REAL ESTATE

The Story Of A Property Owner Who Successfully Terminated A Ground Lease

Joshua Stein Contributor

I write about commercial real estate negotiations, deals and legal issues.

Sep 26, 2022, 10:00am EDT

When a property owner and a developer (or investor) enter into a long-term ground lease, the tenant and its lenders will insist that the property owner cannot easily terminate the ground lease for default. The tenant will have extensive rights to "cure" its defaults. If the tenant doesn't cure, then the tenant's lender has additional cure rights. One way or another, the tenant and its lender should be able to preserve the lease. As a result, property owners can almost never terminate ground leases, as much as they might like to do so.

One recent New York case marked a dramatic variation from this principle. It started when the tenant stopped paying rent. The property owner gave the tenant and its lender various notices of that default, but still no one paid the rent.

As the next step, the property owner decided not to proceed under the lease termination procedure built into the lease, which would have required notice to the lender. Instead, the property owner started an action for nonpayment of rent under a New York statute that allows such proceedings. The property owner didn't notify the tenant's lender of this proceeding, because neither the lease nor the law required such a notice. When the tenant still didn't pay the rent, the property owner eventually terminated the lease as the final event in the nonpayment proceeding.

The lease said that upon any termination of the lease, the property owner had to offer the tenant's lender a new lease to replace the terminated lease. Apparently the lender didn't take the property owner up on that offer, so the lease terminated through the nonpayment proceeding and the lender couldn't claim a replacement lease.

As a Hail Mary measure to rescue its collateral, the lender tried to rely on a bizarre New York law that allows a tenant and its lender to bring a terminated lease back to life by paying everything that was due under the lease. The tenant has a year to accomplish the "redemption" of its lease. If the tenant doesn't redeem its lease within that time, then the tenant's lender has the right to do it – but in most cases only on the day after the tenant's redemption deadline expires, and only until 2:00 PM on that day.

This New York law also says the tenant can waive its redemption rights. Virtually every New York lease includes such a waiver, but the lender in this particular litigation tried to argue that the tenant's waiver didn't apply to the lender. The court disagreed. At one point the lender announced it had changed its mind and didn't want to exercise any redemption right, but that didn't stop the court from ruling against the lender on the issue. That was the end of the lender's collateral.

Any lender against a ground lease can learn some important lessons from this case.

First, any lease should require the property owner to notify any lender of any nonpayment or other proceeding that seeks to terminate the lease. It isn't enough to require the property owner to give the lender notice of the property owner's exercise of a contractual right to terminate the lease.

Second, if the lease gives the lender rights to cure the tenant's defaults, the lender should exercise those rights and not let the property owner start down any road toward lease enforcement.

Third, complex and carefully drafted provisions in a lease (or any other document) sometimes don't cover every case they ought to cover. Here, the property owner was able to find a way around the contractual termination process built into the lease and achieve a termination in a way that didn't involve the lender.

If the lender had acted more aggressively and paid more attention, perhaps it could have preserved its collateral.

The referenced case is *Wells Fargo Bank, N.A. v. Joseph E. Marx Co. Inc.*, New York State Supreme Court 159999/2019.

Joshua Stein

Follow

I help buyers, sellers, borrowers, lenders, tenants, property owners, and other commercial real estate market participants identify and achieve their business goals. To do that, I need to understand risk, security, numbers, value, financeability, flexibility, and exit strategy. Some legal issues matter a lot and many don't. It's important to know the difference. I write extensively on commercial real estate law and practice – over 300 articles and five books on leasing, lending, and other areas, with some emphasis on ground leases. I occasionally serve as an arbitrator or expert witness in complex real estate disputes. That lets me see how transactions go wrong. Often, the problems could have been avoided by keeping it simple and following the money, but everyone got sidetracked. As a Forbes contributor, I try to tell stories that teach worthwhile lessons for real estate deals. **Read Less**