

# FEE MORTGAGES IN GROUND LEASE TRANSACTIONS (WITH MODEL LEASE LANGUAGE)



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comments on this article, send email to [joshua@joshuastein.com](mailto:joshua@joshuastein.com). Copyright © 2018 Joshua Stein. An earlier version of this article appeared in the ACREL Papers, Fall 2018 (New Orleans), published by ALI CLE.

This article will become part of the second edition of the author's book on ground leases, expected to appear in 2019. Consistent with the style of that book, this article capitalizes, without definition, many terms that any Lease would ordinarily define and capitalize. It is assumed that readers know what those terms mean and can easily find or write suitable definitions, or ask the author for definitions. The book will include a Model Lease template, sometimes mentioned in this article.

Whenever Landlord and Tenant negotiate a long-term ground lease (a "Lease"), two major issues that come to mind, after the rent, relate to protection of Leasehold Mortgages and creation of a financeable Leasehold Estate. As important as those issues are, though, the parties also need to think about Fee Mortgages and how they interact with the Lease.

Just like any Leasehold Estate, the Fee Estate needs to be financeable. The ability to finance both the Fee Estate and the Leasehold Estate, potentially to support more debt than if a single party owned the entire Premises, represents a fundamental reason to create Leases. Any Lease should therefore include a limited set of Fee Mortgagee protections. Those protections should recognize that Fee Mortgagees have concerns that are similar to, but narrower than, those of Leasehold Mortgagees.

This article looks at Fee Mortgage issues from five perspectives:

1. Fee Mortgagee's generic due diligence in reviewing a Lease;
2. Fee Mortgagee's other concerns;
3. Tenant's concerns;
4. Landlord's concerns; and
5. The interplay between a Fee Mortgage and rights of first offer, first refusal, or some variation ("First Rights").

After summarizing Fee Mortgage issues considered from those five perspectives, with some sample language in a few cases, this article then offers a complete set of sample provisions Landlord could add to a Lease to address the Fee Mortgage concerns raised in this article.

*Wherever this article offers sample language, italics indicate noncrucial (or possibly "overkill") provisions that sometimes appear, but are not strictly essential.*

## FEE MORTGAGEE'S GENERIC DUE DILIGENCE

When a prospective Fee Mortgagee reviews a Lease for a Loan to be secured by the Fee Estate, Fee Mortgagee starts by asking some questions about the Lease, much as a Landlord or prospective Landlord would:

- Will the Rent support the Fee Mortgage?
- Does the Lease shift all Premises-related obligations and burdens to Tenant?
- Does Landlord have any residual risks or obligations?
- Can Tenant assert any offsets or reductions against Rent?
- Does Tenant have any termination rights?
- Does the deal require a creditworthy Tenant or Guarantor? If so, does the Lease adequately provide

that? And does the deal structure seek to assure that any creditworthy party will stay creditworthy?

- Do the development-related provisions of the Lease mitigate any risk of development failure?
- Do the insurance provisions make sense and match Fee Mortgagee's expectations?
- Does the Lease obligate Landlord to give Leasehold Mortgagees or Subtenants any rights or protections that could turn out to be burdensome, such as an obligation to nondisturb a substantially below-market or abusive Sublease?

Beyond the typical Landlord's agenda in any Lease, though, Fee Mortgagee will have a few additional concerns, placing more weight than a typical Landlord on some other concerns, because lenders worry more than borrowers about some of those things. The following due diligence checklist represents an idealized version of what Fee Mortgagee would like to see in a Lease. To the extent the Lease does not live up to that standard, Fee Mortgagee will need to evaluate the risk and either figure out a way to live with it (basis points can solve a lot of problems), persuade Landlord to obtain (pay for) a Lease amendment, or not make the Loan.

This due diligence checklist does not purport to be exhaustive. It just touches some major bases, without detail. This discussion disregards generic real estate issues that would arise if the Lease did not exist at all and are not affected by the existence of a Lease.

### **Documentation Requirements**

Does the Lease require that any Fee Mortgage contain certain specified provisions? If so, Fee Mortgagee will want to confirm it can live with those provisions. Does the Lease require any notices or deliveries when Landlord obtains a Fee Mortgage? As part of the Fee Mortgage closing process, the Fee Mortgage should include any required provisions and Fee Mortgagee should give any required notices.

### **Escrows**

If Fee Mortgagee wants to maintain escrows for taxes and insurance, can Landlord require Tenant to make the required monthly escrow deposits? If not, Landlord may find it needs to tie up cash to make Fee Mortgagee happy.

### **Exculpation**

Does the Lease limit Landlord's liability to its interest in the Fee Estate? In the worst case, if the Lease obligations turn out to be untenable, Fee Mortgagee or foreclosure purchaser would want the ability to terminate any liability under the Lease. They might accomplish that by somehow abandoning the Fee Estate and the Lease, either by assigning them to an entity that is judgment-proof and bankruptcy-remote or having an express right to renounce any interest in the Fee Estate and terminate liability. Given the allocation of responsibility in any Lease, Fee Mortgagee will not worry as much as Leasehold Mortgagee about these issues. Although the notion of Lease abandonment makes sense, it is not market standard.

### **Indemnification**

Wherever the Lease requires Tenant to indemnify Landlord, does that obligation also extend to Fee Mortgagee and its affiliates, servicers, etc.?

### **Insurance**

Even if the insurance provisions in the Lease make sense from a Landlord's perspective, do they adequately consider Fee Mortgagee's interests and needs? If the Lease does not require Tenant to give Fee Mortgagee the benefit of a great insurance package required by the Lease, then Fee Mortgagee will find it unsatisfactory.

### **Landlord Obligations**

Does the Lease impose on Landlord any obligations that Fee Mortgagee might find unacceptable, or that a future owner of the Fee Estate might be incapable of performing, for example, any construction, particularly off-site?

### **Losses (Condemnation and Casualty)**

Fee Mortgagee will want Landlord to have first claim to any Condemnation Award, at least up to the Fee Mortgage loan balance. Fee Mortgagee will also worry about a panoply of other issues related to Losses, such as:

- Can Fee Mortgagee prevent an inadequate settlement of a claim?
- Will a creditworthy party hold any Loss Proceeds during restoration?
- Do the conditions to release of Loss Proceeds make sense?

- Can the Lease terminate because of a Loss?
- If so, will Fee Mortgagee be made whole?
- Can Leasehold Mortgagee or Tenant take the money and run, rather than restore?

### **Protected Parties**

Can Fee Mortgagee determine with certainty which Leasehold Mortgagees and Subtenants are entitled to protections (notices, etc.) under the Lease? If Fee Mortgagee forecloses, will Fee Mortgagee or Successor Landlord be able to obtain that information? If all such protected parties must record their rights, then Fee Mortgagee won't have a problem. If recordation is not required, then this creates potential uncertainty about who might come out of the woodwork after a foreclosure.

### **Rent Ratchet?**

Occasionally, a Lease will allow Rent to drop at the time of a land value Rent reset, if land values have dropped. In most cases, however, the Rent can never go down at any time during the Lease (a "Rent Ratchet"). Fee Mortgagees like Rent Ratchets, because the possibility of a reduction in Rent makes the Loan much harder to underwrite reliably. Landlords feel the same way, of course, but they may be more willing to trade that issue away in exchange for something else, and more optimistic and risk-tolerant than Fee Mortgagees.

### **Rent Resets and Disputes**

Can Fee Mortgagee participate in any Rent reset process or other dispute under the Lease? The outcome of any such process or dispute could hurt Fee Mortgagee, so Fee Mortgagee will not only want to know about it, but also have the right to participate and potentially approve any settlement. The Fee Mortgage can certainly address all that, but Fee Mortgagee will take more comfort if Fee Mortgagee's rights appear in the Lease.

### **Tenant Flexibility**

Does the Lease give Tenant so much flexibility on assignment, subletting, use, or alterations that Tenant might do something that Fee Mortgagee would find troublesome? For example, Landlord might not care if Tenant decided to construct a cannabis growing facility, but Fee Mortgagee might very well care.

### **Term**

How does the Lease term dovetail with the maturity date of the Loan? In the rare case where the Lease term does not extend significantly beyond the Fee Mortgage maturity date, how will Landlord and Fee Mortgagee plan ahead to deal with Lease expiration? Though Landlord may regard that as a great opportunity to do something different with the Premises, Fee Mortgagee will worry more about the loss of income.

### **FEE MORTGAGEE'S AGENDA, BEYOND LANDLORD'S**

Beyond the need to carefully review and consider the terms of the Lease, any prospective Fee Mortgagee will need to consider some other issues, both within and outside the Lease, that do not directly concern Landlord at all. Of course, any Landlord that might want to obtain a Fee Mortgage in the future, i.e., any Landlord, will also worry about these things.

### **Cash Sweep to Lockbox**

If Tenant suffers financial problems (such as excessive vacancy in a ground-leased shopping center), Fee Mortgagee may want the right to sweep all of Landlord's incoming cash. A very worried Fee Mortgagee might even want Tenant to pay its Rent into a lockbox from the outset, so Fee Mortgagee can both receive its debt service payments before Landlord sees any cash and have an early warning system for possible Tenant issues. Of course, this extra protection comes with an administrative burden and the likelihood of mistakes and confusion. Does anything in the Lease interfere with or prevent Fee Mortgagee from obtaining a lockbox?

### **Closing Deliveries**

When Fee Mortgagee closes its Loan, it will expect to receive closing deliveries equivalent to some but not all the closing deliveries required for a Leasehold Mortgage. Fee Mortgagee should also think about any guaranty, security deposit, prepaid Rent, letter of credit, ancillary agreement, or other document that Landlord received from Tenant, its affiliate, any Leasehold Mortgagee, or a third party such as a hotel manager. Fee Mortgagee's collateral package should capture all these items. For each, Fee Mortgagee should also think about obtaining: (a) estoppel certificates and confirmations; (b) comfort that Fee Mortgagee can control (prevent) future amendments or waivers; and (c) comfort that Fee Mortgagee can assign its rights with any sale of its Fee Mortgage or the Fee Estate.

### **Escrow for Insurance and Taxes**

If Fee Mortgagee likes insurance and tax escrows, then Fee Mortgagee will probably want to: (a) maintain such an escrow if Leasehold Mortgagee does not; and (b) know with certainty that any Leasehold Mortgagee's escrow will be properly applied, even if the Leasehold Mortgagee goes into default.

### **Fee Mortgage Transfer**

If Fee Mortgagee decides to transfer its Fee Mortgage, would anything in the Lease stand in the way, such as unreasonable or discretionary restrictions on who may hold a Fee Mortgage? Must Fee Mortgagee be an "Institution" or fall within some other permitted universe of Persons? How large is that universe? What's an "Institution"? Will any confidentiality restrictions in the Lease impede Fee Mortgagee's transfer? Will Fee Mortgagee be able to obtain any Tenant (or other) estoppel certificates it might need for such a transfer?

### **Fee Mortgagee Cure Rights**

To preserve the Lease, Fee Mortgagee will want the right to cure Landlord defaults. But those cure rights can be simpler than Leasehold Mortgagee's, for two reasons:

- First, any Landlord's obligations are much simpler and more limited than Tenant's. Typically, Landlord won't have any significant obligations at all.
- Second, Landlord's failure to perform its obligations never creates a risk of total loss of Fee Mortgagee's collateral. At worst, Fee Mortgagee will lose the Lease and Tenant and the stable Rent income that the Lease produced. This might even enhance the value of Fee Mortgagee's collateral, but a typical Fee Mortgagee prefers stable Rent over drama. Still, Fee Mortgagee's need for cure rights and other protections is not as compelling as Leasehold Mortgagee's.

### **Fee Mortgagee Deliveries**

Does the Lease require Landlord to obtain from Fee Mortgagee any consent, subordination, nondisturbance agreement ("SNDA"), Leasehold Mortgagee protection agreement, or other future document that might turn out to be undesirable?

### **Fee Mortgagee Protections after Foreclosure**

If Fee Mortgagee forecloses, it may want protections like those in a typical nondisturbance agreement with a space tenant. For example, a foreclosing Fee Mortgagee might want to be protected from any claims Tenant might have had against Landlord before Landlord lost the property to Fee Mortgagee through a Foreclosure Transfer. Although space tenants often live with such protections for a Landlord that acquires a Fee Estate through a Foreclosure Transfer, a Tenant under a ground lease will not necessarily accept such a proposal in its entirety. Tenant and its Leasehold Mortgagee may argue that the idea of protecting Fee Mortgagees from Landlord's incompetence, defaults, or mistakes is inconsistent with the notion that the Fee Mortgagee is totally subordinate to the Lease and all of Tenant's claims under the Lease. On the other hand, a Landlord typically has few obligations to Tenant. Hence, the likelihood of Tenant claims against Landlord is quite low. But even if it's a low likelihood of a large problem, Fee Mortgagee will want the right party to bear it.

Even if Tenant and Leasehold Mortgagee refuse to protect Fee Mortgagee (after a Foreclosure Transfer) from the consequences of Landlord's defaults, they may agree to protect Fee Mortgagee from only the "landlord-tenant conspiracy" category of nondisturbance issues.

For example, Fee Mortgagee will want comfort that any amendment, waiver, or other impairment of the Lease requires Fee Mortgagee consent and cannot take effect without that consent. Fee Mortgagee will worry if the Lease contains any obligation for Landlord to agree to future amendments of the Lease made at Tenant's request or to accommodate a future Leasehold Mortgagee. Fee Mortgagee will want the ability to block any such amendments. Fee Mortgagee will also worry about the possibility that Tenant will pre-pay massive amounts of Rent (which will flow into the pockets of Landlord's principals instead of to future scheduled Fee Mortgagee payments) and then default on the Fee Mortgagee.<sup>1</sup>

If the Lease does not require Tenant to enter into an agreement to protect Fee Mortgagee from these and similar risks, this will create concern for any future prospective Fee Mortgagee, and hence for Landlord. Among other things, it may lead Fee Mortgagee to demand tailored nonrecourse carveouts from a credit-worthy principal of Landlord.

## Priority vs Ground Lease

One issue often raised should not concern Fee Mortgagee at all: the proposition that the Lease will be prior and senior to the Fee Mortgage. That is part of the fundamental structure of any ground lease transaction. Tenants and Leasehold Mortgagees will not tolerate mere nondisturbance agreements from Fee Mortgagees. And Fee Mortgagees should have no objection to being subordinate to the Lease, because the Lease creates the cash flow to service the Fee Mortgage. In addition to requiring subordination language in the Lease, a very worried Tenant may sometimes want Fee Mortgagee to execute a recordable subordination agreement.

## Space Leases, Comparison With

If a Lease were a space lease, it would sometimes contain express cure rights for Fee Mortgagee, but only of a very limited nature. Similarly, if a space tenant entered into an SNDA with Fee Mortgagee, it would typically contain more Fee Mortgagee cure rights. Fee Mortgagees generally live with those arrangements for ordinary space leases. In the case of a ground lease, though, Fee Mortgagees may care more about these issues. Instead of relying on a collection of space tenants, Fee Mortgagee relies almost totally on the rental stream from just one Tenant, as well as Landlord's rights against that Tenant. In an extreme case with a highly credit-worthy Tenant (a so-called "Credit Tenant Lease"), Fee Mortgagee may lend an unusually high amount (high loan-to-value ratio) in reliance on the Lease. For these and other reasons, Fee Mortgagees may have a higher standard for the cure rights they want in a ground lease than in a space lease. They will also start their analysis from the proposition that Landlord should really have no obligations at all. Anything inconsistent with that proposition could be troublesome.

## TENANT'S AGENDA

### Bankruptcy Sale

Tenant may want Fee Mortgagee to agree not to join in any effort by Landlord or Landlord's bankruptcy estate to sell the Fee Estate free and clear of the Lease under Bankruptcy Code Section 365 or any comparable process in a Landlord Insolvency Proceeding.

## Future Deliveries

Any Lease will typically require Landlord to deliver certain documents for Tenants and Leasehold Mortgagee in the future, including:

- Estoppel certificates;
- A New Lease if the Lease terminates;
- Consents (or joinders or subordinations) for future easements and agreements;
- Building permit applications;
- Subtenant nondisturbance agreements;
- Consents to Subleases and Sublease amendments; and
- A separate agreement with an overanxious Leasehold Mortgagee to confirm the Leasehold Mortgagee Protections already in the Lease.

In some cases, those documents will also require consents, joinders, or subordinations from Fee Mortgagees. Ideally, from Tenant's perspective, the Lease will require Landlord to obtain those documents. Landlord may worry, however, that Fee Mortgagees will not cooperate. Thus, Landlord will try to trim back any Landlord obligation to obtain any Fee Mortgagee signature to anything. Tenant will also want to avoid finding it needs some document from (only) Landlord—even a document the Lease requires Landlord to deliver—but the Fee Mortgagee says Landlord can't sign that document without Fee Mortgagee's consent, which is not obtainable. So both Landlord and Tenant will want to assure that Fee Mortgagee has an obligation to cooperate with anything the Lease requires Landlord to deliver.

## Identity of Fee Mortgagee

Tenant might consider whether to try to restrict who may hold a Fee Mortgage, under the theory that some Fee Mortgagees will more likely cause trouble than others. As a separate concern, Tenant might not want to see a Landlord affiliate act as Fee Mortgagee, at least if that Fee Mortgagee wants any special cure rights or other rights. These issues are not too different from Landlord's possible concern about who may act as a Leasehold Mortgagee. Typically, however, Tenant will not be able to negotiate meaningful restrictions on an outright conveyance of the Fee Estate, so it makes little

sense to restrict Fee Mortgagees. Moreover, if a Fee Mortgage must always remain subordinate to the Lease, this should help mitigate any concerns of Tenant. As a practical matter, though, Landlord and Fee Mortgagee will typically not tolerate giving Tenant any restrictions on Fee Mortgagees or any meaningful remedy for violating any restriction if granted. Tenant will have to live with this problem and make sure the Lease adequately protects Tenant regardless of the identity of Landlord.

### Tenant Remedies

In the rare case where Tenant negotiates restrictions on the identity of Fee Mortgagees, what happens if Landlord violates that restriction? Tenant would have trouble proving damages. At a minimum, any prohibited Fee Mortgagee should have no special rights in that capacity against Tenant. In an extreme case, Tenant might have the right to a partial Rent abatement or delayed Rent increases. The mere possibility of such a remedy could, however, impair financeability of the Fee Estate.

## LANDLORD'S AGENDA

### Alignment of Lease and Fee Mortgage

In closing any Fee Mortgage, Landlord will want the Lease and the Fee Mortgage documents to work together and not place Landlord in an impossible position. A few examples of that proposition follow. All are variations on the single idea that Leases and Fee Mortgages should be aligned. Landlord should address that single idea in the term sheet, letter of intent, application, or commitment for the Fee Mortgage. Fee Mortgagee should have no problem with any of these concepts once Fee Mortgagee has reviewed and approved the Lease.

### Documents and Deliveries

If the Lease requires Landlord to obtain any document or delivery from Fee Mortgagees, Landlord will need to assure that the Fee Mortgage requires Fee Mortgagee to cooperate. Here is sample language:

#### Required Deliveries

To the extent the Lease requires Landlord to obtain any document or delivery from its Fee Mortgagee, Fee Mortgagee agrees to execute and deliver that document or delivery, provided that: (x) it is reasonably satisfactory to Fee Mortgagee or meets whatever standards apply under the Lease; and (y) Tenant has met the conditions precedent to require it under the Lease.

## Insurance

If the Lease requires specific insurance, Landlord will not want the Fee Mortgage to require something different or additional. If the Lease requires Tenant to pay for and maintain suitable insurance, then the Fee Mortgage should require Landlord to do nothing more than enforce Tenant's obligations. Landlord should have the obligation to step in only if Tenant does not perform. Here is sample language:

### Lease Insurance Requirements

So long as (a) the Lease is still in effect and (b) Tenant maintains in effect all insurance coverages the Lease requires (subject to Fee Mortgagee's reasonable approval of the deductible amounts to the extent the Lease gives Landlord that approval right), then Landlord's obligations to provide all insurance coverage this Fee Mortgage requires shall be deemed satisfied. That shall not excuse Landlord from the obligation to give Fee Mortgagee evidence of that insurance coverage for Fee Mortgagee's benefit, to the extent of Landlord's right to obtain that evidence under the Lease. If the Lease is not in effect or Tenant fails to maintain any required insurance, then Landlord shall maintain insurance as this Fee Mortgage requires. *To the extent Landlord maintains its own insurance, Landlord shall name Fee Mortgagee as an additional insured or otherwise give Fee Mortgagee the benefit of that insurance in a manner consistent with ordinary insurance practices.*

### Property-Related Obligations

If the Lease makes Tenant wholly responsible for maintaining the Premises and gives Tenant exclusive possession of the Premises, Landlord will not want to have any maintenance obligations beyond trying to get Tenant to do what it said it would. More generally, Tenant should perform all obligations related to the Property. Landlord would not want its Fee Mortgagee to require anything more from Landlord than Landlord can require from Tenant. So long as Tenant performs, Landlord should have no incremental obligations to Fee Mortgagee. Here is simple language for the Fee Mortgage, which should refer to anything involving Property-related covenants or obligations, including Casualty and Condemnation:

### Property-Related Matters

Notwithstanding anything else in any Loan Document, so long as the Lease is in effect and Tenant is performing

its obligations on any matter related to management, operation, repair, or maintenance of the Premises, or relating to \_\_\_\_\_, the Lease provisions on those matters shall control. So long as the Lease has not terminated, nothing in any Loan Document shall require Landlord to take any actions regarding those matters beyond what the Lease requires of Tenant. *Landlord may satisfy that obligation by diligently seeking (short of litigation) to enforce Tenant's obligation to take any such actions.* To the extent that and so long as Tenant or any Leasehold Mortgagee has rights under the Lease, those rights supersede all inconsistent provisions in the Loan Documents. Notwithstanding anything else in the Loan Documents, Landlord's and Fee Mortgagee's rights and obligations on Casualty and Condemnation shall be subject to the Lease provisions on those matters, including adjustment, settlement, holding, application, and disbursement of any insurance proceeds or condemnation award.

Ideally, of course, the parties will adjust the requirements of the Fee Mortgage so they align perfectly with those of the Lease. Typical timing pressures of a transaction, and the volume of paper involved, make that difficult. Hence the need for language such as that suggested here.

### **Tenant Rights; Landlord Consents**

The Lease will often give Tenant broad rights to change use, perform alterations, and sign Subleases. The Fee Mortgage should not give Fee Mortgagee more control over these matters than the Lease gives Landlord. If the Lease gives Landlord consent rights, then Landlord will often allow Fee Mortgagee to control those consents—or at least some of them—but subject to whatever standard (e.g., reasonableness) limits Landlord's exercise of its discretion. Here is sample language on consents:

#### **Consents Under Lease**

Landlord shall Notify Fee Mortgagee of any consents requested of Landlord under the Lease. Tenant shall obtain Lender's approval to grant any such consent before doing so, *if the consent relates to \_\_\_\_\_*. In granting or withholding its approval, Fee Mortgagee shall comply with any standard for consent that applies to Landlord under the Lease. Fee Mortgagee shall respond to a request for its consent within the shorter of (a) \_\_\_ days less than the response time that applies to Landlord under the Lease; and (b) \_\_\_ days

after submission to Fee Mortgagee. Landlord's submission to Fee Mortgagee may include a Conspicuous statement that approval will be deemed granted if not properly withheld within that time. If the submission includes that statement, then Fee Mortgagee's failure to respond in that time shall be deemed approval.

### **Rights of Contest**

The Lease will allow Tenant to contest mechanics' liens, Real Estate Taxes, Laws, and other matters. Landlord cannot find itself in a situation where Tenant can contest a matter under the Lease, but the Fee Mortgage requires Landlord to perform that matter.

### **Representations and Warranties**

To the extent Fee Mortgagee asks Landlord to make representations and warranties on the Property, Landlord should qualify those. If a particular matter, such as legal compliance, is Tenant's responsibility under the Lease, Landlord can often only say that any statements about it are accurate "to Landlord's knowledge." If Tenant has total control of that matter, then any Landlord assurances and covenants need to be "subject to Tenant's rights under the Lease."

### **Escrows**

Fee Mortgagee may want Landlord to maintain escrows for Real Estate Taxes and insurance. Landlord will want to coordinate those with the Lease requirements. With any luck, the Lease has Landlord-friendly language suggested in this article. In that case, the escrows simply need to be documented accordingly. If the Lease contains no such language, Landlord may need to persuade Fee Mortgagee not to worry about escrows. Given the low loan-to-value ratio of Fee Mortgage loans, Fee Mortgagee ought to be willing to go along, but that discussion should take place very early—preferably at the term sheet stage.

### **Inspection Rights**

Fee Mortgagee will probably want the right to inspect the Property. That right will need to be subject to whatever constraints apply in the Lease. If the inspection occurs during the pre-closing process, Landlord may want to include this statement in the term sheet, application, or similar document for the loan:

## Property Inspections

Fee Mortgagee's inspection of the Property must comply with any requirements and limitations in the Lease. Unless the inspection discloses Tenant is in material default under the Lease (for example, Tenant is not prosecuting \_\_\_\_\_ as the Lease requires), the Property shall be deemed to have passed inspection.

## Reporting

The same themes arise in the context of reporting requirements under the Fee Mortgage. Here is an example of how Landlord might protect itself from having to report information it does not have and cannot obtain:

### Reporting

As long as the Lease remains in effect, Landlord need not give Fee Mortgage any property-level report, financial statement, or rent roll that reflects any sublease or Tenant's results of operations, except to the extent the Lease entitles Landlord (and Tenant gives Landlord) that information. Landlord's reporting shall be limited to Landlord's leased Fee Estate subject to the Lease.

## Nonrecourse Carveouts

If Landlord or its principals assume personal liability for any "bad acts," carve out anything done by Tenant, such as Tenant's theft of security deposits. The description of carveouts should speak in the active voice, e.g., "If Landlord steals the security deposits," as opposed to "If any security deposits are misapplied." Fee Mortgagee may want to add carveouts for prohibited Lease amendments and Rent prepayments. Landlord and its principals should be willing to accept that.

## General Statement on Alignment

In addition to the specific concerns and specific language suggested above, Landlord may ask Fee Mortgagee to include language like this in the Fee Mortgage, though a conservative Fee Mortgagee may balk at the contemplated level of generality and insist that Landlord identify in detail each specific provision in any Loan Document that causes concern:

### Alignment with Lease

To the extent the Lease allows Tenant to do anything without Landlord's consent (e.g., alterations), that action by Tenant shall not be deemed to violate the Loan Documents. Any action the Lease requires

Landlord or Tenant to take (or allows Tenant to take without Landlord's consent) shall not be deemed to violate or cause a default under any Loan Document. Notwithstanding anything else in any Loan Document, Landlord shall have no obligation to do anything that would violate the Lease. Where the Loan Documents require Landlord to cause Tenant to take some action or make any payment, Landlord shall diligently seek to cause Tenant to do so in a manner consistent with the Lease. If Landlord fails in those efforts, that shall not constitute a default under the Loan Documents *unless the failure continues for \_\_\_ days. Nothing in this paragraph obligates Landlord to commence any litigation against Tenant.* Fee Mortgagee shall accept performance of any obligation under the Loan Documents by Tenant as if Landlord had performed it.

## Fee Mortgage Closing Process

When Landlord contemplates obtaining a Fee Mortgage, Landlord must plan ahead for the closing process. From Landlord's perspective, however, the most important Fee Mortgage closing delivery doesn't occur at closing. It occurs instead when the Fee Mortgage closing process begins. Fee Mortgagee needs to review the Lease and approve it, with no demand for a Lease amendment, a "clarification" from Tenant, or anything else outside Landlord's control or that the Lease does not already require from Tenant.

Landlord should insist that any prospective Fee Mortgagee have its counsel review the Lease and raise any issues before the rest of the closing process begins. Landlord will probably have to pay for that. Here is sample language for the commitment letter:

### Early Lease Approval

Landlord has submitted a copy of the Lease to Fee Mortgagee. Fee Mortgagee shall review and approve or disapprove it before undertaking any other pre-closing, due diligence, third party, or documentation activities for the Fee Mortgage. Landlord has advised Fee Mortgagee that Fee Mortgagee must either accept or reject the Lease as is. Borrower will not obtain any Lease amendment or "clarification." If Fee Mortgagee rejects the Lease, then Fee Mortgagee shall promptly refund Landlord's Deposit, less only Fee Mortgagee's actual reasonable attorneys' fees to review the Lease.

If Fee Mortgagee's counsel finds any issues, the parties should deal with them before Landlord incurs



significant expense for anything else in the closing process. In most cases, the prospective Fee Mortgagee will thank its counsel for being diligent and then decide to live with whatever issues counsel discovers. In some cases, Landlord and Fee Mortgagee may use loan covenants or nonrecourse carveouts to handle any concerns identified by Fee Mortgagee's counsel. That mechanism may work for issues with the control of Landlord and its guarantor, but not for any issues beyond their control.

In a tiny minority of cases, the issues in a Lease will be so serious that Landlord will need to: (a) obtain (i.e., pay Tenant for) a Lease amendment; (b) find a different lender with less diligent counsel; or (c) persuade this Fee Mortgagee or the next one to accept the Lease without resolution of the issue. In the author's experience, Landlord and a prospective Fee Mortgagee usually agree to option (c) and life goes on without further drama. If, however, the issue arises during the Loan closing process, rather than as a gating issue before the Loan closing process begins, then it can cause a great deal of excitement and wasted time.

### **Inappropriate Provisions**

Landlords sometimes try to add language to Leases that create protections for Fee Mortgagees going beyond cure rights and other rights inspired by Leasehold Mortgage Protections and nondisturbance agreements. More specifically, Landlord will try to look ahead to future Fee Mortgagees and try to assure that the Lease shifts any resulting risks to Tenant and protects Landlord from the risk that Fee Mortgagee will want more than the Lease contemplates Landlord will be able to obtain from Tenant and deliver to Fee Mortgagee. Particularly if Tenant believes all Fee Mortgages should under all circumstances remain subordinate to the Lease (and any inconsistencies between any Fee Mortgage and the Lease should be resolved in favor of the Lease), Tenant will probably not tolerate these proposed provisions.

In rare cases, however, they may make sense. For example, if Landlord and Tenant are (and will remain) related and the Lease is being created just to facilitate Fee Mortgage financing, Tenant may be more willing to roll over for future Fee Mortgages.

Here are some sample overly Landlord-friendly provisions that an aggressive (or deluded) Landlord may want to add to a Lease. These provisions should not be regarded as "recommended" or "desirable." To the contrary, they represent the diametric opposite of the approach suggested in this

article, which is "market standard" in the author's experience. This language—based on language that someone actually proposed to the author in a Lease transaction—appears here only for reference purposes and as an inspiration for creative writing in or about Leases.

### **Fee Mortgages**

Notwithstanding anything else in this Lease, for any Fee Mortgage and Fee Mortgagee, present or future: (a) the Fee Mortgage shall govern to the extent of any conflict with the Lease; (b) if any Fee Mortgage or Fee Mortgagee from time to time requires insurance coverage, or imposes requirements on insurance coverage (including scope of Insurance Documents) that go beyond those of this Lease, those insurance and insurance-related requirements shall also be deemed to constitute Liability Insurance or Property Insurance, as applicable, under this Lease; (c) Landlord shall have no obligation, and Tenant shall have no right, to do anything that would violate a Fee Mortgage or entitle Fee Mortgagee to exercise any right or remedy under a Fee Mortgage; and (d) if any Fee Mortgagee disapproves any matter, including a Transfer of the Leasehold Estate, based on whatever approval standards apply under the Fee Mortgage, then Landlord may withhold its approval to that matter. *Nothing in this paragraph obligates Tenant to make any payment except to the extent this Lease would require Tenant to make that payment if the Fee Mortgage did not exist.*

### **Information for Fee Mortgagees**

If Landlord may eventually obtain a Fee Mortgage (i.e., if Landlord is in the real estate business or might want to sell the Fee Estate to someone in the real estate business), Landlord will know that prospective Fee Mortgagees will want information that Tenant controls—both for initial Fee Mortgage underwriting and closing and continuing over the life of the Fee Mortgage loan. As a starting point, Landlord may want Tenant to deliver an estoppel certificate like the one that the Model Lease requires Landlord to sign for Tenant.

An actual or prospective Fee Mortgagee may also want to know how Tenant is doing in its business of subleasing and operating the Premises. Tenant's success or failure will, as a practical matter, determine whether the Rent will be paid. Fee Mortgagee assumes that payment of Rent is a good indicator for likely payment of Fee Mortgage debt service. Thus, Tenant's financial performance becomes crucial to Fee

Mortgagee's underwriting, closing, and monitoring of its Loan. For that reason, Leases sometimes require Tenant to report financial information to actual or prospective Fee Mortgagees, even if Landlord is not entitled to receive that information. Whatever information Tenant agrees to give Landlord should automatically be deemed a "Confidential Delivery" or subject to whatever confidentiality obligations apply in the Lease. Those obligations should be built into the Lease rather than contemplate execution of a separate confidentiality agreement to be negotiated (fought over) later.

### **Tenant Acquisition of Fee Mortgage**

In some cases, creative Tenants acquire their Landlords' Fee Mortgages, and then use those Fee Mortgages as mechanisms to torment Landlord. Landlord may want to try to prevent that. A few comments on that risk:

#### **Documentation on Transfer**

Landlord can ask for a certificate and other documentation if any Transfer of a Fee Mortgage occurs, but the problems suggested above will remain.

#### **End Runs**

If a Tenant Affiliate has set its mind on acquiring a Fee Mortgage, then as a practical matter it can probably find a way to do it regardless of what the Lease says. Landlord will probably never be able to prove it happened. For example, Tenant Affiliate could enter into a total return swap with Fee Mortgagee, or one or more option agreements coupled with appointment of a Tenant Affiliate as servicer of the Fee Mortgage. Thus, Landlord may just have to live with this risk and keep it in mind when negotiating any Fee Mortgage.

#### **Fee Mortgagee Reluctance**

Fee Mortgagees will probably not agree to any restrictions on Transfer of a Fee Mortgage. Therefore, the prohibitions need to appear in the Lease, in the form of restrictions on Tenant. Any such restrictions will cause concern for Leasehold Mortgagees worried about the possible need to cure unusual defaults.

#### **Fee Mortgage Terms**

In negotiating any Fee Mortgage, Landlord might try to persuade Fee Mortgagee to agree not to transfer to any Tenant Affiliate, or enter into any agreement with any Tenant Affiliate about the Fee Mortgage.

### **Institutional Transferees**

As a back-door way to prevent most Tenants from acquiring Fee Mortgages, Fee Mortgage might agree to Transfer only to Institutions. As a compromise measure, if a Fee Mortgage is Transferred to any Person except an Institution, then some of its terms (or protections for Fee Mortgagees in the Lease) might change in ways that would make it harder for a Tenant-related Fee Mortgagee to squeeze Landlord. Although this sounds reasonable, Fee Mortgagee may hate the idea. Moreover, a smart Tenant could readily figure out a way around these restrictions.

Even if Fee Mortgagee agrees to any restrictions on Transfers to Tenant or its Affiliate, Fee Mortgagee will probably insist that the restrictions go away if an Event of Default exists under the Fee Mortgage, which is the only time when these issues matter. Ultimately Landlord must negotiate the Fee Mortgage so it doesn't matter who holds the Fee Mortgage. Ideally, the terms of the Fee Mortgage should be reasonable enough that Landlord doesn't care who holds it. As a practical matter, however, most borrowers can't achieve that.

### **FIRST RIGHTS**

In any Lease, Landlord will occasionally give Tenant a First Right. Less often, Tenant will give Landlord one. Any First Right, as well as any purchase option, raises a wide panorama of fascinating issues and opportunities for dispute. A handful of those issues and potential disputes relate specifically to Fee Mortgages and are collected here. They affect Landlord, Tenant, and Fee Mortgagee.

#### **First Right Carveouts**

A careful Fee Mortgagee (and hence Landlord) will want to assure that any First Right does not apply to: (a) Landlord's grant of a Fee Mortgage; (b) any Fee Mortgage Foreclosure Transfer; and perhaps (c) any transfers of the Fee Estate occurring after any Fee Mortgage Foreclosure Transfer.<sup>2</sup>

#### **Response to Carveouts**

The suggestion in the previous paragraph will concern any Tenant, if Tenant cares about its First Right. In response, Tenant may request some protections designed to reduce the risk of foreclosure. Every one of these is reasonable, but probably none of them will fly:

### Maximum Amount

Tenant may want to limit the amount that a Fee Mortgage may secure, thus opening a new can of worms. Tenant might also worry that certain types of financing are more likely to lead to foreclosure than others.

### Notice of Foreclosure

Tenant may try to require that Fee Mortgage must give Tenant reasonable prior notice of any foreclosure auction, including any adjournment, so Tenant can bid. This proposal, though very logical, usually fails because Landlord will recognize that it would terrify any prospective Fee Mortgagee.

### Permitted Holders

Tenant may try to limit who may hold the Fee Mortgage, under the theory that certain Fee Mortgagees will behave better than others. See "*Identity of Fee Mortgagee*" above.

### First Right Default

If Landlord exercises a First Right against Tenant, what happens if Landlord defaults in its obligation to purchase the Leasehold Estate? Fee Mortgagee will want to assure that any such default cannot adversely affect Fee Mortgagee. Tenant's rights and remedies should consist of keeping Landlord's deposit under the Purchase and Sale Agreement. The Lease should not suggest that Fee Mortgagee might need to cure the default. Fee Mortgagee would also be unhappy with the prospect of litigation between Landlord and Tenant over Landlord's default. Thus, Fee Mortgagee may want to require that if Landlord wants to exercise a First Right, it must use a different entity for that purpose.

### Interaction with Fee Mortgage

How does Tenant's First Right interact with a Fee Mortgage? Is there any possibility that Tenant might be able to acquire the Fee Estate, free and clear of the Fee Mortgage, without paying the entire Fee Mortgage? If the First Right is in the Lease or otherwise prior to the Fee Mortgage, then it would give Tenant the right to acquire the Fee Estate at a particular price determined through the First Right process. What happens if that price falls short of the amount secured by the Fee Mortgage? Tenant would probably prevail and acquire the Fee Estate free of the Fee Mortgage, although Fee Mortgagee would be entitled to the sales proceeds, such as they were. Conversely, how would Landlord's default under Tenant's First Right affect Fee Mortgagee? Fee Mortgagee's right to cure, in itself, doesn't necessarily solve a future problem if Landlord's obligations are too onerous. If a Lease contains any First Right, Fee Mortgagee will worry about all these issues and insist that the Lease offer adequate protection.

### LEASE LANGUAGE ON FEE MORTGAGES

Based on the preceding suggestions, any Lease should contain language that looks out for Landlord's future Fee Mortgagees. It should start by giving them protections like those of Leasehold Mortgagees, though not as extensive. But it also needs to consider some other issues, not all of them obvious. This sample, below, offers sample language to that effect. Footnote offer some commentary, occasionally but not always repeating any relevant comments earlier in this article.

The author consents to use of this sample language in any Lease. An editable version is available from the author. It will reflect any improvements since publication.

## FEE MORTGAGES

### Priorities and Relationships of Estates

Landlord may grant any Fee Mortgage, but only if at the time Fee Mortgagee is an Institution.<sup>3</sup> This Lease, the Leasehold Estate, and any New Lease shall be prior and superior to all Fee Mortgages and the rights of all Fee Mortgagees.<sup>4</sup> That priority and superiority shall also extend to any amendments to this Lease made with Fee Mortgagee's consent.<sup>5</sup> Nothing in a Fee Mortgage can change Landlord's or Tenant's rights or obligations under this Lease. Every Fee Mortgage shall: (a) attach only to the Fee Estate and not the Leasehold Estate; (b) be, and state that it is, subject and subordinate to this Lease and any New Lease; and (c) require Fee Mortgagee to join in, or subordinate to, any Easements, Incentive Documents, SNDA, and other documents this Lease requires Landlord to sign, provided that each such document is in ordinary and customary form, recorded (*except in the case of any documents not customarily recorded*), and reasonably satisfactory to Fee Mortgagee.<sup>6</sup>

### **Fee Mortgage Foreclosure**

A Fee Mortgage Foreclosure Transfer shall: (a) not affect this Lease or the Leasehold Estate, which shall remain encumbered by any Leasehold Mortgage; (b) impair no rights of Tenant or any Leasehold Mortgagee, New Tenant, or Post-Foreclosure Tenant; and (c) Transfer only the Fee Estate and Landlord's interest in and rights under this Lease, subject to this Lease.<sup>7</sup>

### **Protections**

No Modification of this Lease shall be effective unless consented to in writing by all Fee Mortgagees, Leasehold Mortgagees, Landlord, and Tenant. A Foreclosure Transfer under any Leasehold Mortgage shall not impair the Fee Estate or any Fee Mortgage, and shall Transfer only the Leasehold Estate and Tenant's interest in and rights under this Lease. The Fee Estate shall remain encumbered by the Fee Mortgage.

### **Notices and Defaults**

If Tenant gives Landlord any Notice of any alleged default by Landlord *that could entitle Tenant to terminate this Lease, abate Rent, claim an offset, or claim a partial or total eviction*, then: (a) Tenant shall simultaneously give a copy to each Fee Mortgagee of which Tenant has received Notice; and (b) each Fee Mortgagee shall have the right, but no obligation, to cure Landlord's default within 30 days after Tenant gives that Notice. If Fee Mortgagee cannot reasonably cure a nonmonetary Default within Fee Mortgagee's cure period under the previous sentence, it shall have such additional time as it reasonably needs so long as it prosecutes the cure with reasonable diligence and continuity. If Fee Mortgagee cannot reasonably cure a default without possession, then Fee Mortgagee shall be entitled to any additional time it reasonably needs to consummate a Foreclosure Transfer and obtain possession, but only so long as Fee Mortgagee: (i) prosecutes its rights and remedies with reasonable diligence and continuity; and (ii) timely exercises its cure rights for all other Defaults of which it has received Notice.

### **Multiple Fee Mortgagees**

If at any time Tenant has received Notice of multiple Fee Mortgagees: (a) any consent by or Notice to Fee Mortgagee refers to consent by or Notice to all Fee Mortgagees; (b) except under clause (a), the most Senior<sup>8</sup> Fee Mortgagee may exercise all rights of each Fee Mortgagee, to the exclusion of every junior Fee Mortgagee; and (c) to the extent that the most Senior Fee Mortgagee declines to do so, any other Fee Mortgagee may exercise those rights, in order of priority.

### **Designee, Etc**

Notwithstanding anything else in this Lease, Fee Mortgagee or Successor Landlord may exercise its rights through an Affiliate, assignee, designee, nominee, subsidiary, or other Person, acting in its own name or in Fee Mortgagee's or Successor Landlord's name, *provided that Fee Mortgagee or Successor Landlord confirms in writing (if requested) that such Person is authorized to exercise those rights*. Anyone acting under the previous sentence shall automatically have the same protections, rights, and limitations of liability as a Fee Mortgagee.

### **Fee Mortgage Escrow**

If a Fee Mortgagee requires an ordinary and customary escrow arrangement for Real Estate Taxes or insurance premiums, Tenant shall make all deposits into that escrow as Fee Mortgagee requires, provided that Fee Mortgagee agrees to timely release those deposits only to pay Real Estate Taxes or insurance premiums and not to pay any Mortgage indebtedness or anything else, even if the Fee Mortgage is in default, so long as no Lease Abandonment has occurred.<sup>9</sup>

### **Third-Party Beneficiary**

Every present and future Fee Mortgagee is an intended third-party beneficiary of this Article.

### **Financial Reporting<sup>10</sup>**

If a prospective Fee Mortgagee is an Institution that has executed and delivered to Tenant a confidentiality agreement substantially in the form of Exhibit \_\_\_ (a "Confidentiality Agreement"),<sup>11</sup> then Tenant shall give that prospective Fee Mortgagee these items (the "Confidential Fee Mortgagee Deliveries") for underwriting and closing the Fee Mortgage: (a) reasonable access to the Premises for inspection, subject to Subtenants' rights and compliance with Tenant's reasonable instructions; (x) Tenant's financial statements (balance sheet, income statement, and rent roll) for the Building (*but not those of any Guarantors*)<sup>12</sup> for the previous three fiscal years (which need not be prepared by a certified public accountant unless one was otherwise engaged for that purpose) ("Tenant Financial Information"); (b) copies of all<sup>13</sup> Subleases then in effect; and (c) [\_\_\_\_\_] [such other information and materials as the prospective Fee Mortgagee reasonably requests]. After the closing of any such Fee Mortgage, if the Confidentiality Agreement remains in effect *and Fee Mortgagee remains an Institution*, Tenant shall give Fee Mortgagee updated Financial Information and copies of newly executed Subleases since Tenant's last such delivery to that Fee Mortgagee, but only if that Fee Mortgagee requests, up to once a year. *Landlord shall reimburse all reasonable costs and expenses, including Legal Costs and photocopying costs, but excluding staff time, that Tenant incurs in performing under this paragraph.*

### **First Rights**

*If this Lease contemplates Landlord may give any Notice to Tenant that would or could entitle or require Tenant to acquire the Fee Estate or sell the Leasehold Estate, then no such Notice shall be effective unless it includes written consent by all Fee Mortgagees.*<sup>14</sup>

### **Landlord Bankruptcy**

*If Landlord, or a trustee or debtor in possession acting for Landlord, purports to reject this Lease under 11 U.S.C. § 365(h)(1) (A), then Tenant shall not exercise any 365 Termination Option without Fee Mortgagee's written consent. By accepting its Fee Mortgage, each Fee Mortgagee shall be deemed to have irrevocably agreed with Tenant not to initiate, consent to, or support any Landlord's Free and Clear Sale.*<sup>15</sup>

### **Tenant Control of Fee Mortgagee**

*Tenant shall not, and shall not cause or permit any Tenant Affiliate to, directly or indirectly acquire any Fee Mortgage or obtain any direct or indirect right to control or direct any Fee Mortgagee.*<sup>16</sup>

### **Fee Mortgagee Contact Information**

*To the extent this Lease requires or permits Tenant to give any Notice to a Fee Mortgagee, Tenant may do so based on the name and address most recently either: (a) placed of record before Tenant acquired the Leasehold Estate; or (b) thereafter actually given to Tenant in compliance with this Lease. Tenant has no obligation to run a title search, except when it acquires the Leasehold Estate, or to perform any investigation to determine any Fee Mortgagee's then current name or address.*<sup>17</sup>

### **Dispute Resolution Proceedings**

*If Landlord or Tenant initiates any Dispute Resolution Proceeding, then the parties shall simultaneously Notify each Fee Mortgagee. Fee Mortgagee may participate in those proceedings on Landlord's behalf, or exercise any of Landlord's rights in those proceedings, in each case (at Fee Mortgagee's option) to the exclusion of Landlord, but (as between Landlord and Fee Mortgagee) subject to the Fee Mortgage loan documents. No settlement shall be effective without Fee Mortgagee's consent, unless Landlord simultaneously pays it and the claimant releases any claim against Fee Mortgagee. Nothing in this paragraph limits Landlord's rights against Tenant or Guarantor.*

### **Successor Landlord**

*If a Fee Mortgagee or its designee succeeds to the Fee Estate through a Foreclosure Transfer (a "Successor Landlord"), then at Successor Landlord's request, Tenant shall: (a) automatically attorn to and recognize Successor Landlord as Landlord; and (b) promptly sign and deliver an attornment agreement as Successor Landlord reasonably requests but only if it is reasonably acceptable to Tenant and consistent with this Lease and Successor Landlord assumes all existing undischarged, and future, obligations of Landlord, subject to the Exculpation Clause. On any such attornment, this Lease shall continue as a direct lease between Successor Landlord and Tenant on all the same terms. No Fee Mortgagee or Successor Landlord shall ever have any liability under this Lease beyond its interest in this Lease and the Premises. That liability shall terminate if that Successor Landlord assigns this Lease in accordance with its terms (and the assignee Landlord assumes those obligations).<sup>18</sup>*

### **Successor Landlord Protections**

*Notwithstanding anything else in this paragraph, unless Successor Landlord is an Affiliate of the former Landlord, Successor Landlord shall not be: (a) liable for any previous act or omission of Landlord, except to the extent it continues after attornment; (b) subject to any Offset that Tenant could have claimed against Landlord before attornment; (c) bound by any Modification made without consent by the Fee Mortgagee that initiated the Foreclosure Transfer<sup>19</sup>; (d) required to perform any Construction that Landlord had agreed to perform; or (e) required to account for any security deposit, prepaid Fixed Rent, or letter of credit of Tenant except any that Fee Mortgagee or Successor Landlord actually received.<sup>20</sup> Successor Landlord may at any time abandon its interest in the Fee Estate by Notice to Tenant. After any such abandonment Successor Landlord shall have no further liability under this Lease.<sup>21</sup>*

### **Confirmatory Agreement**

*Tenant shall on request of any Fee Mortgagee or Successor Landlord, and Fee Mortgagee or Successor Landlord shall on request of Tenant or a Leasehold Mortgagee, enter into an agreement in form and substance reasonably satisfactory to the parties, confirming these Lease provisions: (a) the relationship and priorities between Tenant (and Leasehold Mortgagees) and Fee Mortgagee; (b) the consequences of an attornment to Successor Landlord; (c) the protections for a Successor Landlord; and (d) any amendment, waiver, or termination of that agreement requires Leasehold Mortgagee Consent.<sup>22</sup> No such agreement shall increase any party's obligations, or decrease any party's rights, without that party's consent.*

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#### Notes

- 1 For a discussion of nondisturbance agreements, the risks against which they might protect Fee Mortgagee, and how any Tenant might feel about those protections, see Joshua Stein, "Needless Disturbances? Do Nondisturbance Agreements Justify All the Time and Trouble?," 37 ABA Real Property, Probate and Trust Journal, Winter 2003, at 701; "Report of Subcommittee on Nondisturbance Agreements, with model Agreement" (Joshua Stein, subcommittee chair, primary author), New York State Bar Association Real Property Law Section Newsletter, Spring 1994, at 42; and Thomas G. Homburger and Lawrence A. Eiben, "Who's on First—Protecting the Commercial Mortgage Lender," 36 ABA Real Property, Probate and Trust Journal 411 (2001).
- 2 Tenant will not always accept exemption (c). As a compromise position, Landlord and Fee Mortgagee might limit the exemption to future affiliate transfers or multiproperty transfers.
- 3 What happens if Fee Mortgagee later stops being an Institution, such as if an Institution sells the Fee Mortgage to an opportunistic investor? Tenant might want to deny such an investor at least some Fee Mortgagee protections. This language does not address that possibility, as a Fee Mortgagee will typically not tolerate any implied or indirect restrictions on transfer. Tenant should negotiate a Lease, and Fee Mortgagee protections, that work right for Tenant regardless of the identity of any Fee Mortgagee. That argument would imply the Lease should allow anyone at all to hold a Fee Mortgage. The language in the text represents a reasonable compromise.
- 4 The definition of Fee Mortgage should probably require any Fee Mortgage to be recorded. Otherwise, a purchaser of the Leasehold Estate has no way to know with certainty who is entitled to protections. Tenant may want the definition of Lease to include all future amendments. Absent a requirement for Fee Mortgagee approval of each such amendment, Tenant's definition would make the Fee Estate unfinanceable, because an amendment could, e.g., reduce the rent to \$1 per year.
- 5 Tenant may propose that Fee Mortgagee must be "reasonable" about consenting to Lease amendments. That will typically be a non-starter for any Fee Mortgagee. Landlord should categorically reject it.
- 6 This would include, for example, any SNDA that this Lease requires Landlord to deliver to a Subtenant. Landlord may object to the entire concept in this paragraph, and particularly clause (c), as it may scare off at least some potential Fee

Mortgagees. But the requirement is reasonable. If Tenant has negotiated some right against Landlord, Landlord should not have the right to enter into a Fee Mortgage that could frustrate Tenant's exercise of that right. Fee Mortgagee will reasonably want to be subject only to recorded SNDAs. Tenant might want clause (c) to be automatic, i.e.: "(c) contain Fee Mortgagee's irrevocable consent and subordination to any recorded document or agreement affecting the Premises that this Lease requires Landlord to deliver to Tenant or at Tenant's request." Automatic subordination would concern a Fee Mortgagee, hence Landlord. So this model language does not provide for it.

- 7 If Tenant has a First Right that a foreclosure might impair, Tenant may want to limit the amount of Fee Mortgages, e.g.: "No Fee Mortgage shall secure principal indebtedness, including permitted future advances, that exceeds Maximum Permitted Principal." The Lease would define Maximum Permitted Principal separately. Would it include prepayment premiums? Unlimited default interest? One solution is to limit the collateral for the mortgage to the asset—not a perfect solution, but a regulated lender can't overburden an asset with debt except in default.
- 8 The Lease will define Seniority based on a current title report from a licensed title insurance company.
- 9 The parties may prefer to include this language in the Lease Section on Real Estate Taxes or insurance. Tenant will worry that Leasehold Mortgagee will want to control this escrow. That's manageable, as long as Leasehold Mortgagees to use it only for its intended purpose and not to repay any indebtedness.
- 10 This language might better belong in the Lease section on additional deliveries.
- 11 Often any agreement requires the parties to enter into a future Confidentiality Agreement as a condition to delivery of confidential information. That approach just asks for trouble. If there will be a Confidentiality Agreement, then attach it as an exhibit. Landlord will want the confidentiality agreement to be benign and simple, so as to not create issues with (prospective) Fee Mortgagees. Among other things, the Confidentiality Agreement should allow disclosure to regulatory authorities. Leave out the words "indemnify," "damages," and "injunction." For confidentiality obligations between Landlord and Tenant, it makes more sense to include a short paragraph on confidentiality in the Lease, to avoid any need for a separate confidentiality agreement. The Model Lease does that.
- 12 The exclusion for Guarantors may not make sense if either: (a) Tenant has not yet completed for Initial Development; or (b) the Lease contemplates continuation of a meaningful Guaranty for the Term.
- 13 For residential buildings, Tenant may resist providing copies of all Subleases and may offer instead to provide a sample Sublease and a rent roll.
- 14 This paragraph belongs in the Lease section on First Rights.
- 15 This paragraph is nonstandard but legitimate. The first sentence seeks to protect Fee Mortgagee if a Landlord bankruptcy occurs. The second seeks to protect Tenant.
- 16 This was a requirement of a recent absolute net lease with a public REIT. Landlord would not want Tenant to hold or control a Fee Mortgage, as this would give a strong Tenant creative new ways to squeeze Landlord. As a practical matter, however, Tenant can directly or indirectly acquire control of any Fee Mortgage in a way that Landlord may never see or be able to prove. Landlord may want to say that a violation of this covenant results in termination of the Fee Mortgage in question or some other draconian remedy, but that concept probably represents overthinking by Landlord.
- 17 This paragraph makes a great deal of sense, and hardly seems unreasonable. It does not, however, commonly appear in Leases.
- 18 Fee Mortgagee would also like the right to abandon the Fee Estate, but that is not an established legal concept. Instead, Fee Mortgagee might assign to a single purpose entity with no other assets; have that entity assume the Lease; and allow that entity to go out of business. Other mechanisms may also present themselves. In addition to this paragraph negating Fee Mortgagee's personal liability under the Lease, the Lease should contain a general provision stating that no principal, member, partner, shareholder, or other owner of Landlord will ever have any liability under the Lease. That issue goes beyond Fee Mortgagees and Successor Landlords.
- 19 As noted above, Tenant may ask that Fee Mortgagee be "reasonable" about Lease amendments, a proposition Landlord should reject. Tenant might propose that any Modification made without Fee Mortgagee's consent should still bind Landlord and Tenant, but go away upon a Foreclosure Transfer. Though perhaps logical that proposition may cause philosophical nuances and fear for a Fee Mortgagee.
- 20 The italicized language encapsulates the standard protections a Fee Mortgagee would obtain in an SNDA with a space tenant. Fee Mortgagee may not need these protections for most ground leases, and will typically live without them (except protection against unconsented Modifications), because Landlord has few or no obligations.
- 21 This is not a standard concept. It is unclear how abandonment might work.
- 22 Tenant or Fee Mortgagee may want such an agreement. Leasehold Mortgagee might want a reciprocal agreement of broader scope. Any such agreement would start out looking like an SNDA for a space lease, except the subordination would be reversed, nondisturbance would become irrelevant, and attornment probably could occur by operation of law without such an agreement. If anyone wants such an agreement, attach an agreed form as an exhibit. It should include Leasehold Mortgagee Protections (e.g., any amendment, cancellation, or waiver requires Leasehold Mortgagee consent). Because it goes beyond protection of Fee Mortgagees, the Lease might better address it more generically in a section on future deliveries and further assurances.