

MODEL GROUND LEASE CRITERIA FOR CMBS AND OTHER LENDERS



JOSHUA STEIN, one of the most prolific contributors to *The Practical Real Estate Lawyer* in its history, handles a wide range of commercial real estate transactions and regularly serves as an expert witness. His firm, Joshua Stein PLLC, achieved its 10th anniversary in August 2020. He is a member of the American College of Real Estate Lawyers and author of five books and over 300 articles on commercial real estate law and practice. Many appear on his website, www.joshuastein.com. He received his law degree from Columbia Law School, where he was a Harlan Fiske Stone Scholar and a managing editor of the *Columbia Law Review*. The author acknowledges with thanks

helpful comments from Joseph Philip Forte, general counsel of Amtrust Title Insurance Company; Bradford Lavender of Haynes and Boone, LLP; and an anonymous rating agency analyst. The author and reviewers reserve the right to assert positions inconsistent with this article, which is offered for discussion only. Copyright © 2021 Joshua Stein.

This Article will appear in slightly different form in the author's upcoming multivolume *New Guide to Ground Leases*, the successor to a book published in 2005 by ALI CLE's predecessor organization. Toward that end, comments on these Model Ground Lease Criteria for CMBS and Other Lenders will be appreciated.

When a securitization includes a leasehold mortgage, the agencies that rate the securities will test the mortgaged ground lease against a set of criteria. Even if a ground lessee has convinced itself it will never seek a mortgage destined for securitization, and will never want to sell to anyone else who might, the rating agency criteria still provide a reliable benchmark to test any ground lease for leasehold acquisition or financing. (This discussion treats Fannie Mae's and Freddie Mac's published ground lease criteria as if they were additional rating agency criteria.)

If a ground lease fails to satisfy one or more rating agency criteria, a leasehold mortgagee might still accept it as collateral if it considers that deficiency not to be material. If it is deemed material, the loan might cost more. The leasehold mortgagee might require unusual personal guaranties, security measures, a lease amendment (often an ordeal, the easiest part of which consists of writing a large check to the ground lessor), or other less-desirable terms. Or the loan might not happen at all.

Thus, rating agency criteria give a ground lease negotiator or reviewer a good checklist to avoid

problems—including potentially substantial impairment of the value of the leasehold estate—when negotiating a new ground lease or evaluating an existing or proposed ground lease.

A ground lessee or leasehold mortgagee, or B-piece buyer for a securitization, might also have its own criteria for ground leases. Anyone reviewing a ground lease must also consider those internal criteria along with rating agency criteria. Internal ground lease criteria might address, for example: (i) required minimum length of the remaining term; (ii) tolerable rent resets; (iii) requirements for involvement in, and approval of, any settlement of a condemnation or insurance claim; and (iv) variations or acceptable deviations from ordinary rating agency criteria. Failure to meet internal criteria can be at least as serious as failure to meet rating agency criteria.

This model document offers a set of concise ground lease criteria (the "Model Ground Lease Criteria") that summarize, consolidate, and slightly improve on current rating agency criteria. These Model Ground Lease Criteria began as a compilation of all available rating agency criteria, followed by revision, reorganization, and addition of commentary.

This article originally appeared in ALI CLE's *Practical Real Estate Lawyer* publication. For more information on ALI CLE, visit www.ali-cle.org. Copyright (C) 2021 Joshua Stein

The Model Ground Lease Criteria have three components:

1. Transactional Criteria. Business terms and other nonfinancial, nonlegal terms and conditions of the ground lease (all, collectively, the “Transactional Criteria”);
2. Closing Criteria. Standards for the leasehold mortgage closing and underwriting process (the “Closing Criteria”);
3. Minimum Protections. A set of baseline leasehold mortgagee protections (the “Minimum Protections”) that the parties could incorporate verbatim into a ground lease.

The Model Ground Lease Criteria sometimes offer a bit less or more than rating agency criteria, as discussed in the footnotes. Other footnotes explore rating agencies’ thought processes, alternatives to proposed language, and the author’s opinions.

The rating agencies’ ground lease criteria sometimes change, though rarely. The descriptions of a particular agency’s criteria may be incomplete, inaccurate, or outdated. Do not rely on them; instead check for updates and review current rating agency criteria.

The Model Ground Lease Criteria: (i) omit criteria that apply to any mortgage loan, whether or not encumbering a leasehold, e.g., title review, clearance, and insurance, which will always require adjustment for the particulars of any transaction; (ii) do not consider property or liability insurance issues, including any arising from overbuilt improvements; (iii) assume the ground lessor will not join in the leasehold mortgage (“subordinate the fee”) because ground lessors rarely do that anymore, unless perhaps they are affiliates or unsophisticated and represented by inexperienced counsel; (iv) attempt to cover every criterion for ground leases established by any rating agency; (v) contain only a handful of defined terms; and (vi) leave most terms undefined where ordinary dictionary definitions should suffice.

The Model Ground Lease Criteria vary from the norm by offering specific language for the Minimum Protections. In contrast, rating agency criteria typically

offer general conceptual descriptions of what the ground lease should say, leaving specific wording to the writer of the ground lease. That approach opens the door for unnecessarily complex and overthought language far beyond rating agency expectations. The Minimum Protections eliminate these general conceptual directions in favor of clear, succinct language ready for parties to insert into a ground lease.

The Minimum Protections only provide the essential protections the rating agencies want to see. They go no further. They paint with a broad brush by omitting specific time periods or deadlines. Time periods are offered only where both: (i) the market consistently expects a certain time period; and (ii) lenders and rating agencies typically consider it important.

The Minimum Protections address only the interests of leasehold mortgagees and not ground lessors, who will often seek to dilute some protections, particularly on transfers. Just how much dilution a rating agency or leasehold mortgagee might tolerate lies outside this discussion.

Parties negotiating a ground lease can—and (their lawyers) often will—massively complicate the Minimum Protections with clarifications, conditions, exceptions, and so on. This is where problems arise. The more clarifications, conditions, exceptions, and so on, the greater the chance for mistakes and disputes.

In contrast, any ground lease could incorporate the Minimum Protections verbatim because they are straightforward, don’t invite overthinking, and require less editing and negotiation than typical leasehold mortgagee protections. For all these reasons, they reduce the likelihood of mistakes and disputes.

The Minimum Protections, however, omit and disregard a significant number of details that parties typically include in modern ground leases, going beyond rating agency requirements. Any resulting risks should be considered in light of both the infrequency with which leasehold mortgagees actually exercise leasehold mortgagee protections and the

tendency of parties to work things out when a problem arises. During the Great Financial Crisis and real estate recession of 2008-2009, did many leasehold mortgagees activate their protections or request new leases? How many parties actually had to read the lengthy and often unnecessarily complex leasehold mortgagee protections in their ground leases? Not many.

If a ground lease covers each base suggested by the Model Ground Lease Criteria, the ground lease reviewer can reasonably conclude that the ground lease contains minimally adequate leasehold mortgagee protections. The ground lease should thereby pass muster with the rating agencies, subject, of course, to: (i) unique transaction details; (ii) compliance with general rating agency criteria for mortgage loans and any party's internal criteria; (iii) compliance with ordinary mortgage loan closing procedures; and (iv) general unease in the market and legal profession regarding simple, succinct language.

MODEL GROUND LEASE CRITERIA FOR CMBS AND OTHER LENDERS

Any ground lease encumbered by a leasehold mortgage should: (i) comply with the Transactional Criteria and Closing Criteria below; and (ii) contain provisions equivalent to or more protective than the Minimum Protections below (requirements “i” and “ii,” together, the “Model Ground Lease Criteria”).

Any party that deposits a leasehold mortgage into any securitization (the “Depositor”) will need to represent and warrant compliance with the Model Ground Lease Criteria, in addition to making ordinary representations and warranties for any mortgage loan not encumbering a leasehold estate. If the leasehold mortgage transaction does not fully comply with the Model Ground Lease Criteria, then the loan file should include a memorandum identifying and analyzing the noncompliance, and why it should not impair successful securitization of the leasehold mortgage loan.

1. Transactional Criteria

The ground lease and its terms should comply with these criteria (collectively, the “Transactional Criteria”):

1.1. Investment standards. The mortgaged property is located in a market where ground leases are an accepted form of real estate investment. The ground lease is a ground lease, not a space lease, as those terms are commonly understood in commercial real estate. It contains no unusual or burdensome provisions outside the range of typical provisions in ground leases in the market.¹

1.2. Prohibitions. The ground lease does not: (i) give a leasehold mortgagee any shared appreciation rights or equity (or revenue) participation, such as percentage rent;² or (ii) trigger a default based on a default under the leasehold mortgage. The ground lease is not a sublease.³

1.3. Rent increases. Rent will increase taking into account only: (i) a fixed schedule; (ii) fixed percentage increases; or (iii) CPI increases capped at 3.5 percent per year, expressed as either an annual cap or a cap compounded over multiple years. The ground lease does not adjust rent based on any formula involving appraisal, valuation, or other contingent value based review.⁴

1 The last two sentences do not appear in rating agency criteria but accurately describe part of a rating agency’s agenda in reviewing any ground lease. Any ground lease may contain deal-specific concerns that might cause any ground lease reviewer, including a rating agency, to require changes to protect the leasehold mortgagee.

2 Clause (i) comes from Freddie Mac’s ground lease criteria. There is no reason to think the prohibition applies only to leasehold mortgages so it might not belong in these Model Ground Lease Criteria.

3 A sublease raises a surprising range of issues and complexities, beyond the scope of these Model Ground Lease Criteria. Unless it’s really also a direct lease from the ground lessor, a sublease creates more risk than rating agencies will tolerate, e.g., multiple risks of bankruptcy, termination of intervening estates, and other adverse events. A subleasehold mortgage will typically not be securitizable.

4 Although rating agency criteria by their terms often require a fixed or determinable rent stream obligation, the rating agencies have learned to live with some market-based rent adjustments as long as they can be reasonably projected or underwritten. Rating agency criteria do not expressly mention the possibility of CPI increases with a cap, i.e., item (iii) in this paragraph. That cap matches current marketplace expectations. Rating agencies can often underwrite market-based rent adjustments without a cap. Fannie Mae says it doesn’t want any rent increase to reduce the debt service coverage ratio below whatever existed at loan closing. Presumably this entails projections and predictions in the underwriting process rather than words in the ground lease.

1.4. Term. Assuming exercise of all remaining extension options,⁵ the ground lease term extends at least [30]⁶ years beyond the scheduled maturity of the mortgage loan.

1.5. Use. The ground lease allows the present use of the existing improvements. The leasehold mortgagee's appraisal of the leasehold estate fully considers all use and other restrictions in the ground lease.⁷

2. Closing Criteria

The documentation and underwriting should comply with these requirements (the "Closing Criteria"):

2.1. Documents. The ground lease and each amendment, or a memorandum of each, has been recorded.⁸ The loan file contains all documents referred to in the previous sentence. They match the documents listed in the ground lessor's estoppel certificate. Any change in the ground lease necessary to satisfy the Model Ground Lease Criteria was accomplished through a ground lease amendment, signed by the ground lessor and the ground lessee with all necessary fee mortgagee consents, not in a separate agreement.⁹ An estoppel certificate can constitute a sufficient ground lease amendment only if it: (i) was countersigned by the ground lessee; (ii) includes consent by all fee mortgagees; (iii) expressly modifies the ground lease; and (iv) was recorded.¹⁰

2.2. Estoppel certificate. The ground lessor delivered an ordinary and customary estoppel certificate, without material exceptions, dated within the last 30 days before the mortgage loan closing.¹¹

2.3. Mortgage. The leasehold mortgage requires the mortgagor (the ground lessee) to comply with the ground lease. The leasehold mortgagee has satisfied all conditions or requirements for leasehold mortgages in the ground lease. The ground lessor has confirmed in writing receipt of any required notice of the leasehold mortgage and all assignments of the leasehold mortgage or the ground lease.

5 The Minimum Protections allow a leasehold mortgagee to exercise these options by satisfying only conditions that require payment.

6 Some rating agencies will tolerate a remaining ground lease term as short as 10 years beyond loan maturity, perhaps inspired by a provision in the Employee Retirement Income Security Act of 1974 that seemed to bless that concept. More typically, ground lessees and leasehold mortgagees want to see at least 30 years of total remaining term, regardless of loan maturity. Fitch wants the remaining term to be "materially longer" than the loan, whatever that means. For a fully self-amortizing loan, Fannie Mae favors a 10-year remaining term after full amortization. For other loans, Fannie Mae says the remaining term after the loan must be 20 years, subject to some nuances. The various and varying requirements of market participants on remaining term, sometimes driven by statute or regulation, are typically quite rigid. They can make perfectly desirable leases hard to finance even with significant remaining term. This issue merits a more nuanced analysis than this footnote can provide. It is easily missed in the thicket of more interesting issues in any ground lease.

7 Fannie Mae prohibits "unreasonable" use restrictions. Other rating agency criteria prohibit use restrictions that impair value of the leasehold estate. Rating agencies hate use restrictions, but ground lessors and ground lessees often have good reasons to live with them. It makes more sense for the rating agencies to live with them too. But the appraisal (and a rating agency's valuation) of the leasehold estate must fully take into account all use and other restrictions in the ground lease, as suggested in text and as actually required in the rating agencies' underwriting process, though not in their criteria. Any valuation should not limit itself to the directly and obviously economic terms of the ground lease.

8 Some rating agency criteria say it's enough if a memorandum will be recorded at some later date. That seems insufficient, given the occasional surprises and travails in the recording process.

9 A separate agreement, not documented as a ground lease amendment, might be executory and subject to rejection in bankruptcy.

10 Rating agencies may live with an estoppel certificate that does not meet all these tests, especially if it covers only minor issues or minor "clarifications" in the ground lease. The author disfavors such a fix.

11 The estoppel certificate from the leasehold mortgage loan closing should suffice, with no need for an updated estoppel certificate at securitization. If problems or issues arise after closing, the Minimum Protections should properly handle them.

2.4. Status; No default. If the borrower/mortgagor is not the original ground lessee, then it acquired its leasehold estate in compliance with the ground lease, and the ground lessor has recognized the ground lessee as such. The ground lease is in full force and effect. Its term and ground lessee's obligation to pay rent have commenced. No uncured default exists under the ground lease.¹² To Depositor's actual knowledge, no condition exists that, but for passage of time or giving of notice, or both, would result in such a default.

2.5. Title. Except for permitted exceptions:¹³ (i) the leasehold estate is subject to no lien or encumbrance superior or equal in priority to the leasehold mortgage; and (ii) the fee estate is subject to no lien or encumbrance, including any fee mortgage, superior or equal in priority to the ground lease.¹⁴

2.6. Underwriting. The underwriting of the leasehold mortgage loan: (i) treats ground rent as a priority expense like real estate taxes and insurance premiums;¹⁵ and (ii) fully considers any ground lease terms that impair the value of the leasehold estate.¹⁶

3. Minimum Protections

The following language (the "Minimum Protections") can be used in the text of a ground lease to provide a minimally sufficient set of leasehold mortgagee protections. The user should, of course, always check that proposition against actual rating agency criteria. Conform nomenclature to definitions in the ground lease, capitalizing as appropriate. Where these Minimum Protections refer to compliance with "Reasonable Standards," remove that reference or replace it with actual standards that: (i) are appropriate in context, clear, objective, quantitative rather than qualitative, readily determinable, reasonable, short, simple, unambiguous, usually satisfied by ordinary transactions of the type contemplated, and not onerous; (ii) create no material risk of disputes; (iii) contemplate no exercise of ground lessor discretion, determination, or judgment, reasonable or not; and (iv) do not impair the value of the leasehold estate.¹⁷

3.1. Construction. The ground lessee may alter, construct, and modify¹⁸ improvements without the ground lessor's consent, but may need to meet Reasonable Standards to assure completion, payment, and preservation of value.¹⁹

12 Both Moody's and Standard & Poor's require that as of the closing, no default has occurred under the ground lease. Of course they mean no uncured default, but that's not what they say. The rating agency criteria don't include a knowledge qualifier. If Depositor adds one that will probably not create a major issue. Depositor can gain some but not total comfort from the estoppel certificate at closing combined with notification requirements in the Minimum Protections.

13 Other language in rating agency criteria should set standards for permitted exceptions.

14 Any existing fee mortgage will need to subordinate to the ground lease.

15 Fitch says the leasehold mortgagee should always establish a lockbox to assure payment of ground rent. That seems excessive as a universal requirement. Whether to require a lockbox depends on many considerations beyond mere existence of a ground lease. Only to the extent that the leasehold mortgagee requires a lockbox or an escrow for real estate taxes and insurance premiums, the same requirement should probably apply to ground rent.

16 Rating agencies will review the terms of the ground lease for this and many other issues. They will not rely on the appraisal in the loan file to adequately identify and consider all impairments of value of the leasehold estate.

17 Rating agency criteria do not expressly refer to a concept like Reasonable Standards. As a practical matter, however, rating agency review of any ground lease would consider such concepts where relevant, with skepticism about any ground lessor involvement.

18 "Modify" would probably include "demolish."

19 The leasehold mortgage could certainly impose more requirements as between the ground lessee and the leasehold mortgagee.

3.2. Estoppel certificates. The ground lessor shall, on request by the ground lessee or any leasehold mortgagee, promptly certify in writing (subject only to exceptions described in reasonable detail): (i) that this ground lease is in full force and effect; (ii) whether this ground lease has been amended; (iii) that to the ground lessor's knowledge the ground lessee is not in default; (iv) the date through which rent has been paid; and (v) other factual matters as reasonably requested.²⁰

3.3. Ground lessee rights. To the extent any leasehold mortgagee's documents authorize a leasehold mortgagee to exercise any ground lessee rights under this ground lease, the ground lessor shall recognize and accept that authority after notice. If this ground lease contains an extension, purchase, or renewal option and the ground lessee does not timely exercise it, then the ground lessor shall promptly notify each leasehold mortgagee, which shall have 30 days from receipt of notice to exercise it on the ground lessee's behalf.²¹ In doing so, a leasehold mortgagee need not meet any condition that would apply to the ground lessee except payment of money.²²

3.4. Leasehold mortgages. With no requirement for the ground lessor's consent, to the extent law allows: (i) the ground lessee may mortgage or collaterally assign this ground lease to any leasehold mortgagee that meets Reasonable Standards;²³ (ii) any leasehold mortgagee may accomplish a foreclosure, assignment in lieu of foreclosure, sale through bankruptcy or similar proceeding, or other involuntary divestiture of the ground lessee's leasehold estate (any of those is an "Involuntary Transfer"); and (iii) anyone whose title derives directly or indirectly (and through any number of intervening assignments) from an Involuntary Transfer may assign this ground lease.²⁴

3.5. Loss. If at any time any damage, regardless of magnitude, occurs or any condemnation is initiated: (i) the ground lessor and the ground lessee shall promptly notify each leasehold mortgagee; (ii) each leasehold mortgagee may participate in any adjustment, negotiation, or settlement of insurance proceeds or condemnation award and shall have the right to approve any settlement;²⁵ (iii) any such funds shall be held by a financial institution, chosen by the leasehold mortgagee, that complies with rating agency standards for any depository of loss proceeds;²⁶ (iv) those funds shall be released from time to time to pay for restoration under

20 Neither this estoppel certificate paragraph nor anything else in the Minimum Protections requires the ground lessor to amend or "clarify" the ground lease if asked. The ground lease needs to be right the first time.

21 This concept may raise issues under the rule against perpetuities. Those issues lie beyond the Model Ground Lease Criteria. The Fannie Mae criteria say that if the ground lessee exercises a purchase option, then the leasehold mortgage must also become a fee mortgage. Exactly how that would work, or how it interacts with any existing fee mortgage, or what the ground lease needs to say, is beyond the scope of these Minimum Protections.

22 In particular cases, the previous sentence might require adaptation based on the structure of the ground lessee's rights.

23 Freddie Mac allows no limit on who can be a leasehold mortgagee. A requirement to comply with Reasonable Standards should be tolerable. Moody's seems to agree, merely saying the Lease cannot "place commercially unreasonable restrictions" on who may hold a leasehold mortgage. Regulated lenders may be prohibited from agreeing to any restrictions on transfer.

24 Some rating agencies accept a requirement that the ground lessor consent to leasehold mortgages, if that consent cannot be unreasonably withheld or has actually been granted for this particular leasehold mortgage. That seems too relaxed. The criteria should require more, as suggested in text.

25 Freddie Mac doesn't want the ground lessor or its mortgagee involved at all. That would impair financeability of the fee estate.

26 The leasehold mortgagee itself would qualify automatically once the loan has been securitized. Rating agencies care a lot about the standards for any depository. Failure to meet them may produce a nonsecuritizable loan. The parties may wish to spell out the rating agency standards here.

reasonable disbursement procedures; and (v) except upon a total condemnation, this ground lease shall continue and the ground lessee shall restore the remaining premises.²⁷ Loss proceeds shall be applied as follows:

3.5.1. Condemnation. From any award for condemnation of the entire premises, the ground lessor shall first receive the fair market value of its entire interest in the premises,²⁸ as if no condemnation had occurred or been threatened. The ground lessee shall receive the remaining award. After a partial condemnation: (i) the ground lessor shall receive any condemnation proceeds not needed for restoration; and (ii) rent shall equitably decrease on account of that payment.²⁹

3.5.2. Damage. After the ground lessee has completed and paid for restoration after damage, any remaining insurance proceeds shall be released to the ground lessee.

3.5.3. Mortgagees. Any proceeds or award payable to any party shall be: (i) subject to the rights of its mortgagees; and (ii) paid to its most senior mortgagee for application under the loan documents.

3.6. Multiple leasehold mortgagees. If multiple leasehold mortgagees seek to exercise rights under this ground lease, then the most senior may do so (or designate in writing some other person to do so) to the exclusion of other leasehold mortgagees.³⁰

3.7. New lease. If this ground lease terminates because of the ground lessee's default³¹ or if the ground lessee rejects it in bankruptcy or similar proceedings, then the ground lessor shall so notify each leasehold mortgagee. For 30 days after that notice, any leasehold mortgagee may require the ground lessor, by notice, to enter into a new lease with that leasehold mortgagee or its designee. If a leasehold mortgagee gives that notice, ground lessor shall promptly enter into such a new lease, effective retroactively to the termination or rejection. When the parties enter into a new lease, the new ground lessee must cure all monetary defaults and agree to cure any other curable defaults within a reasonable time. The ground lessor shall waive all defaults that are specific to the former ground lessee or incurable. The new lease shall have the same priority and the

27 Fannie Mae and Freddie Mac would cap the ground lessee's obligation to restore at the amount of available insurance proceeds. Why would the ground lessor accept that? The ground lessee must either restore, regardless of cost, or abandon both the lease and the insurance proceeds. Freddie Mac's ground lease checklist requires: "Insurance proceeds and condemnation awards will be applied in accordance with the loan documents, which includes the application of any such proceeds/award to the Mortgage." If this supersedes any requirements for the ground lessee to restore, then it doesn't work.

28 Some rating agency criteria refer to the ground lessor's interest in only the land. For example, Fannie Mae says the leasehold mortgagee's share of the award "must not be less than the total award minus the value of the remainder [sic] interest in the land considered as unimproved." But the ground lessor also has a valuable interest in the improvements, which might be considered separate from its reversionary (not "remainder") interest in the land. Any allocation of a condemnation award should recognize and respect the ground lessor's interests in both building and land—whatever the next investor would pay for them absent any condemnation. Perhaps the value of the land is intended to take into account the value of the ground lessor's claim to the improvements. If so, the rating agency criteria should say that.

29 Fannie Mae wants excess proceeds to go to the leasehold mortgagee. That's wrong because the ground lessor should have first claim. The excess proceeds should actually go to the ground lessor but the rent should drop. If the rent reduction makes sense, then rating agencies should accept this approach.

30 Multiple leasehold mortgagees are unusual, unless the loan documents allow mezzanine loans and the ground lease treats them as equivalent to leasehold mortgages. If multiple leasehold mortgagees want to expound on this paragraph, they can do that in an intercreditor agreement.

31 Some rating agency requirements refer to any termination at all. That could include a termination upon total condemnation and perhaps even an expiration. A new lease delivered in either context would itself also immediately terminate or expire, so references to any termination at all are probably harmless. Still, they could create disputes. The rating agencies would probably tolerate a new lease clause that activates only upon termination for default or rejection in bankruptcy.

same terms and conditions, including rent and remaining term, that this ground lease did when terminated or rejected.

3.8. No merger. If the leasehold estate under this ground lease and the fee estate are ever commonly held, they shall remain separate and distinct estates (and not merge) unless all leasehold mortgagees consent.³²

3.9. No personal liability. No leasehold mortgagee or anyone acting for it shall have any personal liability under this ground lease unless it becomes the ground lessee. That liability ends when it assigns, abandons, or surrenders this ground lease.

3.10. Notice and opportunity to cure. If the ground lessee defaults under the ground lease, all notice and cure periods of the ground lessee have expired, and the ground lessor intends to exercise any right or remedy, ground lessor shall first notify each leasehold mortgagee. Each leasehold mortgagee may cure that default within 30 days after ground lessor's notice. If the default cannot reasonably be cured in that time, then each leasehold mortgagee shall have such additional time as it reasonably needs, so long as it proceeds with reasonable diligence. If cure of a default requires possession of the premises, the ground lessor shall allow additional time as the leasehold mortgagee reasonably needs to complete an Involuntary Transfer (or have a receiver appointed) and obtain possession. Upon completion of an Involuntary Transfer, the ground lessor shall waive all defaults that are specific to the former ground lessee³³ or not curable. So long as the leasehold mortgagee's cure periods have not expired, the ground lessor shall not seek to terminate this ground lease for the ground lessee's default.³⁴

3.11. Notices. No notice by the ground lessor will be effective against a leasehold mortgagee until the ground lessor has given that leasehold mortgagee a copy.³⁵ Any party that commences a dispute resolution or appraisal proceeding shall promptly notify all leasehold mortgagees.

3.12. Preservation of ground lease. Without consent by all leasehold mortgagees: (i) this ground lease may not be amended, cancelled, modified, restated, surrendered, terminated by agreement, or waived; (ii) the ground lessor shall not accept a voluntary surrender or abandonment of this ground lease; (iii) the ground lessee shall have no power or authority to treat this ground lease as terminated if the ground lessor rejects it in bankruptcy; and (iv) the ground lessee shall not subordinate this ground lease to any fee mortgage or other interest in the premises. Any action violating the previous sentence shall be void. It shall not bind any leasehold mortgagee.

32 Fannie Mae requires a ground lease to say any merger of fee and leasehold estates does not terminate the ground lease or extinguish the leasehold mortgage. Ordinarily ground leases go further and say that common ownership of fee and leasehold estates simply does not cause a merger, which is preferable and more typical.

33 Fannie Mae would prohibit the ground lessor from terminating the lease at all for any ground lessee-specific defaults. That seems excessive, though perhaps Fannie Mae doesn't really mean it, given Fannie Mae's language on new leases.

34 Moody's declares that the ground lessor must never, under any circumstance, be able to disturb the ground lessee's possession in any way that would impair the leasehold mortgagee's security. A broad edict of that type would imply that the ground lessor could never even terminate the lease for default after complying with all leasehold mortgagee protections. Surely that was not intended.

35 Somewhere else the ground lease should generally require written notices.

3.13. Priority of fee mortgages. Every fee mortgage is, and every future fee mortgage shall be, and must state that it is, subject and subordinate to this ground lease and all estates derived from this ground lease, and any replacement new lease.

3.14. Transfers. The ground lessee may assign this ground lease³⁶ (or sublease any or all premises) subject only to satisfaction of Reasonable Standards.³⁷ The previous sentence does not restrict any Involuntary Transfer. The ground lessor must agree not to disturb the possession, estate, or quiet enjoyment of any space subtenant whose sublease meets Reasonable Standards.³⁸

36 This paragraph overlaps the paragraph on “Leasehold Mortgages.” Leasehold mortgages and rating agencies like that double comfort. One could eliminate the overlap. Any requirement for the ground lessor’s consent, even if reasonable, will be problematic. Some rating agency criteria suggest that it might suffice if the ground lessor has consented to: (i) this particular ground lessee’s acquisition of the ground lease; or (ii) an Involuntary Transfer instigated by this particular leasehold mortgagee. That notion seems too loose. For a financeable and stabilized ground lease, the ground lessor should have no role at all in ground lease assignments, beyond maybe enforcing Reasonable Standards.

37 The reference to Reasonable Standards may cause concern, depending on how reasonable they are. If the Reasonable Standards fully and unquestionably comply with the definition of that term, so they will not impair any reasonably likely ordinary subleasing, they should create no significant problem.

38 Some rating agency criteria say the ground lessor should agree to nondisturb all space subtenants without exception. Taken literally, that would invite abuse by ground lessees, e.g., below-market subleases to the ground lessee’s brother-in-law. This happens. Even if subleases themselves are not subject to Reasonable Standards in a particular ground lease, a cautious ground lessor will insist on (and a practical ground lessee will accept) Reasonable Standards for any nondisturbance agreements.