



# Leasehold Transactions

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# Lori Bullard, WTP, NTP, Underwriter, First American Title



- Over 25 years experience in the Title Insurance Industry.
- Washington Title Professional (WTP) as well as a National Title Professional (NTP).
- Board Member for the WLTA and committee member for the ALTA, serving on the Government Affairs Committee and the Education Committee.

# Lets get started!

## Leasehold Transactions

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# What are we insuring?

- Fee or Lease
  - When dealing with property that is or will be subject to a leasehold interest, it is important to understand if you are being asked to insure the leasehold interest, or you are being asked to insure a fee estate subject to that leasehold interest.



# Insuring a Leasehold Interest

- A leasehold interest is a real property interest.
- When a policy is issued insuring a leasehold interest, it insures that the interest is valid and was properly created.



# What is contained in a Lease?

- Grantor and Grantee (Lessor and Lessee)
- Conveyance language
- Signed and acknowledged
- Legal description
- Stated term
- Recorded



# Common Types of Leases

- Commercial Buildings
- Utilities (wind/solar farms), Billboards, Cell Tower
- Parking Lots
- Mineral Leases
- Residential- Tribal land



# Things to consider

- Proper creation of the lease.
  - Proper parties?
  - Proper authority?
    - LLC, Partnerships, Corporations- who can sign?
  - Are there other parties that need to approve?- Nevada Claim
- Adequate description of leased premises.
  - Is the leased premises less than the fee parcel?
- Is it expired?





# Nevada Claim

- This claim involved pretty much all of the major underwriters
- Many policies had been issued for years insuring Leasehold interest as to a 99 year lease.
- Native owner questioned peoples rights to this property.
  - Their claim was that BIA failed to approve this time period of lease and some reasons he objected to the lessee rights.
- The lease was found invalid by another body of law.



# Access

- If the leased premises is less than the fee parcel, is there a right of access?
- You may not be able to rely on the same access the fee owner relies upon if the leasehold parcel does not extend to the same public roadway utilized by the fee owner – a private easement may be in order.
- In this scenario you may be asked to insure the access easement in addition to the leasehold estate.



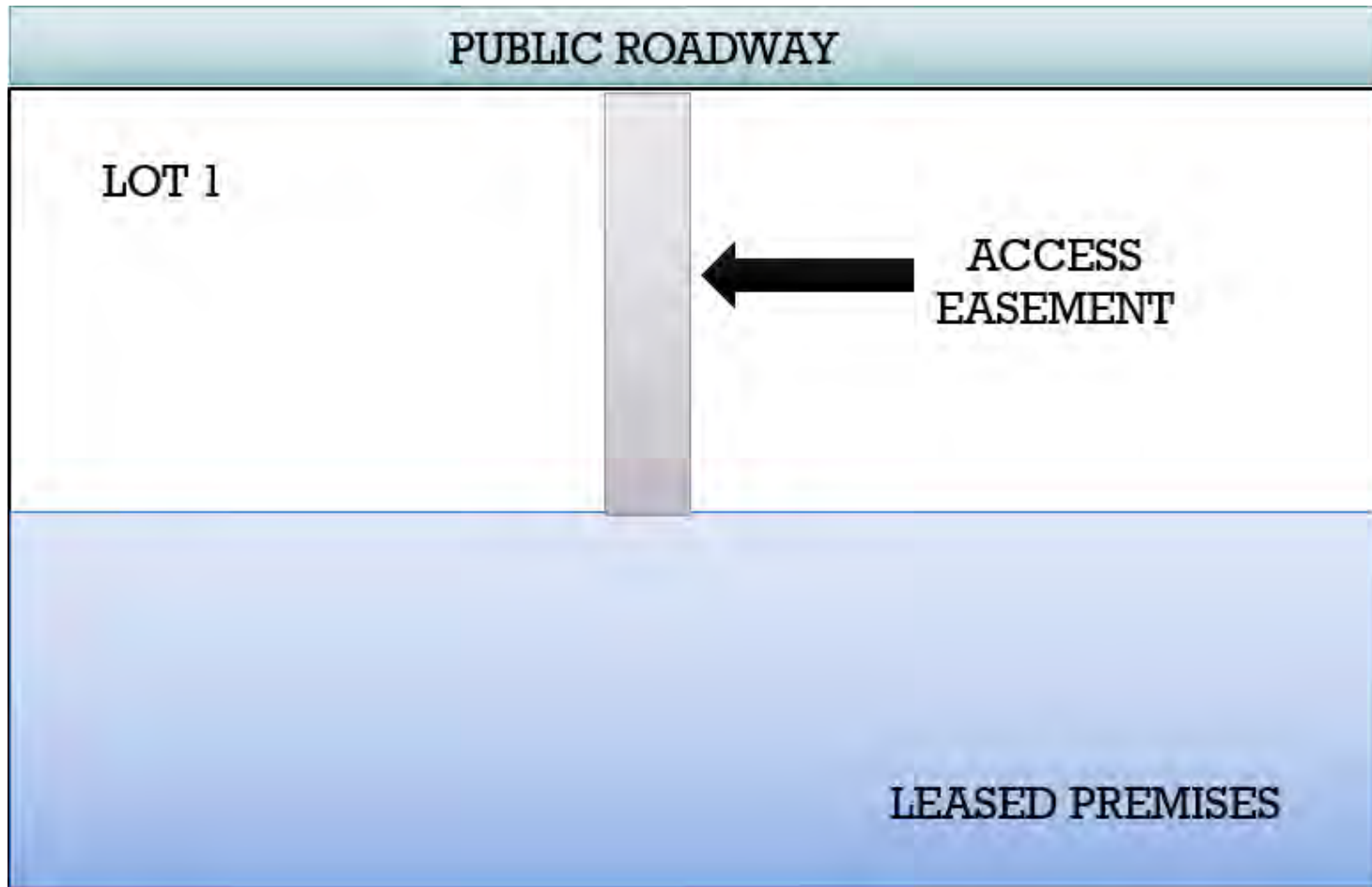
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## Example:

Lessor owns all of Lot 1 in fee.

They have leased the south half of Lot 1.

The legal description should be restricted to the south half of Lot 1, since the Lessee has no real property interest in the north half of Lot 1.



# Examining the Leasehold Interest

- Just like when a fee interest or an easement interest is insured, it is important to perform an examination of the land in which the leasehold interest is held.
- Simply locating a Memorandum of Lease or a recorded lease in the chain of title is not sufficient.



# Schedule A

## Existing Lease

- If the lease already exists Schedule A of the commitment should describe the leasehold interest.
- This includes scenarios where you will be insuring an assignment of an existing lease.

## New Lease

- If the lease is being created as part of the current transaction Schedule A of the commitment should describe the fee estate.
  - Exception: If asked to insure a sub-lease.
- A Proforma policy can be very helpful in this scenario, allowing both the Insurer and the customer see what the policy insuring the leasehold interest will look like.



# Conveyance of Existing Lease Interest

- If the leasehold interest to be insured is pre-existing, there must be a proper conveyance document for that interest.
  - Assignment
  - Deed
- Any Deed of Trust or Mortgage that encumbers the leasehold should be addressed prior to the conveyance.



# Terms and Conditions

- There should be an exception for the terms and conditions of the lease in the policy.
  - Not the Memorandum of Lease.
- The policy insures that the lease is valid and creates a real property interest. It does not insure that the Lessor and Lessee are in compliance with the contractual terms of the lease.
  - A caveat is the expiration of the lease. The lease needs to be in effect when insured.



# Insuring a New Lease

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If the lease is newly created, any lender(s) encumbering the fee interest should consent to the new lease.

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Their interest in the real property pre-dates the lease, so even though they don't encumber the leasehold interest they can potentially foreclose out the leasehold interest.





# Mortgaging & Recording

## Mortgaging

- Does the lease authorize mortgaging of leasehold interest?
- Is landlord consent required?
- Are there other conditions in the lease that need to be met before Lessee is allowed to mortgage?

## Recording

- The lease or a memorandum of the lease should be recorded.
- This provides constructive notice of the leasehold interest.



# Other Exceptions

- Mortgages and liens affecting the leasehold estate.
- Mortgages and liens affecting the fee estate.
  - Include “affects fee interest only”.
- Encumbrances affecting the fee estate (e.g. easements) unless leased area is not affected by them.
- Encumbrances affecting the leasehold estate, if additional to fee encumbrances.
- Right of First Refusal



# Judgements

- **Judgements-** In general, judgments are treated the same as they would be treated in non-leasehold transactions.
- **Judgement against Fee Owner- Insuring Fee**
  - A judgment against a fee owner (lessor) will be shown in all commitments or policies covering the fee, whether entered before or after the commencement of a lease.
- **Judgement against Fee Owner- Insuring Leasehold**
  - A judgment against the fee owner entered after the lease date need not be shown when reporting on just the leasehold if the judgment has not been executed on *unless* the fee owner is subordinating to the interest insured. Judgments entered prior to the lease date should always be shown.



# Judgements

- **Judgement against Lessee- Insuring the Fee**

Judgments against lessee can be ignored when insuring the fee.

- **Judgement against the Lessee- Insuring the Leasehold**

A judgment against a lessee, even if the lessee is also a sublessor, should be shown as affecting the lessee's interest as long as the lessee retains an interest in the property. After an absolute assignment by that lessee removing the lessee from the chain of title, the judgment may be ignored, unless executed on prior to the assignment.



# Mechanics Liens on Tenant Improvements



You may need to show mechanics lien rights of tenant improvements on a Fee interest policy.

- a) Is this an improvement that benefits the property as a whole?
- b) Is the improvement a condition of the lease that could attach to the fee interest?

Review the lease and investigate, if unsure check with your underwriter.

# Bankruptcy

- Bankruptcy of either the lessor or the lessee should be referred to underwriting.
- Courts may try to avoid the lease, but it may only apply to any financial obligations of the party.



# Read the Lease

- Any time a leasehold estate is insured the lease should be read prior to issuing policy.
- This is the case even if there is only a Memorandum of Lease recorded. In this scenario, request a copy of the full lease agreement for review.
- Confirm that the lease has not expired.



# Recharacterization

- A lease that contains terms and conditions that render it a financing vehicle may trigger a need for a recharacterization exception.
- The exception would prevent the Insurer from being responsible for loss or damage should the lease be characterized as a something else (due to the structure of the transaction).





# Mineral leases

- Oil, gas, coal, minerals- are part of the Land as defined in ALTA policies.
- What does a mineral lease insure?
  - The lease is not for the minerals themselves, but for the land. It allows the lessee to extract those minerals.

May be helpful to consult with underwriting if being asked to insure a mineral lease.



# Severed Improvements

- It is not unusual for a commercial lease to provide that the improvements constructed on the property are independently owned by the Lessee.
- Upon severance of the improvements, a new chain of title is created for the improvement
- Upon severance the owner of the improvement holds title to the building in fee.



# Severed Improvements

- In this scenario, the improvements may be separately taxed as real property.
- The legal description may include a leasehold interest in the land on which the improvements sit, and a fee interest in the improvements themselves.



# Sub-Leasehold Estates

- A sub-leasehold estate is created when a Lessee leases a portion of their leased property to a sub-lessee.
- Example: A fee owner grants a “Ground Lease” to a Lessee, and the Ground Lessee then sub-leases the property to an individual or entity that constructs a commercial improvement on the property.
- The title commitment will report on the interest held by the Ground Lessee (the underlying interest).



# Sublease vs. Assignment of Lease

- An Assignee has “privity of contract” with the lessor
  - All rights that a lessee or tenant possesses over a property are transferred to another.
- A Sublessee has no “privity of contract” with lessor
  - The lessee creates a lease to a 3<sup>rd</sup> party for all or part of their estate interest. This may require consent by lessor.



# Policy Amounts

- Filed rate manual may establish rating structure.
- Owner's Policy insuring leasehold interest
  - The customer determines this amount. Typically the value of the lease (reasonable deviations okay).
- Leasehold Loan Policy
  - Amount of loan (if single site) or amount of loan allocated to site (if multiple sites).



# ALTA 13 Series Endorsements

- The ALTA Leasehold Policies have been decertified by the ALTA.
- Instead, we now issue ALTA Owner's Policies and ALTA Loan Policies with the ALTA 13-06 and ALTA 13.1-06 Endorsements.
- The ALTA 13-06 is intended to be issued with the owner's policy, Coverage under ALTA 13-06 leasehold endorsement gives coverage for cost of removing equipment if title claim causes eviction, so some tenants request additional amount of coverage depending on nature of equipment.



# ALTA 36 & 37 Series Endorsements

- **ALTA 36** (Energy Projects)
- These endorsements are similar to the ALTA 13-06 Series of endorsements, which are applicable when insuring leasehold estates, but they are designed to address certain aspects of loss calculation unique to energy projects. Specifically, the endorsements establish valuation methods for the “Integrated Project” and “Severable Improvements” (both as defined in the endorsements) and set forth additional items of loss covered by the endorsements.
- **ALTA 37**
- This endorsement provides coverage for loss or damage due to defects in the execution of a specified assignment of leases and rents (the “ALR”). It also provides coverage for loss or damage due to any other recorded assignment of rents or other recorded assignment of the lessor’s interest in a lease affecting the Title (“Other Assignments”), which Other Assignments are not part of instruments that are Schedule B Exceptions.





# Insuring Fee Estate Subject to Lease

- Raise exception for lease(s).
- No need to raise leasehold mortgage as exceptions if the lease is excepted.
- SNDA (Subordination, Non-Disturbance and Attornment Agreement) needed in order to show lease(s) on Schedule B, Part II of the loan policy.
  - Self-subordinating language: Needs to be unconditional, or Schedule B II exception will be conditioned upon those terms.



# SNDA (Subordination, Non-Disturbance and Attornment Agreement)

An **SNDA** serves **3 primary purposes**:

**(1) subordination** of the tenant's lease to the lien created by the lender's mortgage or deed of trust (such that the lender can terminate the tenant's lease upon a foreclosure)

**(2) non-disturbance** of the tenant's rights under its lease in the event that the landlord is foreclosed on. (such that the lender agrees not to terminate the tenant's lease upon a foreclosure as long as the tenant is not in default under its lease).

**(3) attornment** by the tenant of the landlord, stating that the tenant will recognize and accept the lender as the landlord if the lender forecloses on the property. (Put simply, if the landlord defaults on its loan, the lender will step into the landlord's role under the lease, the tenant will not interfere with the lender exercising its remedies against the landlord, and the lender will not interfere with the tenant's right to occupy the property).



## Estoppel

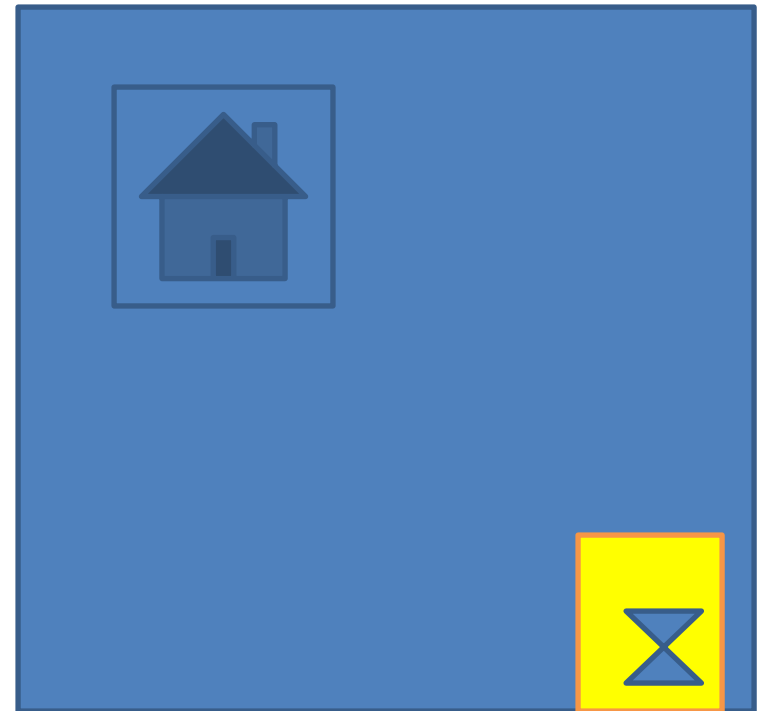
An estoppel certificate or letter is a **binding document** delivered by the signing party (such as a tenant) to the reliance parties named therein (such as a buyer and a buyer's lender), which summarizes certain terms of an underlying agreement (such as a lease), thereby preventing the signing party from disputing such terms at a later date (i.e., the signing party is bound by the statements made in the estoppel certificate and estopped from disputing the facts as presented therein).

- **Purpose of Estoppel:**
- **(1) to *confirm*** matters that the reliance parties can determine by reading the underlying agreement
- **(2) to *disclose*** to the parties any matters which they could not determine simply by reading the underlying agreement.



# Sale of Fee - legal description ?

- Fee property owner contracts to sell lot, except portion that is currently leased for cell tower.
- New buyer willing to be without that portion of land.
  - What is the issue?
- Considerations need to be made
  - Has the property been legally subdivided to allow the sale of the new lot? You may be creating an illegal lot.



# Clearing Title Issues on Leased Property

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# Early Termination of Lease

- **Ways to terminate a lease**
  - Expiration (caution of renewals or terms to extend)
  - Lessor and Lessee mutually agree to terminate the lease
  - Lessee is in default
  - Court order
  - Merger of interest Lessor & Lessee



# Merger

- Lessee assigns leasehold interest to Fee Owner? Why?
  - May be an attempt to terminate the lease
- Fee Owner conveys fee to Lessee? Why?
  - Maybe fulfilling an option to purchase

Never assume merger when fee and lease interest are held by same party. Do not ignore the lease! Ask Questions, know what is happening in the transaction.

# First Right of Refusal

- There can be a First Right of Refusal or Option to Purchase contained in the lease.
  - If so, a separate exception should be taken on the commitment.
  - If the Lease goes away, do not ignore the this First Right or Option to purchase.





# Old Leases on Record (Underwriter considerations for removal)

- Lease Term
- Option to extend
- Tenant status (internet search)
- Possession
- Affidavit from property owner that lease has been terminated
- ALTA 34-06 Endorsement
  - Provides coverage against enforcement, including defense costs, as well as marketability coverage.



# Q & A

# Questions





# Thank you!

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