Fall 2010
REAL ESTATE & CONSTRUCTION NEWS

LANDLORD TENANT LAW – RECENT DEVELOPMENTS

Landlord Waiver and Oral Modifications to Lease Agreement. In *Sabatini v. Its Amore Corp.*, a tenant had commenced and completed parking lot modifications without landlord's written consent, which written consent was required by the lease. The lease also contained provisions preventing oral modifications or waivers of the lease covenants. Landlord sued the tenant for breach of lease as a result of the unauthorized modifications. The Court held that in this instance landlord had waived its lease requirements as (i) landlord was aware of the ongoing modifications; (ii) had conversations with the tenant regarding the work; and (iii) did not object (verbally or in writing) to the work until the work was substantially complete. Good practice for landlords, based on this decision, would be to document promptly and in writing any concerns or issues with tenant actions or breaches under the lease to avoid an assumption of waiver or deemed approvals.

Tax-exempt Tenant Does not Qualify Property for Real Estate Tax Exemption. In this case, a public tax-exempt charter school leased property from a commercial landlord. The lease provided that the tenant would pay all real estate taxes assessed against the property. The tax-exempt school tenant sought real estate tax exemption for the property under the Pennsylvania General County Assessment Law exemption for public schools. The Court held that, despite the fact that the tenant was a public school, the leased property generated revenue for the landlord and was owned by a for-profit entity, therefore the property did not qualify for tax exemption. In *Re Appeal of Collegium Foundation, et al.*, 991 A.2d 990 (PA Comm. Ct. 2010).

Landlord Liability for Fire Damage, No Certificate of Occupancy. In *Community Preschool & Nursery of East Liberty, LLC v. Tri-State Realty, Inc.*, (WDPA 2010) a tenant filed against landlord after the leased premises were damaged by fire, and the landlord terminated the lease in accordance with its casualty clause rather than restoring the premises. The tenant sought damages based on landlord negligence alleging that the upstairs level was leased and occupied without a certificate of occupancy, and that this constituted sufficient evidence of negligence. The Court held that the tenant was unable to sufficiently prove causation of the fire (suspected to be faulty wiring) in order to find landlord negligent or in breach of a duty.

Residential Rental Registration Ordinances. Many townships and municipalities throughout the United States have enacted ordinances requiring the registration and/or periodic safety inspections by landlords of residential rental units. Such ordinances have been subjected to constitutional challenge in Pennsylvania.

Pittsburgh, PA: In December 2007, the City of Pittsburgh passed a rental housing registration ordinance requiring landlords to register before renting or leasing housing rental units in the city. The ordinance requires that, prior to registration, all rental units be inspected and issued a certificate of occupancy, accompanied by the payment of inspection and certification fees. In March of 2009, several parties filed a lawsuit opposing the ordinance alleging (i) violation of the rights to due process, equal protection and privacy under the US and Pennsylvania Constitutions; (ii) violation of the Pennsylvania Home Rule Charter; and (iii) alleging that the ordinance constitutes an illegal revenue-generating tax. Enforcement of the ordinance has been stayed indefinitely by consent order before the Allegheny County Court of Common Pleas, Judge Joseph James, since November 2009, while the parties attempt to negotiate a settlement of the matter. The complaint noted the physical impossibility of inspecting, certifying and registering over 69,000 rental units in the City in the proposed four month registration period. *The Apartment Association of Metropolitan Pittsburgh, et al, v. The City of Pittsburgh, et al*; GD 09-3986, Allegheny County Court of Common Pleas.

Hazleton, PA: The United States Court of Appeals for the Third Circuit in September, 2010 affirmed a district court's permanent injunction against enforcement of rental registration ordinances adopted by the City of Hazleton, PA. The Hazleton rental registration ordinance was adopted for the general purpose of preventing

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the harboring of illegal aliens, and required that, before any person over the age of 18 could occupy a residential rental unit, that person must first obtain from the city code enforcement officer an 'occupancy permit' which required proof of legal US citizenship or residency. The ordinance required compliance and enforcement by landlords, with consequent fines and penalties. The complaint alleged violations of the Supremacy, Due Process and Equal Protection clauses of the US Constitution, the Fair Housing Act, the Pennsylvania Home Rule Charter and Landlord and Tenant Act. The Court in its opinion recognized the right of municipalities to "regulate rental accommodations to ensure the health and safety of its residents," but held that the ordinance in question was designed to regulate who could live there, an immigration policy, which regulation is preempted by federal law. The lawsuit also enjoined a second Hazelton ordinance, which regulated the employment of illegal aliens. *Lozano, et al, v. City of Hazleton*, No. 07-3531, (3rd Cir. Sept. 9, 2010).

DGS' BEST VALUE PROCUREMENT NOT DONE THE BEST WAY

DGS' methods of procuring construction contracts found to have violated state statutory requirements. The Pennsylvania Associated Builders and Contractors ("ABC") challenged the use of request for proposals ("RFP's) by Pennsylvania Department of General Services for additions and alterations to the Foster Student Union at Cheyney University. ABC claimed that seeking RFP's for construction work violated the Pennsylvania Procurement Code. While the Court found that the use of the RFP process was allowed, it did find that the methods followed by DGS violated the Pennsylvania Procurement Code.

Prior to 2005, the typical contract bid process was competitive sealed bidding in which the lowest responsible bidder is awarded the contract. In 2005, DGS issued its "Best Value Policy" which authorized the use of RFP's to accomplish DGS' goals of improving upon timely delivery of quality multiple prime construction projects by qualified contractors. The RFP process should be considered for complex projects with allocations exceeding $5,000,000. The policy statement also required that DGS' Deputy Secretary make a written determination that competitive sealed proposal process was either not practicable or not advantageous to the Commonwealth.

Under the RFP procedure a contractor is required to submit a proposal package consisting of three parts. The first, a cost submission which counted for 60% of the points; a technical submission with specifics spelled out in the RFP counting for 30% of the points; and a disadvantaged business enterprise submission that outlined the MBE, WBE and small disadvantaged business participation of the contractor, which counted for 10% of the points. The contractor with the highest point score would be awarded the contract.

Since the Court found that the best value policy was a valid policy, so long as the policy was consistent with section 513 of the Procurement Code which allows a contract to be entered into by competitive sealed proposals, then the policy would be upheld. Section 513 only allows the RFP procedure when the contracting officer determines in writing that the use of competitive sealed bidding is either not practicable or advantageous to the Commonwealth.

The decision of the case turned on what level of particularity is needed when the contracting officer determines, in writing, that the competitive sealed bidding is either not practicable or advantageous. DGS, in its written determination, stated:

> The use of the standard competitive sealed bid process for the renovation of Foster Union would not be advantageous to the Commonwealth. Competitive sealed proposals are a more practical method of procurement since this will allow Proposers flexibility in developing their proposals to address their experience with this type of work and the ability to complete coordinated construction in a timely manner. In addition to expediting the process, this method will be more advantageous by allowing the Commonwealth the ability to consider criteria other than cost in the award process. The prime contracts to be awarded, if any, will be agreed-upon lump sum awards reflecting the costs submitted in the proposals.

Finding that the proposed construction was not unique, that any contractor was always obligated to coordinate its work with other contractors and timely complete its work, the Court found that DGS did not provide enough specificity for finding impracticability or disadvantageous.

It is interesting to note that by the time that the Court rendered its decision, the project had been completed and the Court could afford no relief. What the case does provide is a warning to DGS that it may not merely select the RFP process because it wants to. DGS, subject to judicial scrutiny must provide sufficient detailed explanation of the unique factors that justify a divergence from the traditional sealed bidding procurement process. It is likely that if DGS continues the use of the RFP process that bid protests will become more frequent.

PRIVATE TRANSFER FEE COVENANTS

A "private transfer fee covenant" (sometimes called a "reconveyance fee" or a "capital recovery fee") refers to a covenant attached to real property that requires a fee to be paid to a third party (frequently the property developer) upon each re-sale of the property, generally for a period of 99 years. For example, the Dupaix of Eagle Mountain, Utah were shocked to learn that the home they purchased was burdened with an undisclosed 13 page Declaration of Covenants on record, which required them to pay a resale fee based on a percentage of the price when they next sell the home (*New York Times, 9/11/2010, "Fees that Only Developers Could Love," Janet Morissey*).

Such fees are not new - in the public sector, realty transfer taxes are collected on real estate resales throughout the United States. In California, many disputes between environmentalists and developers were settled by the establishment of such a resale fee, with the proceeds to be applied to the benefit of the non-profit environmental issue or concern. The Boston Redevelopment Authority charges such a fee in at least 25 of its condominium projects throughout the City of Boston, and the revenue is paid to the BRA for its operating costs. However, recently finance groups and developers are using the fee to offset reductions in home values and the need for additional capital– this profit motive, combined with the lack of disclosures to consumers regarding the fees, is inspiring a public outcry against the practice.

The Federal Housing Finance Agency on August 12 published proposed guidelines prohibiting any FNMA or FHMLC purchases or investment in mortgages on real estate bound by such a covenant or securities backed by mortgages bound by such a covenant. The guidelines will go into effect on or about October 12, 2010, subject to any modifications resulting from public commentary. Many states have enacted legislation restricting such private transfer fees (Arizona, Florida, Kansas, Iowa, Maryland, Minnesota, Missouri, Oregon, Texas, and Utah. In California, sellers must disclose private transfer fees. Bills are pending in Hawaii, Illinois, Louisiana, Alabama, North Carolina, Rhode Island, and South Carolina). The American Land Title Association has published underwriter concerns regarding the validity of the covenants, such as: unlawful restraint on alienation; rights that do not touch, concern or run with the land; public policy concerns; and illegal private transfer taxes.

A developer considering such a fee is well advised to research not just the practicality of the proposed fee structure (and any proposed third party structure put in place for collection), but also the current legal and title concerns regarding the enforceability of such a covenant on real property. The attorneys and staff at Maiello, Brungo & Maiello are available to assist if you have any questions regarding such a fee structure.

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RECENT COURT CASE PROHIBITED PRE JUDGMENT INTEREST IN MECHANICS' LIEN CLAIM

A recent Superior Court case prohibited a sub-subcontractor from recovering pre-judgment interest on its mechanics' lien claim upon which it obtained a judgment. Although much of the case was spent dealing with the applicability of the recent amendments to the mechanics' lien statute, the Court did prohibit the recovery of pre-judgment interest. The Court relied upon its prior ruling holding that interest should only be awarded at the statutory rate of 6% and that it should only be applied form the date judgment was entered. The Court also held that because the mechanics lien statute does not specifically address pre-judgment interest, under the Judicial Code, only interest on the judgment is recoverable. This apparently holds true even if the contract, upon which the mechanics' lien is based provides for interest on unpaid contract balances because the mechanics' lien statute only provides for the recovery of labor and material. Items other than labor and material are more properly sought in an action for breach of contract if that contract authorizes the recovery of interest and other damages.

The MB&M Real Estate & Construction Law Team:

Alfred C. Maiello	acm@mbm-law.net
Lawrence J. Maiello	ljm@mbm-law.net
John H. Prorok	jhp@mbm-law.net
David Raves	dr@mbm-law.net
Kathleen C. McConnell	kcm@mbm-law.net
Jennifer L. Cerce	jlc@mbm-law.net
Donald A. Walsh, Jr.	daw@mbm-law.net

To speak with any of our attorneys, call 412-242-4400.

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