

Real Estate Law Update

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Welcome to another issue of the Real Estate Law Update, a bulletin published regularly by the Land Use and Zoning and Real Estate Transactions Groups at Lerch, Early & Brewer as a service to our clients. Here, you will find articles written by our attorneys covering a variety of current legal issues as they affect real estate law.

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County Council Approves 2007 Growth Policy Amendments

On November 13, 2007, the Montgomery County Council approved multiple amendments to the County's Growth Policy, which significantly increase development taxes and tighten standards governing traffic congestion and school crowding.

Lerch, Early & Brewer Real Estate Group News and Notes

The latest news and information from our firm.

Guarantors of Non-Recourse Loans Should Beware of Broad Interpretation of "Bad Boy" Carve-Outs



If you have ever borrowed money from a lender who syndicates and sells its loans on Wall Street (a "Conduit Loan"), you will have seen a loan document referred to as a guaranty of the non-recourse carve-outs. What the guaranty does is create personal liability for the guarantor of an otherwise non-recourse loan for either the payment of the entire loan amount or, in some cases, just the payment of any loss which the lender incurs if the borrower or guarantor undertakes certain wrongful acts frequently



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referred to as the "bad boy acts". These acts often include fraud, misappropriation of insurance proceeds, transfers of the property in violation of the loan documents, violation of the "single purpose entity" covenants, declaring bankruptcy, etc. In fact, each year the list of bad boy acts gets longer and longer.

In a recent decision, to the surprise of the borrower and many lawyers and legal commentators, a judge found that the actions described below constituted "bad boy acts" thereby causing the entire loan to be fully recourse and making the borrower and guarantor liable for the entire loan amount.

In this case, the borrower owned a small retail center with a major tenant whose lease was about to expire. The neighboring land owner applied for zoning approval to build a new facility to attract the borrower's tenant. The borrower challenged the approval and ultimately the neighbor paid the borrower a significant sum of money to drop its challenge. The borrower arranged to have the funds paid directly to a related entity.



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The neighbor then built its facility, the borrower's tenant moved into the new facility and the borrower was unable to find a replacement tenant. The borrower could not make its loan payments, the loan went into default and upon foreclosure of the property, a large deficiency remained.

The lender sued the borrower and guarantor personally for the deficiency alleging that several bad boy acts of the borrower resulted in the borrower and the guarantor being personally liable for the deficiency.

The Court found that accepting payment from the neighboring property owner in exchange for dropping its opposition to the neighbor's building project constituted a sale of an interest in the borrower's property triggering recourse liability for the loan. The deed of trust broadly defined trust property to include proceeds related to the real property, such as condemnation proceeds, insurance proceeds and even proceeds from the settlement of litigation related to rights or interests in the property.



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In addition, the transfer of the settlement proceeds to a related entity (thereby depriving the lender of additional collateral) was determined to constitute a bad boy act by virtue of either being a further prohibited transfer of trust property or a violation of the single purpose entity requirements.

Often bad facts make bad law, and this borrower's less than above-board action may have motivated the court to find a way to cause the borrower or guarantor to make the lender whole. Nonetheless, this case should cause borrowers and guarantors to think twice when dealing with non-traditional cash proceeds closely related to the property.

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Montgomery County To Require Green Building Design Standards

MONTGOMERY COUNTY IS GOING GREEN, AND AREA DEVELOPERS, LANDLORDS AND LENDERS SHOULD TAKE NOTICE.



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In November 2006, the Montgomery County Council enacted green building legislation, which will require certain new construction in the County to satisfy the U.S. Green Building Council's (USGBC) Leadership in Energy and Environmental Design (LEED) standards. This legislation applies to applications for building permits for newly constructed or extensively modified non-residential or four story or larger multi-family residential buildings with at least 10,000 square feet of gross floor area beginning September 1, 2008.

Specifically, the Department of Permitting Services will condition the issuance of building permits and use-and-occupancy certificates on the achievement of a LEED "silver-level rating" (33-38 points or its equivalent) for County financed non-residential or multi-family residential buildings, and on the achievement of a LEED "certified-level rating" (26-32 points or its equivalent) for privately financed non-residential or multi-family residential buildings.

LEED rating points are awarded to buildings for being designed and constructed with a wide-variety of energy saving and environmentally-sensitive features, such as bike storage and changing rooms, vegetated roofs, and composting toilets. Points can also be earned by locating a building near public transportation or on a remediated site.

The new LEED rating requirements will impact not only developers, but also, landlords and



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lenders. Structural modifications of more than half of a building's gross floor area could require compliance with the LEED design standards. If the modifications are for a major tenant, then the cost of complying with the LEED design standards will have to be addressed in the tenant's lease. Lenders will also need to monitor compliance with the LEED design standards as part of their construction loan administration.

Until the overdue regulations are finally issued by the County, many questions regarding the application and scope of the new green building requirements will remain unanswered. Please contact one of our real estate professionals for more information about this legislation.

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Unambiguous Language – an Update

A PREVIOUS NEWSLETTER ARTICLE REPORTED ON THE CASE OF *WELLS FARGO BANK, N.A. V. DIAMOND POINT PLAZA, L.P.*, DECIDED IN THE MARYLAND COURT OF SPECIAL APPEALS. THE DECISION DEALT WITH A NUMBER OF ISSUES SURROUNDING RETAIL LEASES AND LOANS SECURED BY RETAIL CENTERS, INCLUDING A RADIUS RESTRICTION CONTAINED IN A LEASE WITH WAL-MART FOR A SAM'S CLUB STORE AT THE DIAMOND POINT SHOPPING CENTER.



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As reported in the prior article, the Court of Special Appeals found that the language in the radius restriction clause was ambiguous and sent the case back to the Circuit Court. However, the case was subsequently appealed to the Court of Appeals, which found that the language was not ambiguous, and ruled in favor of Wal-Mart.

The Sam's Club lease contained a clause which provided that Tenant "shall not, during the term of this lease, own, operate, manage or have any financial interest in, any store or business located within a radius of seven miles from the Shopping Center and similar to that then being conducted upon the demised premises." Sam's Club ceased operations at the Diamond Point Plaza shopping center and the next day opened a new store at the Golden Ring Mall, less than seven miles away.



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Sam's Club contended that its actions did not violate the radius restriction clause because the operations of the new store at Golden Ring were not similar to the operations **then** being conducted at Diamond Point, because Sam's Club was at that time having no operations at Diamond Point. The lender, Wells Fargo, focused on the "during the term of this lease" language and argued that it was a breach of the lease for any competing store to be operated within the restricted area during the lease term, regardless of whether the Diamond Point store was then in operation.

In *Diamond Point v. Wells, Fargo*, the Court of Appeals reviewed the following principles of contract interpretation to determine whether the lease clause was ambiguous. A contract is ambiguous if, "when read by a reasonably prudent person, it is susceptible of more than one meaning." Simply because a party in litigation offers a meaning different from the plain meaning of language, does not make that language ambiguous. If the language is unambiguous, a court must give effect to the plain meaning and not contemplate what the parties may have subjectively intended. Further, in determining whether language is ambiguous, a court must give effect to each clause.

In applying these principles to the radius restriction clause in the Wal-Mart lease, the Court of Special Appeals found that the language was unambiguous, and that its plain intent was to prohibit Wal-Mart from operating another store within the restricted area while also operating a store at the Diamond Point shopping center. The Court held that one could only accept Wells Fargo's interpretation, that the clause restricted any competing store to be operated within the restricted area during the lease term, regardless of whether the Diamond Point store was then in operation, by ignoring the last clause in the restriction which read "and similar to that **then** being conducted upon the demised premises" (emphasis added).



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The fact that the Court of Special Appeals and the Court of Appeals came to differing conclusions on whether or not language in a lease was ambiguous emphasizes the need for language be as clear and unambiguous as possible when drafting leases and contracts.

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Guarantor Not Liable to Payor of Letter of Credit



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THE CALIFORNIA COURT OF APPEALS HAS REFUSED TO ALLOW THE PAYOR UNDER A LETTER OF CREDIT PLEDGED AS SUPPLEMENTARY COLLATERAL TO COLLECT FROM THE GUARANTORS OF THE ORIGINAL OBLIGATION.

In *Morgan Creek Residential v. Kemp*, Morgan Creek provided a letter of credit to Citicapital Commercial Corporation to secure the obligations of Morgan Creek Golf Club, LLC. Kemp, Haws and the other defendants were either members of Morgan Creek or principals of the members. The Golf Club requested a \$10 million loan from Citicapital to complete a golf course. The defendants were required by Citicapital to guaranty the loan in the aggregate amount of \$4.8 million. Citicapital requested further collateral, and Morgan Creek loaned \$2.8MM to the operating member of the Golf Club and then provided a \$1.4 million letter of credit to Citicapital as additional collateral for the loan. Citicapital ultimately made a \$6.5 million loan to the Golf Club.



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Thereafter, as a result of mechanic's liens and other issues, Citicapital gave notice of a loan default and provided the Golf Club with an opportunity to cure. None of the members of the Golf Club took any action to cure, and Citicapital called the letter of credit, which Morgan Creek honored. Citicapital used the proceeds from the letter of credit to pay down the principal balance of the loan and the members restructured the remaining debt and sold the assets of the Golf Club to themselves. Morgan Creek sued, in various amended complaints, claiming it was owed i) equitable contribution from all co-obligors under the original loan, and ii) subrogation, under the theory that it was subrogated to the rights of the bank for whose benefit the letter of credit had been issued. The court dismissed Morgan Creek's complaint against Kemp and Haws and Morgan Creek appealed.

On appeal, Morgan Creek claimed that it was entitled to equitable contribution from Kemp and Haws because they were all obligated to answer for the Golf Club's debt and yet Morgan Creek was the only one who paid. The Court disagreed, pointing out that the liability under Morgan Creek's letter of credit was inherently different from the liability under Haws and Kemp's guarantees. The Court pointed to California statute as well as case law and stated that equitable contribution only applies where two parties have debts that are equal and concurrent and, thus, the liability should be shared in proportion to their coverage of risk. Here, the Court determined that since the fundamental obligations under a letter of credit and a guaranty (the one being a principal obligation and the other being secondary) are different, the theory of equitable contribution cannot be applied.



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Further, Morgan Creek claimed that, under the theory of subrogation (which allows someone who has paid the debt of another to step into the shoes of the creditor and pursue the one who should have paid) it should be able to "assert Citicapital's rights under the written guarantees to obtain pro rata contribution from Kemp and Haws" for the money it paid under the letter of credit. The Court disagreed on this count also, stating that it was the Golf Club, not Haws and Kemp, that was primarily liable on the underlying debt. The Court further stated that subrogation, even if applied, would not allow Morgan Creek to assert rights against the guarantors who were, in essence, "third parties not in default to the beneficiary and not liable for the portion of the indebtedness paid by the call on the letter of credit." The Court opined that to allow Morgan Creek to proceed under subrogation would be inconsistent with the aim of subrogation, which is designed for those who pay debts for which another is primarily liable.

This case is a reminder to those who are asked to help out their affiliates – do not agree to do so unless you have a separate agreement regarding contribution or reimbursement or unless you are prepared to make payment and live with the consequences. It is cited as *Morgan Creek Residential v. Earl S. Kemp et al.*, 153 Cal.App.4th 675.

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County Council Approves 2007 Growth Policy Amendments

ON NOVEMBER 13, 2007, THE MONTGOMERY COUNTY COUNCIL APPROVED MULTIPLE AMENDMENTS TO THE COUNTY'S GROWTH POLICY, WHICH SIGNIFICANTLY INCREASE DEVELOPMENT TAXES AND TIGHTEN STANDARDS GOVERNING TRAFFIC CONGESTION AND SCHOOL CROWDING.

OUR SERVICES

Highlights of the amendments include:

Representation of developers and investors in connection with the acquisition, sale,

- As of December 1, 2007, 70% increases in the transportation and school impact taxes (payable at the time of building permit issuance) will take effect. For instance, transportation impact taxes increased from \$6,264 to \$10,649 for a single family detached house, and from \$5.70/sf for office to \$9.69/sf.; the school impact tax increased from \$9,111 to \$20,456 for a single family detached

development, financing, and leasing of commercial and multi-family residential properties.

Assisting clients in negotiating and reviewing contracts of sale and financing documents, structuring the ownership entity and determining the manner in which title to property is acquired.

Providing title services and serving as title agent and settlement agent

Assisting clients in securing acquisition/construction financing.

Assisting owners and developers in obtaining the governmental approvals required to develop real property for residential, commercial, and retail uses.

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house.

- As of December 1, 2007, an increase in the surcharge for single-family dwelling school impact taxes from \$1/square foot to \$2/square foot for homes ranging between 3,500 square feet and 8,500 square feet.
- As of March 1, 2008, an increment of \$3.10/\$1000 (0.31%) will be added to the state recordation tax for any property sold for more than \$500,000 on the amount over \$500,000. This amounts to a 45% increase in the recordation tax.
- The inclusion of a new Policy Area Mobility Review (PAMR) test, in addition to the Local Area Transportation Review (LATR) for new subdivision applications. This will require that developers mitigate the transportation impacts of development that exceeds certain mobility thresholds. PAMR and LATR will be applied to subdivision applications filed on or after January 1, 2007 that have not been approved by the Planning Board by November 13, 2007. Also, the LATR intersection congestion standards were tightened and the rings of intersections required to be analyzed in traffic studies were increased.
- The application of a new school adequacy test, which can place County school clusters in a residential moratorium if school capacity is exceeded. A hefty school facilities payment will be assessed for projects in a school cluster over 105% of program capacity, and a moratorium will be imposed if the school cluster is over 120% of program capacity. The school facilities payment has been increased from \$12,500 per student to \$19,514 per elementary school student, \$25,411 per middle school student, and \$28,501 per high school student. The school adequacy test also will be applied to subdivision applications filed on or after January 1, 2007 that have not been approved by the Planning Board by November 13, 2007.

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Maryland.

The Land Use and Zoning Group is pleased to welcome **April Birnbaum**, who recently joined as an associate. Prior to joining the firm, Ms. Birnbaum worked as a law clerk with the firm of Rich & Henderson, P.C., providing support in matters related to environmental and land use litigation. She received her J.D., with a Certificate of Concentration in Environmental Law, from the University of Maryland School of Law in 2007. In 2003, Ms. Birnbaum received her Master of Environmental Studies degree, with a concentration in Environmental Policy, from the University of Pennsylvania. She received her B.A. degree, with a distinction in Environmental Studies and Urban Studies, from the University of Pennsylvania in 2002. She is admitted to practice in



Patrick O'Neil, an associate in the Land Use Group, has been active in several area organizations, having been recently elected to the position of Vice President of Economic Development for the Bethesda-Chevy Chase Chamber of Commerce. In addition, he was also accepted into the 2008 class of Leadership Montgomery, an organization whose vision is to "bring together current and emerging leaders to make Montgomery County a better place to live and work."

In addition to other attorneys throughout the firm, three attorneys in LEB's Land Use Group were selected to appear in the 2007-08 edition of the "Best Lawyers in America". They include **Robby Brewer**, **Harry Lerch**, and **Steve Robins**. Attorneys who appear in the Best Lawyers directory are selected based upon the recommendations of their peers in the legal industry.

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We Would Like To Hear From You

We publish this newsletter as a service to our clients as a means to make them aware of certain aspects of the law. As always, we would like to hear feedback from our readers regarding the content of the newsletter. If there are items or topics you would like to see covered in future issues, or you have a suggestion concerning the newsletter itself, you may send them to Kathy Sherwick at klsherwick@lerchearly.com.

Additionally, a number of the Firm's other departments periodically issue highly informative newsletters on a variety of other subjects, including Commercial Lending and Community Associations. To view one or more of these newsletters, you may access them through our website, www.lerchearly.com.

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