taxpayers to deduct up to 20% of their qualified business income earned through pass-through businesses;
- the increase in the long-term capital gains holding period to three years for taxpayers receiving a "carried" or "profits" interest;

- the limitation on a taxpayer's ability to deduct interest expenses up to 30% of the taxpayer's net income; and
- limiting interest deductions for home mortgage indebtedness and home equity loans to USD750,000 from USD1,000,000.

The new tax act also limits state and local tax deductions to USD10,000 per year for married taxpayers filing jointly. In certain circumstances, the 20% deduction is limited to 50% of the taxpayer's allocable share of W-2 wages or 25% of the taxpayer's allocable share of W-2 wages, plus 2.5% of the taxpayer's allocable share of the unadjusted basis of "qualified" property (to be "qualified," property must be depreciable), whichever is greater. The provision for 2.5% of the unadjusted basis is beneficial to real estate investors and developers in capital-intensive sectors with large capital investments and comparatively minor labor costs. In addition, taxpayers are allowed to deduct 20% of REIT dividends without being subject to the limitations being described above.

2. Sale and Purchase

2.1 Ownership Structures

Purchasers typically acquire commercial real estate through the use of limited liability companies and corporations. Depending on the nature of the purchaser's business, the use of single- or special-purpose entities that own solely commercial real estate is a common legal tactic to limit liability to such single- or special-purpose entity, thereby protecting the assets of the purchaser's affiliates.

2.2 Important Jurisdictional Requirements

No special jurisdictional rules apply to the transfer of title to real estate in Tennessee. Statutory law does not require specific language to transfer title, but does provide examples of conveyance language that is sufficient for the transfer of title by general and special warranty and quitclaim, and for purposes of a deed of trust (T.C.A. § 66-5-103). A deed of conveyance must be acknowledged in accordance with Tennessee law, or proved by two sworn witnesses (T.C.A. § 66-5-106). Sellers of residential one- to four-unit properties (including single-family homes) are typically required to deliver disclosure statements to prospective purchasers containing all items set forth in T.C.A. § 66-5-210. Transfers of residential real estate must also comply with applicable federal laws and regulations.

2.3 Effecting Lawful and Proper Transfer of Title

A purchaser can effectuate the transfer of title to real estate by recording its deed in the office of the register of deeds in the county where the acquired property lies. The register's office records and indexes the deed according to various methods, depending on the county (eg, grantor-grantee, parcel number, municipal address). Various registers' offices may

provide electronic access to recorded instruments through an online database.

2.4 Real Estate Due Diligence

In performing their due diligence on real estate, buyers typically rely on various third parties to determine the suitability of the property for their intended use. Engineers inspect various aspects of the existing structures on the property, environmental consultants test for the presence of hazardous materials and the potential for contamination from nearby sites, title agents and zoning consultants investigate the status of title to the property and its zoning compliance for the buyer's intended uses, and registered licensed surveyors prepare site surveys reflecting property and improvement dimensions, the presence of any encroachment onto or off the property, and any other material items noted by the surveyor. Attorneys for buyers will primarily be responsible for a detailed review of the survey and recorded instruments affecting title. A careful review of the survey and recorded instrument is critical, as the buyers' economic return on the property could be materially impacted by encroachments on the property, zoning or setback violations, or the terms of recorded instruments that may limit typical ownership rights by restricting permitted uses of the property, proscribing certain architectural designs, or permitting neighboring owners limited use of the buyers' property (eg, through access easements or runoff drainage rights).

2.5 Typical Representations and Warranties for Purchase and Sale Agreements

Representations and warranties are some of the most heavily negotiated provisions of commercial Purchase and Sale Agreements, which typically contain representations and warranties with respect to:

- the seller's existence and authority to sell the property;
- the status of the seller's title to the property;
- pending or threatened litigation or administrative proceedings, including environmental or zoning violations;
- the seller's compliance with applicable laws;
- any leases in effect at the property;
- the accuracy of seller-provided property information; and
- the seller's absence from restricted lists maintained by the Office of Foreign Asset Control.

Implied and statutory warranties do not exist with respect to transfers of title to real property, but sellers commonly seek to disclaim any implied warranties and transfer property in "as-is" condition, subject only to representations and warranties expressly contained in the Purchase and Sale Agreement.

If the Purchase and Sale Agreement does not provide that a seller's representations and warranties will survive closing and delivery of the deed, then the terms of the Purchase and

Sale Agreement are deemed to merge into the deed, whereby the deed is deemed the final contract between the parties. Fraud and mutual mistake of the parties are exceptions to the doctrine of merger.

A buyer may generally terminate a pending Purchase and Sale Agreement prior to closing in the event of a seller's misrepresentation; assuming that the Purchase and Sale Agreement provided for post-closing survival of the seller's representations and warranties, a buyer may recover its actual damages as a result of losses resulting from the misrepresentation. Parties to a commercial real estate sale frequently negotiate threshold amounts for buyers to recover damages for misrepresentation and maximum amounts (anywhere between 1% and 10% of the purchase price) over which the seller will have no liability, but fraud or intentional misrepresentation of the seller are usually excluded from such contractual limitations.

2.6 Important Areas of Laws for Foreign Investors

Foreign investors purchasing real estate in the United States should carefully consider the impact of potential US tax liabilities and reporting obligations incurred in connection with the acquisition of real estate. Specific reporting obligations may stem from: (i) the choice of entity and jurisdiction of formation, as well as the transaction structure, which may also have important tax consequences and may determine the purchaser's potential liability with respect to the property and its intended use; (ii) anti-money laundering laws and associated reporting requirements of the Financial Crimes Enforcement Network ("FinCEN") of the US Department of the Treasury relating to the source of funds and method of payment; and (iii) sanctions administered by the Office of Foreign Asset Control (OFAC) of the US Department of the Treasury relating to the identity of the purchaser.

Tax consequences and additional specific reporting obligations may result from the following:

- any determination that income from the property is or will be "effectively connected" to a US trade or business;
- the imposition of branch profits on foreign corporations, if applicable;
- the provisions of the Foreign Investment in Real Property Tax Act (FIRPTA);
- the requirements of the US Department of Commerce Bureau of Economic Analysis, including the filing of either Form BE-15 Claim for Exemption or the appropriate annual report;
- the imposition of other US income tax return requirements and filings; and
- potential US gift and estate tax liability.

In addition, US lenders providing any amount of financing for the purchase of real property may impose their own loan

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underwriting requirement as a condition of the loan. Such requirements may include, but are not limited to, the provision of additional documentation relating to the identity of the purchaser (borrower), the intended use of the property and the source of non-loan funds being used to fund the acquisition, as well as cash or security deposits to be held by the lending institution.

Although Tennessee has experienced an increase in foreign investment in real estate, none of the housing markets in Tennessee is currently subject to the additional disclosure requirements the Financial Crimes Enforcement Network has imposed through Geographic Targeting Orders on title companies when foreign buyers are paying cash for high-end residential properties in certain markets, such as Manhattan, Los Angeles, Miami and San Francisco. However, FinCEN encourages title companies, financial institutions, brokers and other professionals to voluntarily file suspicious activity reports (SARs) in order to report any suspicious transactions or activity. Also, a SAR is required to be filed for currency and similar transactions in excess of USD10,000.

2.7 Soil Pollution and Environmental Contamination

Under both (i) the Comprehensive Environmental Response, Compensation and Liability Act of 1980 (“CERCLA”), as amended by the 1986 amendments to CERCLA, known as the Superfund Amendments and Reauthorization Act (“SARA”), and (ii) the Tennessee Hazardous Waste Management Act of 1983, the state equivalent to CERCLA and SARA, after a buyer takes title to property, it becomes a potentially responsible party (“PRP”), even if the buyer did not cause or contribute to the existing pollution or contamination. However, in some cases, CERCLA and SARA allow the apportionment of liability for site clean-up (see T.C.A. § 68-212-207). A buyer may prevent being declared a PRP by establishing one of the following:

- the buyer purchased the property, conducted necessary environmental due diligence, and later discovered an environmental issue at the site (the innocent landowner defense);
- the buyer purchased the property clearly knowing that environmental conditions existed on the property (the bona fide prospective purchaser defense); or
- the buyer purchased the property, and the environmental conditions existed on an adjoining property and have or will have moved onto the purchased property (the contiguous landowner defense).

In all cases, the buyer must conduct “All Appropriate Inquiry” prior to purchasing the property, and comply with any continuing obligations related to the allowable use of the property and the management of existing pollution.

2.8 Permitted Uses of Real Estate under Zoning or Planning Law

Even though local jurisdictions often maintain zoning maps, zoning ordinances and development codes online that permit a buyer to research and identify the permitted uses of a parcel under zoning or planning law, a buyer should also contact the relevant zoning authority to obtain a zoning letter confirming those uses for the subject parcel. Alternatively, buyers often engage a third party service to prepare a planning and zoning report for the target property, which is often more informative than zoning letters and will include information on zoning compliance, special use permits and other details that might prove helpful in the due diligence process. Larger urban jurisdictions will have capable planning staff that are able to assist with technical compliance with the zoning and planning laws. Smaller and rural jurisdictions ordinarily do not have extensive planning and zoning restrictions. Tennessee and its local jurisdictions enjoy wide latitude to approve developments, including entering into development agreements with developers, and provide public development incentives.

2.9 Condemnation, Expropriation or Compulsory Purchase

Tennessee permits eminent domain by a condemning authority (eg, the Tennessee Department of Transportation, public utility) and, in certain limited situations, a person or corporation, for public purposes or internal improvements, but not a private purpose. Eminent domain is commenced by filing a petition in circuit court against all persons with an interest in the property. Notice must be given upon the filing of a petition. Just compensation based on the fair market value of the property will be determined in court or by agreement. Overall, Tennessee is fairly permissive regarding the condemning authority’s exercise of the power of eminent domain.

2.10 Taxes Applicable to a Transaction

In the case of a warranty deed transferring title to real property, the recording of the deed requires payment of a recording tax (sometimes referred to as a transfer tax) equal to USD0.37 per USD100 of either the consideration for the transfer or the fair market value of the property, whichever is greater. The recording of a quitclaim deed requires payment of a tax equal to USD0.37 per USD100 of the actual consideration given for the conveyance. Register offices also assess nominal per-page recording fees, which vary by county. Buyers pay the transfer tax on sales of real property in Tennessee but seek to offset the transfer tax by negotiating other closing cost divisions, particularly in commercial transactions. The deed tax does not apply in limited situations, such as transfers between spouses or deeds from executors of estates. Mergers, changes of control or transfers of equity ownership in property-owning entities are not subject to transfer tax.

2.11 Rules and Regulations Applicable to Foreign Investors

See 2.6 Important Areas of Law for Foreign Investors.

3. Real Estate Finance

3.1 Financing Acquisitions of Commercial Real Estate

Tennessee commercial real estate transactions do not offer any unique financing options or strategies. Buyer-borrowers frequently utilize traditional term financing, bridge and construction financing, and – for buyers pursuing a series of property acquisitions or developments – lines of credit. For larger, ongoing credit facilities, lenders arrange financing through syndication or participation. Rates of interest, loan charges and commissions in commercial lending transactions governed by Tennessee law are generally subject to a maximum “formula rate” published monthly by the Tennessee Department of Financial Institutions, which is 4% over the average prime rate. However, through a relatively complex statutory framework, federally chartered banks and Tennessee-chartered banks may charge interest of up to 24% annually.

3.2 Typical Security Created by Commercial Investors

Tennessee law permits a commercial real estate investor to grant several types of security interests to creditors for the purpose of borrowing funds to acquire or develop real property, but deeds of trust are the customary form of security instrument for real estate finance. Tennessee is a title theory state with respect to real property security interests, meaning that legal title to real property is conveyed by the borrower via a deed of trust to a trustee on behalf of the lender. The borrower retains equitable title to the property, including rights of possession and income. The deed of trust is filed in the register of deeds office in the county where the property is located. Typically, a lender will also require a separate assignment of leases and rents from the borrower, whereby (i) the borrower absolutely assigns all leases, including all borrower’s rights thereunder, and rents related to the secured property as additional collateral for the debt, and (ii) the lender grants the borrower a revocable license to operate as the landlord and collect such rents under such leases until a default. The assignment of leases and rents is also filed in the register of deeds office in the county where the property is located.

The Tennessee Uniform Commercial Code (“UCC”) permits creditors to file financing statements with the Tennessee Secretary of State’s office to provide notice of their security interest in a debtor’s property. Furthermore, although most deeds of trust include language creating a security interest in the fixtures attached to the real property, creditors

commonly file a separate UCC-1 “fixture filing” financing statement in the register of deeds office with respect to the secured fixtures.

3.3 Regulations or Requirements Affecting Foreign Lenders

Out-of-state lenders are generally not required to be qualified to do business in Tennessee in order to make a typical commercial loan secured by real estate. The creation or acquisition of indebtedness, deeds of trust, mortgages and security interests in property and the securing or collecting of debts or enforcing of deeds of trust and security interests in property do not constitute transacting of business by themselves in the state, and thus do not require a non-Tennessee corporate entity to be qualified to do business in Tennessee. Except for those activities that do not constitute transacting business in Tennessee under T.C.A. § 48-25-101 and certain others, non-Tennessee corporate entities must qualify to do business in Tennessee. After obtaining a certificate of authority to transact business from the Tennessee Secretary of State, non-Tennessee corporate entities must also register with the Tennessee Department of Revenue for franchise and excise taxes within 90 days. Out-of-state lenders are typically not required to be licensed or registered with the Tennessee Department of Financial Institutions or other state agencies.

Tennessee requires trustees who hold legal title to secured real property on behalf of a lender to be one of the following:

- a Tennessee resident;
- a Tennessee corporation or non-Tennessee corporation whose principal place of business is Tennessee; or
- an individual whose principal place of employment is in Tennessee.

Tennessee also allows a resident of a non-Tennessee state to serve as trustee if such non-Tennessee state permits Tennessee residents to serve as trustees.

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

The recording of an instrument evidencing indebtedness (eg, a deed of trust or UCC-1 financing statement), whether at the county or state level, requires payment of an indebtedness tax equal to USD0.115 per USD100 of indebtedness, excluding the first USD2,000 of indebtedness, which is exempt from the tax calculation.

3.5 Legal Requirements Before an Entity Can Give Valid Security

Tennessee does not maintain any financial assistance or corporate benefit rules with respect to real estate assets.

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3.6 Formalities When a Borrower is in Default

Tennessee allows judicial foreclosure and non-judicial foreclosure upon the default of a loan secured by a deed of trust or mortgage. Judicial foreclosure proceedings are rarely used, as most real estate financing is secured by a deed of trust that allows for power of sale through non-judicial foreclosure.

A deed of trust or mortgage must be properly executed, acknowledged and recorded with the register of the county in which the realty affected is located. A properly recorded deed of trust or mortgage provides constructive notice to all persons, and will establish priority over subsequent liens and interests. Careful drafting of the deed of trust should include provisions that accelerate the debt upon default and waive the right to redemption.

Non-judicial foreclosure proceedings are initiated by providing the debtor with notice of default. Next, the creditor must publish notice of the foreclosure sale at least three times in a newspaper published in the county where the property is located and in compliance with any additional requirements in the deed of trust. A non-judicial foreclosure sale must comply strictly with the language in the deed of trust. The notice of foreclosure sale must include information such as the names of interested parties, a description of the property, the time and place of the foreclosure sale, and other related items. Tennessee law requires the trustee to search for state tax liens on the property, and also governs the manner and timing of the sale process. Specifics may be found in T.C.A. § 35-5-101 et seq. Non-judicial foreclosure in Tennessee typically requires around 30 days from start to finish.

3.7 Subordinating Existing Debt to Newly Created Debt

The holder of a deed of trust or mortgage may consensually subordinate its lien by contract pursuant to a subordination agreement. The subordination agreement should be recorded in the same manner as the original deed of trust or mortgage in order to be valid against third parties.

Also, taxes assessed upon real property are a first lien that takes priority over existing recorded liens, including a deed of trust. If taxes are assessed on something other than real property, the existing recorded lien will still have priority over a subsequently recorded tax lien.

Mechanics' and materialmen's liens may also take priority over a recorded lien, including a deed of trust if (i) the mechanic or materialman gives notice to the lienholder prior to beginning work on real property improvements or delivering goods and (ii) the lienholder does not object within ten days (T.C.A. § 66-11-108). In the absence of such notice or upon an objection, the mechanics' and materialmen's liens are subordinate to properly recorded liens.

3.8 Lenders' Liability Under Environmental Laws

A lender holding or enforcing security over real estate may be liable under environmental laws, even if it did not cause any pollution of the real estate under federal laws or the laws of Tennessee if it engages in "active participation" in the management of a facility. "Active participation" must be more than "the mere capacity, or ability to influence, or the unexercised right to control a site, vessel or facility operations"; and requires "actual participation in the management or operational affairs by the holder of the security interest." The Tennessee Waste Hazardous Waste Reduction Act of 1990 (the "Tennessee Superfund Act") generally follows the provisions of the Superfund Amendments and Reauthorization Act of 1986 ("SARA"), which afford certain liability protections to lenders that are not active participants in the management of a facility (T.C.A. § 68-212-301, et seq (2018)). Examples of active participation include exercising decision-making control over hazardous waste disposal or assuming day-to-day responsibility with respect to environmental compliance or operational aspects of a business (T.C.A. § 68-212-401(1)(A)). If a lender's indicia of ownership are held primarily to protect a security interest, they do not indicate active participation (T.C.A. § 68-212-401(B)). Under this statute, an owner may take emergency response actions when needed to address an immediate threat to the environment or public health, or to conduct an environmental audit or inspection without jeopardizing its non-management status (T.C.A. § 68-212-404(b). In the event of a foreclosure, a holder of a security interest will continue to be considered as an un-active participant, provided that the holder undertakes to sell, re-lease or otherwise divest itself of the property or facility in an expeditious manner (T.C.A. § 68-212-403).

3.9 Effects of Borrower Becoming Insolvent

The automatic stay, effective upon the filing of a federal bankruptcy petition, will stay all foreclosure actions against a debtor's real property. Furthermore, under Tennessee law, a non-judicial foreclosure becomes final upon execution of a trustee's deed to the purchaser – not upon final oral cry at the non-judicial foreclosure sale or upon a memorandum of sale. If a federal bankruptcy petition is filed any time before the execution of a trustee's deed, the foreclosure action will be automatically stayed by bankruptcy, and the lienholder will be forced to proceed in the federal courts to get relief from the automatic stay before finalizing the foreclosure under Tennessee law.

Furthermore, Federal bankruptcy law will allow a bankruptcy trustee or debtor in possession to avoid (i) any lien that has not been properly recorded in a timely manner under Tennessee law, or (ii) a lien that was given for less than reasonably equivalent value while insolvent or other fraud. Tennessee allows fraudulent liens to be avoided any time within four years after the lien attaches.

4. Planning and Zoning

4.1 Legislative and Governmental Controls Applicable to Design, Appearance and Method of Construction

Tennessee and its political subdivisions use a variety of legislative and governmental controls or regulations, such as county, municipal and historical zoning laws, and building ordinances that govern design, appearance and construction methods of new buildings and refurbishments at the regional and municipal level. These regulations commonly affect set-back rules, height restrictions, floor-area ratios impacting density and parking.

Additionally, historical zoning commissions exist at the county or municipal level; in any area of the state served by a regional planning commission, the local legislative bodies of the region served by such commission may create a regional historic zoning commission. The growth and construction of non-residential or multi-family residential buildings located in areas of historical significance are also regulated. Counties have the authority to create design review commissions, which then may develop general guidelines for the exterior appearance of and entrance to properties located in historical areas. The design review commission will often be the same as the planning commission.

4.2 Regulatory Authorities

Regional and municipal planning and zoning commissions are typically responsible for regulating the development and designated use of individual parcels of real estate in Tennessee. Additionally, the Tennessee Department of Economic and Community Development is responsible for creating and establishing planning regions, including the creation of regional planning commissions throughout the state, which are composed of one or more contiguous counties. Regional planning commissions are charged with promoting mutual co-operation among any municipal planning commissions and the regional commission. The regional planning commission also advises municipal and county mayors, legislative bodies and officials on the status of development of the region. Smaller-scale community planning commissions also exist, with similar power and responsibilities.

The chief legislative body of any municipality has the authority to create and establish a municipal planning commission, which may make reports and recommendations relating to the plan and development of the municipality to public officials and agencies, public utility companies, civic, educational, professional and other organizations, and citizens. It may recommend programs for public improvements and financing to the executive or legislative officials of the municipality.

The types of legal restrictions and requirements on development and use of real estate include regulations promulgated by the regional and municipal planning commissions. Examples of requirements include plat approval and building permitting. There are also county, municipal and historic zoning regulations, which vary but are generally enacted for the purpose of promoting the health, safety, morals, convenience, order, prosperity and welfare of the present and future inhabitants of the state and of its counties. They seek to lessen congestion on the roads; secure safety from fire and other dangers; promote adequate light and air; prevent excessive concentrations of the population, as well as excessive and wasteful scattering of the population; promote land development and utilization in a way that will tend to facilitate and conserve adequate provisions for transportation, water flow, water supply, drainage, sanitation, educational opportunity, recreation, soil fertility, food supply and the protection of both urban and non-urban development; and identify areas where there are inadequate or nonexistent services and facilities.

The chief legislative body of a municipality is responsible for enacting zoning ordinances, which regulate the location, height, bulk, number of stories, and size of buildings and other structures, the amount of a lot that may be occupied, the sizes of yards, the density of population, and the use of buildings.

At the neighborhood level, pursuant to Tennessee's Neighborhood Preservation Act, owners of residential property are required to maintain the exterior of such property and the lot in accordance with community standards of other residential property in the area.

4.3 Obtaining Entitlements to Develop a New Project

The process for obtaining entitlements to develop a new project or to complete a major refurbishment in Tennessee includes submitting preliminary and schematic plans to the appropriate planning commission for approval. The commission will review and approve or disapprove of a plan, often requiring changes which can then be re-submitted for approval once made. Plans are subject to a public hearing where third parties may support or object to the plan.

With respect to historically zoned areas, all applications for permits for construction, alteration, repair, rehabilitation, relocation or demolition of any building or structure, or for other improvements to real estate situated within a historic zone or district are referred to the local historic zoning commission or the regional historic zoning commission, which has broad powers to request detailed construction plans and related data pertinent to a thorough review of the proposal. The applicable zoning commission is also authorized to re-

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view construction or alteration plans even where a permit is not required.

Affected parties have the right to participate on or object to planning decisions. Any person aggrieved or any officer, department, board or bureau of the municipality affected by any grant or refusal of a building permit has the ability to appeal to the zoning commission.

4.4 Right of Appeal Against an Authority's Decision

Each county and municipality has the authority to create a board of zoning appeals, which has the power to hear and decide appeals where it is alleged by an individual that there is error in any order, requirement, permit, decision or refusal made by the applicable commissioner or any other administrative official in the carrying out or enforcement of any provision of any ordinance.

At the planning commission level, if the applicable commission approves or disapproves a development plat after a hearing thereon, then the applicant submitting the plat, or any person who was a party for or against the plat, who so requests at the planning commission hearing has the right within 30 days of such approval or disapproval to have the action of the planning commission reviewed by the appropriate municipal legislative body, which shall approve or disapprove the development plans by majority vote. Any further appeal would proceed in the chancery or circuit court.

Property owners affected by historical zoning guidelines or who do not comply with the guidelines may appeal a decision of the design review committee or the county building commissioner to the county board of zoning appeals.

4.5 Agreements with Local or Governmental Authorities

It is possible in Tennessee to enter into agreements with local or governmental authorities or agencies or utility suppliers in order to facilitate a development project. Such arrangements typically take the form of participation agreements or development agreements with the applicable municipality or utility or even the planning department in order to effectuate certain types of projects – eg, parks, roads, infrastructure, and other public developments that can be built more efficiently with the use of a private developer. These arrangements are often complicated because of state procurement and public competitive bidding requirements.

The Department of General Services oversees the central procurement office in Tennessee, and administers, manages and ensures the compliance of procured contracts. The office has an online database of all ongoing procurements, their statuses, and contracts by state agencies, departments and institutions. The department manages construction of state

capital projects, which comprise most of Tennessee's construction and maintenance projects across the state.

4.6 Enforcement of Restrictions on Development and Designated Use

Public agencies in the state have the administrative authority to remedy noncompliance with planning regulations or zoning ordinances. For example, a zoning board has the ability to institute an injunction, mandamus, abatement or other appropriate action to prevent, enjoin or remove an unlawful construction. Alteration, maintenance or use of any real property in violation of a zoning commission's regulations is a misdemeanor, with each day that an illegal construction or use of land or structure exists being a separate offense.

5. Investment Vehicles

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

Real estate owners may hold title to their property through limited liability companies, corporations, limited partnerships, limited liability partnerships or general partnerships, or in their individual names. Limited liability companies and corporations are most frequently used due to the familiarity of investors and lenders with their organisational structure and their inherent liability protection.

5.2 Main Features of the Constitution of Each Type of Entity

The extensive body of law governing the management, capital structure and fiduciary responsibilities of corporate officers and directors offers the principal advantage of the corporate ownership structure of real estate. These features decrease transaction costs and can expedite the formation and closing timelines in property-related private equity offerings or financing transactions. However, continuing development and the increasing ubiquity of limited liability companies have allowed legal counsel and clients to craft greater organisational flexibility while maintaining as simple or sophisticated a capital structure as is necessitated by the given transaction. General partnerships and individual ownership of commercial property are infrequent, due primarily to the unlimited liability exposure each owner faces with respect to the property, but their use allows owners to avoid Tennessee franchise and excise taxes on the real property. In addition, a limited liability vehicle such as an LLC may elect to be an "obligated member entity" simply to avoid Tennessee franchise and excise taxes.

5.3 Tax Benefits and Costs

The inefficiency of the double taxation regime applicable to standard C-corporations is the largest tax disadvantage to selecting such corporate structure for ownership of an income-producing real estate asset; however, in certain con-

texts, owners may be able to elect Subchapter S treatment under the Internal Revenue Code and receive pass-through tax treatment on earnings. Absent the affirmative election to be taxed as a corporation, limited liability companies offer the default benefit of pass-through tax treatment on earnings.

5.4 Applicable Governance Requirements

The governance structure of corporations is characterized by management by a board of directors, and the day-to-day operations of the corporation are carried out by officers. Shareholders of a corporation typically have no management rights, but they have voting rights with respect to the election of directors and certain significant corporate transactions, such as merger, dissolution, and a sale of substantially all the assets of the corporation. The governance structures of Tennessee limited liability companies are variegated, and such entities may be managed by their members, a manager or a board of managers, or a board of directors. Limited liability companies may also employ officers to oversee day-to-day operations. Default statutory rules apply in the case of corporations and limited liability companies, but Tennessee law provides a much greater degree of flexibility in the drafting of documents governing limited liability companies management and governance rights when compared to default statutory rules.

6. Commercial Leases

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

Tennessee law broadly recognizes three arrangements under which a person, company or other organization may occupy and use real estate for a limited period of time without buying it outright: by lease, by easement, and by license.

Under a lease arrangement, one party (the lessor or landlord) leases real property to another party (lessee or tenant) and grants the right of exclusive possession thereof for a period of time, in exchange for a consideration, which most often takes the form of rent. Leases with a term of more than one year must be in writing and signed by the party against whom enforcement is sought. In order for leases with a term of more than three years to be binding on anyone other than the landlord, the landlord's heirs and devisees, or third parties with actual notice, they (or memoranda thereof) must be registered in the county where the subject property is located, in accordance with the requirements of the Tennessee recording statutes (T.C.A. § 66-24-101 et seq). In Tennessee, a lease constitutes an interest in real property.

An easement is also considered an interest in real property, and confers upon its owner the right to use the property of another for a particular purpose. To be enforceable, ease-

ments created by agreement must be in writing, and to be binding upon subsequent purchasers or interest holders without notice they must be registered in the county where the property is located, in accordance with the requirements of the Tennessee recording statutes.

A license confers to the licensee only a personal right to undertake specific activities on the licensor's real property, with or without corresponding obligations. A license is generally revocable and, in the absence of express language to the contrary, cannot be transferred or assigned. Unlike the lease and the easement, a license does not create an interest in land and is not governed by the Statute of Frauds, and thus does not need to be in writing.

6.2 Types of Commercial Leases

Commercial leases often take different forms, depending on the use of the leased premises. A lease for an office in an office building will be substantially different from a lease of warehouse space in an industrial park, or retail space in a shopping center, or commercial space in a single tenant property. There are different considerations, protections for the landlord, representations and warranties, and different ways to handle the charges to be paid by the tenant.

There are multiple options with respect to the charges to be paid by the tenant, including gross (ie, fully serviced), net, modified gross, and percentage. A gross lease is where the landlord pays for the property taxes, insurance and maintenance, and the tenant pays a single flat fee. A net lease is the opposite of a gross lease. There are three types of net leases: single net, double net and triple net. A single net lease is where the tenant is responsible for rent and property taxes; a double net lease is where the tenant is responsible for rent, property taxes and insurance; and a triple net lease is where the tenant is responsible for rent, property taxes, insurance and maintenance. A modified gross lease is a hybrid between a gross lease and a net lease. A percentage lease is where the tenant pays base rent as well as a percentage of revenue earned from its business on the property.

A ground lease is where the tenant pays rent and also constructs improvements on the property during the term of the lease, after which the land and improvements are turned over to the landlord. Ground leases typically have longer terms.

6.3 Regulation of Rents or Lease Terms

Neither rents nor lease terms are regulated in Tennessee, with the exception of certain limitations placed on the term for oil and gas leases: Tennessee law generally limits the term of such leases to a maximum of ten years from the date of execution, unless natural gas or oil is being produced for commercial purposes at the expiration of the ten-year period (T.C.A. § 66-7-103).

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6.4 Typical Terms of a Lease

Although most terms for commercial leases are the product of negotiation, a lease term of five to ten years with renewal options is not uncommon. Ground leases and build-to-suit leases typically have longer terms.

Typically, the landlord is responsible for the maintenance and repair of any common areas of the building or shopping centre, for structural components of the building/demised premises, and for any utility lines to the boundary of the demised premises. Tenants are typically responsible for all maintenance and repair within the demised premises.

Rent is often paid in advance at the beginning of each month, but leases in Tennessee must expressly state that rent shall be paid in advance, contrary to the common law presumption.

6.5 Rent Variation

The rents are determined by the terms of the lease agreement. Many rental rates increase during the term, particularly for terms of longer duration.

6.6 Determination of New Rent

Rent escalations are determined by the lease contract. The terms may include rent escalation provisions that cause the rent to increase annually based upon agreed percentages (with 2% or 3% being typical), or upon market indicators such as increase in fair market value or increases in the Consumer Price Index. All rent provisions must include a key that allows for the rent amount to be objectively determined.

6.7 Payment of VAT

No VAT or other taxes or governmental levy is payable on rent.

6.8 Costs Payable by Tenant at Start of Lease

At the start of a lease, the tenant may be responsible for a security deposit, any application fees, and the first month's rent. In some instances, the landlord could require first and last month's rent.

Tenants are sometimes responsible for the build-out of the leased premises and the corresponding outlay of funds to prepare the premises for occupancy. In other cases, a landlord might provide an improvement allowance to the tenant to pay for the build-out, which would be less likely to result in a pre-occupancy tenant expenditure. The allowance amount is usually a negotiated rate per square foot of the leased premises.

6.9 Payment of Maintenance and Repair

Common area expenses, including maintenance and repair costs for parking lots and landscaping, for example, are often divided among the multiple tenants in proportion to the amount of space leased. Unless the rent is structured as

a full-service gross arrangement (where tenant pays a set, all-inclusive rent), tenants will usually pay a monthly estimate of these common area expenses (or CAM expenses) to the landlord in addition to monthly base rent payments. All of the common expenses for these areas are estimated and amortized over the lease year. The landlord will typically be responsible for maintaining the common areas in good working order and condition, but will recoup those fees and costs from the funds paid by each tenant for CAM expenses.

6.10 Payment of Services, Utilities and Telecommunications

The payment of services, utilities and telecommunications that serve a property occupied by several tenants will likely be determined by whether the separate premises are separately metered. Where separately metered, it is common for tenants to pay utilities directly. If not separately metered, the landlord will usually pay utilities and assess the tenants proportionately or build utilities costs into the base rent. The negotiated contract will establish specific utilities payments.

6.11 Insuring the Real Estate That Is Subject to the Lease

Various considerations will determine whether the landlord or the tenant ultimately insures the property, including which entity can negotiate lower pricing and better coverage. A multi-tenant site will usually be insured by the landlord with costs passed to the tenants, while a single tenant site may be insured by the tenant. Most events causing damages are insured through an all risk or special form property policy. Special endorsements exist in areas where there are high risks of earthquakes or other special casualty events.

6.12 Restrictions on Use of Real Estate

Lease terms affecting a tenant's use of the premises are frequently negotiated points in commercial leases. Restrictions may generally be imposed within the lease in the form of a narrow permitted use provision, general terms aimed at minimising risk or property damage, or generally applicable rules and regulations that may be amended from time to time by the landlord. Tenants will often expressly be required to use the premises in accordance with all laws.

Tennessee allows for local governments to regulate use through zoning laws, but use restrictions may also arise from private covenants and restrictions, easement agreements, and other recorded instruments governing or restricting the use of property.

6.13 Tenant's Ability to Alter and Improve Real Estate

The right to make improvements is often a heavily negotiated lease term, depending on the type of demised premises. The landlord usually wants control or consent rights over any improvements to the premises during the lease term and will

usually specify what work can be performed to the demised premises, and can cap the work at a certain dollar threshold or require prior written consent for work beyond a dollar threshold.

6.14 Specific Regulations

Residential leases in Shelby, Davidson, Knox and other populous counties must comply with the Tennessee Uniform Residential Landlord and Tenant Act, which protects residential tenants from certain actions of a landlord. Most provisions of commercial leases, however, are creatures of contract law that override the default landlord-tenant laws.

6.15 Effect of Tenant's Insolvency

A tenant's insolvency may cause default under a lease, but federal bankruptcy law will ignore as void any insolvency provision in a lease. If bankruptcy is sought, Section 365 of the Bankruptcy Code states that a debtor tenant may assume, assign or reject the lease. Assumption of the lease is a decision to retain or continue the lease by the bankruptcy estate, whereas a rejection is a decision to terminate. The tenant must cure any lease defaults and assure future performance under the lease before assuming or assigning the lease.

6.16 Forms of Security to Protect Against Failure of Tenant to Meet Obligations

Typically, a landlord will collect a security deposit at the beginning of the lease term for a month or several months of rent payments. Upon default, a landlord may liquidate the security deposit and use it to cover some of the tenant's obligations under the lease. A tenant may also be required to provide an irrevocable letter of credit from a financial institution. If the tenant defaults, the landlord can draw upon the letter of credit to satisfy outstanding rental obligations. Furthermore, for the same reasons, a tenant may also be required to provide a personal guarantee from the principal, a parent guaranty, or some other credit enhancement.

6.17 Right to Occupy After Termination or Expiry of a Lease

A tenant does not have a right to occupy the premises outside the stated lease term. However, most commercial leases will contain a holdover provision that converts the tenancy at expiration to a tenancy at will with an increased rental amount; this holdover rent is usually high enough to discourage the tenant's continued possession. In order to recover possession where the tenant fails to surrender the premises, a landlord will need to terminate the lease, seek a forcible entry and detainer against the tenant, and obtain a writ of possession. A lease should specify that abandonment of the premises allows the landlord to re-enter, take possession, and terminate the lease.

6.18 Right to Terminate Lease

An event of default that could result in termination of the lease is governed by the terms of the lease. Nonpayment is the most common event of default. Events of default should also include the breach of any material provision in the lease. Upon an event of default, a lease will often require the non-defaulting party to provide notice to the defaulting party and give a reasonable cure period. If the event of default is uncured, the right to terminate should be permitted. Abandonment should also give a right to terminate the lease. Failure to pay taxes, material changes or termination of insurance, and unauthorized or illegal uses of the premises will ordinarily provide a right of termination. It is also common to have anti-assignment provisions that cause termination of the lease. The lease should also specify rights to termination upon certain casualty or condemnation events.

6.19 Forced Eviction

In the event of default prior to the expiration date, a tenant can be forced to vacate the leased premises through the process of eviction. Even though most leases contain a covenant allowing the lessor to re-enter the premises and remove a tenant upon default, Tennessee prohibits landlords from exercising self-help. Instead, a writ of possession must be obtained through the eviction process. The typical eviction process is a forcible entry and detainer action in general sessions court or circuit court. The time of trial may not be less than six days from the date of service of the summons on the tenant, in accordance with T.C.A. §29-18-115. A writ of possession for the recovery of the property from the tenant will not be issued against the tenant until ten days after judgment is rendered in favor of the landlord. The tenant may appeal within ten days (T.C.A. § 29-18-101 et seq).

6.20 Termination by Third Party

The government or a municipal authority may terminate a lease by condemnation, which occurs when part or all of the leased premises are taken for a public purpose by an entity with the power of eminent domain. Most leases include a condemnation clause that provides for what will occur in the event condemnation occurs. Any rents paid in advance, prior to any condemnation, are required to be refunded to the tenant.

7. Construction

7.1 Common Structures Used to Price Construction Projects

Commonly used pricing structures for construction projects include the following:

- fixed price (sometimes referred to as lump sum);

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- cost-plus, where the price is based on the actual cost of labor and materials plus a fixed or percentage fee for the contractor's overhead and profit; and
- cost-plus with a guaranteed maximum price (or GMP), where the contractor agrees that the actual cost plus the fee will not exceed a certain guaranteed maximum price.

Unit prices may be used as a component of fixed price and cost-plus contracts.

7.2 Assigning Responsibility for the Design and Construction of a Project

Responsibility for the design of most projects is allocated to the architect through an agreement between the owner and the architect, and responsibility for the construction of the project is allocated to the contractor through a separate agreement between the owner and the contractor. The allocation of certain design responsibilities is frequently negotiated among the parties. For example, responsibility for site and foundation work may be assigned to an engineer that has contracted directly with the owner. Likewise, design responsibility for shop drawings and submittals during construction is often negotiated and sometimes shared by the architect and the contractor. For projects utilizing the "design-build" method of project delivery, the design-builder is responsible for both the design and the construction of the project.

7.3 Management of Construction Risk

Construction risk is primarily managed through the contractual provisions between the owner and the contractor. Most construction contracts, including the popular American Institute of Architects (AIA) contract documents, include basic warranties and indemnification provisions. The scope of and exclusions from these provisions are often negotiated. Indemnification provisions are enforceable under Tennessee law, subject to certain limitations and requirements. Tennessee recognizes the nearly "universal rule that there can be no recovery where there was concurrent negligence of both the indemnitor and the indemnitee unless the indemnity contract provides for indemnification in such case by 'clear and unequivocal terms;' and general words will not be read as expressing such intent" (*Kroger Co. v Giem*, 387 SW 2d 620, 624 (Tenn. 1964)). Also, an indemnity provision in a construction contract that purports to indemnify a party for damages caused by such party's sole negligence would be void under Tennessee law as being against public policy) T.C.A. § 62-6-123).

Although responsibility of construction risk is primarily contractual, the management of construction risk generally begins prior to the commencement of construction through the selection of the project team, including evaluation of the experience and financial strength of the contractor and de-

sign professional, the selection of the project delivery method and pre-construction testing and other services.

As discussed below, construction risks may also be managed or mitigated through retainage, liquidated damages and payment and performance bonds.

7.4 Management of Schedule-Related Risk

Construction schedule-related risk is managed through contractual provisions and the possible use of liquidated damages for delays. Owners should consider including a "no damage for delay" clause, which provides that an extension of time is the sole remedy of the contractor in the event of a delay. Also, the contract may include financial incentives for the early completion of a project or an acceleration provision giving the owner the right to demand acceleration of the project. The development of the project schedule and negotiation of events or circumstances allowing for extensions of the contract time are key components of managing schedule-related risks. Liquidated damages clauses providing for the payment of a stipulated amount of damages for the failure of a contractor to complete a project or reach a certain milestone in a timely manner are enforceable in Tennessee, provided that the stipulated amount is a reasonable estimate of damages at the time the parties entered into the contract.

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

Payment and performance bonds are sometimes required by owners to provide security for the contractor's performance under the contract and payment of its subcontractors and materialmen. Some owners do not require payment and performance bonds as the cost of these bonds is generally passed through to the owner, but such bonds are frequently required by lenders providing construction financing. Public projects in Tennessee require payment and performance bonds, and some public projects also require bid bonds. Although less common, a letter of credit or parent-company guarantee is sometimes provided by a contractor as an alternative to payment and performance bonds.

Retainage of a small percentage of each progress payment is commonly used to protect the owner. In Tennessee, retainage is limited to 5% of the gross amount of the contract by the Tennessee Prompt Pay Act of 1991 (T.C.A. §§ 66-34-101, et seq). If the prime contract is USD500,000 or more, the retainage must be deposited by the owner into a separate interest-bearing escrow account (T.C.A. § 66-34-104). This requirement cannot be waived or modified by contract, and the interest earned on the account is the property of the contractor.

7.6 Liens or Encumbrances in the Event of Non-Payment

Contractors, materialmen, architects and others making improvements to the real property have statutory lien rights in Tennessee; however, only prime contractors have lien rights on residential property consisting of one to four units. These liens relate back to the “visible commencement of operations”, excluding demolition, surveying and certain site work. A construction loan secured by a deed of trust recorded prior to the “visible commencement of operations” has priority over mechanics’ and materialmen’s liens, which can be removed by posting a bond to indemnify against the lien.

7.7 Requirements Before Use or Inhabitation

The process for obtaining a certificate of occupancy varies according to the location of the project. Most local jurisdictions have inspection requirements before a certificate of occupancy will be issued, and a temporary certificate of occupancy is sometimes issued when the project is substantially complete. Under Tennessee law, “[s]ubstantial completion means that degree of completion of a project, improvement, or a specified area or portion thereof (in accordance with the contract documents, as modified by any change orders agreed to by the parties) upon attainment of which the owner can use the same for the purpose for which it was intended” (T.C.A. § 28-3-201(2)). Additionally, state and federal government inspections and approvals may be required for certain projects, such as healthcare facilities.

8. Tax

8.1 Sale or Purchase of Corporate Real Estate

Tennessee levies a transfer tax on deeds upon recording, customarily paid by the grantee. For warranty deeds, it is USD0.37 per USD100 of the consideration for the transfer or the fair market value of the property, whichever is greater. For quitclaim deeds, it is USD0.37 per USD100 of the actual consideration for the transfer. There are multiple exemptions to the transfer tax, including transfers between spouses or deeds from executors of estates (T.C.A. § 67-4-409). No federal or local transfer taxes are payable on the sale or purchase of corporate real estate.

8.2 Mitigation of Tax Liability

Because all transfers of realty by deed or other instrument are taxable by Tennessee, except for the handful of explicit exceptions that do not apply in most commercial transactions, the only methods commonly used to mitigate the cost of the transfer tax are the structuring of transactions as mergers, changes of control, or transfers of equity ownership in property-owning entities. However, buyers structuring indirect property acquisitions in such a manner so as to avoid transfer taxes are then faced with the additional complexity of limiting their exposure to the seller entity’s existing liabilities.

8.3 Municipal Taxes

With few exceptions, Tennessee levies a business tax on gross receipts of all businesses that sell goods or services. Businesses must obtain a business license from the county or municipality, and report gross receipts to the Tennessee Department of Revenue on annual returns. Most municipalities, including Nashville, Memphis, Knoxville and Chattanooga, have adopted additional, copycat business taxes on gross receipts. Exemptions apply to nonprofit, religious, medical, farm, charitable, legal, educational, domestic, accounting services, architecture, engineering, surveying and veterinary entities, and entities that generate less than USD10,000 in sales.

8.4 Income Tax Withholding for Foreign Investors

Tennessee does not have an income tax. When a non-US person disposes of an interest in US real estate, the proceeds are subject to 15% withholding under the Foreign Investment in Real Property Tax Act (FIRPTA). The amount of withholding can be adjusted by obtaining a withholding certificate from the Internal Revenue Service.

8.5 Tax Benefits

The primary tax benefit from owning real estate is that property taxes paid are deductible for federal income tax purposes. While land is not depreciable, improvements to land are subject to depreciation. This depreciation is deductible on the owner’s federal income tax return. Owners may also take advantage of the I.R.C. Section 1031 exchange rules, assuming all conditions are satisfied.

8.6 Key Changes in Federal Tax Reform

Please see 1.3 **Impact of the New US Tax Law Changes.**

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