DEVELOPMENTS IN REAL ESTATE:
Key Issues in Real Estate Acquisition and Development

Presented to:

Texas Association of State Senior College & University Business Officers

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A. INTRODUCTION AND SCOPE

There are a myriad of issues that are raised in the acquisition of real estate by colleges and universities. This paper will focus on some of the core issues, including authority, due diligence, Constitutional limitations, land planning, municipal regulations, taxes, and documentation of the real estate transaction. The intent of this paper is to give the business officer who is involved in a real estate transaction but is not a real estate attorney or real estate specialist an understanding of the basics of each of the core topics.

This paper is not intended to give legal advice or to give legal opinions on specific fact situations. It is also not intended to be a comprehensive examination of real property due diligence issues and real estate transactions, but rather to provide an overview of some of the major issues present in real property acquisition and development. Please consult with competent legal, engineering, architectural, and other real estate experts for more detailed advice on the topics covered by this paper.

B. ACQUISITION

1. Authority

A state agency has only such power and authority as is granted by statute or that may be necessarily implied from the statutory authorization. Consequently, before acquiring real property, whether by gift or purchase, and whether by outright acquisition or a lease, it is necessary to consult the enabling statutes for the particular college or university to determine whether the institution has the requisite authority to do so and to determine what requirements must be met.

2. Constitutional Limitation

Article III, Section 51 of the Texas Constitution provides, in part:

> *The Legislature shall have no power to make any grant or authorize the making of any grant of public moneys to any individual, association of individuals, municipal or other corporations whatsoever . . .*

Article III, Section 51 has been construed to prohibit the grant of state property and contract rights as well as money.

In the context of the acquisition of real property, the Constitutional provision may be reasonably interpreted to require that a state agency pay no more than market value

or market rental for the property. The definition of "market value" in *The Dictionary of Real Estate Appraisal* is "[t]he most probable price which a property should bring in a competitive and open market under all conditions requisite to a fair sale, the buyer and seller each acting prudently and knowledgeably and assuming the price is not affected by undue stimulus."

Note that the definition uses the word "probable." A competent appraisal is a guide to the appropriate value of a parcel of real property, but there may be other facts and circumstances that may influence the market value. For example, if a college is assembling parcels of land and is seeking to acquire the last lot in a block, there may be an assemblage premium, although the premium will vary based on the facts and circumstances.

3. Eminent Domain

A state agency is authorized to acquire property by eminent domain "for a public use." Texas Property Code § 21.012. The enabling statutes of the college or university should be reviewed, however, for specific authority or limitations on authority.

Legislation enacted in 2005 limits the exercise of eminent domain by institutions of higher education. Texas Education Code § 51.9045 prohibits an institution of higher education from using eminent domain to acquire land to be used for a lodging facility or for parking or a parking structure intended to be used in connection with the lodging facility. "Lodging facility" is defined to exclude a dormitory or other student housing. The prohibition is applicable to condemnation proceedings initiated on or after November 18, 2005.

Additionally, Texas Government Code, § 2206.001 prohibits a governmental entity from acquiring property by eminent domain if the taking (1) confers a private benefit on a particular private party through the use of the property, (2) is for a public use that is a pretext for conferring such a private benefit, or (3) is for economic development purposes. The prohibitions do not apply to the acquisition of property by eminent domain for, among other purposes, (a) public buildings, hospitals and parks, (b) a library, museum, or related facility and infrastructure, (c) transportation projects, and (d) provision of utility services. The prohibitions also do not apply to (i) the taking of a leasehold on property owned by the governmental entity or (ii) a condemnation action initiated before the effective date of November 18, 2005.

An additional limitation pertains to property that is acquired by eminent domain for a public use that is canceled before the 10th anniversary of the date of acquisition. Texas Property Code §§ 21.101-21.103 requires that the condemning authority, within 180 days after the use is canceled, notify the owner, its successors or assigns, of the right to repurchase at fair market value.

The 79th Texas Legislature established an interim committee to study the use of eminent domain, including takings for economic development purposes and adequate compensation for property taken. Additionally, interim charges to standing committees

in the Texas House and Senate were issued for a study of eminent domain, including the exercise of eminent domain by non-elected governmental bodies.

4. Texas Higher Education Coordinating Board

The Texas Higher Education Coordinating Board is statutorily authorized to approve the acquisition of real property by institutions of higher education, excluding public junior colleges. Texas Education Code § 61.0572(b)(5). The Coordinating Board has adopted rules governing the review and approval process. 19 Texas Administrative Code §§ 17.1 – 17.52.

Section 17.11 of the Coordinating Board's rules exempts some types of transactions from the requirement for Coordinating Board approval. Exemptions exist for, among other things: gifts, grants, or lease-purchase arrangements intended for clinical or research facilities; lease of property or facilities (although a lease-purchase agreement for improved property that is intended to be added to Education and General inventory and that has a value in excess of $300,000 is subject to the approval requirements); and gifts or lease-purchase of unimproved real property.

It is prudent to consult the rules well in advance of a planned acquisition to determine whether Coordinating Board approval is required. If Coordinating Board approval is required, various documentation must be submitted to the board, including evidence of the prior approval of the institution's governing board, and documentation of the value of the property. If the property value is $300,000 or more, two appraisals must be submitted to the board. Appraiser qualifications are specified in § 17.51 of the rules.

5. Due Diligence

a. Title

There is no one document that shows the status of title to real property. A deed reflects ownership of the property, but usually will not reveal the existence or status of liens or other encumbrances against the property, possible defects in title, or other significant matters. Similarly, a lease evidences the leasehold interest but most likely will not reflect all matters that may affect the use and enjoyment of the leasehold estate.

The most efficient means of determining the status of title to real property is obtaining and reviewing a commitment for title insurance early in the process. A commitment for title insurance is a title insurance underwriter's proposal for a title insurance policy and reflects the underwriter's conclusions as to encumbrances and other matters affecting title, based on a search of applicable public records.

Title insurance is a contract of indemnity that protects against loss incurred by the named insured if the status of title to the property or interest insured is not as stated in the title insurance policy. As with all insurance, what the title insurance policy

excludes from coverage is often as important as what the policy **includes** in the coverage. The policy will cover loss or damage up to the insured amount stated in the policy. A one-time premium is paid for the policy at the time of the closing of the real estate transaction. The premium is based on the amount of the insurance and in Texas the premium amount and even the content of the insuring forms are regulated by state law. Title insurance policies may be obtained to insure fee simple ownership, rights in an easement, a leasehold interest, a mortgage or other lien, and other interests in real property.

Title insurance is not a panacea, as there are significant exclusions from its coverage. It is also not a substitute for conducting your own due diligence review of the property, including a review of all documents referred to or listed in the title commitment. Further, the title insurance is only as good as the title insurance underwriter behind the policy, so be sure to confirm that the title underwriter has ample reserves.

The following examples help to illustrate what title insurance offers:

Example 1: A university purchases a parcel of land on which it plans to build a new science research building. After the university purchases the property, it learns that past due taxes are owed on the property. The past due taxes are not listed as an exception to coverage in the policy. The title insurance underwriter will then pay the amount of the taxes, up to the policy amount.

Example 2: A university receives a gift of real property as a distribution of a deceased donor's estate. After it accepts the deed conveying the gift property, the university discovers that the deceased donor's family has filed a lawsuit challenging the conveyance for a variety of reasons. The title insurance policy does not contain an exception for such claims of title by the relatives. The title underwriter will hire legal counsel to defend the university's title to the property in order to obtain clear title. If clear title cannot be obtained, the underwriter will indemnify the university, up to the policy amount, for the loss of title.

Example 3: A university purchases a parcel of land on which it plans to build a satellite campus. A gravel road crosses the property. The title policy does not contain an exception for the road, but does contain an exception for "rights of parties in possession" and for "visible and apparent easements." At the time of purchase, the university assumed the gravel road was used solely for internal access within the parcel. It later discovered that the road is used--and has been used for the past 50 years--by adjoining landowners to access their property. Because of the exceptions in the title policy, the title insurance may not cover the loss incurred; the university may be faced with the unhappy option of revising its site plan to accommodate the existing road or attempting to strike an agreement with adjoining owners to relocate the road--at the university's expense.

As the above examples illustrate, it is important to know what the title insurance policy covers and what it does not cover. The policy is issued at the closing of the

transaction, but the important work should be done well in advance of the closing. The title commitment is issued in advance of the closing and should be carefully reviewed. If changes to the commitment are negotiated prior to the closing of the real estate transaction, it is wise to obtain a revised commitment on or before the closing. Once the title policy is issued, it should be carefully reviewed to confirm that it accurately reflects the terms of the title commitment.

Below is a list of some of the important matters to consider when reviewing a title commitment.

- **Access.** It is important to confirm that the title company will insure that the property has legal access to a public road. Even if the property has physical access to a public road, it may not have legal access. There may be documents limiting access. The title commitment should report the existence of any such documents, such as a document creating a controlled access highway or a gas pipeline easement that prohibits roadways from crossing the easement area.

- **Documents.** The title commitment **and** all documents referred to or listed in the title commitment should be reviewed and any matters visible on the property but not reflected in written documents should be evaluated. If the review reveals any potential problems, they should be addressed before closing.

- **Easements.** If the commitment lists any easements affecting the property, copies of the easement instruments should be obtained and reviewed. Easements for which no written documents exist also pose potential problems. If the commitment states that the policy will not insure against claims by "parties in possession," then the policy may not provide coverage against an unwritten or unrecorded easement.

  An easement granted by a written document may be "blanket" in nature, meaning that it is not limited to a particular location on the tract, but burdens the entire tract. Blanket easements, because they are not limited to a particular location, hamper development of a tract and should be modified to specify the location of the easement. Modifications require the consent of the party in whose favor the easement was granted.

  Easements that are restricted to a specific location should be shown on the survey plat in order to confirm whether the easement (1) in fact affects the tract and (2) is located in a problem area, such as where an existing building stands. If a building encroaches on an easement and the easement document does not permit the encroachment, it should be determined whether any potential risk--physical or financial--is posed by such an encroachment. The description of an easement in the title

commitment should tie the location of the easement to its location as depicted on the survey plat.

- **Encroachments and Other Matters Reflected on the Survey Plat.** The commitment may except to matters shown on a survey plat of the property, such as a fence line that encroaches into the property, or a roof that protrudes onto adjoining property. All such exceptions should be studied and the risks analyzed.

- **Identity of Current Owner.** The commitment will also reveal who is the current owner of the property. If the owner is other than the party with whom you are dealing, then you must confirm who in fact is the owner(s) and what steps are necessary to address the situation.

- **Leases.** Often a commitment will except to "rights of parties in possession" or rights of tenants under unrecorded leases. As discussed above, a broad exception for rights of parties in possession is never acceptable. A broad exception for rights of tenants under unrecorded leases is also unacceptable. If there are in fact any leases of the property, then the exception should be revised to specifically list leases applicable to the property. You should carefully review each such lease to confirm that it contains no provisions that will adversely affect your interest in the property. For example, a lease may grant a tenant a right of first refusal to purchase the property or an option to lease additional space at a below-market rental for an extended term.

- **Liens and Taxes.** If the commitment states that any liens affect the property, such as tax liens, judgment liens or mortgages, those liens should be reviewed to determine if they are still in effect. If a lien is still in effect, it will be necessary to determine what is required to remove the lien--usually payment of the amount that the lien secures--and who will bear the burden of taking the steps necessary to remove the lien. If the lien is no longer in effect, then documentation must be provided to the title underwriter to remove the exception.

- **Mineral Interests.** The title commitment should reflect whether the mineral estate has been severed from the surface estate. In Texas, the mineral estate is dominant over the surface estate, meaning that unless the owner of the mineral estate has agreed otherwise, it may drill for oil, gas and other minerals anywhere on the tract. That broad right may pose a problem if a university is planning to construct its new building on the tract. Even if the mineral estate has not been severed from the surface estate, there may be outstanding oil and gas leases, which will also limit the use of the tract. If a severance of the surface and mineral estates has occurred or if any oil and gas leases are outstanding, these matters should be carefully evaluated for possible resolution before the closing.

- **Personal Property.** The title commitment does not address the status of title to any personal property located on the real property. If personal property, such as office or medical equipment, is included in the real estate transaction, a separate search of the financing statements filed in the Secretary of State's office and in the County Clerk's office should be made to confirm whether there are any liens against the personal property.

- **Restrictive Covenants.** The commitment should list any restrictive covenants that may limit the use of the property. For example, restrictive covenants may limit the property to use for single-family residences, limit impervious cover, or limit the height of buildings on the site. Copies of the documents referenced in the commitment should be obtained and reviewed. If potential problems exist, they should be addressed with the title underwriter before the closing. For example, if the property has been used for commercial purposes for years, notwithstanding that a restrictive covenant limits the property to use for residential purposes, a title underwriter may agree to provide coverage insuring against loss caused by a violation of the restrictive covenant.

b. Survey

A survey consists of a drawing of the property (the "survey plat") and, unless the property is a lot within a recorded subdivision, a narrative description of the boundary lines of the tract, using courses, distances, and references to natural or artificial monuments (the "metes and bounds description"). It is prepared by an individual licensed by the state to perform surveys.

Only a survey can confirm the boundaries of the property and the other characteristics of the property--the location of easements, improvements, waterways, flood zones, etc. A survey is therefore essential to the transaction. Moreover, because the standard form title commitment excludes from coverage discrepancies or conflicts in boundary lines or encroachments or protrusions of improvements, a land title survey (also called a "Category 1A survey") is required to confirm that no such problems exist so that the title policy may be issued without that exclusion. A "boundary survey" shows only boundaries and is not intended to show easements, improvements or other matters that are important in a land sale, purchase or lease transaction.

Minimum standards of practice for land surveys have been promulgated by the Texas Board of Professional Land Surveying in 22 Texas Administrative Code Part 29. Additionally, the Texas Society of Professional Surveyors promulgates a manual of practices for the various categories of land surveys in Texas, which is available from the society's website at http://www.tsps.org/index.html. These standards of practice specify classifications of land title surveys based on the location of the land (urban, suburban, rural, etc.), and the purpose for the survey.

If you are not familiar with reviewing surveys, it can be a daunting task at first. Knowing what to look for is the key. Some of the major issues are discussed below.

- **Access.** The survey plat should show the access that the tract has to a public street. Note, however, that it should not be assumed that a tract has legal access even if the tract physically abuts the street.

- **Adjoining Property.** It is usually desirable to show on the survey plat the adjoining property in order to be certain that there are no strips or gores between the surveyed tract and the adjacent tract. The recording information for the deed held by the owner of the adjoining parcel should be shown on the survey plat.

- **Certificate.** The surveyor's certificate defines the scope and extent of work. It constitutes a representation by the surveyor of the matters stated in the certificate. Certificates generally take one of two different forms: a basic certificate that simply states that the survey meets the requirements of published standards, or a detailed certificate listing a variety of specific actions taken and conclusions reached by the surveyor. Each type of certificate has certain benefits. The more detailed form will be appropriate when there are particular issues of interest that the parties want the surveyor to address. The certificate should be addressed to the parties to the transaction (and often is also addressed to the title company), should be signed by the surveyor, and should state that the survey was made "on the ground"--in other words, a certification that the surveyor actually went to the site to make the survey, as opposed to sitting in his office and redrawing an old survey.

- **Easements and Other Matters.** All easements, all building lines imposed by restrictive covenants, the subdivision plat or zoning ordinances, and all other matters on the title commitment that can be shown on the survey plat should be depicted on the survey plat. The survey plat should also show any easements or rights-of-way or other possible evidence of the existence of rights of parties in possession not evidenced by recorded documents, but which are evident from a physical inspection of the tract. Any offsite easements that affect the use of the land, such as access and drainage easements, should be shown on the survey plat.

- **Flood Plain.** If some portion of the tract is in the flood plain, the certification should identify the flood plain map used as the basis for that conclusion and state the type of flood hazard area located on the property. The location of the flood plain should be depicted on the survey plat.

- **General Matters.** The survey plat should be dated to ascertain that it is a current survey. There should be a legend on the survey plat that identifies

the symbols used. The survey plat should also show the property's street address.

- **Improvements.** All existing improvements, including parking areas, sidewalks, internal streets, etc., should be shown on the survey plat. If construction is planned, the survey plat should show the proposed location of the improvements. Once the foundation is laid, a resurvey should be made to confirm that the foundation has been placed where intended (and within the property boundaries).

- **Metes and Bounds Description.** The course and distance calls on the survey plat should match exactly those stated in the metes and bounds description prepared by the surveyor. The metes and bounds description should substantially conform to the property description contained in prior deeds or other conveyances. Confirm also that the metes and bounds description matches the property description contained in the title commitment.

- **Utilities.** The location of utilities serving the tract should be located on the survey plat. A sewer line easement running along the boundary of a tract does not necessarily mean that the owner or occupant of the tract has the right to tap into that line. The same caveat applies to almost any utility crossing the tract. Therefore, the availability and adequacy of utilities to the property should be investigated. Utilities include water, wastewater, storm drainage, natural gas, electricity, telephone, and cable service.

c. Environmental Assessment

An environmental due diligence assessment is an analytical method of identifying, evaluating and managing environmental risks. It identifies historical uses that have been conducted on the site, identifies the presence and extent of environmental contamination of hazardous substances, evaluates the risks associated with the contamination, identifies potential environmental issues that may affect any planned development on the site, and determines the most feasible method of managing the environmental risk and complying with environmental regulations applicable to development or use of the site.

The primary purpose for conducting an environmental due diligence assessment is to reduce the risk of liability. If the property is to be developed, the environmental due diligence assessment must go beyond identifying existing risks, to also evaluate potential environmental issues that may affect the development process.

Environmental due diligence and acquisitions. Federal and state statutes impose certain liabilities on owners or operators of real property when hazardous or other regulated substances have been deposited, stored, or released on the property. Hazardous and other regulated substances include not only the most dangerous or toxic

substances, but also a wide array of chemicals and compounds, many of which are components of household trash or are found in raw materials and wastes. Liabilities related to hazardous and other regulated substances may include costs associated with removal of these substances from the property, including overhead and enforcement expenses. If environmental hazards are identified, the institution should then weigh the risks that may arise with respect to such hazards in determining whether the acquisition is beneficial and appropriate. If no risks are identified, the institution may, under certain circumstances, be able to assert a defense to liability if contamination that was unknown at the time of acquisition is later discovered.

With respect to existing environmental risks on the property, the standard against which to measure the scope of the environmental due diligence assessment is statutorily prescribed by the federal Comprehensive Environmental Response, Compensation and Liability Act (CERCLA) (42 U.S.C. §§ 9601-9657) as “all appropriate inquiry into the previous ownership and uses of the property consistent with good commercial or customary practice in an effort to minimize liability.” The Environmental Protection Agency (EPA) recently established federal standards and practices for conducting all appropriate inquiries as required under CERCLA.

The EPA rule (40 CFR Part 312), which is effective November 1, 2006, establishes specific regulatory requirements and standards for conducting all appropriate inquiries into the previous ownership and uses of a property for the purposes of qualifying for certain landowner liability protections under CERCLA. CERCLA provides a defense to CERCLA liability for those persons who demonstrate, among other requirements, that they "did not know and had no reason to know" prior to purchasing a property that any hazardous substance that is the subject of a release or threatened release was disposed of on, in, or at the property. Such persons, to demonstrate that they had "no reason to know," must have undertaken, prior to acquiring the property, "all appropriate inquiries" into the previous ownership and uses of the property. Liability protection does not extend, however, to liabilities arising under other environmental statutes or the common law or liabilities associated with petroleum.

The EPA “all appropriate inquiries" rule requires that the investigation must be conducted within one year prior to the date of acquisition of the property, although portions of the investigation must be completed within 180 days of and prior to acquisition of the property. Required elements include an inquiry by an environmental professional, the collection of specified information by specified persons, and searches for recorded environmental cleanup liens. The inquiry of the environmental professional must include, among other information, interviews with past and present owners, reviews of historical sources and government records, visual inspections, and gathering of commonly known or reasonably ascertainable information.

The environmental professional must seek to identify current and past property uses and occupancies, current and past uses of hazardous substances, waste management and disposal activities that could have caused releases or threatened releases of hazardous substances, current and past corrective actions and response

activities undertaken to address past and on-going releases of hazardous substances, engineering controls, institutional controls, and properties adjoining or located nearby the subject property that have environmental conditions that could have resulted in conditions indicative of releases or threatened releases of hazardous substances to the subject property.

Whether an institution first conducts a more limited assessment in the form of a "transaction screen," or whether it begins with a Phase I environmental site assessment that meets the requirements of the "all appropriate inquiries" rule, will be dictated by the particular facts of the transaction. ASTM has established standards for a transaction screen process, designated E1528. To qualify for liability protection under CERCLA, however, a property purchaser must comply with the requirements of the EPA "all appropriate inquiries" rule. The standards set forth in the ASTM E1527-05 Phase 1 Environmental Site Assessment meet the requirements of the rule. ASTM may be contacted at http://www.astm.org.

It should be stressed that the environmental site assessment must be tailored to the particular facts. If there is any concern about whether the site has any asbestos containing materials, radon, lead-based paint, lead in drinking water, or wetlands, those inquiries should be specifically undertaken. Note also that a Phase I environmental site assessment is non-intrusive and does not include field sampling or soil and water testing. Depending on the particular facts, the parties may wish to include additional areas of investigation in the initial environmental site assessment.

If the initial environmental site assessment indicates areas of concern, an institution will need to consider various options, which, depending on the facts of the transaction, may include the following: (i) not acquire the property, (ii) acquire the property with the identified risks, (iii) require the seller or lessor to remove the contamination, or (iv) require further investigation.

Environmental due diligence and land development. With respect to planned development of the site, there are a myriad of state and federal environmental laws that may affect the time frame, cost and, sometimes, even the ability to develop the site. Some of the areas of concern in the federal environmental law arena are the following:

- Clean Water Act (42 U.S.C. §§ 7401 et seq.). This federal act makes it unlawful to discharge any pollutant except in accordance with the provisions of the act. Included in the act are two federal permitting programs: the National Pollutant Discharge Elimination System ("NPDES") program implemented by the Environmental Protection Agency, and the dredged or fill material permit program, implemented by the U. S. Army Corps of Engineers. Development activities may trigger NPDES permitting requirements for discharges of storm water runoff from the construction site into a municipal separate storm sewer system or waters of the United States. Plans to place fill material on the site or dredge a portion of the site may require a permit from the U. S. Army Corps of Engineers.

- National Flood Insurance Program (42 U.S.C. §§ 4001-4127). This act makes federally subsidized flood insurance available to political subdivisions that meet minimum qualifications. To qualify, the political subdivision must adopt flood plain ordinances restricting development in flood plains. An ordinance may require permits for construction in areas that are in designated flood plains.

- Endangered Species Act (16 U.S.C. §§ 1531 et seq.). This act provides for the determination and protection of endangered species. It prohibits the "taking" of an endangered species. A taking is defined to include modifying an endangered species' habitat. Because of the broad definition of a taking, real estate development may often result in a "taking" because of the development activity's effect on the habitat. No taking may occur without a permit, which must be sought from the U. S. Fish and Wildlife Service.

C. DEVELOPMENT

1. Planning

The necessary first step in development of real property is planning. The campus master plan should align with the institution's goals and should be revised and updated to stay current with those goals.

Some colleges and universities around the country have found a value in extending the planned uses beyond traditional college and university uses to a mixture of uses that serve multiple purposes such as enhancing the amenities for students, faculty, and staff, producing revenue for the institution, better integrating the college or university with the larger community, or providing an interim use for land not currently needed for specific campus purposes.

2. Constitutional Limitation

The same provision of the Texas Constitution (Article III, Section 51) that serves as the basis for the concept that a college or university may pay no more than market value for a property it is acquiring also sets limitations in the structuring of leases and other agreements for the development of state-owned property. As a rule of thumb, leases and other business arrangements for the private development of property owned by the state should be at market rates, as established by an independent appraisal or other competent evidence of market value.

A below market rate is not permitted except in one narrow circumstance. If the use or development of state property serves the specific purposes of the institution, a below market rate may be allowed if the requirements set forth by the Texas Attorney General are met.

In an opinion addressing whether The University of Texas at Austin may provide space in university facilities to The University of Texas Law School Foundation rent-free, the Texas Attorney General enunciated the following requirements that must be met:

1. the grant of public property must serve a public purpose, appropriate to the function of a university;

2. adequate consideration must flow to the public; and

3. the university must maintain controls over the foundation's activities to ensure that the public purpose is actually achieved.

The determination of whether a public purpose is served is to be made by the Board of Regents in the first instance, and if challenged, ultimately by a court. Texas Attorney General Opinion MW-373 (1981).

3. Municipal Regulations

Real property owned by the state or its agencies and used for a public purpose is not subject to municipal ordinances and control with regard to building codes and zoning. In Texas Attorney General Opinion JM-117 (1983), the Attorney General concluded that land under the control of a state agency is exempt from municipal zoning. In that opinion, the Texas Attorney General stated that a "legislative grant of police power to a city is not considered a surrender of the Legislature's right to regulate the state's own property which may be located within a city, unless the statutes clearly show that the Legislature intended to waive state immunity from local regulation." The opinion states that because "the Texas Constitution prohibits home rule city regulation which conflicts with programs and activities of the state and its agencies that are undertaken under constitutional or statutory authority, a state agency delegated by law the responsibility for regulation and control of state property is not subject to the police power of such a city."

No Texas Attorney General opinions address the application of municipal regulations to state property leased to a private entity, but such property is still under the control and jurisdiction of the state, subject to the terms of the lease, and therefore there is a reasonable argument that the property is not subject to the building and other codes and ordinances of a municipality. From a policy standpoint, however, a university or college may nevertheless wish to include in leases with private entities that the private lessee comply with such codes and ordinances.

Subdivision platting requirements are not applicable to real property acquired by a state agency for public purposes, whether the acquisition is by eminent domain, negotiated purchase, or gift, unless the land subdivision includes streets, alleys, parks or other parts intended to be dedicated for public use. *El Paso County v. City of El Paso*, 357 S.W.2d 783 (Tex. Civ. App. – El Paso 1962, no writ); Texas Local Government Code § 232.0015(h).

If a state agency sells less than the whole of the tract of land to a private party for private purposes, however, it must comply with the subdivision platting requirements. Those requirements differ depending on whether the property is within the city limits or the extraterritorial jurisdiction of a city, or whether the property is subject to county jurisdiction.

4. Historic and Archaeologically Significant Properties

Designated state archaeological landmarks may not be removed, altered, damaged, destroyed, salvaged or excavated without a permit from the Texas Historical Commission. Painting of a previously unpainted surface constitutes alteration. Even if a property has not been designated as a state archaeological landmark, certain requirements must be met:

- Structures at least 50 years old. A state agency may not alter, demolish or renovate a building at least 50 years old even though it is not designated as a landmark without first notifying the Texas Historical Commission at least 60 days prior to the proposed work. If the Texas Historical Commission institutes proceedings to determine whether to designate the building not later than 60 days after it receives the notice, the state agency must receive a permit to take the proposed action while the proceedings are pending.

- Discovery of archaeological sites. If during the course of construction or other work, an archaeological site is discovered, the state agency is to stop work immediately and report the site to the Texas Historical Commission. Such sites are to be protected and preserved pending consideration for landmark status. Additionally, contractors working on public lands that discover archaeological sites or historic structures that may qualify for designation are to report the discovery to the state agency and to the Texas Historical Commission, which may initiate designation proceedings.

- Notice before construction. Before breaking ground at a project located on state land, the agency must notify the Texas Historical Commission, which will determine whether an historically significant archaeological site is likely to be present and whether an archaeological survey is necessary. Some institutions have previously received letters from the Texas Antiquities Committee, the predecessor to the Texas Historical Commission, permitting construction without such notice on all or specified portions of the campus.

5. Fire Codes

If the institution is acquiring improvements or planning to construct improvements, part of its early due diligence should be a determination of the requirements of the applicable fire code, as those requirements may have a significant

impact on the cost of modifications to existing improvements or the design and cost of new improvements.

6. Accessibility Requirements

The federal Americans with Disabilities Act (42 U.S.C. §§ 12101 et seq.) and the Texas Architectural Barriers Act (Texas Government Code, Chapter 469) seek to remove architectural barriers to the disabled. State law requires that a state agency, including an institution of higher education, comply with the Texas Architectural Barriers Act when leasing space in a building owned by a private party. The Texas Architectural Barriers Act also applies to new construction, renovations, and modifications of state buildings. The advice of an architect who is skilled in accessibility issues should be sought early in the planning stages for a lease, acquisition, new construction, or renovation.

7. Health Care Regulations

Both state and federal laws may prohibit many of the incentives and commonplace practices of the non-health care real estate industry. Strongly consider seeking the advice of a specialist in this area of the law if the transaction involves property used or to be used in the health care industry. For example, below market rent offered to a doctor to induce the doctor to locate in an office building and refer patients to the adjoining hospital operated by the landlord may violate federal law and result in a void lease if Medicare or Medicaid payments are involved. Two federal laws to investigate are the Stark Anti-Referral Statutes (42 U.S.C. § 1395nn and a portion of the Omnibus Budget Reconciliation Act of 1993) and the Medicare and Medicaid Fraud and Abuse Statute (42 U.S.C. § 1320a). Both acts have leasing "safe harbor" requirements, but the requirements mandate the payment of rent at market value. The advice of a specialist in this area of the law is critical.

8. Taxes

A variety of tax issues may be implicated in real estate development, including the following matters:

a. Property Tax Exemptions

Section 11.11 of the Texas Tax Code governs when public property is exempt from real property taxes (also called ad valorem taxes). The rule in Section 11.11(e) is that public property used for public purposes is tax exempt. Public property used for non-public purposes is taxable. Non-public purposes are (i) purposes that are not related to the performance of the duties or function of the institution and (ii) residential housing that serves the public other than students and employees of the institution. If public property (such as an office building) is leased partially to private tenants for purposes NOT related to the performance of the duties or function of the institution and

is used partially by the institution for its purposes, then the portion leased to private parties is taxable.

If use by a private entity is anticipated, and if the tax exempt status is of importance to the business projections for the transaction, the potential property tax effects of the transaction should be evaluated.

Sometimes taxing jurisdictions levy a tax on a benefit basis, often called a "special assessment." Special assessments may not be levied against state property in the absence of clear legislative authorization if the state has not made and is not contemplating any use of the land and has neither received nor requested the services rendered by the assessing agency. Texas Attorney General Opinion DM-374 (1996).

b. Tax Exempt Bonds and the Private Use Issue

State institutions of higher education often acquire property by issuing bonds, the interest on which is exempt from federal income taxation under Section 103(a) of the Internal Revenue Code. Section 103(b) of the Code, however, contains an exception to that rule for “private activity bonds” that are not “qualified bonds.” Thus, if a proposed transaction involves the use of some portion of the bond-financed property by a private entity, even if that entity is a 501(c)(3) corporation, compliance with the Internal Revenue Service regulations must be ascertained. Transactions involving bond-financed property that occur after the bonds have been issued but before the bonds have been retired must also be evaluated to confirm that a change in ownership, use or management does not jeopardize the tax exempt status of the interest paid on the bonds.

c. Private Developer Financing and Debt Capacity

Some institutions are seeking new ways to provide services and facilities, including the use of a private developer to construct and operate student housing, campus bookstores, parking garages and similar facilities. Depending on how the transaction is structured, it may have an effect on the debt capacity of the institution. Rating agencies will look at whether the proposed project is essential to the mission of the institution or is so linked to the institution that the university would be compelled (although not necessarily legally compelled) to support it should the project run into financial difficulties. If either test is met, then the project will likely be determined to affect the institution’s debt capacity. On the other end of the spectrum, if the property is held solely for investment purposes and any debt on the project is non-recourse, the project will likely not be determined to affect the institution’s debt capacity. A proposed developer financed project should therefore be discussed with bond counsel in the very earliest stage of a proposed transaction.

d. Unrelated Business Taxable Income

Sections 511 and 512 of the Internal Revenue Code impose a tax on the income of exempt organizations that is derived from any unrelated trade or business regularly carried on. Sales and leases of real property should be evaluated to determine whether they may trigger unrelated business taxable income (called "UBIT" by tax professionals). With respect to sales of real property, the focus will be on whether the proposed activity is "regularly carried on." The specific facts of the proposed transaction must be analyzed. With respect to leases, rent of a set amount or calculated as a percentage of gross proceeds will not constitute UBIT. If rent is calculated on a net basis, after the lessee deducts its expenses, the lessor runs the risk that the rent will be treated as UBIT. If, as a part of the lease, services--other than those customarily provided in connection with similar leases--are provided, the rent may be treated as UBIT. A tax advisor should be consulted before the transaction structure is finalized to determine if UBIT is an issue.

D. TRANSACTIONAL DOCUMENTS

The documents that are used in a real property transaction **DO** matter. They define the parties' rights and obligations. Pre-printed, standard forms are rarely acceptable, as such forms take a "one size fits all" approach that rarely fits any specific transaction. Forms drafted by the other party will likely be even less acceptable because the form may represent and protect only the interests of the other party and not your interests. Short, simple letter agreements—tempting though they may be from a time standpoint—are rarely acceptable in real property transactions because of the importance of details and the reality of the litigious nature of our society.

The due diligence reviews of title, survey, environmental matters and other items may reveal issues that should be addressed in the transaction documents. For example, if property to be purchased is subject to leases, an assignment of those leases will be needed; the deed will not convey the seller's interest in the leases. Tenant estoppel certificates should also be obtained. If the due diligence review of the leases reveals that tenants have given security deposits or that brokerage commissions are due periodically during the lease term, the lease assignment must address who has responsibility for those items. Similarly, if a survey reveals a discrepancy in a boundary line, such as a fence located other than on the boundary line, a boundary line agreement with the adjoining property owner to confirm the location of the mutual boundary line may be needed. As another example, an environmental site assessment may reveal existing contamination, in which event indemnifications and assignment of responsibility for clean up and related matters should be included in the transactional documents. As an initial step, the real estate contract should provide the buyer with a feasibility period in which to study such matters and elect to cancel the transaction.

It is beyond the scope of this paper to go into the details of the various transactional documents. An entire paper could be devoted to leases; indeed, an entire paper could be devoted to ground leases or office leases alone. Similarly, there are many issues that must be considered in preparing a contract for the purchase and sale of real property and the related conveyancing documents. Easements, deeds of trust and other security instruments also pose unique legal issues that must be considered and carefully addressed.

Consider the following questions to test your knowledge of different types of transactional documents:

- What is the difference between a general warranty deed, a special warranty deed, a deed without warranty, and a quitclaim?
- What is the difference between an option contract, a letter of intent and a contract for deed? Does a letter of intent bind the parties?
- Are there any notices that federal law requires a seller of residential property to give at the time the real estate sales contract is entered into?
- What is the difference between a right of first refusal and an option to purchase?
- Does an easement granted for a utility line terminate when the utility line no longer exists in the easement area?
- What is the difference between a covenant of continuous operation and a covenant of quiet enjoyment? (In what type of document would you find both covenants?)
- Does an easement constitute a conveyance of the land described in the document or merely the grant of a right-of-way across or beneath the land?
- If a seller contracts to convey to you all of his “right, title and interest” in certain land, is that satisfactory?

If you find yourself stumped by the above questions, I strongly recommend that you seek the advice of competent counsel well in advance of a transaction to ensure that proper documents may be drafted to accurately reflect the business terms and to properly and fairly protect your interests. The foregoing discussions of due diligence items are irrelevant if you sign a contract that obligates you to complete the transaction without reserving the right to conduct those due diligence investigations and without providing a mechanism for addressing and resolving issues that are identified in that due diligence process.

E. CONCLUSION

The many and complex topics covered in this paper underscore the need to include specialists in the real estate transaction from the outset. Because of the degree of detail and the potentially significant liability that may result from overlooked or improperly handled details in real estate transactions, I strongly recommend the use of an advisors with specialized knowledge of the various aspects of property acquisitions and development.