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Before you start negotiating, consider the following to making your ground lease financeable

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The owner of the site of your next project will not sell, but instead has presented you with a ground lease. Before you start negotiating, consider the following:

Term. The lease term must be long enough to be financeable. Many lenders require that the term extend at least 20 years beyond the mortgage. If your lender forecloses, the remaining lease term must provide sufficient value to allow the lender to sell the lease and recover the debt.

Rent. The lessor will want base rent escalations, and may also seek percentage rent and kickers on sales or refinancings. Escalations may be based on consumer price index (CPI) increases or fixed yearly percentages. The lessor may seek to reset the rent by an appraisal once or more during the term. Issues to consider are:

- How often will the base rent reset and how will that schedule mesh with any contemplated subleases?
- How certain is the escalation formula? A set yearly percentage increase gives you, your subtenant and lender certainty for budgeting

and underwriting. A CPI escalator provides less certainty; reset of the base rent by appraisal even less.

- If the ground lease resets the base rent by appraisal, the appraisal should not be for “highest and best use” but rather for the land as encumbered by the lease with the existing uses. If you’re constructing improvements, the appraisal should exclude the improvements.

- If the ground lease provides for percentage rent or a “kicker” upon a sale or refinancing, make sure the lease is clear about whether the percentage applies to gross revenues or net revenues.

Subletting and Assignment Use. The ground lease should permit you to assign the lease or sublet the premises to credit-worthy assignees/subtenants. If there are restrictions on assignment and subletting, your lender will want it and its successors to be exempt from such restrictions. The ground lessor may want to prohibit subletting and assignment prior to completion of any improvements and may want to restrict the allowed uses.

Leasehold Financing. The ground lease must expressly permit you to finance your leasehold interest. Most landlords will not subject their fee interest to tenant’s financing so your lender’s collateral will be your leasehold. Your lender will likely want the following:

- Notice of tenant’s defaults and a right and sufficient time to cure.

- If the lender cannot cure without possession, the lender must have time to foreclose. The lessor should not be able to terminate the lease if the lender is proceeding to cure the default.

- If the default is incurable by lender (e.g. tenant bankruptcy), the lessor should be obligated to enter into a new lease with the lender for the unexpired term and on the same terms as the original lease. This right should survive termination or rejection of the lease in bankruptcy.

- Except for the payment of past due rent, the lender should only be liable during the period of its possession.

- Amendments to and termination of the lease must require the lender’s written consent.

- All renewal and other options must be exercisable by lender.

Defaults. Termination of a ground lease when a developer has constructed improvements is economically draconian. The lease should require notices of all defaults, lengthy cure periods, even for monetary defaults, and alternative remedies such as self-help, late fees, damages, injunction and arbitration.

Most importantly, do not sign the ground lease without lender’s approval (or make the transaction contingent on this approval).

Kathryn Murphy has been practicing in the area of commercial real

estate law for over 30 years and joined Krokidas and Bluestein in 2006. Murphy has been a Fellow of the American College of Real Estate Lawyers (ACREL) since 1993, served as secretary in 2012 and was recently elected treasurer for 2013. She serves as a member of ACREL’s board of governors and executive committee. In addition, she is a member and former steering committee member of New England Women in Real Estate (NEWIRE) and a member of the Urban Land Institute. She is co-chair of the board of YWCA Boston, vice-chair of the board of the Emerald Necklace Conservancy, and an honorary trustee of the Boston Children’s Museum. Murphy has served as a panelist for the ALI/ABA Modern Real Estate Transactions and Commercial Leasing programs and has contributed to the ABA Mortgage Foreclosure book and the State-by-State Guide to Commercial Real Estate Leases.

Krokidas & Bluestein provides legal services in the areas of public, non-profit and for-profit real estate development, finance and property management, general corporate law, health and education law, public and private civil litigation, labor and employment law, and social services law. The firm is staffed by 19 attorneys, over half of whom are women.