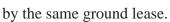
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Focus Real Estate

Keys to making a ground lease financeable

I often receive questions about what constitutes a financeable ground lease. The answer is relatively simple – any ground lease that you can

get financing on. Although this response is a little "tongue-incheek," it's not far from the truth. Different lenders focus on different aspects of a ground lease, and it's not unusual for one lender to make a loan secured by a ground lease, while another insists that no lender would make a loan secured

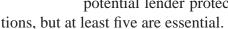


A loan secured by a ground lease has more inherent risk than a loan secured by a fee simple interest in the same real property. The reason is simple; a ground lease can be terminated, whereas fee simple ownership is typically not terminable. If a ground lease is terminated, a lender's lien is also terminated, and the lender then becomes an unsecured creditor of the ground lessee. Ground leases also have increased bankruptcy risks as both the ground lessee and the ground lessor could file for protection under bankruptcy laws.

Lender differences aside, there are certain provisions that every lender looks for in determining whether or not a ground lease is financeable. Some of the more important provisions relate to the term of the ground lease, rent, use restrictions and ownership of improvements, to name a few, none of which are addressed

> in this article. Instead, this article focuses on lender protection provisions.

> Lender protections provisions are agreements made by a ground lessor, for the benefit of the ground lessee's lender, which give the lender assurances that it can maintain its lien and foreclosure rights. There is a long list of potential lender protec-



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The first lender protection requires the ground lessor to deliver written notice of a default under the ground lease to the lender and grants the lender an opportunity to cure such default. Most lenders will insist on receiving the same cure periods as the ground lessee plus additional cure periods. Typically, a lender will want a minimum of 30 extra days to cure monetary defaults and 90 extra days (or more if a lender is in the process of foreclosing on the ground lease) to cure non-monetary defaults.

The second lender protection grants the lender the right to obtain a new ground lease if the original ground lease is terminated for any reason, including a termination as a result of a bankruptcy of the ground lessee, on the same terms and conditions as the terminated ground lease. Typically, this right must be exercised within 90 days after the ground lessor gives notice to the lender that the ground lease has been terminated. This provision protects a lender from defaults by a ground lessee that a lender cannot cure (such as a bankruptcy of the ground lessee).

The third lender protection provides that the ground lease cannot be amended, supplemented, surrendered, terminated or otherwise modified without the written consent of the lender. Unsophisticated ground lessors often take the position that this restriction should not be included in the ground lease, but should instead be included solely in the loan documents. However, this position is not acceptable to lenders because the ground lessor and ground lessee could still modify the ground lease. A claim by the lender of a breach by the ground lessee under the loan documents is not a sufficient remedy.

The fourth lender protection provisions relate to the ability of the ground lessee to mortgage the ground lease. A ground lease typically restricts the ground lessee from transferring the ground lease to a third party without the ground lessor's consent. Most financeable ground leases include an express right of the ground lessee to mortgage its interest in the ground lease without the consent of the ground lessor; how-

ever, in some instances, a ground lessor will insist on having approval rights or limitations on the terms of the ground lessee's mortgage. Obviously, the more restrictions or approval rights a ground lessor has, the more likely the ground lease will be considered unfinanceable.

The final lender protection relates to the lender's ability to foreclose on the interests in the ground lease without the consent of the ground lessor. All lenders will require that they have the ability to foreclose on the ground lease without the consent of the ground lessor. Many lenders also require provisions permitting the lender to make one transfer of the interest in the ground lease after the foreclosure to a third party without obtaining the ground lessor's consent.

It's worth mentioning that if the ground lessor is willing to mortgage its fee interest in the property in connection with the loan, the distinction of whether or not a ground lease is financeable becomes less important. However, it's uncommon for an unaffiliated ground lessor to agree to encumber its fee interest in connection with a loan made to a ground lessee.

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