

# Real Estate Issues Affecting the Retail Industry

August 2009

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# Tenant Letters of Credit and Bankruptcy: What If the Tenant Files? What If the Landlord Files?

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In recent years, there has been much discussion regarding the treatment of a Letter of Credit ("LOC") posted by a tenant as security for its obligations under a commercial lease agreement when the tenant files for bankruptcy under the federal bankruptcy code (the "Code").

This article will examine the landlord's options regarding an LOC when the tenant files for bankruptcy. In addition, in light of the current economic climate, this article will examine whether a tenant is better off having posted an LOC instead of a cash security deposit when the landlord files for bankruptcy.

## Why Landlords Prefer LOCs Instead of Cash Security Deposits

It is well established that a cash security deposit posted by a tenant is considered to be property of the tenant's estate in bankruptcy and, therefore, is subject to the automatic stay and may not be accessed by a landlord without court approval. *In re Communicall Central, Inc.*, 106 B.R. 540, 544 (Bankr. N.D. Ill. 1989) (A creditor must obtain relief from the automatic stay or must obtain an order allowing setoff prior to exercising any right of setoff.) An LOC, however, is not property of the tenant's estate in bankruptcy. Rather, an LOC is considered an independent obligation of the issuing bank in favor of the landlord, as beneficiary of the LOC. *ITXS, Inc. v. F&S Hayward, LLOC (In re ITXS, Inc.)*, 318 B.R. 85, 87 (Bankr. W.D.PA 2004). For that reason, it has become almost axiomatic that a landlord should require the tenant to post an LOC *in lieu* of a cash security deposit, so that, even if the tenant files a bankruptcy petition, if the landlord has the right to draw on the LOC, the landlord can provide a sight draft to the bank and get paid.

Once the landlord has drawn on the LOC, however, the question arises as to whether the proceeds of the LOC are subject to the statutory cap on the landlord's damages under a rejected commercial lease pursuant to § 502(b)(6)(B) of the Code.

In *EOP-Colonnade of Dallas Limited Partnership v. Faulkner (In re Stonebridge Technologies, Inc.)*, 430 F.3d 260 (5th Cir. 2005) ("Stonebridge"), the landlord drew down on an LOC, the proceeds of which would have exceeded the statutory cap on damages under the Code, had the landlord filed a proof of claim in the tenant's bankruptcy case. The landlord did not file a proof of claim, and the Fifth Circuit held that the landlord was entitled to retain the entire proceeds of the LOC. The *Stonebridge* court stated: "It is well-established in this circuit that letters of credit and the proceeds therefrom are not property of the debtor's bankruptcy estate. [Citation omitted.] Insofar as letters of credit embody obligations between the issuer and beneficiary, such contractual rights and duties are entirely separate from the debtor's estate."

As for the applicability of the statutory cap on the landlord's damages under a rejected commercial lease pursuant to § 502(b), the court went on to state that:

[b]y its terms, § 502(b) applies only to claims against the bankruptcy estate. See, e.g., *In re SKA! Design, Inc.*, 308 B.R. 777, 781 (Bankr.N.D.Tex. 2004) ("Section 502 deals only with allowance by a landlord of a claim, if presented, against the bankruptcy estate.") (quoting *In re Mr. Gatti's, Inc.*, 162 BR 1004 (Bankr.W.D.Tex. 1994) (*emphasis added*)). Claims under § 502(b) are not

automatically assumed simply because the debtor assumes or rejects a lease under § 365, but rather must be formally filed against the estate in the bankruptcy court.

The court concluded by stating "In sum, § 502(b)(6) does not alter the entitlement of [the landlord] to the full proceeds of the [LOC] in the case where [the landlord] has not also filed a claim against the estate for recovery of unpaid lease monies."

It is for this reason that it has been suggested that a landlord holding an LOC as security for a lease should consider whether it would be better served by not filing a proof of claim in a tenant's bankruptcy case. See Richard Levy, Jr., "Recent Developments in the Bankruptcy Treatment of Letters of Credit Under Commercial Real Estate Leases," *The Practical Real Estate Lawyer*, March 2007, 27.

This is especially true if, as in *Stonebridge*, the proceeds of the LOC apparently did not exceed the landlord's damages for the tenant's breach of the lease (without regard to the statutory cap). If, however, the proceeds of the LOC exceed the amount of the landlord's damages under the lease, the bankruptcy trustee may bring an adversarial proceeding against the landlord to recover the excess proceeds under contract theories (as opposed to bringing claims under the damages cap under the Code). In *Two Trees v. Builders Transport, Inc. (In re Builders Transport)*, 471 F.3d 1178 (11th Cir. 2006) ("*Builder's Transport*"), the court allowed a "turnover" action in which the debtor could seek to recover from the landlord the proceeds of the LOC, which were in excess of the damages to which the landlord would have been entitled under the lease agreement and applicable state law for the tenant's breach of the

lease. Thus, the issue was not whether the LOC proceeds exceeded the statutory cap on damages under the Code, but whether the landlord had the right pursuant to the underlying lease agreement and applicable state law to retain all of the LOC proceeds. See also *In Re Lexington Healthcare Group, Inc.*, 363 B.R. 713 (Bankr. D.Del. 2007).

So, while not immune from challenge, on balance it would seem that landlords are still better off to require an LOC *in lieu* of a cash security deposit. Landlords and their real estate counsel are cautioned to check with knowledgeable bankruptcy counsel in the district in which the bankruptcy is filed in order to determine how best to proceed.

As a practice pointer for the drafters of lease agreements, in particular in light of current turmoil in the banking world, landlords that hold LOCs as security need to take another look at which bank issued the LOC. Landlords should be reviewing every LOC that they are holding, in order to check on the financial stability of the issuing bank. It would be a terrible result for a landlord if, when a tenant defaulted

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on its lease, the landlord went to draw on the LOC and the bank had failed. In fact, it was reported in the media that the FDIC, as part of its placing failed banks into receivership, was sending letters to landlords notifying landlords that the FDIC will not be honoring LOCs that were issued by the failed bank. See, e.g., Michael Kuhn and Pat Sharkey, "FDIC Magic-The Disappearing Letter of Credit," <http://images.jw.com/ealert/realestate/2009/0204.html>, accessed June 1, 2009; and article by Kevin Groarke *infra*.)

This issue also arose in the early 1990s when many savings and loan institutions were failing. At that time, landlords started to wonder what would happen to the LOCs that they were holding if the bank that issued them failed. For these reasons, landlord's counsel should include language in the lease to require the tenant to replace the LOC if the rating of the issuing bank is ever lower than when the LOC was originally issued. Here is suggested language:

If at any time during the term of the Lease the rating of the issuing bank by Standard & Poor's, Moody's, or a similar nationally recognized rating organization is ever lower than the rating of the issuing bank as of the date of the Lease, then, at Landlord's option, Tenant shall replace the Letter of Credit with a Letter of Credit issued by a different bank acceptable to Landlord, or, if Tenant is unable to replace the Letter of Credit, Tenant shall post a cash security deposit with Landlord in the amount of the Letter of Credit.

### **Why Tenants Should Prefer to Post LOCs Instead of Cash Security Deposits**

While much attention has been paid to the issue of how landlords are affected by a bankruptcy filing by a tenant, comparatively little attention has been paid to how tenants are affected by a bankruptcy filing by a landlord. In the current economic climate, however (highlighted by a landlord having recently filed the largest real estate bankruptcy ever), this issue is worth exploring.

For most commercial tenants and their counsel, the prevailing thinking has been to prefer to post a cash deposit, unless the required deposit was a substantial sum. Most tenants do not want to incur the expenses associated with (a) having the LOC issued; (b) providing sufficient security to the issuing bank to serve as collateral for the LOC, should the landlord draw down on the LOC; and (c) maintaining the LOC for every year of the term of the lease agreement. (For larger tenants with large credit facilities, LOCs can often be issued without much additional expense, and those types of tenants will often post an LOC even if the required deposit is a relatively small amount of money; however, those types of tenants are not the norm.)

However, perhaps it is time for attorneys representing commercial tenants to counsel their clients on the ramifications of posting a cash security deposit, should the landlord file bankruptcy. In the authors' experience, the vast majority of commercial lease agreements provide that a tenant's security deposit is not being held in trust, and may be commingled with the landlord's other funds. Essentially, this makes the cash security deposit not much more than a book entry in the landlord's ledger. If the landlord

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“If the security deposit is in cash and the landlord is foreclosed, the deposit is basically gone.”

files for bankruptcy, what happens to that cash deposit? Although most tenants would probably assume that the money goes back to them, a cash deposit that is commingled with the landlord's general funds is probably just a general unsecured claim.

Although in many cases the cash security deposit would be protected because the bankrupt landlord will likely assume the lease (in particular, if there are a number of years left on the lease), if the tenant's lease expires during the pendency of the bankruptcy and the tenant moves out of the space, the tenant may need to file a proof of claim to get back its deposit. Similarly, if the landlord rejects the lease (if, for example, the lease is expiring in the near term), the tenant may need to file a proof of claim to get its deposit back (even if the tenant elects to remain in the space following the landlord's rejection pursuant to §365(h)(1)(A)-(B) of the Code).

In contrast to a cash security deposit, if the landlord files for bankruptcy and the tenant has posted an LOC, because the landlord only has a right to draw under the LOC if the tenant fails to perform under the lease, the landlord only has a possessory interest in the LOC, but no right to the proceeds absent the tenant's default. Therefore, assuming the tenant is not in default under the lease, the LOC may not be drawn on by the landlord or its bankruptcy trustee, and will ultimately expire by its own terms. With that risk in mind, the costs to post the LOC, provide collateral to the issuing bank and maintain the LOC annually seem like a good investment for the tenant when compared to the possibility of a cash deposit ending up as an unsecured claim in the landlord's bankruptcy.

Another reason for tenants to consider posting LOCs instead of cash security deposits is what happens in a foreclosure. In a foreclosure, there is a good chance that the cash deposit could be wiped out as well. In many states, the return of the security deposit is considered to be a personal obligation of the landlord, and not a covenant running with the land. If the landlord's lender forecloses on the property, then the lender (or other purchaser at the foreclosure sale) will not have a legal obligation to return the cash deposit to the tenant. See, e.g., Milton R. Friedman and Patrick A. Randolph, Jr., *Friedman on Leases*, § 20:5.2[A] (Patrick A. Randolph, Jr., Ed., 5th ed. 2004, Supp. 2009); Mark A. Senn, *Commercial Real Estate Leases: Preparation, Negotiation, and Forms* § 28.07 (3rd ed. 2000, Supp. 2006). Instead, similar to an unsecured claim in a bankruptcy of the landlord, the tenant is left trying to chase down the money from the original landlord, with the chances of recovery slim to none.

Even for a large tenant that has a non-disturbance agreement (“NDA”) in place with the landlord's lender, typically the NDA will specifically provide that the lender (or other purchaser at a foreclosure sale) is not responsible for the return of any security deposit not actually received by the lender (or purchaser). Therefore, if the security deposit is in cash and the landlord is foreclosed, the deposit is basically gone. If the tenant posted an LOC, however, the tenant's deposit is still intact.

# Key Aspects of the Federal Stimulus Package Directly Affecting the Real Estate Market

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With the enactment of the American Recovery and Reinvestment Act (ARRA), the federal government presents an exciting opportunity for business owners, corporations, real estate developers, and investors in the real estate market to acquire, develop, and/or improve real property at values that have been unavailable in recent past. Under the ARRA, the federal government has directed more than \$15 billion to the states and bolstered certain financial programs that are key to the real estate market in an effort to stimulate development and effect job creation in areas most impacted by the current economic stagnation.

The key aspects of the federal stimulus package directly affecting the real estate market include the following:

**Economic Recovery Zone Facility Revenue Bonds** - \$15 billion (nationally) in Economic Recovery Zone Facility Revenue Bonds is available for allocation to the states and their municipalities, providing tax-exempt financing for the acquisition of land and the new construction of facilities (including commercial and retail properties but

excluding rental residential projects) in state-designated "recovery zones".

**Tax-Exempt Debt** - Tax-exempt debt is available to finance the construction, renovation, expansion, or improvement of facilities used in the creation or production of intangible property, such as research and development spaces, and of facilities that are "functionally related and subordinate to" manufacturing operations, such as offices, training facilities, and warehouse space.

**Higher Borrowing Limits** - There are higher borrowing limits under the Small Business Administration loan programs enabling a greater pool of business owners access to affordable commercial loans.

**Low Income Housing Tax Credit Programs** - \$2.25 Billion is allocated for the Low Income Housing Tax Credit programs to bolster the market for the development of affordable housing.

**Brownfields Redevelopment Funding** - Increased funding is available for the redevelopment of brownfields and the remediation of environmentally impacted real property.

**New Market Tax Credit Program** - There is a \$1.5 Billion increase in the availability of federal tax credits under the New Market Tax Credit program to attract the private investment in projects located in and serving low-income communities.

**“Build America Bonds”** - These bonds provide a 35% or 45% direct annual subsidy for the interest payments due, or a 35% income tax credit for the holders of these bonds. Proceeds of the bonds may be used for public projects including infrastructure and any other project which a municipality, agency, or authority could finance with public funds or general obligation debt, i.e., the projects must be publicly owned and used by the public.

**“Shovel Ready” Grants** - Federal grants are available for “shovel ready” infrastructure projects which can support or enhance nearby private property or proposed development.

**EDA Grant Funds** - \$150 million (nationally) of U.S. Department of Commerce grant funds will be disbursed through the U.S. Economic Development Authority (EDA) to state and local governmental entities and eligible non-profits to generate and retain private sector jobs and to generate private investment in economically distressed areas, particularly those areas suffering from sudden and severe job loss and dislocation due to corporate restructuring, with a focus on creating high skilled, high wage-earning jobs; promoting innovation and entrepreneurship; attracting new industry; and significantly benefiting the regional economy. EDA grant funds are also available to support construction or rehabilitation of public infrastructure and facilities necessary to attract private sector jobs and investments.

**Community Development Block Grants** - These grants are available through the U.S. Department of Housing

and Urban Development (HUD) to states (allocated in accordance with existing statutory formulas to existing HUD recipients) for use by state and local agencies, non-profits, and community-based organizations for the acquisition of real property, the rehabilitation of residential and non-residential structures, and the provision of public facilities and improvements amongst other eligible activities and programs geared toward job creation, neighborhood revitalization, energy conservation, or infrastructure improvement projects that can be initiated within 120 days after funds are available. The grant monies may also be used by micro enterprises and for profit entities that seek to fulfill the economic policy of HUD or to fund urgently needed community development projects that state and local HUD contracted agencies are currently unable to finance.

**HUD Grants and Loans** - \$250 million in grants and loans will be available through HUD beginning in June 2009 to owners of Section 202, Section 811, and project based Section 8 properties exclusively to fund the retrofitting of such properties with energy efficient utilities and other infrastructure that will result in environmental benefits. The funds will be administered by the Office of Affordable Housing Preservation, using established policy and programmatic approaches with loans being available up to \$15,000 per unit for individual eligible projects and grants being available only to owners of Section 202 and 811 projects and certain nonprofit owners. Additional incentives exist in connection with the pre-development work, the rehabilitation of the units upon completion and for jobs to low-income community created by the rehabilitation work, as well as for the on-going efficient performance of

“The opportunity for long term capital investments at a significant value exists now for those ready, willing, and able to seize the benefits that are available under the ARRA.”

the housing. Recipients of grant or loan proceeds must meet certain HUD due diligence requirements, comply with certain wage restrictions, renew the existing HUD project-based contracts for an additional 15 years beyond expiration of the existing contract, and be able to close within 120 days.

The opportunity for long term capital investments at a significant value exists now for those ready, willing, and able to seize the benefits that are available under the ARRA.

Akerman offers vast experience in accessing federal and state programmatic financing and economic incentives that lowers the cost of development. Our real estate team includes more than 140 lawyers with substantial experience in complex real estate transactions, tax certiorari, economic development incentives, development and construction projects, environmental and natural resources matters, public-private initiatives, and litigation matters.

# Implementing The “Community Renewal Act”

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“The next several months are critical in implementation of SB 360 and questions have already surfaced regarding interpretation of key features.”

On June 1, 2009, Governor Crist signed into law SB 360, resulting in major changes to Florida’s growth management requirements. The “Community Renewal Act” was designed to streamline real estate development and concurrency processes in urbanized areas throughout the state, potentially providing opportunities for stalled projects and encouraging development in targeted areas. The bill became law upon the Governor’s signature.

The next several months are critical in implementation of SB 360 and questions have already surfaced regarding interpretation of key features. Stakeholder input will be essential as local governments make decisions that will determine the ultimate impact of the legislation. This may create new opportunities for projects which have been stalled or abandoned due to concurrency and DRI problems or due to the high costs of proportionate fair-share mitigation. Development interests will need to work with the local governments where these projects are located to explore the possibilities for obtaining relief. In addition, certain actions are required on the part of development interests in order to take advantage of significant benefits, most notably a two-year extension of certain permits and approvals.

It must be noted that on July 7, a coalition of local governments filed a lawsuit challenging the constitutionality of the legislation, on the grounds that it violated constitutional provisions relative to unfunded mandates and single subject requirements. This lawsuit is creating additional uncertainty for local governments and other stakeholders, further complicating the already difficult process of implementation.

Outlined below are the key changes to Florida’s growth management laws under SB 360 and major implementation issues that have been raised:

**Development Approval Extensions.** The legislation extends by 2 years, with conditions and limitations, permits with expiration dates of September 1, 2008 through January 1, 2012 issued by the Department of Environmental Protection (DEP) or the water management districts (WMDs) pursuant to part IV of Chapter 373, Florida Statutes. The extension also applies to local government-issued development orders, building permits and build-out dates, including any build-out date extension previously granted under s. 380.06(19)(c). This will allow many projects to retain their approvals through the economic downturn. Conditions include written notification by the permit or approval holder to the authorizing agency by December 31, 2009.

A question has been raised regarding whether the extension applies only to those local government approvals associated with a DEP or WMD approval or whether it applies to any local government approvals meeting the criteria. With the notification deadline approaching, those who wish to take advantage of the extension should begin working on filing the notices soon, to provide time to work through any issues that may be raised regarding eligibility. In addition, some development orders may have received a 3-year extension under HB 7203 in 2007 and may need to document that extension in order to qualify under the expiration date criteria outlined above.

**Dense Urban Land Areas.** SB 360 defines “dense urban land areas” as municipalities of over 5,000 population with an average density of at least 1,000 persons per square mile and counties (including their municipalities) with at least 1,000 persons per square mile or 1 million population. Dense urban land areas will be identified by the Office of Economic and Demographic Research no later than July 1 each year and the state land planning agency must publish the list of qualifying jurisdictions within 7 days of receipt. The bill provides certain streamlining incentives to development in these areas as explained below.

**Urban Service Areas.** The legislation provides a revised definition of “urban service area” (USA) and allows local governments to use the streamlined alternative state review process to designate USAs within comprehensive plans. These changes should enable more communities to take advantage of

the transportation concurrency exceptions and DRI exemptions under the new law. Urban growth boundaries and USAs established prior to July 1, 2009 in dense urban land areas are “grandfathered” for purposes of the legislation.

**Transportation Concurrency Exceptions Areas (TCEAs).** SB 360 creates by statute new TCEAs in cities that are dense urban land areas, in the USAs of counties that are dense urban land areas and in counties that (with municipalities) have a population of 900,000 and no USA. The bill also provides for the establishment of TCEAs at the local jurisdiction’s option in other targeted areas, including urban infill areas, urban infill and redevelopment areas and USAs and, within cities, community redevelopment areas and downtown revitalization areas. Broward County and Miami-Dade are excluded from these provisions. TCEAs remove state requirements for strict compliance with roadway level of service standards in favor of mobility strategies and thereby eliminate a major obstacle to growth in urban areas. Strategies to “support and fund mobility within the exception area, including alternative modes of transportation” must be adopted into the comprehensive plan within two years.

The bill further provides that plans and plan amendments within TCEAs that are designated and maintained in compliance with the law are deemed to meet the requirement to achieve and maintain level of service standards for transportation. This provision will facilitate plan amendments that increase intensity of land uses within TCEAs.

Language is included specifically providing that designation of a TCEA does not limit local government’s ability to adopt ordinances or impose fees, nor

do the provisions affect any contract or agreement entered into, or development order rendered prior to the creation of the TCEA, except as provided under the DRI exemption language. This language has raised a host of issues regarding implementation.

Some local governments are taking the position that because their comprehensive plans and concurrency systems are locally adopted ordinances, they may retain these systems without change as a matter of local choice. Further, Florida Department of Community Affairs (DCA) Secretary Pelham has stated that if a local government wishes to remove the level of service standards and concurrency systems from its plan, it must process a plan amendment to do so and in the interim, the current provisions remain in effect. Others believe that this position negates the intent of the bill and that while local governments may be able to set development standards for transportation, these standards cannot amount to a

“Stay informed of how local governments are approaching implementation and seek legally sound strategies that can advance implementation and achieve common goals.”

concurrency requirement. Another question under discussion is whether affected local governments must readopt provisions with specific reference to and under procedures of their home rule authority since the transportation concurrency provisions of Chapter 163, Florida Statutes no longer apply.

The uncertainties created by the recently filed lawsuit and the various interpretations of the legislation, coupled with the possibility of additional legislative changes in upcoming sessions, have led many local governments – even some who were moving towards implementing the TCEAs – to conclude that they should do nothing in the short term. It will be critical in the coming months to stay informed of how local governments are approaching implementation and seek legally sound strategies that can advance implementation and achieve common goals.

**Development of Regional Impact (DRI) Exemptions.** SB 360 creates by statute exemptions to the DRI process in the same areas identified for TCEAs. There is an important difference, however, because if a local government that is not a dense urban land area creates any of the designated urban infill and redevelopment and urban service areas within their plan, the DRI exemption within those areas is automatic rather than at the local government's discretion (as is the case for TCEAs outside the dense urban land areas).

The bill also contains provisions to govern the treatment of existing and pending DRIs in exempt areas. Pending DRIs may continue through the review process or opt out. Existing DRIs may continue as a DRI or rescind their development orders (DOs) under the usual requirements, including having completed all mitigation requirements for development existing on the date of rescission (s. 380.115 (1), F.S.).

The legislation requires submittal to the state land planning agency of development orders for projects within exempt areas exceeding 120 percent of any applicable DRI threshold that would otherwise be subject to DRI review. The bill allows for appeal by the state land planning agency based only on comprehensive plan consistency.

With respect to transportation, methodologies for DRIs must use the same level of service (LOS) standards that are applied by the local government for concurrency, to provide more consistency in modeling and mitigation.

Fewer implementation questions have been raised with respect to the DRI exemption, as local governments have fewer choices to make. DRIs will need to assess the advantages and disadvantages of their DRI status, with particular consideration given to the potential changes that could be made in roadway LOS requirements, funding and possible changes to the local government capital improvements element. Depending on the provisions of the particular DO and how the local government implements the various features of the bill, there could also be some opportunity to seek renegotiation of DO conditions. Analysis should include any change that could affect the project not only in the host jurisdiction, but also in adjacent jurisdictions.

There are obvious concerns on the part of local governments as well, especially with regard to the removal of the DRI mechanism as a means of receiving funding for roadway impacts, particularly from projects in neighboring jurisdictions. Because

“Fewer implementation questions have been raised with respect to the DRI exemption, as local governments have fewer choices to make.”

the DRI process has been a primary means of addressing extrajurisdictional impacts, the legislation may lead to an increased use of local intergovernmental coordination mechanisms to serve this purpose. This issue could also be addressed through the proposed mobility fee, which is currently under study (see below).

**State Road Levels of Service.** Local governments will be required to use FDOT LOS standards only on the Strategic Intermodal System (not the Florida Intrastate Highway System) and TCEAs are exempted from the requirement. This provision gives local government the ability to accept more congestion on certain state roads where this is consistent with community objectives and thereby strengthens local government’s control of land use decisions.

**Public School Mitigation Options.** The legislation provides flexibility on the use of portable structures and charter schools in mitigating for impacts on public schools, thereby expanding options for addressing development impacts. In communities that have failed to comply with requirements for public school facilities planning, the bill removes the prohibition against processing certain plan amendments and provides for potential sanctions by the Administration Commission.

**Delay in Financial Feasibility Requirement.** The bill revises a mandate included in the previous SB 360 (passed in 2005) by delaying until 2011 the requirement for financial feasibility of the capital improvements element update. The

annual update must still be submitted.

**Other Land Development Regulations.**

At the request of the applicant, local governments must now consider required zoning changes at the same time as the related comprehensive plan amendments. This is currently done by many local governments and provides increased certainty and a more efficient process for the applicant.

The legislation also requires that local government land development regulations maintain the density of residential properties or recreational vehicle parks if the properties are intended for residential use, are located in the unincorporated area, have sufficient infrastructure as determined by the local government and are not located in the coastal high hazard area as defined by statute.

**Mobility Fee.** SB 360 calls for a joint report from the Florida Department of Transportation and DCA regarding a “mobility fee” that could take the place of transportation concurrency throughout the state. The mobility fee has been considered in the past few legislative sessions, but SB 360 requires that the report be completed by the end of 2009, in time for the 2010 session. Although a variety of options are currently being studied, the mobility fee has often been discussed as a single fee for transportation impacts that would be set using a statewide methodology, replacing impact fees and other funding mechanisms. The intent is to provide a more equitable method for distributing the costs of roadway improvements.

A wide variety of stakeholder groups from developers to growth management

oversight groups have expressed support for the mobility fee concept, but reaching agreement on the particulars will be a huge challenge. If the fee is adopted and preempts local government’s ability to impose other fees, it will be a significant change that could not only affect the amount and source of funding for roads, but also how the funds are distributed among responsible jurisdictions and agencies. Equitable distribution of transportation impact and proportionate fair-share fees has been a major intergovernmental issue.

**Affordable Housing.** In a late amendment, a number of provisions were added to SB 360 relating to affordable housing. These include tax exemptions, use of local government infrastructure surtax, housing for children and young adults leaving foster care, and various changes to the State Housing Initiatives Partnership (SHIP) program.

“SB 360 calls for a joint report from the Florida Department of Transportation and DCA regarding a ‘mobility fee’ that could take the place of transportation concurrency throughout the state.”

# Akerman Team Responds to Toxic Chinese Drywall Issues

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Akerman has formed a new legal team to address potential liability, construction defect, building code violations and toxic tort issues surrounding the installation of Chinese drywall in new construction in the United States. The team represents developers, home-builders, general contractors, construction companies, building supply distributors, banks and mortgage lenders, and others involved in the construction industry, who may be associated with the use or installation of tainted Chinese drywall in buildings. Several class action lawsuits have already been filed against residential and commercial developers, and contractors and suppliers, alleging that the drywall they installed was defective and is now emitting sulfur gas. The plaintiffs in these lawsuits argue that the tainted drywall is responsible for a whole host of problems in their buildings, including corrosive damage to electrical, plumbing, and air conditioning systems, and other components made of metal or containing wire, as well as adverse health effects.

## What is Chinese Drywall?

Chinese drywall is defective or tainted drywall (also referred to as wallboard or plasterboard) imported from China. Not all drywall manufactured in China is defective and some drywall bearing the brands of U.S. companies has also been found to be tainted. The U.S. drywall may have been first imported from China and then re-labeled with U.S. drywall brand-names.

Although it is not entirely known why Chinese drywall is causing problems in buildings, the most likely explanation is that humidity in the air causes sulfur in the drywall to more rapidly off-gas and migrate into the indoor air. The problem with Chinese drywall was originally thought to be limited to construction in the Southeastern states and California during the increased demand for construction materials between the years 2004 and 2006, but is now thought to be more widespread, with problems identified in many more geographical areas throughout the United States. In addition, Chinese drywall has allegedly been recently found in homes built or remodeled as early as 2001.

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### Potential Recall of Chinese Drywall

Most recently, the issue has gotten the attention of two U.S. Senators. Senators Bill Nelson of Florida and Mary Landrieu of Louisiana, filed new legislation aimed at initiating a recall and imposing an immediate ban on “tainted building products from China.” In particular, the senators are calling for a recall of the high-sulfur Chinese drywall. The legislation also asks the U.S. Consumer Product Safety Commission and the Environmental Protection Agency to determine the level of potential hazard and toxicity posed by the drywall. The Akerman Team will be closely tracking this and other related legislation as it develops.

### Toxic Tort and Health Concerns

In addition to problems with corrosion and damage to electrical and other components, homeowners have also alleged toxicity and health-related problems from the drywall, leaving an opening for developers and others in the construction industry to be exposed to potential liability for toxic tort. The science is currently developing in this area but the results of current and future research and testing may give potential plaintiffs the ammunition they need to move forward with health-related lawsuits.

One such report already has surfaced from the Florida Department of Health. The report contains preliminary results from testing samples of Chinese drywall. The tests found that the material contained higher sulfuric and organic compounds than an American drywall sample. The Chinese drywall contained traces of strontium sulfide while the American sample did not. The Chinese drywall also contained hydrogen sulfide, carbonyl sulfide, and carbon disulfide, all of which are potentially toxic compounds. Carbon disulfide in particular is also extremely flammable. The report also found that Chinese drywall gave off a sulfur odor when exposed to extreme heat and moisture. It recommends further testing to determine whether organic or sulfur components are to blame for problems associated with the drywall in Florida. At this time, the Department of Health has not indicated that the drywall poses a medical hazard or that the data suggests an imminent or chronic health hazard.

### The Akerman Team

The Akerman Team has been mobilized to work with clients in the construction industry who are facing warranty claims, lawsuits, and other legal and business issues stemming from the use or alleged use of tainted drywall. Akerman offers a comprehensive and one-stop resource for the investigation and defense of drywall-related and other construction liability claims. Our multi-disciplinary team consists of attorneys from Akerman’s Construction, Environmental, Toxic Torts and Products Liability Litigation, and Insurance practice groups. Our attorneys have developed relationships with environmental, indoor air quality, and construction scientists and experts who can help diagnose and evaluate specific situations. We can advise concerning potential legal liability, remediation strategies and cost, mitigation strategy, the duty to warn homeowners or end users, and requirements for notices. Our team of experienced litigators can help defend against lawsuits and class actions alleging liability, and can establish a litigation strategy customized to each client.

Akerman is ranked among the top 100 law firms in the U.S. by *The National Law Journal NLJ 250* (2008) in number of lawyers and is one of the largest firms in Florida. With more than 500 lawyers and government affairs professionals, we serve clients from major business centers in Florida, New York, Washington, D.C., California, Virginia, Colorado, and Texas.

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