

Complex Closing Stories Part II

Leasehold Interests &
Improvements, Options &
Rights of Refusal

Leasehold Interests Insuring

- ALTA 13-06 (Owners) & ALTA 13.1-06 (Loan) Endorsements
- Replaced former ALTA Leasehold Owners and Loan Policies
- Old Policies designed a tenant leasing space in an office building
- Old Policy - Losses = FMV of remaining lease term less the remaining rent to be paid (No tenant Improvements)
- New Endorsements - Designed for leases involving significant tenant improvements

Leasehold Interests Insuring –Special Coverages

- Special Coverages under ALTA 13-06 and 13.1-06
 - Tenant Leasehold Improvements – defined and included in valuation
 - Valuation - Remaining lease term plus tenant improvements

Continued

Slide 3

MSoftware2 INSERT ALTA 13-06, 13.1-06
, 2/2/2009

Leasehold Interests Insuring – Special Coverages

- Additional Items of Loss:
 - Removing and Relocating personal property
 - Rent paid to someone other than lessor
 - Rent paid to lessor after eviction
 - FMV of lease/sublease made by tenant as lessor
 - Costs to secure replacement leasehold
 - Costs for improvements not substantially complete, less salvage value

Continued

Slide 4

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Leasehold Interests

Insuring – Special Coverages

- “Evicted” and “Eviction” are defined to include:
 - Lawful deprivation of the tenant’s right of possession contrary to the terms of the lease, or
 - Lawful prevention of the tenant’s use of the land or improvements for the purposes set forth in the lease.
- Full possession of property covered:
 - Policy recognizes damages
 - Example - loss of parking spaces or specifically insured access. Note - loss of business income is not covered

Leasehold Interests

Insuring – Amount of Coverage

- Amount should match potential “covered losses” as discussed above
- Valuation of leasehold estate very difficult
- Improvements valuation easier
- Include “Additional Loss” matters

Leasehold Interests

Methods of Leasehold Valuation

- No one required method
- Most focus on term of lease and annual gross rentals:
 - 25 years or less – 10 times annual gross rentals
 - 25 to 49 years – 20 times annual gross rentals
 - 50 + years – full value of land plus improvements

Simultaneous Leasehold & Fee Interests

- Both ABC, LLC (Fee) and XYZ, LLC (Leasehold) need title insurance
- How much should each purchase?
- Consider – Who will sell the land and improvement?
 - XYZ exercises option, then sells
 - Lease collapsed, then ABC sells
- Assume land is worth \$2 million and improvement worth \$8 million
- If ABC obtains fee policy for \$2 million, are they covered if lease collapsed, they sell, and buyer makes claim on warranties?

Continued

Simultaneous Leasehold & Fee Interests

- One solution – One policy insuring both ABC and XYZ
 - Amount is 10 million
 - Both named as Insureds
 - Parties would have to agree on division of claims funds
 - Policy would not indicate any value allocation between fee and leasehold interests.

Options to Purchase Insuring

- Option is an insurable interest in real property
- Policy insures:
 - Option is valid and enforceable
 - Rights of the holder are vested
- The coverage is subject to the *terms of the option agreement* and the holder's compliance with those terms
- Option or Memorandum must be recorded
 - Per (NCGS §47-18)

Options to Purchase The Memorandum

- NCGS § 47-119 requires the following
 - Names of the Parties
 - Description of the property
 - Expiration date of option
 - Reference sufficient to identify complete agreement

Options In Gross

- Holder of option does not have leasehold or other interest (NCGS § 41-28(1))
- Invalid if not exercised within 30 years (NCGS § 41-29)
- Title insurance policy would include exception

Rights of First Refusal (ROFR)

- Similar to options, but holder cannot compel the sale of the property
- Must wait until owner decides to sell
- Can be insured under similar circumstances as option to purchase (all liens must be cleared)
- ROFR in gross is also subject to 30 year limitation (NCGS § 41-29)

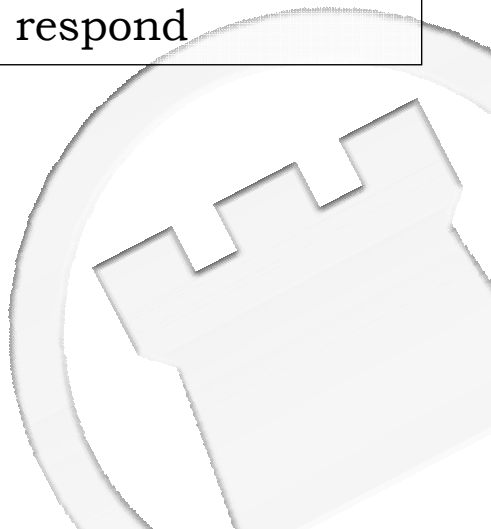
Options and ROFR's in Foreclosure

- Affect of Foreclosure on **Option**
 - If Option is senior to foreclosed lien– Option should continue
 - If Option is subordinate – Option extinguished by foreclosure

- Affect of Foreclosure on **Right of First Refusal (ROFR)**
 - If senior to the foreclosed lien – the ROFR should continue
 - If subordinate – Does foreclosure trigger the ROFR
 - Exact language may control
 - “Offer to purchase ... willing to accept”
 - Foreclosure not an offer

Options and ROFR's in Foreclosure Issues

- Is notice of foreclosure required?
- Does service of Notice of Sale satisfy the ROFR
 - Time limits to respond



Installment Land Contracts Insuring

- Can be Insured
- Treated similar to Options to Purchase for insuring
- Must be recorded
- Intervening matters must be satisfied

Installment Land Contracts

Equity of Redemption

- Monthly payments made until purchase price satisfied
- Standard clause – Upon default, amounts paid are treated as rent and not subject to equity of redemption
- Lambreth v. McDaniel - Clause did NOT extinguish equity of redemption – treated the contract like a mortgage
- Seller required to convey property upon payment of purchase price, interest and ad valorem taxes

Installment Land Contracts

Termination of Record

- Buyer defaults and relinquishes property...
 - At what point our buyer's rights extinguished?
 - Must owner foreclose? File self-serving Notice of Default?
- Brannock v. Fletcher – Buyer must tender unpaid balance within reasonable time.
- Cannot tell if expired by terms – many extensions
- Title insurers may rely upon off-record information:
 - Property vacant for extended period
 - Demand letters

Fee Title vs. Leasehold Competing Interests

Non-Disturbance and Attornment Agreement (“NDA”)

- If fee lender forecloses and/or takes possession of fee:
 - Lender agrees not to disturb tenant’s possession
 - Tenant agrees to recognize lender as landlord

Subordination Non- Disturbance and Attornment Agreement (“SNDA”)

- Tenant may subordinate to later lien by lender
- Lender may subordinate to leasehold interest
- Contains same provisions as NDA

Lender's Requirements Leasehold Agreements

- Leasehold interests used as security for loans
- Limited by the terms and conditions of the lease
- Lender will require matters be included in lease
 - Permission (allows mortgage)
 - Ability to cure
 - Term (exceeds loan term)

Recording Matters Leasehold Agreements

- Recording Matters – Memorandum
 - Memorandum of lease - avoids recording lease (NCGS § 47-120)
 - Memo must contain:
 - Names of Parties
 - Description of property
 - Term of lease, including extensions, renewals, and options to purchase, if any
 - Reference sufficient to identify complete agreement

Mechanics' Liens & Leasehold Agreements

- Claims of lien only extend to the interest of the obligor
- Leasehold owner contracts - contractor's lien rights only extend the leasehold interest
- Do not extend to the fee interest.
 - Caveat? Tenant as agent for landlord/fee owner??

