



Other Elements in a Ground Lease That Vary From Ordinary Leases

Prepared by:
Craig A. Kepler
Ballard & Spahr LLP

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OTHER ELEMENTS IN A GROUND LEASE THAT VARY FROM ORDINARY LEASES

Written by Craig A. Kepler

Though individual ground leases vary, there are a number of features that are often found in ground leases that are perhaps different than in an “ordinary” lease. It is useful to be aware of these features if you are contemplating a ground lease.

A. Due Diligence Period

Since the purpose of a ground lease is to enable the lessee to develop improvements on the land, most ground leases will contain a due diligence or contingency period much like a purchase agreement. During the due diligence period, the ground lessee can typically undertake the usual due diligence that any developer would perform, such as environmental, soils, zoning/approvals, etc. Often, this is coupled with a free rent period.

Property owners that suspect the presence of contamination on their land should be careful about environmental assessments. The law of many states requires a property owner to disclose to a potential transferee any condition about the property known to the property owner that materially affects its value. If the ground lessee’s environmental testing reveals the presence of contamination that was previously unknown to the property owner, the property owner could thereafter be charged with disclosing this to any potential buyer.

B. REA or CC&R (Reciprocal Easement Agreement or Covenants, Conditions and Restrictions)

From the ground lessor's perspective, be prepared for a ground lessee, especially a large big box operator, to request recorded restrictions on all nearby land owned by the lessor. If the ground lease parcel is already part of a shopping center, this will not be a surprise and in fact the developer/owner probably already has some level of reciprocal easements in place. In that case, the issue will be to make sure that the various easement documents are integrated with one another.

However, if the ground lease carves out a parcel from a larger tract of undeveloped land – such as a Wal-Mart at the edge of town that is split off from a farm – many landowners fail to anticipate that the lessee will request a blanket set of easements and restrictions covering all of the farmland. Often this is highly restrictive and puts the first ground lessee in a position of control over the development of the rest of the land.

For this reason, for a large landowner contemplating marketing some of the land to a commercial use, it may be wise to carve out the lease parcel and put it into a single purpose entity prior to even marketing the parcel.

C. Co-tenancy

Retail leasing may have provisions such as exclusive use, co-tenancy, etc. Sometimes those same concepts appear in ground leases. For example, a ground lease may involve an outparcel in a shopping center.

Keep in mind that the wording of the co-tenancy provision should be carefully considered by both the lessor and the lessee. The

provision needs to clearly contemplate the various circumstances under which a ground lease might be terminated by the ground lessee.

For example, in *Rockwell Acquisitions, Inc. v. Ross Dress for Less* the question was whether a landlord could satisfy a co-tenancy involving an anchor tenant by filling the anchor space with two nationally recognized tenants, rather than a single tenant in the entire anchor space. The court in that case held that the lease was written in the singular and thus the landlord failed to satisfy the co-tenancy provision (giving the tenant in the case a significant rental reduction).

In *Staples the Office Superstore East, Inc. v. Flushing Town Center III, L.P.*, the co-tenancy requirement specified that a “national retailer” must occupy at least 100,000 square feet. The landlord leased the anchor space to BJ’s Wholesale Club. At the time, BJ’s operated stores in 15 eastern states, with Ohio being the westernmost state. The court found that BJ’s was regional, not national, and thus that the landlord failed to satisfy the co-tenancy requirement.

These are but two examples of dozens of co-tenancy cases, but they are listed here to show the importance of paying careful attention to parsing the language in these clauses. Make sure that (1) the parties are in clear agreement on how the co-tenancy provision will apply, and (2) that the written provision states exactly what the parties mean it to state.

D. Assignability by Tenant

As discussed above, many ground leases will be assignable as security for financing extended to develop improvements on the land.

In addition, some ground lessees are developers who do not intend to operate the facility. For example, it may be a build-to-suit development for a big box retail user. Some major national retailers

prefer to work with various entrepreneurial developers who scout new locations, pitch them to the retailer and, if given approval, obtain financing and take on the attendant risks of construction. After construction is done, they transfer to the big box.

However, there is risk to the developer. Often, the retailer will not commit to the lease until after the facility is completed. There thus risk that the retailer may not agree to assume the lease. To hedge this risk, the developer will need some flexibility in assigning the lease. Here is a sample provision:

Assignment. The provisions of this Section ___ are subject to the provisions of Section ___, below. Following Lessee's completion of the Improvements as evidenced by the issuance of a certificate of occupancy or similar authorization permitting occupancy of the Improvements (which condition will be referred to herein as the "Project Completion,") the Lessee will be entitled to assign this Lease without the consent of the Lessor; provided, however, that any such assignee has, as of the date of assignment, a net worth equal to or greater than that of Lessee, and Lessee and/or the proposed assignee have furnished documentation reasonably establishing the net worth of the proposed assignee. If such information is not provided, or if the net worth of the proposed assignee is less than that of Lessee, then the Lease may, nonetheless, be assigned by Lessee to the proposed assignee,

but only with the written consent of Lessor, which shall not be unreasonably withheld, conditioned or delayed. Prior to Project Completion, however, Lessee will not be entitled to assign this Lease without the Lessor's consent, and any such assignment made with out Lessor's consent prior to Project Completion will be void and of no force or effect. In an instance hereunder where the Lessor's consent is required for any such assignment, the Lessor's consent will not be unreasonably withheld, conditioned or delayed.

E. Tenant Can Set Size of Parcel, And Thus Rent

Sometimes a ground lease is intended to apply to only a portion of a larger parcel, but the exact location and description of the actual leased parcel will not be determined until after the tenant has completed its due diligence, which will include a survey. Here is a sample provision:

The Development Tract. The Lessee will provide the Lessor with a written notification prior to the end of the Inspection Period (as defined in Section _____, below) along with a copy of an ALTA boundary survey prepared by a registered land surveyor (the "Survey") designating the exact size, location and configuration of the Development Tract (the "Development Tract Location Notice"). The parties acknowledge that the net acreage of the Development Tract will include

approximately eight (8) acres. The parties acknowledge that the portions of the Lessor's Land that will be identified in the Development Tract Location Notice will represent that portion of the Lessor's Land that the Lessee deems to be suitable for development for the use contemplated in Section _____, above.

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