

MODEL TERM SHEET FOR GROUND LEASE (FORMS)



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This article will appear, in slightly different form, in the author's upcoming multivolume *New Guide to Ground Leases*, the successor to a book published by ALI CLE's predecessor organization in 2005. Publication is targeted for mid-2021. Toward that end, comments on this Model Term Sheet will be appreciated.

This Model Term Sheet¹ offers a template for the basic business terms of a ground lease (the "Lease"). It starts with a "Base Case"—a set of ordinary and typical provisions one would expect to see, reflecting the typical agendas of both Landlords and Tenants, for a 99-year Lease. The Base Case omits many possible provisions and much commentary. The Base Case might, for example, become the starting point to develop a framework for a bidding process in which potential Tenants are invited to fill in the fundamental business terms.

After the Base Case, the Model Term Sheet offers a menu of numerous "Bells & Whistles" that might sometimes apply. The Bells & Whistles include optional but common provisions, alternatives, and more detail on provisions that already appear in the Base Case. Users should pick and choose based on their transactions and tastes. In doing so, users should confirm that the document defines each capitalized term, but does so only once. The Bells & Whistles also offer alternative possible definitions for some terms, which can cause confusion if not properly handled.

The Base Case assumes Tenant will undertake a significant development project soon after signing the Lease, and perhaps one or more redevelopment projects in the long term of the Lease. The Base Case and Bells & Whistles assume reasonable

sophistication and knowledge on both sides. Less sophistication will usually mean less to discuss, and less to say on each topic, perhaps at the cost of more negotiations later.

No Term Sheet would ever actually include all or even most provisions in the Bells & Whistles. These provisions have accreted from many transactions and could become relevant again in future transactions. They offer a checklist from which to select items to cover in any Term Sheet.

The parties could sign a letter agreement, attaching a Term Sheet as an exhibit, or create a letter of intent by incorporating this Model Term Sheet into the text of the letter agreement. Either way, in that letter agreement or letter of intent, the parties could agree to Binding Provisions like those suggested here.²

Every Term Sheet will, by definition, not cover every issue. One can always suggest more issues to cover. With enough iterations and enough comments from enough smart clients and smart counsel, that process could eventually produce a Term Sheet as long as the Lease itself. Instead, a Term Sheet typically covers only fundamental business terms (economics, development, credit, Landlord controls, use, and major risk/cost allocations). Particular transactions might justify additional inclusions. If the outcome of

a particular issue (other than the standard and typical outcome of that issue) might cause Landlord or Tenant not to proceed with the Lease, then the Term Sheet should cover it. If the outcome of an issue, no matter how bad, would not kill the deal, then one can reasonably leave it for the Lease rather than the Term Sheet.

One might want to shorten rather than lengthen a Term Sheet, leaving more issues for the Lease—with the risk that they will require more work to negotiate in the Lease than they would have required in the Term Sheet. That tension arises with any Term Sheet for any transaction, but a Lease raises more issues than many other common transactions.

Before the parties start to discuss the terms of any possible Lease, they should sign a confidentiality agreement³ and Landlord should reach a suitable understanding with any broker involved. That understanding can consist of either a full brokerage agreement or a written acknowledgment that no commission is due unless a Lease is signed and becomes effective, with the idea that Landlord and the broker will negotiate an agreement if an actual Lease seems near. This protects Landlord from the risk of premature claims for a commission.

The parties may also find that before they even start work on a Term Sheet, Landlord should understand who will act as Guarantor and should understand and get comfortable with that person's credit. Without a satisfactory Guarantor, the parties could be wasting their time and money on a Term Sheet.

MODEL TERM SHEET FOR GROUND LEASE

Base Case

The following represents a nonbinding summary of the terms and conditions of the proposed ground lease (the "Lease"). Nothing in this Term Sheet, except the Binding Provisions, binds any party in any way.

Landlord

_____, or a wholly owned SPE.

Tenant

_____, or a wholly owned SPE.⁴

Property

_____.

Commencement Date (option 1)⁵

On signing. No contingencies. Tenant to finish due diligence during Lease negotiations.

Commencement Date (option 2)

After signing, Tenant has due diligence period⁶ of ___ days. Only if Tenant gives notice to proceed in that time, then "Commencement Date" occurs within ___ days after that notice.⁷

Access Agreement

The parties will promptly enter into an access agreement, with indemnification and insurance.⁸

Deposit

On signing, Tenant deposits in escrow \$_____, refundable if Tenant gives no timely notice to proceed. If Tenant timely gives that notice:

- On Commencement Date, Landlord receives Deposit, credited against any Commencement Date payments; and
- If Commencement Date does not occur, Tenant keeps Deposit unless Tenant defaulted, in which case Deposit constitutes liquidated damages to Landlord.

Term

[99] years, starting on Commencement Date.

Base Rent

Starting on the date ___ after Commencement Date (the "Rent Commencement Date), Tenant pays annual base rent (the "Base Rent) starting at \$_____.⁹

Base Rent Schedule

Exhibit ___ specifies Base Rent in each Lease Year.¹⁰

Regular Increases¹¹

Every ___ Lease Years, Base Rent rises by [___ percent of Base Rent (before abatement) in the previous Lease Year]¹² [the increase in consumer price index (CPI) in the previous Lease Year].¹³

Periodic Increases

Every ___ Lease Year[s], Base Rent rises to equal [original Base Rent, increased by CPI since Commencement Date] [Base Rent at the beginning of that period, adjusted by CPI over the same period].

FMV Resets

Every ___ Lease Years after Commencement Date, Base Rent rises to ___ percent of then-current land value (FMV). [That increase shall, however, never be less than the current CPI-based increase.] Any FMV dispute shall be resolved through baseball arbitration. FMV assumes the Land:¹⁴

- [Consists of vacant and unimproved land] [Includes improvements in their condition and state of repair at Commencement Date, disregarding any work by Tenant];¹⁵
- Is unencumbered by the Lease, but subject to matters of record at the Commencement Date and zoning laws [and restrictions on use and development in the Lease, as listed in the FMV definition];
- Cannot legally be used for any use the Lease prohibits;
- Can be used for [any Permitted Use] [only its then-existing use and bulk] [its then highest and best use];¹⁶
- Includes all development rights of the Land at the Commencement Date; and
- Disregards all development rights Tenant brought to the Land from other sites after the Commencement Date.

Limits on Increases

Each Base Rent increase shall be [capped at ___ percent per annum, cumulative and compounded, from the Commencement Date] [subject to a floor of ___ percent and a cap of ___ percent]. Base Rent never drops.

Rent Abatement¹⁷

Base Rent shall be abated as follows, but any future Base Rent adjustments ignore these abatements.

Lease Year 1: ___ percent abated

Lease Year 2: ___ percent abated

Lease Year 3: ___ percent abated

Use

[Any lawful use.] [Multifamily rental and commercial.] [_____]. No for-sale residential units, whether cooperative apartments, a condominium, tenancy-in-common interests, or otherwise.¹⁸

Construction and Demolition

Tenant may alter and demolish without Landlord approval, but must first satisfy objective requirements in the Lease.

Development

Tenant must: (i) within ___ years, start a development project; and (ii) finish [within ___ months] [in a reasonable time defined in Lease], with extensions for force majeure and lenders. [Tenant can further extend the deadline so long as it is diligently trying to complete] [for up to ___ months] [and pays extension fee of \$___ per month] [and prepays Base Rent for a period equal to the extension, credited only against Base Rent after completion] [delivers additional security equal to _____].

Standards

Any Building will need to meet these standards:

- Minimum objective criteria (e.g., size, value, \$/ft) for any building.
- Overall concept or criteria in a Lease exhibit.
- Use of at least [95 percent] of development potential of the Land.

Assurances of Completion¹⁹

[Before starting Tenant's initial project] [At Lease signing] [On Commencement Date], and before starting any future major project (as defined in Lease), Tenant must deliver:²⁰

- Guaranty of completion and payment (Completion) [and all Lease obligations until Completion] from _____²¹ [or a replacement guarantor] [with at least similar credit] [meeting these criteria: _____] (a "Satisfactory Guarantor). If Lease terminates because of Tenant default before Completion, Guarantor shall deposit with Landlord estimated cost to complete.²²
- Evidence Tenant: (i) has closed its construction loan, if any, and met all substantive conditions to first advance, including delivery of required guaranties, except any required further equity investment; and (ii) has (access to) funds as needed for all equity investment for the project.
- All permits for Tenant's initial project that can then legally be obtained given the stage of construction.
- A fixed price or guaranteed maximum price contract consistent with Tenant's budget with a general contractor reasonably satisfactory to Landlord.

Future Major Construction

- All permits for Tenant's initial project that can then legally be obtained given the stage of construction.
- A fixed price or guaranteed maximum price contract consistent with Tenant's budget with a general contractor reasonably satisfactory to Landlord.

Tax Abatements

Landlord will cooperate with Tenant to obtain tax abatements, subsidies, favorable financing, and other incentives.²³

Financing

Lease will be prior to all present and future fee mortgages. Fee and leasehold estates will be fully financeable. Leasehold mortgages attach only to leasehold and not Landlord's estate. [Mezzanine lenders will have the same rights as leasehold mortgagees.] Lenders must be institutional or holders of bona fide purchase money financing. Landlord will not join in, or "subordinate to," Tenant's mortgages.

Condemnation

Landlord first receives value of fee estate, as if no condemnation occurred.²⁴ All remaining proceeds go to Tenant. Each party's claim is subject to the rights of its Mortgagees.²⁵

Damage

Tenant must restore in all cases²⁶ and may use loss proceeds. A third party Institution (including Institutional Leasehold Mortgagee) must hold and apply undisbursed proceeds in compliance with the Lease.

Tenant Transfer

Until [____ years after Commencement Date] [Tenant has achieved Completion of its initial project], Tenant shall not assign, and no change of Tenant control may occur (a "Transfer). After that, a Transfer must meet simple and objective tests not involving Landlord discretion or judgment. These tests could refer to net worth, experience, and legality. Landlord shall have a reasonable prior opportunity to confirm compliance. These restrictions do not apply to Transfers to affiliates or through foreclosure.

Condition; Costs and Risks

Tenant accepts the Property, including Land, as is. No representation or warranty. Tenant indemnifies Landlord against, all past, present, and future conditions, including environmental²⁷ and noncompliance.

Recourse

No liability for either party beyond its interest in the Property. That does not limit any guaranty.

Subleases

[Landlord shall nondisturb Subleases that meet simple and objective standards²⁸] [Landlord shall have no obligation to nondisturb or recognize Subtenants.]

Lease Document

Counsel to _____ shall prepare first draft of Lease.²⁹

Publicity

[Landlord and Tenant jointly control.] [None.]

Binding Provisions

Whether or not the parties sign a Lease, they agree to these provisions (the "Binding Provisions):

- The parties shall maintain confidentiality of these discussions and any nonpublic information received from the other party.
- Each party shall pay its own broker. No broker shall be entitled to any compensation unless the parties sign a Lease and all conditions to occurrence of the Commencement Date have been satisfied.
- Tenant shall not rely on any information Landlord provides.
- Neither party shall have any liability or obligation of any kind relating to any Lease or its negotiation unless and until the parties have signed final documents.

The parties agree to the Binding Provisions above. This Term Sheet does not otherwise bind any party in any way.

[SIGNATURE BLOCKS]

MODEL TERM SHEET FOR GROUND LEASE

Bells & Whistles Term Summary

Extension Options

Tenant shall have ___ options to extend, each for ___ Lease Years. Exercise deadline will be 18 months before the then-current expiration date.³⁰

Interim Rent

From Commencement Date until day before Rent Commencement Date, Tenant pays "Interim Rent" of \$_____ per month.

Base Rent Reset

On the ____, ____, and ___ anniversaries of the Commencement Date, Base Rent shall reset to greater of: (i) Base Rent in the previous Lease Year [plus _____]; or (ii) the Pricing Factor times FMV.³¹

Pricing Factor

The "Pricing Factor" means [___ percent] [the sum of: (i) average current yield to maturity for U.S. Treasury obligations with remaining term of ___ years; plus (ii) ___ percent per annum].³²

Downzoning

If, after Commencement Date, the Land is downzoned and later subject to damage after which Tenant cannot legally restore, then FMV shall reflect the downzoning. Insurance proceeds shall be distributed accordingly.

Upzoning

If, after Commencement Date, the Land is upzoned or its highest and best use changes, then FMV shall reflect that upzoning or change only to the extent the improvements actually use it.³³ If that usage occurs within ___ years after an FMV Base Rent reset date, then Landlord may require another Base Rent reset [limited to the incremental value created by] [Tenant's exploitation of] [the upzoning].

Rent Prepayment

At Commencement Date, Tenant shall prepay Base Rent [through estimated stabilization, discounted to present value at ___ percent per annum] [in the amount of \$_____, which Landlord shall credit only against Base Rent after Completion] (the "Prepaid Rent). That payment shall not be refundable.³⁴

Section 467 Rent

At Commencement Date, Tenant shall prepay \$_____ on account of Base Rent, which the parties shall spread through the Lease term under Internal Revenue Code section 467.

Landlord's Participation

[After each adjustment, Base Rent shall in no event be [more/less] than] [Tenant shall pay Base Rent equal to] ___ percent of Tenant's net operating income before Base Rent and debt service, to be more fully defined in the Lease.³⁵

Landlord's Rights

Landlord reserves: (i) use of rooftop except _____; (ii) exterior signage and billboards, except as necessary to identify Tenant's project;³⁶ (iii) approval rights under any REA involving adjacent property; (iv) transferable development rights [that remain unused as of ___ Lease Years after the Commencement Date]; and (v) _____. Tenant to cooperate as needed.

Existing Tenants

Before (and as a condition to) the Commencement Date, Landlord shall remove all existing tenants and obtain and deliver vacant possession. If Landlord has not accomplished that within ___ days after _____, then Tenant may [terminate this Lease] [elect that the Commencement Date shall nevertheless occur and Tenant shall take over Landlord's efforts to remove the existing tenants (in which case Landlord shall reimburse ___ percent of Tenant's costs of doing so, up to a maximum reimbursement of \$_____)].

Additional Considerations

Tenant shall provide Landlord's principals with [retail space, apartments, parking, free room nights, diamonds, Caribbean cruises, steak dinners, cars, etc., etc.].³⁷

Environmental Indemnity

Guarantor (or, after assignment, a Satisfactory Guarantor) shall guaranty Tenant's environmental indemnity obligations throughout the Term.³⁸

Development Rights

Tenant may not move development rights from the Land. To the extent Tenant obtains by any means, or from any source, additional development rights for the Land, beyond zoning floor area existing on Commencement Date, Tenant shall pay Landlord \$_____ per square foot of development rights acquired.³⁹

Development Rights⁴⁰

If Tenant desires to acquire development rights, Landlord shall cooperate. Only if Landlord elects to pay for the acquisition, then future FMV determinations shall reflect the additional development rights.

Repairs⁴¹

Tenant repairs and maintains structure, building systems, roof, and all other elements, regardless of nature, size, character, or timing of any problem.

Expenses

Tenant pays all taxes and insurance⁴² and bears all other risks, expenses, and responsibilities, both capital and operating. Tenant controls operations, leasing, tax protests, etc. Tenant provides all customary insurance required for similar properties.

Restriction Period

Landlord shall, however, control tax protests (and have the right to reasonably approve any construction and substantial Subleases) in any "Restriction Period," which means: (i) the last five Lease Years of the Term; and (ii) any period when Landlord has given Tenant notice of an uncured default [and the cure period has expired].

Escrows

[During any Major Construction Period,] Tenant will make monthly deposits for insurance and taxes into a Landlord-controlled escrow, structured to satisfy all Mortgagees.⁴³

Operation

Tenant must operate at all times only as a _____ under the _____ brand, with limited exceptions for construction.⁴⁴

Pre-Construction Letter of Credit

At Commencement Date, [Tenant] [a Satisfactory Guarantor (or a single-purpose entity) having no claims against Tenant] shall provide a letter of credit (an "L/C) for \$_____, increasing to \$_____ on the date ___ months after Commencement Date and \$_____ on the date ___ months after Commencement Date. Landlord shall release this L/C when Tenant has [met all conditions to start] [achieved Completion of] the initial project.

Assurance of Completion⁴⁵

- Cash or L/C of \$_____ (capped at ___ percent of project costs), to be released based on milestones. If Lease terminates, Landlord keeps unreleased balance. [This security shall be provided by a Satisfactory Guarantor or by a single-purpose entity, in each case having no claims against Tenant.]
- Completion bond with dual obligee rider naming Landlord.⁴⁶
- Other documents and deliveries matching those required by Tenant's construction lender, but subject and subordinate to the rights of Tenant's construction lender.⁴⁷

Interim Operations

Landlord may, at its expense, operate existing _____ until Construction Commencement. Revenues shall belong to Landlord. Landlord need not pay rent, but shall pay real estate taxes and operating costs and perform all typical obligations of a _____ operator, including Indemnifying Landlord. Landlord shall reasonably accommodate Tenant's predevelopment work.

Removal by Landlord

Landlord [may] [shall] remove any improvements or personal property before Commencement Date.

Construction Commencement Notice

Tenant must give 90 days' notice before Construction Commencement (the "Construction Commencement Notice). Before Construction Commencement, Landlord will discontinue its interim uses, remove all _____, and otherwise deliver the Property vacant and as-is. If, as of 91 days after the Construction Commencement Notice, Landlord has not complied with the previous sentence, then Landlord shall pay liquidated damages as follows: _____.

Design

Initial Project design must conform to objective guidelines attached as Exhibit ____.⁴⁸ If Lease attaches schematics, Landlord will confirm they comply.

Satisfactory Guarantor⁴⁹

A "Satisfactory Guarantor" means a person that meets these tests:

- In the case of a Guaranty for Major Construction: (i) net worth at least 200 percent of the cost of the Major Construction; and (ii) liquidity at least 20 percent of that cost.
- Has successfully developed, or owns, at least ____ (total) square feet of ____ buildings in at least ____ locations.
- Not a convicted felon or in litigation with any Landlord affiliate at any time in the last five years.
- No substantial widespread reputation for not prevailing in commercial real estate or financial litigation.⁵⁰
- Is a person with whom U.S. persons can legally do business.

Assignment⁵¹

After Completion, Tenant may assign the Lease, and equity owners of Tenant may assign, subject to these conditions:⁵²

- Compliance with Landlord's First Right.
- Cure of all Events of Default and all monetary defaults.⁵³
- Assignee must be a person with whom US citizens can legally do business.

Financing

Leasehold financing, except takeout of existing loan or after completion of Tenant's initial project, capped at 75 percent of leasehold value (or of total budgeted project costs, if lower), based on lender's appraisal and completed value of Tenant's project.⁵⁴ Mezzanine lenders have rights like Leasehold Mortgagees.

First Rights⁵⁵

If Landlord or Tenant (or a controlling equity owner in either) decides to sell its interest (Seller), Seller must, before marketing, give the other party (Holder) a right to purchase (a "First Right). The First Right notice must include a proposed contract and a complete due diligence package. The First Right will remain open for 30 days.

If Holder exercises its First Right, the purchase will close pursuant to the contract. Holder's default under the contract will not constitute a Lease default. If Holder does not exercise and Seller lowers the price by more

than five percent or otherwise materially improves the contemplated transaction for a prospective purchaser, Holder will have a 15-day “second bite.”

The First Right will not apply to: (i) affiliate/family transactions; (ii) mortgages; (iii) foreclosures; (iv) a mortgagee’s first disposition after foreclosure;⁵⁶ or (v) a portfolio transfer of multiple properties, to be defined in the Lease. The First Right will otherwise apply to all future sales.

Purchase Option

Tenant will have option to purchase Landlord’s interest [within ___ years after death of _____] [on each of these anniversaries of the Commencement Date: _____] [in the last year of the Term]. The option price will equal [FMV of Landlord’s Fee Estate] [as if the Lease continued] [then-current Base Rent capitalized at a capitalization rate of ___ percent] [the dollar amount in Exhibit ____].⁵⁷

Subleasing⁵⁸

Tenant may sublease only for occupancy. Statutory tenancies must be entered into only with unrelated parties based on prudent property management. Subtenants must agree to attorn to Landlord, only at Landlord’s option.

In the last ___ years of Term, Landlord shall agree to recognize as direct leases any subleases that extend for up to ___ years beyond Term, if they meet objective standards.

Leasehold Mortgagee Protections

Notice; cure right (but need not cure personal defaults); control of amendments, terminations, and certain Tenant rights under Lease; new Lease on any termination or rejection of Lease; control of Landlord bankruptcy proceedings; and other typical Leasehold Mortgagee protections.⁵⁹

Ownership of Improvements

[Landlord] [Tenant] shall own the improvements in the Term. Tenant shall be entitled to claim all depreciation attributable to any investment by Tenant.⁶⁰

End of Term⁶¹

At end of Term, Tenant shall [remove all improvements] [return the improvements to Landlord in a condition such that they can be legally occupied] [and require no major capital expenditures].

Tenant shall deliver the Property free of contracts, management agreements, and subleases except permitted statutory tenancies. Tenant shall deliver all books, records, maintenance records, and operational documents. Tenant shall also deliver those items quarterly in any Restriction Period.

In the last ___ years of Term, the parties shall jointly approve and share the cost of major capital expenditures based on relative useful lives in and after the Term.

Financial Reports

Annual and monthly. Audited if required by any Mortgagee or Tenant’s regular operating procedures.

Lease Consideration

\$_____, payable to _____ on Lease signing, not credited against any other obligations of Tenant under the Lease.⁶²

Radius Clause

Tenant will have no interest in any other _____ within _____.

Lease Document

The first draft Lease shall be based on a fully negotiated similar document. Both parties shall direct counsel to make the Lease reasonable, balanced, brief, straightforward, and financeable by each party. The parties shall seek to negotiate a Lease within _____.

Transfer Taxes

Paid by [the party with primary legal liability for payment] [the parties equally] [Tenant].⁶³

Binding Provisions

Unless and until either party, in its sole discretion and for any reason or no reason, has given notice terminating these discussions, Landlord shall deal exclusively with Tenant on the Property [for a period of _____ days after the date of this Term Sheet].⁶⁴ 🍷

Notes

- 1 Contact the author at joshuastein.com for an editable version of this Model Term Sheet.
- 2 The author can provide a sample letter agreement to wrap a letter of intent or Term Sheet.
- 3 Confidentiality agreements can be very short and simple. The parties should resist the common urge to beef up these agreements. They just need to make two points: (i) the parties will preserve confidentiality; and (ii) no one will be bound except by final signed documents. For more on confidentiality agreements, see the author's article on Confidentiality Agreements: A Base Case and Many Bells & Whistles, *Practical Real Estate Lawyer*, July 2019, at 19.
- 4 Tenant will typically have no credit. Landlord should demand a guaranty of completion and payment for Tenant's initial project. After that the building itself will usually give Landlord all security Landlord will ever get. Of course, exceptions exist, e.g., : (i) a Lease where the Rent reflects the high credit quality of a corporate Tenant; and (ii) a single-purpose Building.
- 5 Keep this paragraph or the next, but not both. In competitive investment sales transactions or Landlord-friendly markets, Landlord can perhaps require Tenant to complete due diligence before Lease signing. The parties can document a due diligence period as an agreement to lease, like a purchase and sale agreement, with Landlord obligated to deliver a Lease in the form attached to the agreement, not a deed, at closing. Tenant may emotionally favor having a document called a "lease," even if actual commencement depends on future events.
- 6 If the Lease gives Tenant a due diligence period, Tenant's Leasehold Estate should not start until the end of that period. Otherwise, a New York Landlord may owe a premature Transfer Tax.
- 7 Landlord might add: "On the Commencement Date, Tenant must meet all conditions to breaking ground for Tenant's initial project."
- 8 In Landlord-friendly market periods or if Tenant badly wants this specific site, Landlord may be able to require an escrow account to assure payment of costs.
- 9 The parties may prefer to express Base Rent as dollars per buildable square foot, although that invites differences of opinion down the road. The next few rows of the Base Case Model Term Sheet offer options for Base Rent adjustments. The user should edit whichever option(s) apply and delete the others.
- 10 A schedule of Base Rent for the entire Lease term is unusual but sometimes seen. In effect, Landlord exchanges the property for a bond, a series of defined payments, which could include fixed and known increases over time. Landlord must present-value that bond, using a suitable interest rate, typically six percent or less. If Tenant uses a higher discount rate than Landlord in valuing the deal, this may help explain how Leases create value.

- 11 Keep this paragraph or the next, but not both. If the Lease provides for any contingent future Base Rent adjustments, the parties will typically negotiate a floor and a cap for those adjustments. Suggested language appears at the end of the menu of possible Base Rent adjustments.
- 12 Annual rent bumps could refer back to the Commencement Date or the most recent Base Rent reset. These two options create different dynamics and calculations. Carefully consider which to use. Then carefully document that choice. These formulas can become very tricky to write correctly, creating a fruitful source of expert witness work for the author.
- 13 Landlords like annual Base Rent bumps, typically a low single-digit percentage. More often, Base Rent bumps occur every two to five years, from three percent to 10 percent.
- 14 The FMV definition constitutes the single most important Lease term and the single best source of future work for attorneys, appraisers, and expert witnesses in this area. Scrutinize the definition carefully, taking into account only what Landlord delivers to the transaction, not value Tenant adds later. This is why, for example, Tenant does not want FMV to consider the value of “the Property” or any improvements Tenant built or upgraded. Try to keep the definition simple and not overly philosophical. If Landlord demises an existing structure, FMV becomes particularly tricky. Do not interpret this footnote as a complete summary of FMV issues. Any Tenant and its lender would prefer to eliminate any FMV adjustment entirely. That would expose Landlord to a risk it tries hard to avoid, often without success.
- 15 If Landlord demises an existing building with value (i.e., that Tenant will redevelop rather than demolish), then future FMV determinations should assume existence of improvements equal to what Landlord delivered. For example, one might appraise the Land assuming it is improved by: “an office building that: (i) contains ____ square feet of usable space; (ii) is fully leased at current market rates with leases having an average remaining term of __ years; and (iii) requires no significant capital expenditures or upgrades.” One would need to tailor this definition for the circumstances. The parties might document the existing condition of the improvements by attaching dozens of photographs (and other documentation) as an exhibit. Whatever detail one decides to leave out of the definition will turn out to be the detail that precipitates years of litigation at rent reset. Thus it may make more sense to appraise vacant land but, e.g., boost the appraisal by 10 percent to recognize the value of the building and call it a day.
- 16 The assumed use should at most match the Permitted Use. Tenant may want to assume a narrower use, i.e., the use actually conducted. Tenant may also want FMV to consider rent regulation. If the Land would qualify for tax incentives or other subsidies if vacant, Landlord will want FMV to reflect the value of those benefits, but Tenant will prefer that FMV consider only any benefits Tenant actually obtained and still uses.
- 17 Abatements are traditional in early years while Tenant has no revenue. There is no obvious reason they are essential. Tenant could instead pay slightly lower Base Rent starting immediately. Landlord may prefer to spread abatements over the Term. Front-ending the abatements maximizes Landlord’s early credit risk but minimizes Tenant’s pain while Tenant has no income.
- 18 Landlords fear litigation, complaints, and ultimately political interference near the end of the term when apartment owners may “lose their homes.” These situations create great photo opportunities for politicians, activists, community organizers, and other anti-real-estate groups.
- 19 Landlord might also require a collateral assignment of Tenant’s contract and other similar measures. Lawyers can justify each of these additional measures because it mitigates risk. But each costs money to document. Many involve third parties. As a practical matter, if Landlord ever takes over, Landlord will probably find a new developer who will have no interest in the failed developer’s program or counterparties. And Landlord might conclude that Landlord should either obtain a completion guaranty (and perhaps just a bond, but don’t assume it’s obtainable) that fully protects Landlord without extra measures, or not do the deal at all.
- 20 Assurances of completion are the second most difficult issue in every Lease, after Base Rent. Tenant often agrees to provide a completion guaranty from a reasonable guarantor plus a letter of credit or cash deposit for less than cost of completion, perhaps up to a year’s Base Rent. Any larger security amount creates bankruptcy issues, as a result of which Landlord would prefer the security to come from a creditworthy party (or a single-purpose entity) with no rights against Tenant. If Guarantor is weak, then Landlord may want much more, e.g., construction loan closing, GMP contract, building permits, architect’s certificate, cash collateral for some percentage of the cost of the job, etc.
- 21 Identify a creditworthy guarantor, not Tenant. Landlord may want this Guaranty at the Commencement Date. Tenant will argue that until Construction Commencement, the project is undefined and hence an undefined obligation. This represents a negotiation. Landlord would expect a “walkaway payment” if Tenant signs the Lease and then does not start construction. Landlord would want a guaranty of that payment and, before walking away, Tenant would need to meet conditions like those in a good-guy guaranty.
- 22 If Tenant’s development project fails, then Landlord may face: (i) some risk of liens against the Fee Estate, a risk totally at odds with the idea that Landlord’s Fee Estate remains free of any liens to support Tenant’s activities (though that risk varies by state); and (ii) the cost of removing or repairing a partially complete failed project, in the worst case potentially reducing the value of the Fee Estate below zero. Landlord cares a lot about completion guaranties. Landlord also must recognize that the measure of damages under a completion guaranty creates some uncertainty. Thus, if the Lease terminates before Completion, this Model Term Sheet requires Guarantor to deposit with Landlord the cost to achieve Completion, to bring clarity to an otherwise murky obligation. Guarantor will worry about how that interacts with its exposure to Tenant’s construction lender. Tenant will prefer to offer as little comfort as possible on Completion, such as: (i)

- no guaranty; (ii) capped guaranty; (iii) prepaid rent only; (iv) walkaway fee only; or (v) obligation to pay liens and scrape the site if the project fails.
- 23 Landlord might worry that these incentives—especially any not yet known—could impose unwanted burdens on Landlord, even after the Term. But the existing incentives already known will typically generate value for Tenant reflected in Base Rent. In other words, in a competitive market for development sites, some substantial percentage of the value of the incentives will simply become part of land value. Landlord will probably need to live with known and existing incentives. But Landlord must first understand and approve them, at the Term Sheet stage, and might wish to limit Landlord's obligations, especially for any future measures not available on the Commencement Date or that will burden Landlord after the Term.
 - 24 If the fee estate is equivalent to a first mortgage, then it should be paid first from condemnation proceeds, up to fair market value of the fee estate, what someone would pay for that estate, encumbered by the Lease, as if the Lease continued.
 - 25 Leasehold mortgagees may worry about holding a subordinate claim to loss proceeds, though they should accept it as just another issue to consider in their underwriting or valuation analysis. Another possible approach: "Fee and leasehold share condemnation proceeds based on relative values of the two estates considered as if no condemnation had occurred." Another possible approach: "Leasehold mortgagees shall have first claim until paid in full, provided either: (i) their LTV did not exceed ___ percent at date of closing; or (ii) the loan took out a previous leasehold mortgage that met the standards of clause (i) or clause (ii) of this sentence." Either of these alternatives would require further thought and adjustments. This footnote does not provide a complete discussion of condemnation proceeds.
 - 26 If a loss occurs near end of Term, Tenant may want the right to abandon the Lease. This has a ring of fairness to it, but the cost of negotiating it and thinking it through probably exceeds the present value of the hypothetical benefit. If Landlord accepts that concept, then upon any such termination Landlord would want all insurance proceeds to go to Landlord. The parties could also negotiate that in such a case, Tenant must restore but will have an additional renewal option. Beware of insurance policies that pay out restoration costs only if someone actually restores, failing which the policy would pay only the much lower actual cash value, net of depreciation.
 - 27 Tenant might insist that Landlord stay responsible for pre-existing environmental conditions. This will, of course, become contentious. Landlord may sometimes at least partly concede—even though the Lease should be functionally equivalent to an outright sale with a deferred purchase price. The parties often resolve this issue by saying: (i) Tenant is responsible for anything that happens after Tenant takes possession, regardless of fault; (ii) Tenant releases Landlord from any claims arising from previous contamination; but (iii) neither party indemnifies the other on previous contamination. The parties sometimes buy environmental insurance, and perhaps share premiums.
- Often, the premiums are prohibitive, especially if someone must maintain environmental insurance for the entire Term. To the extent Landlord bears environmental risks, Tenant will worry about Landlord's credit. The parties can mitigate that concern through limited offset rights. The allocation of environmental risks is particularly important to resolve in the Term Sheet. It will depend on the parties, market conditions, leverage, pricing of the overall deal, and historical uses of the site. Gas stations, for example, are more likely to have past issues. Environmental exposures have become less traumatic and unpredictable than they once were. Dry cleaners remain a problem.
- 28 "Simple and objective standards" could include, e.g., minimum (or market) sub-rent; ordinary terms; configuration; minimum size; and maximum term. It may suffice to specify only one standard: at least one Institutional Leasehold Mortgagee agreed to nondisturb the Subtenant. Landlord may want these standards to apply to all Subleases, not just any Landlord will nondisturb. Nonoccupancy subleases (e.g., sub-ground-leases) raise other issues, especially if they demise less than the Lease, involve Tenant affiliates, or contemplate construction or unusual uses. The entire subject of nondisturbance exposes a Landlord to risks and creates opportunities for unscrupulous Tenants. Any desirable space Subtenants will demand nondisturbance, so Landlord may need to hold its nose and cooperate, with reasonable protections. If Landlord is unwilling to nondisturb Subtenants, that topic should be part of the Term Sheet agenda.
 - 29 If Landlord's counsel will prepare the first draft, Landlord could add: "Landlord will direct its counsel to start work on the Lease only if Landlord has approved Guarantor's financial statements." This responds to the typical sequence where Tenant delays providing financial information until the very last minute, when Landlord is very committed to the deal and Tenant hopes Landlord won't pay much attention.
 - 30 The parties might prefer a 99-year Term, with cancellation rights. Rent reset dates will often align with renewal or cancellation deadlines. That timing gives Tenant (and not Landlord) an opening to renegotiate each reset. Of course, Tenant can renegotiate rent at any time, if willing to walk away from the Lease. An operating Tenant might want a short extension option, e.g., a year on a year's notice, for relocation if Tenant isn't quite ready to move. The language in text sets an exercise deadline, but Tenant could exercise at any time before that. Landlords typically prefer a window before which Tenant cannot exercise, perhaps hoping Tenant will forget.
 - 31 Market gyrations may favor use of an "average" fair market value over several years before the reset, not a single bright-line valuation date. As brilliant as that idea may be, no one seems to have adopted it, even since the Great Financial Crisis of 2008. The COVID-19 pandemic could change that.
 - 32 For a very long time, the Pricing Factor would typically have been six percent to seven percent. Since 2010, there has been pressure to reduce the Pricing Factor because of disasters Tenants have suffered in a commercial real estate market that has seen capitalization rates of three percent

- or four percent. Today's Tenants often reject FMV resets entirely.
- 33 If Tenant has not exploited the upzoning within, e.g., 25 years, then perhaps Landlord should have the right to reflect it in FMV anyway.
 - 34 This is nonstandard but represents a reasonable way to give Landlord comfort that Tenant has equity in the Lease and will not walk away so easily. If construction slips beyond a certain point, Landlord may want the right to require Tenant to prepay more Base Rent, to be applied only after Completion. Landlord might also want to credit the prepayment only against, e.g., Base Rent in year 49. That may create tax problems or opportunities.
 - 35 This can protect Tenant in a very meaningful way but it opens a rat's nest for: (i) extended negotiations; (ii) recreation of the Internal Revenue Code; (iii) extraordinary legal fees; and (iv) future disputes. What's gross revenue? What can Tenant deduct? What about reserves? What if they're "required" by a lender? Additional capital investment? Early operating losses? Vacancy periods? Abusive contracts with affiliates? Underexploitation? Nevertheless, the parties sometimes agree to this concept. It may make sense to refer to definition(s) in the Internal Revenue Code.
 - 36 Signage restrictions will need to be fleshed out in Lease negotiations. They will depend on the circumstances of the particular project and the parties' business agendas. Landlord will want to protect any billboards not only from blockage but also from distraction and interference, so the Lease might require some minimum buffer around the signs. It will usually make sense to create a separate tax lot for them.
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 - 38 Ordinarily, after completion of construction Landlord will rely on the right to terminate the Lease and receive back the building in place of any credit support for anything. If, however, the building is idiosyncratic, single-use, or tailored for a particular user, Landlord may want continued credit support for all Lease obligations—not just environmental—throughout the Term. In exchange, Tenant would expect a more favorable Base Rent.
 - 39 The potential for such transactions constitutes an attribute of the Land, for which Landlord might reasonably claim a right to compensation.
 - 40 This paragraph and the next (mutually exclusive) reflect two possible ways to deal with peculiarities of New York zoning and development law. These paragraphs only scratch the surface. The parties will need to negotiate arrangements specifically for each deal, taking into account Tenant's development plans and any opportunities available.
 - 41 The Base Case covers this topic adequately though cursorily. Some Landlords prefer more expansive language even in the Term Sheet.
 - 42 In the author's experience, Tenant ordinarily obtains, pays, obtains, and maintains all insurance. That aligns with Tenant's ownership of the risks of loss and the burdens of restoration. But good reasons exist for Landlord to want to obtain and maintain insurance, with Tenant paying for it. That's the only right way to handle insurance, according to some insurance consultants and smart Landlords. Nevertheless, in the author's experience Tenant universally handles insurance. This makes sense because the Lease shifts all risks to Tenant, so Tenant should insure. Landlord protects itself by monitoring Tenant and maintaining Landlord's own liability insurance. Landlord's premiums should be low, because Tenant bears primary responsibility for all risks.
 - 43 Tenant will want the right to have its institutional lender Leasehold Mortgagee hold the escrow. Landlord will typically agree, provided Leasehold Mortgagee agrees to use the escrowed funds only for their intended purposes and not to repay the loan.
 - 44 Such a covenant is very unusual but sometimes seen, for example in a campus or mixed-use development project with multiple sites. Tenant should insist on some flexibility for change of brand and perhaps even change of use within a defined menu.
 - 45 These might supplement the Base Case Assurances of Completion.
 - 46 Bonds typically cover a general contractor's performance under its contract, not Tenant's performance under its Lease. If Tenant fails to pay its general contractor, or the project encounters risks not shifted to the general contractor (e.g., subsurface, environmental conditions, or unavoidable delay), a general contractor's bond will not help Landlord. Some bonding companies may offer bonds to backstop Tenant rather than its general contractor. Bonds are often suggested but rarely used because of, among other things, their cost, the belief that they are just a license for a lawsuit, and other issues.
 - 47 Tenant will ask for this subordination. Landlord should not necessarily agree to it, especially for a guaranty, and especially if the guarantor is highly creditworthy.
 - 48 Guidelines could include, e.g., floor to ceiling height and a few objective design items, while giving Tenant flexibility. Landlord may not care about design, just bulk. Ordinarily any guidelines should be objective, with no Landlord discretion, reasonable or otherwise. This will change if, e.g., Landlord owns a larger development project of which this site is only part, or Landlord is a university and this site will provide housing or other ancillary services or is otherwise part of the campus, or at least perceived that way.
 - 49 This could replace the simpler and shorter definition in the Base Case.
 - 50 This language introduces factual issues, uncertainty, and possible disputes because it is not objective. It involves too much characterization.
 - 51 This language offers an alternative to the simpler and shorter Base Case language on assignment.

- 52 Landlord may want a reasonable consent right. A strong Tenant will resist. After Completion, a Lease usually becomes freely assignable, subject only to objective criteria to protect Landlord while giving Tenant ample flexibility. Landlord could supplement the criteria with requirements on experience and track record. In the rare and unusual case in which Landlord receives an environmental indemnity or other credit support throughout the Term, any assignment will also need to provide for replacement of those arrangements with new ones from a Satisfactory Guarantor.
- 53 Landlord may prefer a cure of “all” defaults. This paragraph and its variations and permutations can create factual issues and disputes. Landlord can wreak havoc for a proposed assignment by asserting defaults in an estoppel certificate.
- 54 Landlord will sometimes limit leasehold financing to a certain percentage of value or budgeted costs, or in any number of other ways. Landlord may also limit who may acquire Leasehold Mortgages post-closing (e.g., no vultures). The resolution of these issues may depend on what the parties agree on Lease assignability more generally. If the Lease allows free assignability, then it will more likely also allow free mortgageability. If Tenant has personal liability under the Lease (e.g., a corporate credit tenant with Base Rent reflecting the high quality credit), then the Lease will more likely restrict assignment. Both assignability and mortgageability are likely to loosen up after Tenant has completed and paid for initial development. If a Lease limits mortgages, Landlord may also want to limit mezzanine financing. Tenants generally resist limits on financing, arguing that a leasehold mortgage is just an inchoate Lease assignment and can’t really hurt Landlord because someone will always have to pay the rent. Tenant usually has the stronger argument on this issue.
- 55 The author strongly disfavors First Rights, but they often appear in Leases. If either party expects a First Right, the Term Sheet should say so.
- 56 In place of clause (iv), a First Right will more often go away completely after any foreclosure affecting the burdened estate.
- 57 Purchase options rarely appear in Leases because Landlord’s desire not to sell typically motivated the use of a Lease in the first place. Landlord will quite appropriately expect Tenant to exercise the first available purchase option, defeating Landlord’s goal. Sometimes, though, a purchase option will make sense. For example, if Landlord is an individual who acquired the property long ago, they may be willing to negotiate a purchase option upon death, because the resulting step-up in basis will ease the tax pain of a sale.
- 58 The Base Case says little on subleasing. This language is offered for cases in which the parties want to say more. If Tenant intends to enter into a sublease that is itself equivalent to a ground lease, that will require extensive tailoring.
- 59 Leasehold Mortgagee Protections are reasonably standard and well-established. They need little attention in a Term Sheet.
- 60 Ordinarily Landlord has trivial basis in improvements and nothing to depreciate. Actual ownership of improvements typically doesn’t matter as long as Tenant can depreciate its investment. The parties should discuss these issues with tax advisers early in the process.
- 61 Many Leases do not adequately consider end-of-term issues, including credit issues and possible sharing of capital expenditures. Nor does this Model Term Sheet. These issues will vary with circumstances, agendas, expectations, sophistication, leverage, and the parties’ willingness to spend real dollars today on issues that typically will not matter for about a century.
- 62 This payment will trigger New York City transfer tax, which a Lease would not otherwise attract. The parties would probably try to recharacterize the payment as rent, but would then need to consider New York City’s commercial rent tax, which is higher, but applies only to some Leases.
- 63 To the extent Tenant pays, that constitutes additional taxable consideration for both New York City and New York state purposes.
- 64 Occasionally, the parties provide for a binding breakup fee if one or the other walks from the deal. That can create factual questions about who jilted whom. It is disfavored. Should Landlord request a reciprocal assurance of exclusivity?



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