Financeable Ground Leases and Leasehold Mortgages
Structuring Leases for Owners, Lessees and Lenders That Balance the Competing Interests

TUESDAY, JUNE 26, 2012
1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

Today’s faculty features:
Teryl R. Gorrell, Partner, Gorrell Giles Gollata, Denver
Marc S. Intriligator, Member, Cozen O’Connor, New York
Stacie L. Gollata, Partner, Gorrell Giles Gollata, Denver

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COMMERCIAL GROUND LEASES

SAMPLE LETTER OF INTENT
October 13, 2009

Mr. John Smith
ABC Corporation
1234 Development Boulevard
Anywhere, USA

Re: Letter of Intent Re Development of Office Building for ABC Corporation

Dear Mr. Smith:

This term sheet letter outlines the principal terms for ABC Corporation ("ABC"), and Developer LLC, a Delaware limited liability company ("Developer"), to consider developing an office building at ABC’s Office Complex (the "Complex") in Anywhere, USA (the "Project").

**Project Overview**

Developer desires to construct the project (the "Project") at the Complex pursuant to plans and specifications approved by ABC. The Project will consist of an approximately 65,000 gross square feet ("GSF") corporate office building for ABC. The size of the Project is subject to change based on ABC’s final programming for the building.

**Corporate Office Building:** The planned two-story corporate office building (the "COB"), will consist of approximately 65,000 GSF. The first and second floors of the COB (the “First Floor” and “Second Floor”) will be approximately 27,000 GSF and 28,000 GSF, respectively. In addition to the COB, the Project will also include a 10,000 GSF conference center (the “Conference Center”), which will be connected to the First Floor of the COB. The design of the Conference Center will also include convenient and functional work and meeting space for the Complex.

**Site & Infrastructure Upgrades.** Certain site and infrastructure upgrades may be necessary for the Project development. The onsite and offsite infrastructure upgrades shall be the responsibility of ABC, and will not be included in Developer’s budget or scope of work. Developer will work with its general contractor and ABC to specifically outline the required onsite and offsite infrastructure work, and to establish a collaborative work schedule.
Leases

1. **Ground Lease.** Developer will create an affiliated entity (the “Ground Lessee”) to enter into a ground lease (the “Ground Lease”) with ABC, pursuant to which the Ground Lessee will lease from ABC (as the “Lessor”) a site of approximately ____ acres (the “Project Site”). The size of the Project Site is subject to change based on ABC’s final programming. Developer/Ground Lessee will cause the Project to be constructed on the Project Site. Following construction of the Project, Ground Lessee will sublease the COB and the Conference Center to ABC pursuant to the Occupancy Lease described below.

   The Ground Lease will include, among other standard terms and conditions, the following provisions which must be in a final form and content acceptable to the parties and their legal counsel.

   (a) **Ground Lease Premises and Term:** The leasehold premises under the Ground Lease shall include not only the Project Site, but also rights of access, parking, and temporary construction easements subject to ABC’s reasonable approval. The primary term of the Ground Lease shall be for a minimum of 75 years following “Substantial Completion” of the Project. “Substantial Completion” shall mean when a certificate of occupancy (or its equivalent), if available, has been issued for the core and shell construction of the Project. If local building authorities do not issue a certificate of occupancy for the core and shell, then Substantial Completion shall mean the date the Project is completed substantially in accordance with the final plans and specifications, as determined by the Project architect. In no event shall Developer/Ground Lessee be obligated to commence any construction activities until Lessor acquires fee title to the Project Site and all required entitlements and other approvals as set forth herein.

   (b) **Economics:** ABC shall be responsible for, and shall not pass through to Ground Lessee, any of ABC’s costs or expenses associated with its ownership and operation of the Complex (including the Project Site). The Ground Lessee shall not pay any base rent under the Ground Lease until substantial completion of the COB. Base Rent shall be payable at the annual rate of $____ per square foot of land, escalating ____% per lease year. At the end of the twenty-fifth and fiftieth lease years, base rent and the escalation shall be redetermined based upon market appraisals. Developer/Ground Lessee shall not be required to pay any rent or operating expenses until Substantial Completion of the COB and Conference Center.

   (c) **Title to the Project Site:** ABC will make its best efforts to acquire fee title to, and create a separate legal parcel for the Project Site on or before June 1, 2010, to facilitate the transactions contemplated by this term sheet, free and clear of all liens, charges, encumbrances, and subject only to those exceptions set forth in a to-be-issued commitment for title insurance (the “Title Commitment”) and that are reasonably acceptable to Developer, and that do not interfere with the ability of the Ground Lessee or
Lessor to perform their respective obligations under the Ground Lease and related agreements.

(d) **Ground Lessee’s Leasehold Mortgage:** Ground Lessee shall have the right at any time, and from time to time, to mortgage or otherwise hypothecate its interest in the Ground Lease upon terms and conditions reasonably acceptable to ABC, provided that any debt instruments Ground Lessee may execute in connection with such mortgage or hypothecation shall have a maturity date no later than the expiration of the Ground Lease term. Notwithstanding the foregoing, ABC shall not be required to subordinate its fee interest in the Project Site or the remainder of the Complex to any debt instrument(s) Ground Lessee may execute with respect to the Project.

(e) **Mortgagee Rights:** Given the nature of the Project, the Ground Lease will provide that ABC will not exercise its default remedies (including termination) unless the Ground Lessee or the mortgagee shall fail to cure a default within any applicable grace period (which grace period shall commence, with respect to the mortgagee, upon receipt by such mortgagee of the copy of the notice of default) and for an additional 60 days thereafter or such other reasonable time if the default is of a nature that it cannot, despite the exercise of due diligence, be cured within such 60 day period. However, a mortgagee shall not be required to cure or remedy default which is of a nature that cannot by cured by the mortgagee (including, but not limited to, Ground Lessee’s bankruptcy), and upon foreclosure or other acquisition of the Ground Lessee’s interest in the Ground Lease by the mortgagee, all such incurable defaults under the Ground Lease shall be deemed to have been fully cured as to mortgagee, provided that the foregoing shall not waive or release Ground Lessee with respect to such default. In addition, except for a termination of the Ground Lease as the result of an uncured default, Lessor shall not terminate or accept a surrender of the Ground Lease for any reason or modify or amend the Ground Lease to shorten its term or increase the obligations of the Ground Lessee without the mortgagee’s prior written consent. No such purported action without the mortgagee’s consent shall be binding on the mortgagee.

(f) **Parking:** ABC will make available to the Ground Lessee 4 parking spaces per 1,000 rentable square feet (“RSF”) contained in the Project. The parking spaces shall be directly accessible and in close proximity to the Project, in a location on the Complex mutually acceptable to the Ground Lessee and ABC.

(g) **Right of First Refusal:** The Ground Lease will also include a right of first refusal arrangement in favor of ABC in a form and content reasonably acceptable to ABC, whereby ABC shall have the right to purchase the entire Project if Ground Lessee intends to sell the Project and transfer its interest in the Ground Lease. However, Ground Lessee shall have the right to assign all of its interest in Ground Lease and sell the Project, without ABC’s consent being required, to an entity in which investors in the Ground Lessee or principals of Developer, or its affiliates, or any one or more of them, retain(s) an ownership or management interest (a “Permitted Transfer”). If Ground
Lessee makes a Permitted Transfer, ABC’s right of first refusal shall not apply to such transfer, but the transferee shall thereafter be subject to all applicable provisions of the Ground Lease. Approval by ABC shall be required, however, if the transferee is a direct competitor of ABC offering competitive services.

(h) **Ground Lease Purchase Option:** In addition to a right of first refusal, ABC shall have an option (an “Option”) to purchase the Project. ABC shall have the opportunity to purchase the entire Project (but in no event less than the entire Project). The Option shall be exercised, if at all, during (but no later than the end of the fifth (5th) month of) the seventh (7th) year of the primary term, and the closing of the purchase and sale pursuant to the first option shall take place on the last business day of such seventh (7th) year. The purchase price for the Option shall be calculated pursuant to a mutually agreed formula that considers actual net operating income based on the entire rentable area of the Project and having appraisers determine the fair market value based on such actual net operating income calculations. In addition, the Option shall set forth certain minimum purchase price requirements that would be no less than that required to retire the then-outstanding balance (and other charges associated with payment) of Ground Lessee’s permanent financing. ABC shall be responsible for all closing and transaction costs related to the exercise of its Option.

2. **Occupancy Lease.** The Ground Lessee will enter into a build-to-suit form of tenant space lease (the “Occupancy Lease”) with ABC. The Occupancy Lease will include, among other terms and conditions, the following provisions.

(a) **Premises and Term:** The leasehold premises under the Occupancy Lease shall consist of the entire rentable area of the Project. The Project architect shall determine the rentable area of the Project by, among other factors, measuring to the exterior surface of the dominant portions of the permanent outer walls. The primary term of the Occupancy Lease will be twenty (20) years following Substantial Completion of the Project.

(b) **Economics:** The Occupancy Lease will be triple net (“NNN”).

Assuming the final, approved plans and specifications reflect the size, scope and finish of the Project, the initial base rent rate for the Project shall be $____ per RSF per month, NNN. The base rent shall escalate ______% every three years over the previous year’s base rent. Developer reserves the right to adjust the base rent payable under the Occupancy Lease to reflect any change in the size, scope and finish as set forth in the final, approved plans and specifications.

(c) **Tenant Improvements:** Developer shall provide ABC a turnkey tenant improvement budget not to exceed $____ per RSF, according to an agreed upon scope of work by the parties, and shall be capitalized into and made part of the base rent described above. The current turnkey tenant improvement budget is based on the


conceptual design, scope and budget cost estimates set forth in Developer’s proposal dated _______.

(d) Operating Expenses: In addition to NNN base rent, ABC will be responsible for 100% of all costs and expenses associated with ABC’s use of the Project, together with all of Ground Lessee’s/Landlord’s costs and expenses associated with use of the Project, including exterior site improvements (including parking, landscaping, lighting, and signage), real and personal property taxes, insurance, operating expenses, ground lease payments, and maintenance and replacement costs, including replacements and repairs that may constitute capital expenditures. Estimated operating expenses are included on Exhibit A.

Costs and Expenses

Developer will be solely responsible and shall pay for its development personnel and all legal expenses associated with structuring of the debt and equity for the Project. ABC shall be solely responsible and shall pay for certain master planning, entitlement and other development costs not otherwise specifically set forth in this term sheet. In addition, ABC will be solely responsible and shall pay for design, third-party expenses, and legal expenses (including Developer’s and/or the Ground Lessee’s legal expenses) (collectively, the “Reimbursable Expenses”) incurred in drafting and negotiating all legal documents for the Project, including but not limited to the Ground Lease, the Occupancy Lease and all other documents between ABC and Developer or the Ground Lessee, and related to the Project development. ABC agrees to pay for the work completed to date by XYZ Architect and future work to be completed by geo-technical engineering services, “Phase I” environmental services and civil engineer services. The third-party engineering service providers shall be selected and engaged pursuant to written agreement after full board approval. Additional third-party expenses, other than those set forth herein, will require ABC’s prior authorization. Developer shall cause the Reimbursable Expenses to be repaid to ABC upon closing of the Developer’s construction loan for the Project, but neither Developer nor the Ground Lessee shall have any obligation to repay the Reimbursable Expenses if ABC and Developer do not proceed with the Project. Developer shall make its best efforts to obtain the construction loan for the Project in a diligent and timely manner, on terms and conditions reasonably acceptable to Developer. Developer agrees to include in its first draw against the construction loan an amount sufficient to repay ABC all of the Reimbursable Expenses. ABC will continue to reimburse Developer for respective out of pocket costs associated with travel, lodging, transportation and food (the “Travel Expenses”). Developer will bill ABC on a monthly basis for Reimbursable Expenses and Travel Expenses, which in total shall not exceed $_________ without the prior written consent of ABC. ABC shall remit payment to Developer within twenty (20) days following receipt of an invoice. Attached to this term sheet as Exhibit B is a proposed budget (the “Expense Budget”) setting forth Developer’s estimate of the Reimbursable Expenses and Travel Expenses. ABC shall not be obligated to reimburse Developer for any particular Reimbursable Expense or Travel
Expense line item that exceeds the amount set forth in the Expense Budget unless Developer has obtained ABC’s prior consent.

**Miscellaneous Matters**

**Document Ownership.** ABC will share ownership with Developer of all pre-development plans, materials, studies, correspondence and other documents. In the event the parties decide not to proceed with the Project, Developer shall promptly deliver these documents to ABC following ABC’s payment in full to Developer of all Reimbursable Expenses and Travel Expenses. These documents shall be delivered without warranty of any kind, and ABC agrees to waive any claim against Developer and the Ground Lessee if ABC uses the documents for the development or construction of any improvements, and ABC will indemnify Developer and the Ground Lessee with respect to such use.

**Future Development Rights.** If during the term of the Ground Lease, ABC receives: (i) a bona fide proposal or offer from a third party to develop an office building at the Complex, or (ii) ABC desires to have an office building constructed at the Complex using an unaffiliated third party developer, ABC shall provide Developer with an opportunity to participate in its selection process, should there be such a process, to select a developer for such development. Under no circumstances shall ABC be obligated to offer or grant to Developer any future development rights contemplated by this paragraph.

**Developer’s Right of First Refusal.** Developer or Ground Lessee, as Developer may elect, shall at all times during the term of the Ground Lease, have the right to compete with other third party purchasers for the purchase of any land, office building or condominium located at the Complex that is owned by ABC or its affiliates. Notwithstanding the foregoing, under no circumstances shall ABC be obligated to enter into an agreement to sell any such land unless the terms and conditions are acceptable to ABC.

**ABC & Governmental Approvals.** The Project is subject to approval from ABC’s management, including any governing boards. ABC agrees to provide all required approvals on or before __________. In addition, the Project shall also be subject to all land use requirements of the City of Anywhere and other applicable local government entities. ABC shall cooperate and use its best efforts to expeditiously obtain such governmental and other approvals.

**Milestone Schedule.** The successful achievement of the activities identified within the milestone schedule (see Exhibit C) allows for the Project to be developed with no construction inflation cost. Working with 123 Construction, Developer is currently evaluating what inflation factor (cost) that would need to be added to the Project construction costs if the activities are not achieved as targeted in the milestone schedule. Developer and ABC agree to use commercially reasonable efforts to meet the milestones in order to start the construction of the Project in second quarter __________. Developer’s
failure to timely submit required applications or other documents for governmental approvals (other than for reasons caused by ABC) shall be considered Developer delay. Notwithstanding the foregoing, governmental approvals are outside of Developer’s control and, accordingly, the milestone dates shall be extended if such approvals are delayed or withheld. All milestone dates are further subject to any force majeure events. In addition to the foregoing, the target construction start dates will require prompt ABC’s approval of all space plans, drawings, and construction documents, as well as negotiation and execution of the Ground Lease, Occupancy Lease and other related documents. In order to prevent Project delay, ABC and Developer agree to amend the preliminary milestone dates established in Exhibit C with a detailed milestone schedule identifying critical activities, due dates, and the parties responsible for certain identified tasks. ABC and Developer will mutually agree, and set forth in the Ground Lease and the Occupancy Lease the milestone dates and the parties’ respective rights and obligations in the event the milestone dates are not achieved.

Construction Estimate. The original construction cost estimate was developed by Developer and 123 Construction Company. The estimates were based on the block diagrams and square footage/architectural drawings prepared by XYZ Architect as reviewed during our selection approval process and submitted in Developer’s proposal dated __________.

Exclusions. The following items have been excluded from Developer’s scope, budget pricing, and lease rates:

1. Land costs/land lease payments (i.e., ABC’s site acquisition costs)
2. All broker commissions
3. Relocation expenses
4. Cost for on-site retention/detention ponds
5. All off-site costs
6. Payment and performance bonds
7. Bathrooms exceeding code requirements
8. Master planning
9. Unknown environmental, sub-surface, and site conditions
10. Fiber optics
11. Redundant power or emergency generator

This term sheet outlines the principal terms upon which ABC and Developer intend to proceed with the Project, but does not contain all of the pertinent terms and conditions thereof. This term sheet is not intended to be and shall not be contractually binding on either party, but rather to serve as a basis upon which to proceed with further negotiation and execution of legally binding agreements, except with respect to ABC’s obligation to pay Reimbursable Expenses and Travel Expenses as provided in the “Costs and Expenses” section above, which the parties intent to be a contractual covenant. The parties agree to proceed in good faith in drafting and negotiating agreements as generally described herein, and as the parties may deem necessary for the Project. Either party may
terminate the negotiation of the Project documents at any time prior to the execution of final documents, and such termination shall not give rise to liability of either party; provided, however, in the event of such termination, ABC shall remain obligated to repay Reimbursable Expenses and Travel Expenses as provided in the “Costs and Expenses” section above, for costs incurred prior to such termination.

We look forward to working with you on this exciting project. Please confirm by signing and returning a copy of this letter that you desire Developer to proceed with pre-development documentation in accordance with the terms of this letter. Upon receipt, we will begin preparation of formal agreements and planning documents.

Very truly yours, ACKNOWLEDGED AND AGREED
this ___ day of October, 2009

Developer LLC ABC Corporation
ENDORSEMENT
ATTACHED TO AND FORMING A PART OF
POLICY NUMBER  

ISSUED BY
CHICAGO TITLE INSURANCE COMPANY

ALTA ENDORSEMENT 13.1 – LEASEHOLD – LOAN

1. AS USED IN THIS ENDORSEMENT, THE FOLLOWING TERMS SHALL MEAN:

   a. "EVICTED" OR "EVICTION": (a) THE LAWFUL DEPRIVATION, IN WHOLE OR IN PART, OF THE
   RIGHT OF POSSESSION INSURED BY THIS POLICY, CONTRARY TO THE TERMS OF THE LEASE OR
   (b) THE LAWFUL PREVENTION OF THE USE OF THE LAND OR THE TENANT LEASEHOLD
   IMPROVEMENTS FOR THE PURPOSES PERMITTED BY THE LEASE, IN EITHER CASE AS A RESULT OF
   A MATTER COVERED BY THIS POLICY.

   b. "LEASE": THE LEASE DESCRIBED IN SCHEDULE A.

   c. "LEASEHOLD ESTATE": THE RIGHT OF POSSESSION GRANTED IN THE LEASE FOR THE LEASE
   TERM.

   d. "LEASE TERM": THE DURATION OF THE LEASEHOLD ESTATE, AS SET FORTH IN THE LEASE,
   INCLUDING ANY RENEWAL OR EXTENDED TERM IF A VALID OPTION TO RENEW OR EXTEND IS
   CONTAINED IN THE LEASE.

   e. "PERSONAL PROPERTY": PROPERTY, IN WHICH AND TO THE EXTENT THE INSURED HAS RIGHTS,
   LOCATED ON OR AFFIXED TO THE LAND ON OR AFTER DATE OF POLICY THAT BY LAW DOES NOT
   CONSTITUTE REAL PROPERTY BECAUSE (i) OF ITS CHARACTER AND MANNER OF ATTACHMENT TO
   THE LAND AND (ii) THE PROPERTY CAN BE SEVERED FROM THE LAND WITHOUT CAUSING
   MATERIAL DAMAGE TO THE PROPERTY OR TO THE LAND.

   f. "REMAINING LEASE TERM": THE PORTION OF THE LEASE TERM REMAINING AFTER THE INSURED
   HAS BEEN EVICTED.

   g. "TENANT": THE TENANT UNDER THE LEASE AND, AFTER ACQUISITION OF ALL OR ANY PART OF
   THE TITLE IN ACCORDANCE WITH THE PROVISIONS OF SECTION 2 OF THE CONDITIONS OF THE
   POLICY, THE INSURED CLAIMANT.

   h. "TENANT LEASEHOLD IMPROVEMENTS": THOSE IMPROVEMENTS, IN WHICH AND TO THE EXTENT
   THE INSURED HAS RIGHTS, INCLUDING LANDSCAPING, REQUIRED OR PERMITTED TO BE BUILT ON
   THE LAND BY THE LEASE THAT HAVE BEEN BUILT AT THE INSURED'S EXPENSE OR IN WHICH THE
   INSURED HAS AN INTEREST GREATER THAN THE RIGHT TO POSSESSION DURING THE LEASE TERM.

   (CONTINUED)
ENDORSEMENT
ATTACHED TO AND FORMING A PART OF
POLICY NUMBER: [Redacted]

ISSUED BY
CHICAGO TITLE INSURANCE COMPANY

2. VALUATION OF ESTATE OR INTEREST INSURED:

If in computing loss or damage it becomes necessary to value the title, or any portion of it, as the result of an eviction of the insured, then, as to that portion of the land from which the insured is evicted, that value shall consist of the value for the remaining lease term of the leasehold estate and any tenant leasehold improvements existing on the date of the eviction. The insured claimant shall have the right to have the leasehold estate and the tenant leasehold improvements affected by a defect insured against by the policy valued either as a whole or separately. In either event, this determination of value shall take into account rent no longer required to be paid for the remaining lease term.

3. ADDITIONAL ITEMS OF LOSS COVERED BY THIS ENDORSEMENT:

If the insured is evicted, the following items of loss, if applicable to that portion of the land from which the insured is evicted shall be included, without duplication, in computing loss or damage incurred by the insured, but not to the extent that the same are included in the valuation of the title determined pursuant to section 2 of this endorsement, any other endorsement to the policy, or section 8(a)(ii) of the conditions:

a. The reasonable cost of (i) removing and relocating any personal property that the insured has the right to remove and relocate, situated on the land at the time of eviction, (ii) transportation of that personal property for the initial one hundred miles incurred in connection with the relocation, (iii) repairing the personal property damaged by reason of the removal and relocation, and (iv) restoring the land to the extent damaged as a result of the removal and relocation of the personal property and required of the insured solely because of the eviction.

b. Rent or damages for use and occupancy of the land prior to the eviction that the insured as owner of the leasehold estate may be obligated to pay to any person having paramount title to that of the lessor in the lease.

c. The amount of rent that, by the terms of the lease, the insured must continue to pay to the lessor after eviction with respect to the portion of the leasehold estate and tenant leasehold improvements from which the insured has been evicted.

d. The fair market value, at the time of the eviction, of the estate or interest of the insured in any lease or sublease permitted by the lease and made by the insured as lessor of all or part of the leasehold estate of the tenant leasehold improvements.
ENDORSEMENT

ATTACHED TO AND FORMING A PART OF
POLICY NUMBER: [Redacted]

ISSUED BY
CHICAGO TITLE INSURANCE COMPANY

e. DAMAGES CAUSED BY THE EVICTION THAT THE INSURED IS OBLIGATED TO PAY TO LESSEES OR SUBLSEES ON ACCOUNT OF THE BREACH OF ANY LEASE OR SUBLEASE PERMITTED BY THE LEASE AND MADE BY THE INSURED AS LESSOR OF ALL OR PART OF THE LEASEHOLD ESTATE OR THE TENANT LEASEHOLD IMPROVEMENTS.

f. THE REASONABLE COST TO OBTAIN LAND USE, ZONING, BUILDING AND OCCUPANCY PERMITS, ARCHITECTURAL AND ENGINEERING SERVICES AND ENVIRONMENTAL TESTING AND REVIEWS FOR A REPLACEMENT LEASEHOLD REASONABLY EQUIVALENT TO THE LEASEHOLD ESTATE.

g. IF TENANT LEASEHOLD IMPROVEMENTS ARE NOT SUBSTANTIALLY COMPLETED AT THE TIME OF EVICTION, THE ACTUAL COST INCURRED BY THE INSURED, LESS THE SALVAGE VALUE, FOR THE TENANT LEASEHOLD IMPROVEMENTS UP TO THE TIME OF EVICTION. THOSE COSTS INCLUDE COSTS INCURRED TO OBTAIN LAND USE, ZONING, BUILDING AND OCCUPANCY PERMITS, ARCHITECTURAL AND ENGINEERING SERVICES, CONSTRUCTION MANAGEMENT SERVICES, ENVIRONMENTAL TESTING AND REVIEWS, AND LANDSCAPING.

4. THIS ENDORSEMENT DOES NOT INSURE AGAINST LOSS, DAMAGE OR COSTS OF REMEDIATION (AND THE COMPANY WILL NOT PAY COSTS, ATTORNEYS' FEES OR EXPENSES) RESULTING FROM ENVIRONMENTAL DAMAGE OR CONTAMINATION.

THIS ENDORSEMENT IS ISSUED AS PART OF THE POLICY. EXCEPT AS IT EXPRESSLY STATES, IT DOES NOT (I) MODIFY ANY OF THE TERMS AND PROVISIONS OF THE POLICY, (II) MODIFY ANY PRIOR ENDORSEMENTS, (III) EXTEND THE DATE OF POLICY, OR (IV) INCREASE THE AMOUNT OF INSURANCE. TO THE EXTENT A PROVISION OF THE POLICY OR A PREVIOUS ENDORSEMENT IS INCONSISTENT WITH AN EXPRESS PROVISION OF THIS ENDORSEMENT, THIS ENDORSEMENT CONTROLS. OTHERWISE, THIS ENDORSEMENT IS SUBJECT TO ALL OF THE TERMS AND PROVISIONS OF THE POLICY AND OF ANY PRIOR ENDORSEMENTS.
How Much Protection Does A Leasehold Mortgagee Need?

Joshua Stein

In this article, the author presents and explains a set of “middle ground” leasehold mortgagee protections that try to balance the concerns of the landlord and the leasehold mortgagee in a simple and straightforward way.

Every real estate developer, investor, or attorney who negotiates a long-term ground lease (a “Lease”)
knows that the Lease must be “financeable.” This means the Lease must contain certain provisions (the “Leasehold Mortgagee Protections”) to protect the interests of a likely future Leasehold Mortgagee.

Those interests boil down to assuring that Leasehold Mortgagee can always: (a) take and readily enforce a Leasehold Mortgage; (b) preserve the Lease and its value, even if the transaction goes into default or surprises occur; or (c) abandon a bad investment.

To achieve these goals, Tenant and its counsel might say a Lease should contain: (a) every possible Leasehold Mortgagee Protection any real estate lawyer has ever devised; (b) absolute clarity and full detail about every single element of every single one of those Leasehold Mortgagee Protections, leaving nothing to be resolved later and no possible hypothetical sequence or confluence of events unaddressed; and perhaps (c) as many words and pages as possible devoted to protecting Leasehold Mortgagee. Such an approach, if carefully and intelligently implemented, may minimize the possibility that any particular prospective Leasehold Mortgagee or its counsel ever will find a substantive basis to disapprove a Lease. It can, however, lead to complexity, verbiage, negotiations, and risk of error.

At the opposite extreme, Tenant and its counsel might say a Lease should contain only the bare minimum Leasehold Mortgagee Protections necessary to satisfy the literal requirements and expectations of the rating agencies. The Lease would simply parrot the express requirements of the rating agencies (just the words in their published ground lease criteria), so that in any securitization the Lease should match up to the published words and pass without objection. This approach keeps everything simple and avoids problems.

“Minimal” Leasehold Mortgage Protections will work, though, only if: (a) Landlord and its counsel don’t try to festoon those “minimal” Leasehold Mortgagee Protections with too many conditions, limitations, procedures, qualifications, requirements, restrictions, and so on; and (b) no future prospective “B-piece” buyer, Leasehold Mortgagee, participant, purchaser, rating agency, or syndicate member ever decides it wants the Lease to contain more than the bare minimum Leasehold Mortgagee Protections as the rating agencies had publicly defined them when the parties negotiated their Lease.

The author has previously published Leasehold Mortgagee Protections at both the “minimum” and “maximum” extremes suggested above. In response to reactions from readers, the author has now prepared a “middle ground” set of Leasehold Mortgagee Protections, which is presented here, after these introduc-
How Much Protection Does A Leasehold Mortgagee Need?

In addition to looking for "pure" Leasehold Mortgagee Protections, which serve Leasehold Mortgagee's interests without directly serving Tenant's, any Leasehold Mortgagee evaluating a Lease as possible collateral for a loan will also care about all the other terms of the Lease—everything that makes the Lease a valuable asset. That analysis forces Leasehold Mortgagee to consider nearly every issue that can arise in a Lease. Nearly every such issue, if handled badly enough, can make a Lease "unfinanceable."

To try to cover all these issues in a discussion of Leasehold Mortgagee Protections could turn the discussion into a general discussion of ground leases, which is not the goal here. Nevertheless, Tenant and Leasehold Mortgagee share a very few fundamental concerns. The issues on that "short list" are commonly regarded as Leasehold Mortgagee Protections even though they are not unique to Leasehold Mortgagees. The following "medium" Leasehold Mortgagee Protections cover a few of those fundamental "shared issues" before turning to issues of concern primarily to Leasehold Mortgagees.

The numbered comments at the end of this article (the "endnotes") describe some judgment calls, beyond mere omissions, that these Leasehold Mortgagee Protections reflect. Anyone can always argue for some other judgment call. That is inevitable once one tries to identify a "middle ground" approach to a document. Similarly, anyone might deem any omitted issue to be worth covering.

Because of their substantive nature, the endnotes are an important part of this article, which should be considered by anyone reading this article.

In addition to defining a "reasonable" set of Leasehold Mortgagee Protections, the following model seeks to demonstrate straightforward, simple, and comprehensible legal writing, consistent with the author's published pleas for use of Plain English even in sophisticated commercial real estate transactional documents. The author tries to prove in this document that attorneys can write substantial legal documents in readable English that nonlawyers can readily understand. Legal documents don’t need to be written in some weird and perverted form of quasi-English, marked by long sentences, convoluted verb structures, the passive voice, redundancy, and gratuitous complexity.

The author welcomes comments on these Leasehold Mortgagee Protections, both substantive and stylistic.

Definitions

"Bankruptcy Termination Option" means Tenant’s right to treat this Lease as terminated under 11 U.S.C.A. § 365(h)(1)(A)(i) or any comparable provision of law.

"Fee Estate" means Landlord’s fee interest in the Premises, including Landlord’s reversionary interest, all subject to this Lease.

"Foreclosure Event" means any: (a) foreclosure sale, trustee’s sale, assignment of this Lease in lieu of foreclosure, sale under 11 U.S.C.A. § 363, or similar transfer affecting this Lease or (b) Leasehold Mortgag-
Termination Option.”

“Bankruptcy Termination Option.”

Termination Option.”

“Lease Termination Option.”

“Preemptive Right” means any renewal, expansion, or purchase option; right of first refusal or first offer; or other preemptive right this Lease gives Tenant.

“Remaining Premises” means any Premises that Tenant is divested of its interest in this Lease.

Tenant may use the Premises for any lawful purpose.

Assignment

Tenant may, without Landlord’s consent, assign this Lease provided that Tenant or the assignee gives Landlord a copy of the assignment documents and also, except in the case of an assignment through a Foreclosure Event or a collateral assignment to a Leasehold Mortgagee, Tenant: (a) has achieved Substantial Completion of Development; and (b) causes the assignee to deliver to Landlord an assumption of this Lease.

Subleases

Tenant may, without Landlord’s consent, sublease the Premises in whole or in part. If this Lease terminates, Landlord shall not disturb the possession, interest, or quiet enjoyment of any Subtenant not in default beyond applicable cure periods under its Sublease, provided that either: (a) such Sublease demises the entire Premises and is in all material respects at all times no less favorable to Landlord than this Lease; or (b) all the following conditions have been satisfied: (1) Subtenant is unrelated to Tenant; (2) the Sublease was on commercially reasonable and fair market terms when Subtenant became legally bound; and (3) at least one Leasehold Mortgagee has agreed to grant Subtenant nondisturbance protection.

Loss

If a Loss occurs: (a) the party that first becomes aware of it shall notify the other party; (b) the parties shall direct the payor to pay all Loss Proceeds to Leasehold Mortgagee; (c) Loss Proceeds shall be applied as fol-
How Much Protection Does A Leasehold Mortgagee Need?

Every Fee Mortgage shall be, and shall state that it is, subject and subordinate to this Lease and any New Lease. Any Leasehold Mortgage shall attach solely to Tenant’s leasehold estate under this Lease. Any Foreclosure Event under a Leasehold Mortgage shall: (a) transfer only Tenant’s interest in this Lease; and (b) not impair any estate or rights under any Fee Mortgage.

Leasehold Mortgages

Without Landlord’s consent, from to time, but subject to all other terms of this Lease not inconsistent with this paragraph: (a) provided that any Event of Default has been, or simultaneously is, cured, Tenant may grant Leasehold Mortgage(s); (b) Leasehold Mortgagee may initiate and complete any Foreclosure Event; and (c) any transferee through a Foreclosure Event, and its successors and assigns, may assign this Lease.

Rent Adjustments

Any Lease Impairment made without Leasehold Mortgagee’s consent shall be null, void, and of no force or effect, and not bind Leasehold Mortgagee or New Tenant.

Opportunity to Cure

Landlord shall accept Leasehold Mortgagee’s cure of any Tenant Default at any time until ___ days after both: (a) Tenant and Leasehold Mortgagee have received the Tenant Default Notice; and (b) Tenant’s cure period for the Tenant Default has expired. If Leasehold Mortgagee cannot reasonably cure the Tenant Default within such period, Leasehold Mortgagee shall have such further time as it shall reasonably need so long as it proceeds with reasonable diligence. If Leasehold Mortgagee cannot reasonably cure a Tenant Default without possession of the Premises, or in the event of an Incurable Tenant Default, Leasehold Mortgagee shall be entitled to such additional time as it shall reasonably need to consummate a Foreclosure Event and obtain such possession, provided Leasehold Mortgagee timely exercises its cure rights for all other Tenant Defaults. If Leasehold Mortgagee consummates a Foreclosure Event, Landlord shall waive all Incurable Tenant Defaults.

Cure Rights Implementation

At any time when Leasehold Mortgagee’s cure rights...
have not expired, Landlord shall do nothing to terminate this Lease or accelerate any rent, or otherwise interfere with Tenant’s or Leasehold Mortgagee’s possession and quiet enjoyment of the Premises. Leasehold Mortgagee may at its option enter the Premises to seek to cure a Tenant Default. This right or its exercise shall not be deemed to give Leasehold Mortgagee possession of the Premises. Leasehold Mortgagee need not cure any Tenant Default arising from any lien or encumbrance that attaches solely to this Lease (and not to the Fee Estate) but is junior to its Leasehold Mortgagee, provided that Leasehold Mortgagee endeavors with reasonable diligence to consummate a Foreclosure Event.

New Lease
If this Lease terminates for any reason (except with Leasehold Mortgagee’s consent or because of a Total Loss), even if Leasehold Mortgagee failed to timely exercise its cure rights for a Tenant Default, then Landlord shall promptly give Leasehold Mortgagee a Lease Termination Notice. Upon Leasehold Mortgagee’s request, Landlord shall enter into a New Lease with New Tenant. Any such request must be made, if at all, at any time before the day that is _____ days after Leasehold Mortgagee has received Landlord’s Lease Termination Notice. Landlord’s obligation to enter into a New Lease shall be subject to the conditions that New Tenant shall (in accordance with the Lease Termination Notice): (a) cure all remaining uncured Tenant Defaults that New Tenant can then reasonably cure; and (b) pay Landlord’s reasonable costs and expenses (including reasonable attorneys’ fees and expenses) in terminating this Lease, recovering the Premises, and entering into the New Lease. New Tenant need not cure any Incurable Tenant Default.

New Lease Implementation
If Leasehold Mortgagee timely requests a New Lease in conformity with the conditions and requirements of this Lease, then from termination of this Lease until execution and delivery of a New Lease: (a) New Tenant shall be entitled to all net income of the Premises; and (b) Landlord shall not terminate any Subleases except for Subtenant’s default, or enter into any lease affecting any of the Premises except with New Tenant. When the parties sign a New Lease, Landlord shall cooperate with New Tenant to transfer to New Tenant all Subleases (including any security deposits Landlord held), service contracts, and operations of the Premises. Landlord shall cause every Fee Mortgagee to unconditionally subordinate to any New Lease.

Tenant’s Rights Under Lease
If this Lease contains any Preemptive Right and Tenant does not timely exercise it when this Lease allows, Landlord shall promptly notify Leasehold Mortgagee. Until _____ days after Leasehold Mortgagee has received such notice, Leasehold Mortgagee may exercise the Preemptive Right for Tenant. Leasehold Mortgagee may exercise any or all of Tenant’s rights (including Preemptive Rights) under this Lease. So long as Leasehold Mortgagee’s cure rights under this Lease have not expired, Leasehold Mortgagee may exercise any such rights even if Tenant is in default under this Lease, notwithstanding anything to the contrary in this Lease. Tenant irrevocably assigns to Leasehold Mortgagee, to the exclusion of Tenant and any other person, any right to exercise any Bankruptcy Termination Option.

Certain Proceedings
If Landlord or Tenant initiates any appraisal, arbitration, litigation, or other dispute resolution proceeding affecting this Lease, then the parties shall simultaneously notify Leasehold Mortgagee. Leasehold Mortgagee may participate in such proceedings on Tenant’s behalf, or exercise any or all of Tenant’s rights in such proceedings. At Leasehold Mortgagee’s option, any actions of Leasehold Mortgagee under the preceding sentence shall be to the exclusion of Tenant. Any settlement shall not be effective without Leasehold Mortgagee’s consent.

No Merger
If this Lease and the Fee Estate are ever commonly held, they shall remain separate and distinct estates (and not merge) without consent by Leasehold Mortgagee and Fee Mortgagee.

No Personal Liability
No Leasehold Mortgagee or New Tenant shall have any liability under this Lease beyond its interest in this Lease, even if it becomes Tenant. Any such liability shall: (a) not extend to any Tenant Defaults that occurred before such Tenant took title to this Lease (or a New Lease), except any identified in a Tenant Default Notice or Lease Termination Notice; and (b) terminate if and when any such Tenant assigns (and the assignee assumes) or abandons this Lease (or a New Lease).

Multiple Leasehold Mortgagees
If at any time multiple Leasehold Mortgagees exist: (a) any consent by or notice to Leasehold Mortgagee refers to all Leasehold Mortgagees; (b) except under clause “a,” the most senior Leasehold Mortgagee may exercise all rights of Leasehold Mortgagee(s), to the exclusion of junior Leasehold Mortgagee(s); (c) to the extent that the most senior Leasehold Mortgagee declines to do so, any one other Leasehold Mortgagee may exercise those rights, in order of priority; and (d) if
Leasehold Mortgagees do not agree on priorities, a written determination of priority issued by a title insurance company licensed in the State shall govern.

**Further Assurances**

Upon request from Tenant or any Leasehold Mortgagee (prospective or current), Landlord shall promptly and in writing, under documentation reasonably satisfactory to Landlord and the requesting party: (a) certify that this Lease is in full force and effect, whether it is subject to any Lease Impairment, that to Landlord’s knowledge no Tenant Default exists, the date through which Rent has been paid, and such other similar matters as may be reasonably requested, all subject to any then exceptions reasonably specified in such certificate; (b) agree directly with Leasehold Mortgagee that it may exercise against Landlord all of Leasehold Mortgagee’s rights under this Lease; (c) acknowledge any Subtenant’s nondisturbance and recognition rights (provided Subtenant joins in such agreement); and (d) provided that Tenant reimburses Landlord’s reasonable attorneys’ fees and expenses, enter into any Lease modification that any current or prospective Leasehold Mortgagee requests, if it does not adversely affect Landlord in any material respect or reduce any payment this Lease requires.

**Miscellaneous**

Notwithstanding anything to the contrary in this Lease, Leasehold Mortgagee: (a) may exercise its rights through an affiliate, assignee, designee, nominee, subsidiary, or other Person, acting in its own name or in Leasehold Mortgagee’s name (and anyone so acting shall automatically have the same protections, rights, and limitations of liability as Leasehold Mortgagee); (b) shall never be obligated to cure any Tenant Default; (c) may abandon such cure at any time; and (d) may withhold its consent or approval for any reason or no reason, except where this Lease states otherwise. Any such consent or approval must be written. To the extent any Mortgagee’s rights under this Lease apply after this Lease terminates, they shall survive.

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1 The sample Leasehold Mortgagee Protections below define many capitalized terms. Obvious definitions of other capitalized terms are omitted. “Lease” should include any amendments made in compliance with the Lease.

2 Tenant does not directly share the special concerns of a Leasehold Mortgagee—at least if Tenant knows with absolute certainty that it, and its successors and assignees, will never need a Leasehold Mortgage. A more typical Tenant will, of course, care a great deal about Leasehold Mortgagee Protections. They make a Lease financeable and hence more valuable to a broader universe of future debt and equity investors.

3 It also causes headaches, according to counsel for at least one Landlord.

4 The rating agencies’ published standards do not always track their current practices.


6 This is not a representation or warranty. Any prospective Leasehold Mortgagee’s counsel can, if it wishes, almost always find some basis to disapprove any Lease.

7 Beyond the “shared issues” covered here, a Leasehold Mortgagee would also look first at the following issues: remaining term, transferability, rent adjustment (including particularly the absolute clarity of any evaluation formula), unusual obligations, alterations, demolition, insurance, and environmental matters.

8 Anything these Leasehold Mortgagee Protections omit is generally covered, often at length, in the author’s previously published “maximum” Leasehold Mortgage Protections.


10 In “Short and Simple,” *The American Lawyer*, October 2002, at 59, the author suggested these seven principles for better legal writing. (1) Break long sentences into shorter ones. (2) Get rid of words, sentences, and paragraphs you do not need. (3) Prefer verbs to nouns. (4) Question any use of a word that includes “here”; try to substitute something less legalistic. (5) Use simple words if you can. (6) Use the active voice. (7) Write larger numbers as numerals. These principles are hardly new, unique, or previously undiscovered. See, e.g., William Strunk, Jr. & E.B. White, *The Elements of Style* (4th ed. 2000). Even so, the legal profession remains largely oblivious to them. The author has tried to apply them consistently in these Leasehold Mortgagee Protections.

11 “Premises” should include appurtenant air rights and development rights.

12 The Lease should say somewhere, once, that “include” means “without limitation.”

13 “Modification” seems synonymous with “amend-
ment’” or “‘change,’” both of which one also often expects to see, redundantly, in any definition like this one.

This assumes the Lease originally demised raw land. The valuation of Landlord’s leased fee estate raises many issues, including nuances such as how to deal with downzoning or upzoning since the Commencement Date.

For this and other value-related provisions, the Lease should set appraisal procedures.

Mezzanine lenders may want protections like those of Leasehold Mortgagee, but this language does not provide them. Landlord may argue that a mezzanine lender is effectively an equity investor and should rely on its rights as an equity investor rather than bother Landlord. Landlord may want to limit the amount, purpose, or type of loan(s) that Leasehold Mortgages secure. For long-term ground leases, such limitations are generally not market standard or appropriate, at least after Tenant has completed initial construction/development. Once Tenant has reached that point: (a) any Leasehold Mortgage of any size to any Leasehold Mortgagee merely creates a possible future Foreclosure Event and a possible future Lease transfer; (b) Landlord should not care; and (c) even if overleverage creates some theoretical possibility of slightly impairing or temporarily deferring Landlord’s rental income, Landlord’s concerns are not compelling. Tenant will usually agree that Leasehold Mortgagee must: (1) be “institutional”; (2) have a minimum net worth; and (3) meet other objective and reasonable criteria. These concessions will cause definitional issues, complexity, and risk of obsolescence.

Landlord may also want copies of: (a) the unrecorded loan documents; and (b) future amendments. Neither request seems justified.

Leasehold Mortgagee will usually tolerate a somewhat narrower permitted use. Some argue that the breadth of the use clause merely affects the value of the Lease rather than its financeability. That argument may be correct, assuming a narrower use clause remains broad enough so Leasehold Mortgagee can still easily resell the Lease after a Foreclosure Event.

Landlord may also want to assure that, even if the Sublease is at market, Subrent does not decline over time and Subtenant agrees to pay Subrent upon request (and any Sublease termination payments) directly to Landlord.

Landlord (and its Fee Mortgagee) may hesitate to “nondisturb” (or more often “recognize”) all future Subtenants, even under the conditions stated. Landlord may argue that once the Lease terminates, Landlord should recover clear possession of the entire Premises, without having to deal with any bits or pieces of Tenant’s failed plan for the Premises. Subtenants that make substantial investments in their space (and Tenant and Leasehold Mortgagee) will feel otherwise, and will usually win this discussion.

The possibility of a Loss and its variations often consume many pages in a Lease. The parties can negotiate and fine-tune this topic, and create new categories, distinctions, and conditions, to whatever degree they want or can stand. Of all the issues these Leasehold Mortgagee Protections cover, the treatment of a Loss may be the one least suited to a “one size fits all” resolution, but also the one where cost-benefit considerations most cry out for it. These Leasehold Mortgagee Protections make a valiant effort. One lawyer has proposed, not entirely as a joke, that the government should: (a) prohibit all condemnation clauses; (b) require any condemning authority to compensate each holder of an interest in the condemned property for the separate value of that interest; (c) collect a miniscule fee from each real estate transaction to establish a condemnation undercompensation protective fund; and (d) use that fund to make whole any real property owner ever undercompensated for a condemnation.

Even if Landlord has agreed to allow just anyone to be Leasehold Mortgagee, Landlord can legitimately set standards for who may hold Loss Proceeds.

On the issue of a temporary condemnation, silence will usually suffice.

Tenant may want to cap or narrow these expenses, or treat them as a risk of ownership.

Leasehold Mortgagees often want Loss Proceeds to go first to repay all Leasehold Mortgages in full. This may be unreasonable, based on the following arguments. A condemnation clause should give each party a package that reflects the value and relative risks/benefits of its position under the Lease if the Lease had continued. Neither party should find itself in a better position (wealthier) after a condemnation than before. Absent condemnation, Landlord would hold a low-risk high-priority relatively fixed annuity (much like a first mortgage, see, e.g., “Special Report: CMBS: Moody’s Approach to Rating Loans Secured By Ground Leasehold Interests,” October 23, 2001). In contrast, as holder of a higher-risk and lower-priority interest in the real estate, Tenant (and its mortgagees) would bear the risk of “first loss” if the value and cash flow of the property could not adequately support Landlord, Tenant, and their lenders.

To do justice to these positions after a single unexpected “liquidation” of the Premises because of a Loss, Landlord should be paid first, but only to the extent of the value of Landlord’s low-risk annuity under the Lease, including the reversion. Tenant should own what’s left: the risk of inadequate Loss Proceeds, and the possible windfall of excessive Loss Proceeds. In response to these issues, some Leases say Landlord and Tenant share Loss Proceeds in proportion to the relative values of their positions. Landlord may fear that any formula tied to the value of Landlord’s position at the moment of condemnation may undercompensate Landlord if a condemnation occurs during high interest rates or an anomalous real estate market, such as the market that existed in 1991. This undercompensation is much like the loss a mortgagee suffers under 11 U.S.C.A. §§ 506(a) and 1129(a)(7), which let a debtor “cram down” a mortgagee based on current adverse circumstances - temporary impairment of value of the collateral—at the moment of a bankruptcy filing, even though the mortgagee thought it had bought into the real estate for the long haul. The condemnation formula can set a floor for Landlord’s share of the award, taking into account such factors as the remaining term, a maximum discount rate, and a minimum projected residual value. Any such protection will create a corresponding risk for Tenant and Leasehold Mortgagee (a “zero-sum game”). Some of this risk may be insurable.

Landlord may want to add a decision deadline. Without one, the courts will infer a “reasonable” time, creating tolerable uncertainty. If a Lease is fully nonrecourse, then: (a) Tenant has a termination option at all times; (b) a further termination option might be a waste of words, so long as Tenant must unambiguously leave behind all Loss Proceeds...
if Tenant ever just ‘‘walks away’’; and (c) a Loss-based termination becomes interesting only when Tenant wants the right to terminate and yet keep some Loss Proceeds, a possibility not provided for here.

27 A ‘‘Termination Option Loss’’ lets Tenant decide whether to terminate. In such a case, Landlord would reasonably argue that Landlord should keep Loss Proceeds, or Tenant should nevertheless restore. Tenant and Leasedhold Mortgagee may disagree. Landlord would say that Landlord’s claim to the value of the improvements should defeat the claim of the fickle Tenant and Leasedhold Mortgagee, who ‘‘chose to walk away.’’ If, however, Tenant and Leasedhold Mortgagee had no real choice, then Landlord’s ‘‘expectation’’-based claim to Loss Proceeds seems weaker. For example, if a 60-story office building was originally a ‘‘legal nonconforming use’’ but current code allows restoration only as a single-family residence, or if the condemnor took 95% of the site (either, a ‘‘Total Loss’’), then Landlord still receives its first-priority claim for any resulting diminution in the Leased Fee Value, but any remaining Loss Proceeds (typically the value of the improvements) go to Tenant and Leasedhold Mortgagee.

28 Tenant and Leasedhold Mortgagee cannot just ‘‘take the money and run.’’ Landlord has its own independent and legitimate interest in seeing the Premises restored. But what happens if Loss Proceeds are insufficient to restore as required? Typically a Lease will require Tenant to make up the shortfall before starting work, but that obligation will not be personally guaranteed. If at that point Tenant chose to ‘‘walk away,’’ then Landlord would receive the remaining Loss Proceeds. The Leasedhold Mortgage loan documents will also have something to say about this issue. Landlord will want some ability to control how Tenant restores the Premises. This will raise the same issues as any other major construction project on the Land and usually justify the same outcomes.

29 These Leasedhold Mortgagee Protections do not require that any Fee Mortgage must be ‘‘subordinate’’ to every Leasedhold Mortgage. That issue is a can of worms caused mostly by confusion about leasehold transactions. Instead, this paragraph tries to explain very succinctly how Fee Mortgages, the Lease, and Leasedhold Mortgages interact.

30 Tenant should agree, in the Leasedhold Mortgage, not even to try to subordinate the Lease to any Fee Mortgage. Landlord or Fee Mortgagee may suggest that Fee Mortgagee: (a) be superior and prior to the Lease, but (b) enter into an absolute and unconditional nondisturbance agreement with Tenant and Leasedhold Mortgagee. Tenant and Leasedhold Mortgagee typically reject that proposition in short order, in part because it might be treated as an executory contract in Fee Mortgagee’s bankruptcy. They may, however, reluctantly tolerate a prior Fee Mortgage if Fee Mortgagee ‘‘joins in’’ the Lease when the parties sign it—a joinder in the present creation of a property interest rather than an ‘‘executory’’ promise to do something later. As another option, the Fee Mortgage could be expressly subordinate to the Lease, except during any period when Fee Mortgagee is bound by a fully effective nondisturbance agreement in the form the Lease requires. If the nondisturbance agreement goes away, so does the subordination of the Lease.

31 Fee Mortgagee may want the right to cure Landlord defaults. Given the limited scope of Landlord’s obligations under a Lease, Fee Mortgagee’s cure rights can be simpler than Leasedhold Mortgagee’s. But Fee Mortgagee cure rights are neither relevant to financeability of Leases nor uniformly included in Leases.

32 The parties may want to say that Leasedhold Mortgagee’s rights end when Tenant has repaid its loan. This seems obvious and hence unnecessary. Silence avoids the need to identify, define, and carve out loan repayments that should not terminate Leasedhold Mortgagee’s rights (e.g., those resulting from a Foreclosure Event).

33 Without Leasedhold Mortgagee’s consent, any Lease amendment is not even effective as between Landlord and Tenant. This may be overkill, but it prevents issues, complexity, and controversy that might arise if some amendments were effective between Landlord and Tenant but did not bind Leasedhold Mortgagee.

34 If the parties disagree over an alleged Tenant Default, Leasedhold Mortgagee may want the right to pay under protest and obtain a refund if Leasedhold Mortgagee wins the fight. Such a provision probably duplicates what any court would do anyway under the circumstances. It does not seem essential to financeability, as its absence should not create intolerable risks. Leasedhold Mortgagee will want to confirm that Tenant has ample cure periods and dispute rights even before Leasedhold Mortgagee’s cure period begins.

35 Landlord may want a shorter cure period for failure to insure. Although this sounds compelling, it is probably not realistic. Landlord should rely on its own (and Leasedhold Mortgagee’s) monitoring; a 30-day notice requirement for cancellation, and, if necessary, the ability to expeditiously force-place single-interest coverage at Tenant’s expense.

36 Landlord may argue that this gives Leasedhold Mortgagee too many bites at the apple and, for example, Leasedhold Mortgagee should lose its New Lease rights if at any time any monetary obligation was more than ____ days past due. Leasedhold Mortgagee usually wins this discussion.

37 If a dispute exists about any of these items, Leasedhold Mortgagee may want a New Lease even while the dispute is being resolved.

38 From Lease termination until New Lease execution, the Lease could set rules to govern Landlord’s interim leasing program, Subleases, operations, and so on. Given how rarely (if ever) any Landlord has ever terminated a Lease and then entered into a New Lease, the topic probably does not merit the attention it sometimes receives. These Leasedhold Mortgagee Protections cover it in a minimal and ‘‘broad brush’’ way.

39 The preceding sentence is not standard, but some secondary market players want it.

40 This assignment should also appear in the Leasedhold Mortgage and loan documents.

41 Many Leases address the Bankruptcy Termination Option at length. Everything they say boils down to this sentence and the definition of Lease Impairment. If Landlord rejects the Lease in bankruptcy and Tenant does not exercise the Bankruptcy Termination Option, then Tenant can offset damages against rent. Incorrect offsets can conceivably lead to Lease terminations. Thus, some Leases let Leasedhold Mortgagee approve and confirm each offset. These Leasedhold Mortgagee Protections contain no such procedures, because: (a) such offsets are quite rare (the author will pay $1.00 to anyone who can identify one that ever occurred under any mortgaged Lease); and (b) Leasedhold Mortgagee can reasonably protect itself through pre-emptive litigation if necessary.
Tenant will want Leasehold Mortgagee not to exclude Tenant unless an uncured Event of Default exists. Any such restrictions belong in the loan documents, not the Lease.

If a proceeding involves a monetary claim of less than $\text{DEL/DEL}, perhaps Tenant should be able to settle it without Leasehold Mortgagee's consent.

The senior Leasehold Mortgagee may want more control than this paragraph grants. All Leasehold Mortgagees need an intercreditor agreement.

This clause "c" governs as between Landlord and Leasehold Mortgagees as a group. The most senior Leasehold Mortgagee might want to go further, reserving the right to determine that a particular Leasehold Mortgagee Protection shall not be exercised at all, by anyone. That issue belongs in the intercreditor agreement among Leasehold Mortgagees, not the Leasehold Mortgagee Protections.

Landlord may want Leasehold Mortgagee to commit at some point that Leasehold Mortgagee will in fact eventually cure a Tenant Default, especially if construction-related. Leasehold Mortgagee, though, will want a "right to walk" at any time, regardless of how long Landlord may have had to "wait around," and will point out that all monetary obligations will have been kept current at all times.
23. LEASEHOLD MORTGAGES.

23.1 Leasehold Mortgages, Generally. Tenant may mortgage, hypothecate, or pledge the leasehold estate created hereby and the interest of Tenant in and to this Lease, together with Tenant’s right, title and interest in the Improvements, subject to the terms of this Lease (herein called a “Leasehold Mortgage”) for the purpose of financing or refinancing the initial Tenant’s permitted improvements to the Premises, provided that:

(a) such Leasehold Mortgage shall provide that such Leasehold Mortgage and the rights of the mortgagee, its successors and assigns thereunder, are and shall be subject and subordinate to all the terms, covenants and conditions of this Lease; and

(b) such Leasehold Mortgage shall affect and encumber only, and no more, than Tenant’s leasehold estate existing at the time of the execution and delivery of the Leasehold Mortgage, and the right, title and interest of Tenant in and to the leasehold estate and leasehold improvements.

23.2 Notices to Landlord

(a) If Tenant shall mortgage Tenant’s leasehold estate pursuant to Section 23.1 above, and if the holder of such Leasehold Mortgage shall provide Landlord with written notice of such Leasehold Mortgage together with a true copy of such Leasehold Mortgage and the name and address of the Leasehold Mortgagee, Landlord and Tenant agree that, following receipt of such notice by Landlord, the provisions of this Article 23 shall apply in respect to such Leasehold Mortgage.

(b) In the event of any assignment of a Leasehold Mortgage, or in the event of a change of address of a Leasehold Mortgagee or of any assignee of such Leasehold Mortgage, notice of the new name and address shall be provided to Landlord in writing.

(c) Landlord shall, promptly upon receipt of a communication purporting to constitute the notice provided for by subsection (a) above and request of the Tenant and Leasehold Mortgagee, acknowledge receipt of such communication as constituting the notice provided for by subsection (a) above or, in the alternative, notify the Tenant and the Leasehold Mortgagee of the rejection of such communication as not conforming with the provisions of subsection (a) and specify the specific basis of such rejection.
(d) After Landlord has received the notice provided for by subsection (a) above, Tenant, upon being requested to do so by Landlord, shall with reasonable promptness provide Landlord with copies of the note or other obligation secured by such Leasehold Mortgage, and of any other documents pertinent to the Leasehold Mortgage. Tenant shall thereafter also provide the Landlord from time to time with a copy of each amendment or other modification or supplement to such instruments.

(e) The term “Leasehold Mortgagee” as used in this Section 23.2 shall refer to a holder of a Leasehold Mortgage in respect to which the notice provided for by subsection (a) or (b) hereof has been given and received, and as to which the provisions of this Section 23.2 are applicable.

23.3 Consent of Leasehold Mortgagee Required. No voluntary termination, surrender, or modification of this Lease by Tenant shall be effective unless consented to in writing by the Leasehold Mortgagee.

23.4 Default Notice. Landlord, upon providing Tenant any notice of default under this Lease or a termination of this Lease, shall at the same time provide a copy of such notice to Leasehold Mortgagee. No such notice by Landlord to Tenant shall be deemed to have been duly given unless and until a copy thereof has been so provided to Leasehold Mortgagee. From and after the date that such notice has been given to Leasehold Mortgagee, Leasehold Mortgagee shall have the same period, after the giving of such notice upon it, for remedying any default or causing the same to be remedied, as is given Tenant after the giving of such notice to Tenant, to remedy the defaults, or with respect to non-monetary defaults, to commence remedying or cause to be remedied the defaults specified in any such notice. Landlord shall accept such performance by or at the instigation of such Leasehold Mortgagee as if the same had been done by Tenant. Tenant authorizes Leasehold Mortgagee to take any such action at such Leasehold Mortgagee’s option and does hereby authorize entry upon the Premises by the Leasehold Mortgagee for such purpose.

23.5 Notice to Leasehold Mortgagee.

(a) Anything contained in this Lease to the contrary notwithstanding, if any default shall occur which entitles Landlord to terminate this Lease, Landlord shall have no right to terminate this Lease unless, following the expiration of the period of time given Tenant to cure such default, Landlord shall notify Leasehold Mortgagee of Landlord’s intent to so terminate at least ten (10) days in advance of the proposed effective date of such termination if such default is capable of being cured by the payment of money, and at least thirty (30) days in advance of the proposed effective date of such termination if such default is not capable of being cured by the payment of money. The notice required by this Section 23.5 may be the same notice as the notice required by Section 23.4 above. The provisions of Section 23.6 below shall apply if, during such ten (10) or thirty (30) day termination notice period, as applicable, any Leasehold Mortgagee shall:

(i) notify Landlord of such Leasehold Mortgagee’s desire to nullify such notice;
(ii) pay, or cause to be paid, all Rent and other payments then due and in arrears, as specified in the termination notice to such Leasehold Mortgagee, during such ten (10) day period; and

(iii) comply, or in good faith, with reasonable diligence and continuity, commence to comply with all nonmonetary requirements of this Lease then in default (other than the Personal Defaults identified in Section 23.9) during such thirty (30) day period.

(b) No notice that Landlord gives Tenant shall be effective unless Landlord has furnished a copy thereof to Leasehold Mortgagee.

(c) Any notice to be given by Landlord to a Leasehold Mortgagee pursuant to any provision of this Section 23.5 shall be deemed properly addressed if sent to the Leasehold Mortgagee who served the notice referred to in Section 23.2(a) or 23.2(b).

23.6 Procedure on Default.

(a) If Landlord shall elect to terminate this Lease by reason of any default of Tenant, and a Leasehold Mortgagee shall have proceeded in the manner provided for by Section 23.5, the specified date for the termination of this Lease as fixed by Landlord in its termination notice shall be extended for a period of ninety (90) days, provided that Leasehold Mortgagee shall:

(i) during the first ten (10) days of such ninety (90) day period, pay or cause to be paid any Rent then in arrears, and thereafter pay all Rent reserved under this Lease as the same shall become due;

(ii) during the first thirty (30) days of such ninety (90) day period, perform all of Tenant’s other obligations under this Lease and commence and diligently prosecute the performance of non-monetary requirements then in default, excepting Non-Curable Defaults (defined in Section 23.9 below) and Possession-Related Defaults (defined in subsection (c) below); and

(iii) during such ninety (90) day period, if not enjoined or stayed, take steps to obtain possession of the Premises and to acquire or sell Tenant’s interest in this Lease by foreclosure of the Leasehold Mortgage or other appropriate means, prosecute the same to completion with due diligence and, thereafter, cure all Possession-Related Defaults with due diligence.

(b) If, at the end of such ninety (90) day period, such Leasehold Mortgagee is complying with Section 23.6(a), this Lease shall not then terminate, and the time for completion by such Leasehold Mortgagee of its proceedings shall continue so long as such Leasehold Mortgagee is enjoined or stayed and thereafter for so long as such Leasehold Mortgagee proceeds to complete steps to obtain possession of the Premises and to acquire or sell Tenant’s interest in this Lease by foreclosure of the Leasehold Mortgage or by other appropriate means with reasonable diligence and continuity, and continues to comply with Section 23.6(a). Nothing in this Section 23.6(b), however, shall be construed to extend this Lease beyond the original term.
thereof as extended by any options to extend which may hereafter be granted properly exercised by Tenant or Leasehold Mortgagee.

(c) If a Leasehold Mortgagee is complying with Section 23.6(a), upon the acquisition of Tenant’s leasehold estate by such Leasehold Mortgagee or its designee or any other purchaser at a foreclosure sale or otherwise, this Lease shall continue in full force and effect as if Tenant had not defaulted under this Lease; provided that the Leasehold Mortgagee shall have completed the cure of all prior defaults, except Personal Defaults, and shall be diligently completing the cure of all defaults which require possession of the Premises (‘Possession-Related Defaults’).

(d) For the purposes of this Section 23.6(d), the making of a Leasehold Mortgage shall not be deemed to constitute an assignment or transfer of this Lease or of the leasehold estate hereby created, nor shall any Leasehold Mortgagee, as such, be deemed to be an assignee or transferee of this Lease or of the leasehold estate hereby created so as to require the Leasehold Mortgagee, as such, to assume the performance of any of the terms, covenants or conditions on the part of the Tenant to be performed hereunder, but the purchaser at any sale of this Lease and of the leasehold estate hereby created in any proceedings for the foreclosure of any Leasehold Mortgage, or the assignee or transferee of this Lease and of the leasehold estate hereby created under any instrument of assignment or transfer in lieu of the foreclosure of any Leasehold Mortgage, shall be deemed to be an assignee or transferee, and (except for any transfer to the Leasehold Mortgagee itself or any subsidiary thereof, for so long as Leasehold Mortgagee qualifies as an Institutional Lender, defined below) shall be subject to any consent or approval by Landlord or required under Section 13.1,1 and shall be deemed to have agreed to perform all of the terms, covenants and conditions on the part of the Tenant under the Lease then in default except Personal Defaults and those to be performed hereunder from and after the date of such purchase and assignment; provided, however, that such assignee or transferee shall remain bound by the provisions of Section 5.1.2 If the Leasehold Mortgagee or its designee shall become holder of the leasehold estate, and if the any of the Improvements shall have been or become materially damaged on, before, or after the date of such purchase and assignment, the Leasehold Mortgagee or its designee shall be obligated to repair, replace or reconstruct such Improvements only to the extent of the net insurance proceeds received by the Leasehold Mortgagee or its designee by reason of such damage. As employed herein, the term “Institutional Lender” shall mean:

(i) any savings bank, savings and loan association, bank or trust company, insurance company, or educational institution;

(ii) any federal, state, municipal, teachers, or other public employees’ welfare, pension, or retirement trust, fund, or system;

(iii) any other employees, welfare, pension, endowment, or retirement trust, fund or system having assets of at least $350,000,000;

(iv) any real estate investment or mortgage trust the securities of which are publicly traded;

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1 Section 13.1 is the general restriction against assignments without the landlord’s consent.
2 Section 5.1 is the section of the lease governing the permitted uses of the premises.
(v) any Person not referred to above that is subject to supervision and regulation by the insurance or banking department of any of the United States, the Board of Governors of the Federal Reserve System, the Comptroller of the Currency, the Federal Deposit Insurance Corporation, or the Federal Savings and Loan Insurance Corporation, or by any successor hereafter exercising similar functions, having assets of at least $350,000,000; or

(vi) any governmental, public, quasi-governmental, or quasi-public authority, including without limitation IDA or any instrumentality utilized by IDA for the purpose of financing the Improvements.

(e) Notwithstanding any other provisions of this Lease, any Leasehold Mortgagee acquiring the leasehold estate of Tenant pursuant to foreclosure, assignment in lieu of foreclosure or other proceedings may, upon acquiring Tenant’s leasehold estate, sell and assign the leasehold estate on such terms and to such persons and organizations as are acceptable to such Leasehold Mortgagee and thereafter be relieved of all obligations accruing thereafter under this Lease; provided that such assignee has cured all then existing defaults other than Personal Defaults and delivered to Landlord its written agreement to be bound by all of the provisions of this Lease.

(f) Notwithstanding any other provisions of this Lease, any sale of this Lease and of the leasehold estate hereby created in any proceedings for the foreclosure of any Leasehold Mortgage, or the assignment or transfer of this Lease and of the leasehold estate hereby created in lieu of the foreclosure of any Leasehold Mortgage to any Leasehold Mortgagee, shall be deemed to be a permitted sale, transfer or assignment of this Lease and of the leasehold estate hereby created subject to compliance by such Leasehold Mortgagee with this Section 23.6.

23.7 **New Lease.** In the event of the termination of this Lease for any reason, Landlord shall, in addition to providing the notices of default and termination as required by Sections 23.4 and 23.5 hereof, provide each Leasehold Mortgagee with written notice that the Lease has been terminated, together with a statement of all sums which would at that time be due under this Lease but for such termination, and of all other defaults, if any, then known to Landlord. Landlord agrees to enter into a new lease (the “**New Lease**”) of the Land with such Leasehold Mortgagee or its designee for the remainder of the term of this Lease, effective as of the date of termination, at the Base Rent, and upon the terms, covenants and conditions (including all options to renew but excluding requirements which are not applicable or which have already been fulfilled) of this Lease, provided:

(a) Such Leasehold Mortgagee shall make written request upon Landlord for such New Lease within sixty (60) days after the date such Leasehold Mortgagee receives Landlord’s notice of termination of this Lease given pursuant to this Section 23.7.

(b) Such Leasehold Mortgagee or its designee shall pay, or cause be paid, to Landlord at the time of the execution and delivery of such New Lease any and all sums which would at the time of execution and delivery thereof be due pursuant to this Lease but for such termination and, in addition thereto, all reasonable expenses, including reasonable attorney’s fees and disbursements,
which Landlord shall have incurred by reason of such termination and the execution and delivery of the New Lease and which have not otherwise been received by Landlord from Tenant or on behalf of Tenant. In the event of a controversy as to the amount to be paid to Landlord pursuant to this Section 23.7(b), the payment obligation shall be satisfied if Landlord shall be paid the amount not in controversy, and the Leasehold Mortgagee or its designee shall agree to pay any additional sum ultimately determined to be due plus interest (at the Default Rate) and such obligation shall be adequately secured.

(c) Such Leasehold Mortgagee or its designee shall pay all sums due under the Lease (subject to the offset in Section 23.8(b), if applicable) and agree to remedy any of Tenant’s other defaults (other than Personal Defaults) of which said Leasehold Mortgagee was notified by Landlord’s notice of termination within a reasonable period.

(d) Any New Lease made pursuant to this Section 23.7, and any renewal Lease entered into with a Leasehold Mortgagee pursuant to any options hereafter granted to Tenant under this Lease, shall, if and to the extent provided by Law, retain the priority of lien which this Lease enjoys, and the lessee thereunder shall have the right to receive a Non-Disturbance Agreement.

(e) If more than one Leasehold Mortgagee shall request a New Lease pursuant to this Section 23.7, Landlord shall enter into such New Lease with the Leasehold Mortgagee whose mortgage is prior in lien, or with the designee of such Leasehold Mortgagee. Landlord, without liability to Tenant or any Leasehold Mortgagee with an adverse claim, may rely upon a mortgagee title insurance policy issued by a responsible title insurance company doing business within the state in which the Premises are located as the basis for determining the appropriate Leasehold Mortgagee who is entitled to such New Lease.

23.8 Landlord Bankruptcy. If Landlord shall be the debtor in any proceeding under laws relating to bankruptcy or insolvency, and if the Lease is rejected by Landlord or by Landlord’s trustee in bankruptcy:

(a) Tenant shall not have the right to treat this Lease as terminated except with the prior written consent of all Leasehold Mortgagees; and the right to treat this Lease as terminated in such event shall be deemed assigned to each and every Leasehold Mortgagee, whether or not specifically set forth in any such Leasehold Mortgage, so that the concurrence in writing of Tenant and each Leasehold Mortgagee shall be required as a condition to treating this Lease as terminated in connection with such proceeding.

(b) If this Lease is not treated as terminated in accordance with Section 23.8(a) above, then this Lease shall continue in effect upon all the terms and conditions set forth herein, including Base Rent, Additional Rent, and all options to renew, but excluding requirements that are not then applicable or pertinent to the remainder of the term hereof. Thereafter, Tenant or its successors
shall be entitled to any offsets against Base Rent and Additional Rent payable hereunder for any damages arising from such rejection, and any such offset properly made shall not be deemed a default under this Lease. The lien of any Leasehold Mortgage then in effect shall extend to the continuing possessory rights of Tenant following such rejection with the same priority with respect to each such Leasehold Mortgage as it would have enjoyed had such rejection not taken place.

23.9 **Non-Curable Defaults.** Nothing herein contained shall require any Leasehold Mortgagee or its designee, as a condition to its exercise of rights hereunder, to cure any default specified in Section 16.1(c)³ (“**Personal Defaults**”) or any Possession-Related Defaults which are otherwise not reasonably susceptible of being cured by such Leasehold Mortgagee or its designee (collectively, “**Non-Curable Defaults**”).

23.10 **Eminent Domain.** Tenant’s share of any Award, as provided in Section 11.5⁴ of this Lease shall, subject to the provisions of such Section 11.5, be disposed of as provided for by any Leasehold Mortgagee.

23.11 **Casualty Loss.** A standard mortgagee clause naming Leasehold Mortgagee may be added to any and all insurance policies required to be carried by Tenant hereunder on condition that the insurance proceeds are to be applied in the manner specified in this Lease and the Leasehold Mortgage shall so provide; except that the Leasehold Mortgage may provide a manner for the disposition of such proceeds, if any, otherwise payable directly to the Tenant (but not such proceeds, if any, payable jointly to the Landlord and the Tenant or to be held in trust under this Lease) pursuant to the provisions of this Lease.

23.12 **Right to Participate.** If Landlord or Tenant initiates any appraisal, arbitration, litigation, or other dispute resolution proceeding affecting this Lease, then the parties shall simultaneously notify Leasehold Mortgagee. Leasehold Mortgagee may participate in such proceedings on Tenant’s behalf, or exercise any or all of Tenant’s rights in such proceedings. Unless Leasehold Mortgagee shall notify Landlord to the contrary, any settlement shall not be effective without Leasehold Mortgagee’s consent.

23.13 **Further Assurances.** Upon request from Tenant or any Leasehold Mortgagee, Landlord shall enter into any modification of this Article 23 that any current or prospective Leasehold Mortgagee reasonably requests, if the modification does not adversely affect Landlord in any material respect or reduce or change the timing of any payment this Lease requires, and provided that Tenant reimburses Landlord for Landlord’s reasonable attorneys’ fees and expenses in connection therewith.

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³ Section 16.1(c) is the default provision dealing with bankruptcy or related proceedings involving the tenant.
⁴ Section 11.5 deals with the order of distribution of eminent domain awards.