

## Unique issues for Ground Leases (and when your landlord is a ground lessee)

### 1. *What is a Ground Lease?*

A ground lease is a lease where the tenant is leasing the ground and, typically, constructing its own building. Given the inherent costs of such a process, the lease is for a relatively long term. A standard ground lease includes provisions whereby the expenses of the property (taxes, repair, insurance, etc.) are for the tenant's account and provisions permitting significant leasehold financing.

### 2. *Why Not Sell?*

From a landlord perspective, there are a few advantages to a ground lease rather than a sale:

- (a) avoidance of realized gains;
- (b) landlord maintains long term ownership for investment purposes without development risks – common concern for institutional / municipal owners;
- (c) if landlord retains adjacent lands, development of leased lands may increase value of remainder; and
- (d) landlord may maintain certain controls over the property – i.e. use and operation.

### 3. *Why Not Buy?*

From a tenant perspective, there are similarly some advantages to a ground lease rather than a purchase:

- (a) access to lands that might not be available for sale;
- (b) reduction in front-end development costs;
- (c) depreciation available for the cost of improvements; and
- (d) availability of deduction of rent as a business expense.

### 4. *Why Not Space Lease?*

(a) From the tenant perspective – the ground lease offers more control over improvements and costs of improvements, the tenant can build the space it wants, the ground lease permits more certainty as to length of term, rent (since no additional rent is typically payable) and transferability.

(b) From the landlord perspective – the ground lease limits the landlord's responsibility and greatly reduces the administrative burden, the site becomes a much more passive investment than a space leased site, the landlord avoids investing capital to improve the space for lease, and the ground lease typically provides more certainty in terms of timing and rent.

### 5. *Two Ontario Specific Issues to Consider:*

(a) Planning Act implications – subject to certain exceptions, lease term (including renewals/extensions) cannot exceed 21 years less a day if the landlord owns abutting lands;

(b) Land Transfer Tax implications – for leases over 50 years less a day, the tenant has to pay land transfer taxes as though it is purchasing the property.

### 6. *Financing: Subordinated vs. Unsubordinated Ground Leases*

(a) In a subordinated ground lease, the fee owner agrees to subordinate its claim on the ownership of the land to the interests of the tenant's lender.

(b) In an unsubordinated ground lease, the fee owner maintains priority over any tenant lender.

### 7. *Leasing Space from a Ground Lessor: Items to Note*

(a) Term – pursuant to basic common law principles, the sublandlord cannot sublease to the subtenant an interest equal to or greater than its own interest. The term of the sublease should always be at least a day less than the term of the underlying ground lease.

(b) Damage and Destruction – given the limited term of the underlying ground lease, the sublandlord may not have an interest in rebuilding the buildings it has constructed on the ground leased property during the last years of the underlying ground lease. The subtenant should consider the implications of such considerations during its review of the sublease.

(c) Rent – on occasion, rent will be bifurcated with the subtenant paying a percentage of the underlying ground lease rent to the fee owner and the remainder of its rent to the sublandlord.

(d) Permitted Uses – subtenant must confirm restrictions on use in the underlying ground lease, as the sublandlord cannot agree to more than it is permitted.

(e) Risks – termination of the underlying ground lease, particularly where the subtenant has invested in the improvement of the sub-premises:

(i) in cases of surrender: some protection afforded by Section 17 of the *Commercial Tenancies Act*:

“17. Where the reversion expectant on a lease of land merges or is surrendered, the estate which for the time being confers as against the tenant under the lease the next vested right to the land shall, to the extent of and for preserving such incidents to and obligations on the reversion as but for the surrender or merger thereof would have subsisted, be deemed the reversion expectant on the lease. R.S.O. 1990, c. L.7, s. 17.”

BUT, no protection where the fee owner exercises right of re-entry and termination or a contractual option to terminate;

(ii) in cases of forfeiture: some protection afforded by Section 21 of the *Commercial Tenancies Act*:

“Where a lessor is proceeding by action or otherwise to enforce a right of re-entry or forfeiture under any covenant, proviso or stipulation in a lease, the court, on motion by any person claiming as under-lessee any estate or interest in the property comprised in the lease or any part thereof, in the lessor’s action, if any, or in any action or application in the Superior Court of Justice brought by such person for that purpose, may make an order vesting for the whole term of the lease or any less term the property comprised in the lease, or any part thereof, in any person entitled as under-lessee to any estate or interest in such property upon such conditions as to execution of any deed or other document, payment of rents, costs, expenses, damages, compensation, giving security or otherwise as the court in the circumstances of each case thinks fit; but in no case is any such under-lessee entitled to require a lease to be granted to him, her or it for any longer term than the under-lessee had under the original sub-lease. R.S.O. 1990, c. L.7, s. 21; 2006, c. 19, Sched. C, s. 1 (1).”

BUT, the court in granting such an order can change the rent, the amount of space, etc.

(iii) in cases of bankruptcy of the sublandlord: some protection afforded by Section 39(2) of the *Commercial Tenancies Act*:

Where the assignor, or person or firm against whom a receiving order has been made in bankruptcy, or a winding up order has been made, being a lessee, has, before the making of the assignment or such order demised any premises by way of under-lease, approved or consented to in writing by the landlord, and the assignee, liquidator or trustee surrenders, disclaims or elects to assign the lease, the under-lessee, if the under-lessee so elects in writing within three months of such assignment or order, stands in the same position with the landlord as though the under-lessee were a direct lessee from the landlord but subject, except as to rental payable, to the same liabilities and obligations as the assignor, bankrupt or insolvent company was subject to under the lease at the date of the assignment or order, but the under-lessee shall in such event be required to covenant to pay to the landlord a rental not less than that payable by the under-lessee to the debtor, and if such last mentioned rental was greater than that payable by the debtor to the said landlord, the under-lessee shall be required to covenant to pay to the landlord the like greater rental. R.S.O. 1990, c. L.7, s. 39 (2).”

BUT, rent and leased premises may increase

(iv) contractual protections can be included – ideally, in the underlying ground lease at the time of the initial lease or negotiated with the fee owner, the sublandlord and the subtenant.

8. Emphyteutic Lease: Just Another Ground Lease?