

COMMERCIAL GROUND LEASES

- I. Scope of Discussion – Defining the Ground Lease.
 - A. Lease of undeveloped land parcel.
 1. Stand alone.
 2. Part of Development – such as Shopping Center.
 - B. Generally long term, sufficient length to justify amortization of investment in improvements.
 - C. Tenant constructs and owns improvements during lease term.
- II. Benefits of Ground Leases.
 - A. Landlord.
 1. Reduced management responsibility, Tenant develops and operates property.
 2. Converts unproductive asset into income producing asset with predictable income stream.
 3. Strategy for avoiding taxable gain on appreciated property.
 4. Means of retaining ownership of "control" of property while offering investment development opportunity to third party.
 - a) government-owned property.
 - b) tax-exempt organizations.
 - B. Tenant.
 1. Avoids upfront capital investment in land.
 2. Provides effective alternative to secondary financing, often at more attractive rate than conventional financing.
- III. Ground Lease Terms.
 - A. Lease Term.
 1. Basic Term – sufficient to amortize investment, generally 40-100 years, including renewal options.
 2. Renewal Options.

- a) Notice.
- b) Evergreen Provision.

B. Rent.

- 1. Absolute Net Lease
- 2. Periodic Adjustments, Inflation protection.
 - a) Timing of Adjustments.
 - b) Types of Adjustments.
 - (1) fixed – predictability, subject to underperforming inflation.
 - (2) CPI or other inflation indices – less predictable, Tenant may require limits; subject to "clawbacks".
 - (3) fair market rental adjustments
 - (a) by agreement.
 - (b) appraisal.
 - (x) land vs. land and improvements
 - (y) land encumbered by lease vs. land encumbered by use clause only vs. unencumbered
 - (z) effect of changes, such as zoning changes or addition of development rights
 - (c) arbitration.
 - (d) importance of defining term.
- 3. Rent other than or in addition to Fixed Rent – Trade-off for below market fixed rents, Subordination of Fee.
 - a) Percentage Rent.
 - b) Shared Appreciation.

C. Purchase Rights.

- 1. Purchase Option.

- a) defining price.
 - b) time for exercise.
 - 2. Right of First Refusal.
 - 3. Right of First Offer.
 - 4. Exempt Transactions.
 - a) Affiliate.
 - b) Foreclosure of fee mortgage.
 - c) Transfer as part of development or portfolio sale.
- D. Use.
 - 1. Limitations – Tension between Ground Lessor desire for control and Ground Lessee desire for flexibility, maximizing value.
 - 2. Stand-alone properties versus developments.
 - 3. Changes in use.
 - 4. Rights in adjoining property
 - a) parking, access
 - b) restrictions, exclusives (retail properties)
- E. Improvements.
 - 1. Title to Improvements, Reversion.
 - 2. Construction, Alterations.
 - 3. Casualty – reconstruction.
 - 4. Condemnation – sharing of proceeds, rights of leasehold mortgagee.
- F. Assignment and Subletting.
- G. Covenants.
 - 1. Payment of Real Estate Taxes.
 - 2. Maintenance.

3. Environmental.
4. Operation.
5. Insurance.

IV. Financeability.

A. Required for construction of improvements, taking advantage of benefits of financial leverage, sale as exit strategy.

B. Lease Priority, Mortgage Lien Priority.

1. Subordination of the Fee Estate to tenant mortgage debt. (so-called "Subordinated Ground Lease").

(Landlord joins in the mortgage encumbering the Ground Lessee's leasehold interest and Tenant's ownership interest in the improvements and thereby encumbers the land. Essentially, this is the same as a conventional mortgage on land and buildings and preservation of the Ground Lease is of less importance. Financeability of ground lease (i.e., mortgage protections) not as important).

a) Reasons for Encumbering Fee Estate.

- (1) can require higher rent, percentage rent.
- (2) create development incentive, greater financeability.
- (3) Advance agreements to subordinate fee, enforceability issues.
- (4) Limitation to construction or post-development period.
- (5) Conditions.

b) Limitation as to amount.

c) Involvement in development process, consent rights.

d) Notice and cure rights.

2. Fee Estate in Land not encumbered by Tenant mortgage debt (so-called "Unsubordinated Ground Lease").

a) Ground lease must be "financeable" (See IVD. below.)

- b) Less justification for Landlord participation in development decisions or "upside".
- C. Effect of Existing Mortgage Fee.
 - 1. Prohibition of Secondary Financing.
 - 2. Subordination or Non-disturbance.
- D. Leasehold Mortgages Requirements/Unsubordinated Ground Lease.
 - 1. Basics.
 - a) A fixed or predictable rent.
 - b) A term with renewal options that exceeds the maturity date of the loan by a substantial amount of time. Lender right to exercise renewal options.
 - c) A broad use clause.
 - d) A "no merger" clause in case the lessee acquires the fee interest in the property.
 - e) Free assignability, subletting.
 - 2. Right to cure, Notice of Default, Additional Cure Periods.
 - 3. Minimal non-monetary covenants limitation upon termination rights.
 - 4. Insurance and condemnation loss proceeds.
 - 5. Estoppel certificates.
 - 6. Title to improvements; if the lessee builds the improvements, then the ground lease customarily provides that the lessee has title to the improvements until the end of the ground lease term.
 - 7. New lease: upon termination of the ground lease for any reason, the Landlord will enter into a new ground lease with the lender or a third party.
 - 8. Amendments: Lender's right to consent to amendments to the ground lease, as well as the right to consent to any early cancellation or termination of the ground lease.
 - 9. Fee mortgages: subordination or non-disturbance.

- 10. Exculpatory language or ability to use SPE as assignee.
- E. Memorandum of Lease, Loan Title Insurance Policy.
- V. Title Insurance.
 - A. Owner's Leasehold Endorsement (See Exhibit A).
 - B. Lender's Leasehold Endorsement (See Exhibit B).

EXHIBIT A

Form of ALTA 13 Leasehold Endorsement

ENDORSEMENT

ATTACHED TO POLICY NO. _____

ISSUED BY

[Name of Title Insurance Company]

1. As used in this endorsement, the following terms shall mean:
 - a. "Evicted" or "Eviction": (a) the lawful deprivation, in whole or in part, of the right of possession insured by this policy, contrary to the terms of the Lease or (b) the lawful prevention of the use of the land or the Tenant Leasehold Improvements for the purposes permitted by the Lease, in either case, as a result of a matter covered by this policy.
 - b. "Lease": the lease agreement described in Schedule A.
 - c. "Leasehold Estate": the right of possession for the Lease Term.
 - d. "Lease Term": the duration of the Leasehold Estate, including any renewal or extended term if a valid option to renew or extend is contained in the Lease.
 - e. "Personal Property": chattels located on the land and property which, because of their character and manner of affixation to the land, can be severed from the land without causing appreciable damage to themselves or to the land to which they are affixed.
 - f. "Remaining Lease Term": the portion of the Lease Term remaining after the insured has been Evicted as a result of a matter covered by this policy.
 - g. "Tenant Leasehold Improvements": Those improvements, including landscaping, required or permitted to be built on the land by the Lease that have been built at the insured's expense or in which the insured has an interest greater than the right to possession during the Lease Term.
2. The provisions of subsection (b) of Section 7 of the Conditions and Stipulations shall not apply to any Leasehold Estate covered by this policy.
3. Valuation of Estate or Interest Insured

If, in computing loss or damage, it becomes necessary to value the estates or interests of the insured as the result of a covered matter that results in an Eviction, then that value shall consist of the value for the Remaining Lease Term of the Leasehold Estate and any Tenant Leasehold

Improvements existing on the date of the Eviction. The insured claimant shall have the right to have the Leasehold Estate and the Tenant Leasehold Improvements valued either as a whole or separately. In either event, this determination of value shall take into account rent no longer required to be paid for the Remaining Lease Term.

4. Additional Items of Loss Covered by this Endorsement

If the insured is Evicted, the following items of loss, if applicable, shall be included in computing loss or damage incurred by the insured, but not to the extent that the same are included in the valuation of the estates or interests insured by this policy.

- a. The reasonable cost of removing and relocating any Personal Property that the insured has the right to remove and relocate, situated on the land at the time of Eviction, the cost of transportation of that Personal Property for the initial one hundred miles incurred in connection with the relocation, and the reasonable cost of repairing the Personal Property damaged by reason of the removal and relocation.
- b. Rent or damages for use and occupancy of the land prior to the Eviction which the insured as owner of the Leasehold Estate is obligated to pay to any person having paramount title to that of the lessor in the Lease.
- c. The amount of rent that, by the terms of the Lease, the insured must continue to pay to the lessor after Eviction with respect to the portion of the Leasehold Estate and Tenant Leasehold Improvements from which the insured has been Evicted.
- d. The fair market value, at the time of the Eviction, of the estate or interest of the insured in any lease or sublease made by the insured as lessor of all or part of the Leasehold Estate or the Tenant Leasehold Improvements.
- e. Damages that the insured is obligated to pay to lessees or sublessees on account of the breach of any lease or sublease made by the insured as lessor of all or part of the Leasehold Estate or the Tenant Leasehold Improvements caused by the Eviction.
- f. Reasonable costs incurred by the insured to secure a replacement leasehold equivalent to the Leasehold Estate.
- g. If Tenant Leasehold Improvements are not substantially completed at the time of Eviction, the actual cost incurred by the insured, less the salvage value, for the Tenant Leasehold Improvements up to the time of Eviction. Those costs include costs incurred to obtain land use, zoning, building and occupancy permits, architectural and engineering fees, construction management fees, costs of environmental testing and reviews, landscaping

costs and fees, costs and interest on loans for the acquisition and construction.

This endorsement is made a part of the policy and is subject to all of the terms and provisions thereof and of any prior endorsements thereto. Except to the extent expressly stated, it neither modifies any of the terms and provisions of the policy and any prior endorsements, nor does it extend the effective date of the policy and any prior endorsements, nor does it increase the face amount thereof.

[Name of Title Insurance Company]

BY:

AUTHORIZED SIGNATORY

ALTA Form 13 (Leasehold – Owner’s) – (10-13-01)

ALTA Owner’s Policy

EXHIBIT B

Form of ALTA 13.1 Leasehold Endorsement

ENDORSEMENT
ATTACHED TO POLICY NO. _____

ISSUED BY
[Name of Title Insurance Company]

1. As used in this endorsement, the following terms shall mean:
 - a. "Evicted" or "Eviction": (a) the lawful deprivation, in whole or in part, of the right of possession insured by this policy, contrary to the terms of the Lease or (b) the lawful prevention of the use of the land or the Tenant Leasehold Improvements for the purposes permitted by the Lease, in either case, as a result of a matter covered by this policy.
 - b. "Lease": the lease agreement described in Schedule A.
 - c. "Leasehold Estate": the right of possession for the Lease Term.
 - d. "Lease Term": the duration of the Leasehold Estate, including any renewal or extended term if a valid option to renew or extend is contained in the Lease.
 - e. "Personal Property": chattels located on the land and property which, because of their character and manner of affixation to the land, can be severed from the land without causing appreciable damage to themselves or to the land to which they are affixed.
 - f. "Remaining Lease Term": the portion of the Lease Term remaining after the insured has been Evicted as a result of a matter covered by this policy.
 - g. "Tenant": the tenant under the Lease and, after acquisition of all or any part of the estate or interest in the land described in Schedule A in accordance with the provisions of Section 2(a) of the Conditions and Stipulations of this policy, the insured claimant.
 - h. "Tenant Leasehold Improvements": those improvements, including landscaping, required or permitted to be built on the land by the Lease that have been built at the insured's expense or in which the insured has an interest greater than the right to possession during the Lease Term.
2. Valuation of Estate or Interest Insured

If, in computing loss or damage, it becomes necessary to value the estates or interests insured by this policy as the result of a covered matter that results in an

Eviction of the Tenant, then that value shall consist of the value for the Remaining Lease Term of the Leasehold Estate and any Tenant Leasehold Improvements existing on the date of the Eviction. The insured claimant shall have the right to have the Leasehold Estate and the Tenant Leasehold Improvements valued either as a whole or separately. In either event, this determination of value shall take into account rent no longer required to be paid for the Remaining Lease Term.

Additional Items of Loss Covered by this Endorsement

If the insured acquires all or any part of the estate or interest in the land described in Schedule A in accordance with the provisions of Section 2(a) of the Conditions and Stipulations of this policy and thereafter is Evicted, the following items of loss, if applicable, shall be included in computing loss or damage incurred by the insured, but not to the extent that the same are included in the valuation of the estates or interests insured by this policy.

- a. The reasonable cost of removing and relocating any Personal Property that the insured has the right to remove and relocate, situated on the land at the time of Eviction, the cost of transportation of that Personal Property for the initial one hundred miles incurred in connection with the relocation, and the reasonable cost of repairing the Personal Property damaged by reason of the removal and relocation.
- b. Rent or damages for use and occupancy of the land prior to the Eviction which the insured as owner of the Leasehold Estate may be obligated to pay to any person having paramount title to that of the lessor in the Lease.
- c. The amount of rent that, by the terms of the Lease, the insured must continue to pay to the lessor after Eviction with respect to the portion of the Leasehold Estate and Tenant Leasehold Improvements from which the insured has been Evicted.
- d. The fair market value, at the time of the Eviction, of the estate or interest of the insured in any lease or sublease made by the Tenant as lessor of all or part of the Leasehold Estate or the Tenant Leasehold Improvements.
- e. Damages that the insured is obligated to pay to lessees or sublessees on account of the breach of any lease or sublease made by the Tenant as lessor of all or part of the Leasehold Estate or the Tenant Leasehold Improvements caused by the Eviction.
- f. Reasonable costs incurred by the insured to secure a replacement leasehold equivalent to the Leasehold Estate.
- g. If Tenant Leasehold Improvements are not substantially completed at the time of Eviction, the actual cost incurred by the insured, less the salvage value, for the Tenant Leasehold Improvements up to the time of Eviction.

Those costs include costs incurred to obtain land use, zoning, building and occupancy permits, architectural and engineering fees, construction management fees, costs of environmental testing and reviews, landscaping costs.

This endorsement is made a part of the policy and is subject to all of the terms and provisions thereof and of any prior endorsements thereto. Except to the extent expressly stated, it neither modifies any of the terms and provisions of the policy and any prior endorsements, nor does it extend the effective date of the policy and any prior endorsements, nor does it increase the face amount thereof.

[Name of Title Insurance Company]

BY:

AUTHORIZED SIGNATORY

ALTA Form 13.1 (Leasehold - Loan) – (10-13-01)

ALTA Loan Policy