

# Is a Ground Lease the Right Move for Your New York or New Jersey Business?

by Victor Kinon on February 17, 2012

For both tenants and landlords, commercial ground leases are often a viable alternative to purchasing or selling real property. A ground lease is typically a long-term lease of unimproved land (or previously developed property) that requires the tenant to construct improvements.

While commercial ground leases may offer unique benefits for both parties, they are not without their risks and potential pitfalls. For New York and New Jersey businesses contemplating a ground lease, this post takes a look at several important advantages and disadvantages for both prospective tenants and landlords.

## *Ground Lease Advantages for Tenants*

- Up-front costs are dramatically lower when compared to purchasing land.
- Rent payments are deductible as an ordinary business expense on state and federal tax returns.
- A lease agreement can sometimes be negotiated in cases where the property owner is unwilling to sell.

## *Ground Lease Advantages for Landlords*

- The landlord maintains ownership of the property.
- A ground lease allows the landlord to retain some control over how the property is used and developed. This is particularly important if the landlord also owns adjoining property.
- In some cases, leasing has tax advantages over selling a property.
- Leasing can avoid the costs and legal requirements of subdividing the property.

## *Ground Lease Disadvantages for Tenants*

- The long term costs of a long-term lease are often higher than purchasing property.
- Restrictions in the lease may limit the tenant's options for the development and use of the property.
- Tenants often cannot tap into equity through refinancing due to lease provisions regarding financing.
- Should the tenant default, it risks losing both its leasehold estate and the improvements it has made (as opposed to the protections afforded under a mortgage).

### *Ground Lease Disadvantages for Landlords*

- Unless protections are put in place, the landlord could lose the property through foreclosure if the tenant defaults under its loan.
- An existing ground lease will reduce the universe of potential purchasers if the landlord elects to sell the property.
- The landlord could lose control over the use and development of the property if limitations are not included in the lease documents.
- Rent payments are calculated as income and, therefore, may have negative tax implications in some cases.

Several added items to consider with regard to a ground lease are as follows:

- Be sure that one understands all applicable laws and ordinances that may treat a long-term ground lease as a sale.
- Title Insurance is often necessary in a ground lease development project and may only be obtainable if the lease is recorded.
- In order to secure financing for any improvements on the property either (i) a detailed leasehold financing clause or (ii) a clause by which the landlord subordinates its fee interest is necessary.
- Environmental considerations are not to be overlooked.
- Options to purchase the property and/or rights of first refusal upon a proposed sale by the landlord are important.

The above items are hardly all of the important issues related to negotiating and/or understanding a ground lease. Because commercial ground leases are complex transactions, we recommend working with an experienced New York or New Jersey commercial real estate attorney to negotiate the terms of the agreement.