

Foreword

Ground leases represent a creative way to accommodate the demand for space against a background of extremely limited supply. In return for a lengthy commitment (decades, in most cases) to pay rent, a tenant gets land on which it can build and operate a business. As might be imagined, all sorts of issues arise given the lengthy time that the parties will be together and their different goals. The landlord wants what amounts to an annuity that it doesn't have to think much about, while the tenant wants virtual free reign to do as it pleases on the land. Neither will get exactly what it wants; Joshua Stein's purpose in *A Guide To Ground Leases (With Forms And Checklists)* is to help each side's lawyers do their best to make the entire enterprise work.

Thus, after a lengthy and "encyclopedic" look at the issues surrounding ground leases, as well as the case law applicable to them, Mr. Stein provides the heart of the deal: a model ground lease (and accompanying term sheet). Since the value of a ground lease is closely tied to its financeability, Mr. Stein next covers three levels of leasehold mortgage protections (maximum, medium, and minimum) and explains why and when each level of protection applies. Succeeding chapters deal with model construction and development provisions, model leasehold mortgage provisions, memoranda of leases, landlord estoppels, and a ground lease review checklist. The final chapter includes the criteria various rating agencies use when assessing the financeability of any given ground lease.

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Introduction To Ground Leases

Real estate developers and investors often use a long-term ground lease as a technique to obtain long-term control and possession of a development site or sometimes an existing building (either typically referred to, usually in the singular, as the “premises”) without raising the money to acquire the premises outright from its existing owner.

Instead of purchasing the premises, the developer or investor leases the premises from the landlord for a relatively long term. The tenant agrees to pay ground rent over time and takes over almost all the benefits and burdens of ownership—just about everything except actual ownership itself. The tenant’s position becomes much like outright ownership, but the tenant must pay a stream of ground rent functionally much like another layer of real estate taxes.

Based on the amount of the ground rent and the value of the tenant’s improvements, the tenant’s estate under the lease (the “leasehold estate”) will itself have substantial value and can be traded just like any other real estate.

For a ground lease to support a transaction of this type, it must contain relatively tenant-oriented (at least when compared against a typical space lease) business and economic terms, and hence give the tenant a reliable source of value over the long term. The lease must create a stable, reliable, and appraisable interest in real estate that can support a long-term investment. The tenant needs to know the lease gives it the flexibility and site control necessary to create a valuable asset. This analysis forces the tenant—or anyone else investing in a leasehold estate—to consider a wide range of issues relating to the lease.

Practically every term in a lease can affect its value and reliability as a platform for a long-term real estate investment.

1.1 MODEL GROUND LEASE AND THE TENANT'S AGENDA

This book includes a sample lease that both a reasonable tenant and a reasonable landlord should find acceptable, or at least a reasonable starting point ready to be customized for the nuances of any particular transaction.

From the tenant's perspective, the sample lease offered in this book works because it gives the tenant ample flexibility and site control, with minimal risk of needing to "go back to the landlord" to obtain a consent or any form of discretionary landlord cooperation to accommodate the tenant's future activities.

From the landlord's perspective, the sample lease works because it should give the landlord a reliable and uninterrupted stream of cash flow, as well as some comfort that the tenant should not be able to impair the short-term or long-term value of the premises.

To achieve those two goals, the sample lease begins from the belief that it is perfectly easy to accommodate the landlord's and the tenant's interests, if one is willing to give each party what it truly needs as opposed to everything it might conceivably want if it thinks hard enough.

This approach requires thinking through every issue in the lease, and figuring out how that issue should turn out for a "typical" tenant, and what protections a "typical" landlord will expect to receive. Like any other lease, this one addresses a wide range of issues—everything that can happen to a parcel of commercial real estate during the very long term of a lease. Each of these issues raises significant substantive concerns for the parties.

The encyclopedia of ground leases in Chapter 2 is intended to cover all issues that can arise in negotiating or reviewing a long-term ground lease, other than some issues fully dealt with through the text of sample documents or sample provisions included in this book. If the lease handles these and other issues correctly, it will have value to the tenant and justify the tenant's construction of substantial improvements on the premises.

1.2 A SECOND REQUIREMENT FOR ANY LONG-TERM GROUND LEASE

For a lease to work well as a vehicle for long-term real estate investment, though, it isn't enough for the tenant to consider it a valuable and desirable asset. The lease also must satisfy a second test: the tenant also needs to know that a future lender (a "leasehold mortgagee") will be willing to lend against the tenant's valuable leasehold estate, either to support the tenant's initial investment and development of the premises or to support the tenant's long-term carrying or enhancement of the premises.

Many mortgage lenders will accept leaseholds as collateral for loans, but only if the terms of the lease take into account the leasehold mortgagee's interests. Those interests boil down to assuring that a leasehold mortgagee can always:

1. Predict (or at least reasonably estimate) the burdens that the lease will impose;
2. Take and readily enforce a leasehold mortgage;
3. Preserve the lease and its value, even if the transaction goes into default or surprises occur; and
4. Abandon a bad investment.

If a leasehold mortgagee cannot achieve these goals, then the arrangement loses the stability and predictability that are essential in any form of real estate finance or other investment.

Leasehold mortgagees achieve stability and predictability by demanding that any "financeable" lease include a number of terms and conditions that protect the interests of the leasehold mortgagee (commonly referred to as "leasehold mortgagee protections"). Those leasehold mortgagee protections collectively convert a relatively fragile possessory estate into a solid and reliable set of rights against which a leasehold mortgagee believes it can safely advance substantial amounts of nonrecourse financing.

Any leasehold mortgagee will start by asking about the business terms of the lease—an analysis of the lease much like the tenant's analysis as described above. The leasehold mortgagee will also, however, want the lease to contain an appropriate set of leasehold mortgagee protections.

If a lease is not financeable, then a lender will hesitate or even refuse to lend against it. In that case, the tenant might also find that

Encyclopedia Of Ground Leases

AMENDMENTS OF LEASES

Any long-term ground lease will, over time, very likely need to be amended, simply because circumstances change or unexpected issues arise. Even though an amendment is “needed,” however, it will not necessarily be obtainable, because either the landlord or the tenant has become dissatisfied with its position and therefore refuses to cooperate with the other party. Over time, either the landlord or the tenant—perhaps even both of them—will almost inevitably find itself in that position.

Therefore, as the first advice about lease amendments, both parties should negotiate their lease and proceed with their business on the assumption that no lease amendment—however essential it may be—will ever be available from the other party, or at best the only way to obtain a lease amendment will be by enduring protracted and painful negotiations that culminate with the writing of a large check.

Of course, that assumption will not always be accurate. But it will usually be. In the rare case where the parties are still communicating and cooperating when one of them “needs” a lease amendment, here are some comments on how to go about getting the amendment done.

Broker or Consultant. If the lease amendment relates to pricing or will give either party an opportunity to adjust the pricing, each may want to engage a real estate broker or consultant to assist in negotiating the transaction. Any party that engages a broker should consider the usual issues in any such engagement, primarily the desire to assure that the

Leasehold Mortgagee's Duty To Indemnify For Cure Activities

If the landlord wants the leasehold mortgagee to agree to indemnify the landlord for any loss the landlord suffers as a result of the leasehold mortgagee's efforts to cure the tenant's default, the landlord may want to add language like the following to the lease:

Notwithstanding anything to the contrary in this Lease, if any Leasehold Mortgagee (or its Leasehold Mortgagee's Representative) desires to enter the Premises to cure any Default, then [as a condition to such entry, such Leasehold Mortgagee shall agree] [by entering the Premises, such Leasehold Mortgagee shall be deemed to have agreed] to Indemnify Landlord in the same manner as this Lease requires Tenant to Indemnify Landlord, but solely regarding direct damages that Landlord suffers as a result of any acts or omissions of such Leasehold Mortgagee or its Leasehold Mortgagee's Representative on or in the Premises in seeking to cure any such Default.

A leasehold mortgagee may fear that this language does not adequately define the form of the indemnity that the leasehold mortgagee will need to sign as a condition to entering the premises, hence creating the risk of negotiations and delay if a default ever arises. Therefore, the leasehold mortgagee may want the form of indemnity to be attached to the lease.

The landlord may want any leasehold mortgage to contain (or be deemed to contain) language setting forth and confirming the leasehold mortgagee's indemnity of the landlord. The landlord may want to go a step further and have a direct indemnity agreement between the landlord and the leasehold mortgagee entered into at closing. Such an indemnity agreement is nonstandard and might be considered overkill, an example of the landlord's counsel trying too hard to think of new issues and requirements. If a particular landlord demanded it, the tenant and the leasehold mortgagee may want the leasehold mortgagee's liability under any such indemnity to be limited to the leasehold mortgagee's interest in the premises.

To the extent that a leasehold mortgagee ever agrees in any way to indemnify the landlord for the leasehold mortgagee's cure activities, any such indemnity should be subject to at least the usual substantive

those installations and will want to allocate the resulting costs, risks, and benefits.

Financial Reporting. A landlord may desire financial information about the premises and its operations. In such cases, a landlord might start with the language below. As a compromise position, the tenant might agree to give financial information to actual and prospective institutional fee mortgagees, but not to the landlord. For sample language to that effect, see FEE MORTGAGES.

Financial Reports To Landlord

If the tenant agrees to give the landlord financial information about the premises, the following language may do the job, although the parties must tailor the information requirements to reflect the landlord's specific requirements and expectations; what the tenant is willing to do; and any nonstandard activities to be conducted in the building. If the tenant will actually sublease the building to subtenants (rather than operate the building itself), the financial reporting requirements will need to reflect that fact, as well as any limits on the tenant's present or future ability to obtain information from subtenants.

***Financial Reporting.* Within __ days (to the extent reasonably available, and otherwise within ___ days) after the end of each __, Tenant [and Guarantor] shall deliver to Landlord a statement of Tenant's income and expenses for Tenant's operations at the Premises (except to the extent previously reported to Landlord) during such period[, and Guarantor's financial statements for such period]. Tenant [and Guarantor] shall certify such statements as true and correct. [All such statements shall be in customary form reasonably satisfactory to Landlord.] [On _____ Business Days' notice (which may be telephonic and shall not be required if an Event of Default shall have occurred and be continuing), only during normal business hours, and (so long as no Event of Default shall have occurred and be continuing) no more often than once a year, Landlord's auditor may audit such statements. Tenant [and Guarantor] shall without charge assist in such audit as Landlord's auditor shall reasonably request. Land-**

want to call a default under the lease. The lease effectively becomes a mortgage. Conversely, if the tenant has any claims arising out of the transaction, the tenant may want the right to offset rent. The lease effectively becomes a letter of credit.

Other Omitted Provisions. The model lease in this book leaves out a number of leasing provisions that may make sense in a space lease, but typically do not make sense in ground leases, at least under the usual circumstances. These omitted topics include the following:

- Covenant to operate (*but see* USE);
- Possible delay or inability in landlord's delivering the leased premises to the tenant when the lease begins;
- Security deposit, prepaid rent, or other credit enhancement for the tenant's obligation to pay rent (as opposed to obligations regarding construction and development);
- The landlord's right to transfer development rights to other sites, and the tenant's obligation to cooperate; and
- Any landlord concerns that might be specific to particular types of real property.

LEASE TERMS, GENERALLY

Scope Of Review. Any leasehold mortgage should review the lease as a whole, from a generic tenant's perspective, and confirm that a possible future tenant—whether the leasehold mortgage or some future purchaser of the lease—will find the lease satisfactory.

The model ground lease in Chapter 5 offers a benchmark for testing any other lease. To the extent some other lease restricts or burdens the tenant in ways that go beyond the restrictions and burdens in Chapter 5, that difference may (but will not necessarily) create a concern for future tenants, leasehold mortgages, and rating agencies.

As a less complete way of considering these issues, the following represents a list of the major concerns of any leasehold mortgage (or tenant) when reviewing any long-term ground lease, beyond those already addressed in some or all of the leasehold mortgage protections this book offers.

- *Alterations.* The lease should allow the tenant to alter and probably even demolish the improvements. The landlord should agree to cooperate with the tenant's applications as needed. Nothing in the lease should give the landlord any "hook" to prevent or frustrate future

LOSS (CASUALTY OR CONDEMNATION)

The possibility of a loss (a casualty or a condemnation) and its endless variations often consume many pages in a lease or a set of loan documents. The parties can negotiate and fine-tune this topic, and create new categories, conditions, and distinctions, to whatever degree they want or can stand (and whatever they dream up will, in all likelihood, bear little similarity to whatever actually happens in the real world in the unlikely event that the property suffers any loss).

Of all the issues any leasehold mortgagee protections cover, treatment of a loss may constitute the one issue least suited to a “one size fits all” resolution, but also the one where cost-benefit considerations most cry out for it. The leasehold mortgagee protections in this book make a valiant effort.

A lease must treat casualty and condemnation rather differently. After the former occurs, the improvements can typically be rebuilt and the parties can, at least in theory, be put back to exactly the same physical position that they were in before the casualty. (If, however, all the leases go away and the leasing market has worsened, the parties will not find themselves in the same financial position.) After a condemnation occurs, in contrast, neither the landlord nor the tenant retains an interest in the premises, and the premises—the shared asset—has changed its character from real estate into cash or a claim for payment against the condemning authority. That cash or claim should ultimately give each party something as close as possible (under the circumstances) to their interest in the premises before the condemnation occurred.

The rest of the world may consider real estate lawyers rather odd for spending so much time thinking about these things. Casualties and condemnations do happen, though, particularly in the long run, such as the 50-year or 99-year term of a lease. If a lease does not handle these events correctly, the defect may represent more than a minor anomaly. Instead, it may lead a conservative lender to reject an entire transaction, merely because under one particular unlikely hypothetical circumstance (a loss) the value that the lender counted on will simply vanish—with nothing to replace it.

Partial Condemnation. The various issues and inquiries relating to loss proceeds become particularly complex as they relate to application of a condemnation award that arises from an insubstantial or partial condemnation, especially where parts of the project have special characteristics that may require special treatment depending on when,

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Selected Cases On Ground Leases

3.1 INTRODUCTION

Certain problems arise again and again in the world of ground leases. Most of this book seeks to prevent those problems by recognizing that they can occur and suggesting specific language that would have prevented problems that have already occurred. This Chapter, in contrast, focuses in detail on how some reported cases have dealt with problems that have already occurred. The discussion of each area begins with the “story” that each case tells, then turns to a discussion of how the particular case dealt with the problem, and concludes with an analysis of “lessons learned” and points that drafters should keep in mind for future leases.

The consistent theme of this Chapter is that lease drafters cannot rely on the courts to “get it right” and drafters therefore need to go into full detail on every possible issue that can arise in a lease. That theme is not at all consistent with transactional efficiency, speed, cost control, and “quick and dirty” lease drafting. It is, however, consistent with the real world, in which most courts do not necessarily understand complex commercial real estate transactions—no surprise given how many judges come from the personal injury bar, prosecutor’s and public defenders’ offices, and “public interest” organizations rather than from commercial real estate practices.

This Chapter covers only a selected handful of problem areas—believed to be the most important ones that arise again and again—and examines only a small number of selected cases in each area. Many more problem areas exist, and many more cases could be discussed in

mencement, rather than the expiration, of the renewal term—the typical format for any long-term ground lease.

Wallace illustrates what New York practitioners have long known: New York courts are far more willing than the courts in some other states to enforce the clear unequivocal words of a written agreement or lease. Other jurisdictions, particularly California, Florida, and New Jersey, seem to be far more willing to rewrite the parties' agreement, whether because of drafting errors or because the judges retrospectively decide the parties' agreement just wasn't a very good agreement.

3.3(e) Valuation Of Option Sales

Some leases give the tenant an option to purchase the leased property from the landlord, perhaps several decades into the term of the lease. Often these options require an appraisal at the time of exercise, to determine the purchase price. An appraisal of this type is much like an appraisal for a rent adjustment, and therefore raises many of the same issues.

One question that has arisen surprisingly often is whether the ground lease itself should be considered when calculating the ultimate sales price. If the property is being sold "subject to" an existing ground lease, it will usually be worth much less than if it were being sold "unencumbered."

For some reason, this issue seems to have arisen with particular frequency in Florida.

In *Nicholas Contos v. Evalyn Lipsky*,¹⁹ the land at issue was worth \$172,000 encumbered by the lease and \$600,000 free of the lease. Following the lead of a New York case, *William Rae v. Courtney*,²⁰ the court began by framing the issue as one arising under the doctrine of merger: Did the leasehold merge into the fee when the tenant exercised her option to purchase? Merger is an equitable doctrine and will be applied in accordance with the intention of the parties. What the parties meant by the term "leased premises" was ambiguous. Hence the court assumed that the party acquiring both estates (the tenant) must have intended the result most beneficial to her, that is, no merger. Under the facts of this case, before the tenant exercised her option, she owned a valuable and assignable leasehold estate. The court reasoned

¹⁹ 433 So. 2d 1242 (Fla. Dist. Ct. App. 1983).

²⁰ 165 N.E. 289 (N.Y. 1929).

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Model Ground Lease Term Sheet

The following represents a nonbinding summary of the basic terms and conditions of the proposed ground lease, which Tenant's counsel will prepare. No party is to be bound in any way unless and until final documents have been agreed upon and exchanged.¹

Premises	_____
Landlord	_____, or its wholly owned single-purpose entity.
Tenant	_____, or its wholly owned single-purpose entity.
Lease Term	___ years, starting when parties have signed the Lease and Landlord has delivered possession (" <u>Commencement Date</u> ").
Options	_____
Expenses	"Triple net" lease. Tenant pays all taxes, insurance, and repairs, and bears all other risks, expenses, and responsibilities, with a few exclusions related to ownership of the fee. Tenant controls all operations, leasing, tax protests, etc.
Condition of Premises	As is at Commencement Date. No representations or warranties. Landlord may remove any improvements or personalty at any time before Commencement Date.
Interim Rent	From Commencement Date until the day before the Base Rent Commencement Date, " <u>Interim Rent</u> " of \$ _____ per month.

¹ The parties may want to enter into a separate letter agreement to memorialize a few binding obligations, such as exclusivity, confidentiality, brokerage, and waiver of claims from any failure of negotiations.

Model Ground Lease

This document consists of a triple-net ground lease. It gives the tenant almost all incidents of ownership during the lease term, and the landlord only an annuity and minimal controls (or at least objective protections) for the leased premises.

This Model Lease is far more tenant-oriented than a “typical” commercial space lease, because the relationship is far more balanced than a “typical” commercial space lease would contemplate. Each party has substantial expectations, demands, and requirements. All must be met. The tenant needs flexibility, control, and ability to realize the value of its position without interference from the landlord. The landlord simply needs stable and reliable cash flow plus comfort that if the tenant crashes and burns (or when the lease expires) and the premises reverts to the landlord, the landlord can tolerate its condition.

Landlords and tenants can resolve their competing concerns without imposing on the tenant oppressive restrictions of the type that commercial space leases often contain. Each of those oppressive restrictions may give the landlord a future opportunity to “leverage” the tenant, as soon as the tenant needs any future flexibility about the property. Tenants under ground leases, and their lenders, will not tolerate the possibility of being on the receiving end of any landlord leverage. This model lease protects the tenant by building in great flexibility.

Because of the even-handed character of much of this model lease, counsel should review it from beginning to end when using it for any particular transaction. Although the compromises in this document seemed reasonable for each particular transaction where this model lease and its predecessors were used, they might not work for a particular transaction. And even though this lease favors the tenant in some important ways, a particular tenant may want more.

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Model Leasehold Mortgagee Protections (Maximum)

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- II. LOSSES AND LOSS PROCEEDS
 - A. Prompt Notice
 - B. Casualty
 - C. Substantial Condemnation
 - D. Insubstantial Condemnation
 - E. Condemnation Near End of Term
 - F. Temporary Condemnation
 - G. Use of Loss Proceeds
 - H. Payments for Fee Estate
 - I. Continuation of Lease
- III. FEE MORTGAGES
 - A. Landlord's Rights
 - B. Fee Mortgage Foreclosure
 - C. Protection of Fee Mortgagees
- IV. LEASEHOLD MORTGAGES
 - A. Tenant's Rights
 - B. Effect of Leasehold Mortgage

Model Leasehold Mortgagee Protections (Medium)

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2. Use
3. Assignment
4. Subleases
5. Loss
6. Fee Mortgages
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8. Lease Impairments
9. Notices
10. Opportunity To Cure
11. Cure Rights Implementation
12. New Lease
13. New Lease Implementation
14. Tenant's Leasehold Rights
15. Certain Proceedings
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17. No Personal Liability
18. Multiple Leasehold Mortgagees
19. Further Assurances
20. Miscellaneous

Model Leasehold Mortgagee Protections (Minimum)

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1. Assignments and Mortgages
2. Priority of Fee Mortgages
3. No Merger
4. Notice and Opportunity to Cure
5. Copies of Notices
6. New Lease
7. Subleases
8. Condemnation Awards
9. Casualty and Partial Condemnation
10. Preservation of Lease
11. Options
12. Tenant's Rights, Generally
13. No Personal Liability
14. Estoppel Certificates

Notwithstanding anything to the contrary in this Lease:

1. ASSIGNMENTS AND MORTGAGES

Tenant may, without Landlord's consent, assign this Lease, including any options it contains. Tenant may also, without Landlord's consent, mortgage this Lease (including any options it contains) to any

Model Construction And Development Provisions

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 - 2.1 Initial Development
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Model Leasehold Mortgage Provisions

This Chapter provides optional clauses and section-by-section instructions for a leasehold mortgage, prepared from the perspective of the leasehold mortgagee. This language goes into the mortgage, not into the ground lease. It can be used with any mortgage or, with appropriate changes in references to the parties, any deed of trust. Some of it can go in the loan agreement rather than the security instrument. For comments on this language, please see various entries in the *Encyclopedia of Ground Leases*, Chapter 2.

In addition to the specific provisions offered here, the mortgage may need to be modified as follows:

- In any reference to the mortgagor's "title," refer to "leasehold" title rather than "fee simple" title.
- Change space "leases" to "subleases," or at least clarify that they are subleases rather than leases.

Some additional comments on this language:

- This language assumes the mortgage encumbers a lease, not a sublease. If the collateral consists of a sublease, appropriate changes would need to be made throughout.
- The general "further assurances" clause of the loan documents should also obligate the borrower to deliver any further separate assignments or other documents necessary to perfect the leasehold mortgagee's interest in the lease.

Model Memorandum Of Lease

11.1 INTRODUCTION

The document in this chapter consists of a Memorandum of Lease (the “Memorandum”), which the parties may record to give constructive notice of any lease whose term exceeds three years, without recording the entire document. *See* New York Real Property Law (“RPL”) §291-c. This document is designed for use in New York. In any other state consult local counsel for state-specific problems, issues, and requirements.

11.2 COMMENTS FOR THE USER

11.2(a) Execution Requirements

A Memorandum of Lease must be executed by the parties and acknowledged as necessary for a conveyance to be recorded. *See* RPL §291-c.

11.2(b) Addresses

Addresses for the parties in the Memorandum must be consistent with those in the lease. *See* RPL §291-c.

11.2(c) Lease Or Sublease?

This Memorandum is designed to work for either a lease or a sublease. For a sublease, confirm that a correct memorandum of the underlying lease has been recorded. Include its recording information in this Memorandum. Change “Lease” to “Sublease” except, of course,

Model Landlord Estoppel

12.1 DESCRIPTION

This document consists of a ground landlord's estoppel, suitable for use in transactions involving leasehold mortgages or acquisitions of ground leases. The document is prepared from the perspective of the leasehold mortgagee or prospective assignee.

12.2 POINTS NOT COVERED

A document of this type could cover the following points, but this one does not, for the following reasons:

12.2(a) Duplicate Original Lease

If the original lease cannot be located you may wish to re-execute one, or attach a copy as an exhibit (perhaps with initials on every page, although this seems excessive).

12.2(b) Landlord's Lien Waiver

An estoppel certificate could also include a short-form landlord's lien waiver. This specimen includes an optional lien subordination instead. One could modify it to become a lien waiver, or delete it. The parties may prefer to record any lien waiver or lien subordination.

12.2(c) Leasehold Mortgagee Protections

If the lease is not mortgageable, you may wish to add mortgagee protections via the estoppel certificate. You can also try to use an estoppel certificate to achieve any other form(s) of lease improvement. The

Ground Lease Review Checklist

This Chapter offers a minimal checklist (in menu format) for review of a ground lease just for “financeability” issues. The list offered here is deceptively simple, and should not be used in a vacuum, *i.e.*, without understanding the issues this book covers. This list is somewhat shorter than typical.

MEMORANDUM

VIA EMAIL

To: _____
From: _____
Date: _____
File no: _____
Copies to: _____
Subject: Ground Lease — Assessment of “Financeability”

The following table compares the ground lease for the _____ site against industry standard expectations for “financeable” ground leases. For any deficiency we have noted, we have included comments on its importance, alternatives, marketplace expectations, and possible reactions of “the next lender.” For purposes of this memo, we reviewed only the ground lease dated _____ and the following amendments: _____.

Rating Agency Requirements For Ground Leases

14.1 OVERVIEW AND INTRODUCTION

Any tenant's or leasehold mortgagee's attorney negotiating a ground lease should understand what the rating agencies expect and require regarding ground leases, and then fully satisfy those expectations and requirements (or confirm that any exceptions will not create a problem). Ultimately, a "financeable" ground lease is nothing more and nothing less than whatever the rating agencies say it is. (The term "rating agencies" is used loosely here to include—without limitation, of course—secondary market players such as Fannie Mae and Freddie Mac.)

Rating agency representations, warranties, and criteria collectively define a minimum standard, the satisfaction of which should make a ground lease financeable in the eyes of the larger world. For the most part, that definition is rational and appropriate and a sensible benchmark for any ground lease transaction.

Rating agency expectations sometimes change, officially or unofficially. It is probably safe to assume that expectations will over time only become tighter and not looser, although typically no single rating agency will want to take the first step in either direction. Nevertheless, in negotiating a lease on behalf of a tenant or a leasehold mortgagee, it would not hurt to comply more than minimally with current rating agency requirements. (One should also check for updates of whatever standards one is using, much as one should "shepardize" a decided case.)

To the extent that a lease does not meet rating agency standards, this will raise an issue in any future securitization, refinancing, or other