

Oregon Land Title Association Educational Seminar
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Leasehold Transactions

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Lessor, Lessee;
what's the
difference?

- Definitions
- **Leasehold**: a conditional estate for a specified time in which the tenant has possession of the land to the exclusion of the landlord.
 - It is a possessory interest, unlike an easement.
 - It is time-limited and conditional, unlike fee simple.
- **Lessor**, aka landlord
- **Lessee**, aka tenant
 - What's an easy mnemonic to distinguish "lessor" from "lessee"?

Insuring the Lease or Insuring Subject to a Lease?

- Are you being asked to insure the leasehold interest (in Schedule A), or to insure the fee estate subject to a leasehold interest (in Schedule B)?
- Distinguish:
 - Tenancies subject to the Oregon Residential Landlord Tenant Act
 - All others (generally commercial leases)



Insuring a Leasehold Interest

- **Two aspects of a lease:**
 - A real property interest (the “leasehold estate”).
 - A contract: requiring payment of rent, etc.
- **When a policy is issued insuring a leasehold interest, it insures that the real estate interest is valid, was properly created, and has not expired.**
- **We do not insure the tenant’s ongoing compliance with the terms of the lease.**

Parties to the Lease



- Proper creation of the lease.
 - Proper parties?
 - Proper authority?
- The leasehold estate is a separate chain of title.
 - Each interest may be assigned or pledged without the consent of the other party (unless required in the lease).
- Assignments are frequently **off-record**
 - Our requirements if assignments are off-record?

Description of Premises

- Requirement: adequate description of leased premises.
- Is the leased premises less than the fee parcel?
 - Ground lease of entire fee premises vs.
 - Space Leases:
 - Shopping center pad, office suite, building floor, sketch of warehouse area
- Starter policy usually based on entire fee parcel.
- Underwriting challenges (do other instruments on fee affect leasehold?)
 - Exclusive uses granted to other tenants (Sidebar next page)
 - Related issue: permitted uses
- Note, the legal description of the leased premises should *not* include the term “leasehold”.
 - The premises description is the land leased; not the estate in land.

Is a burger a sandwich?

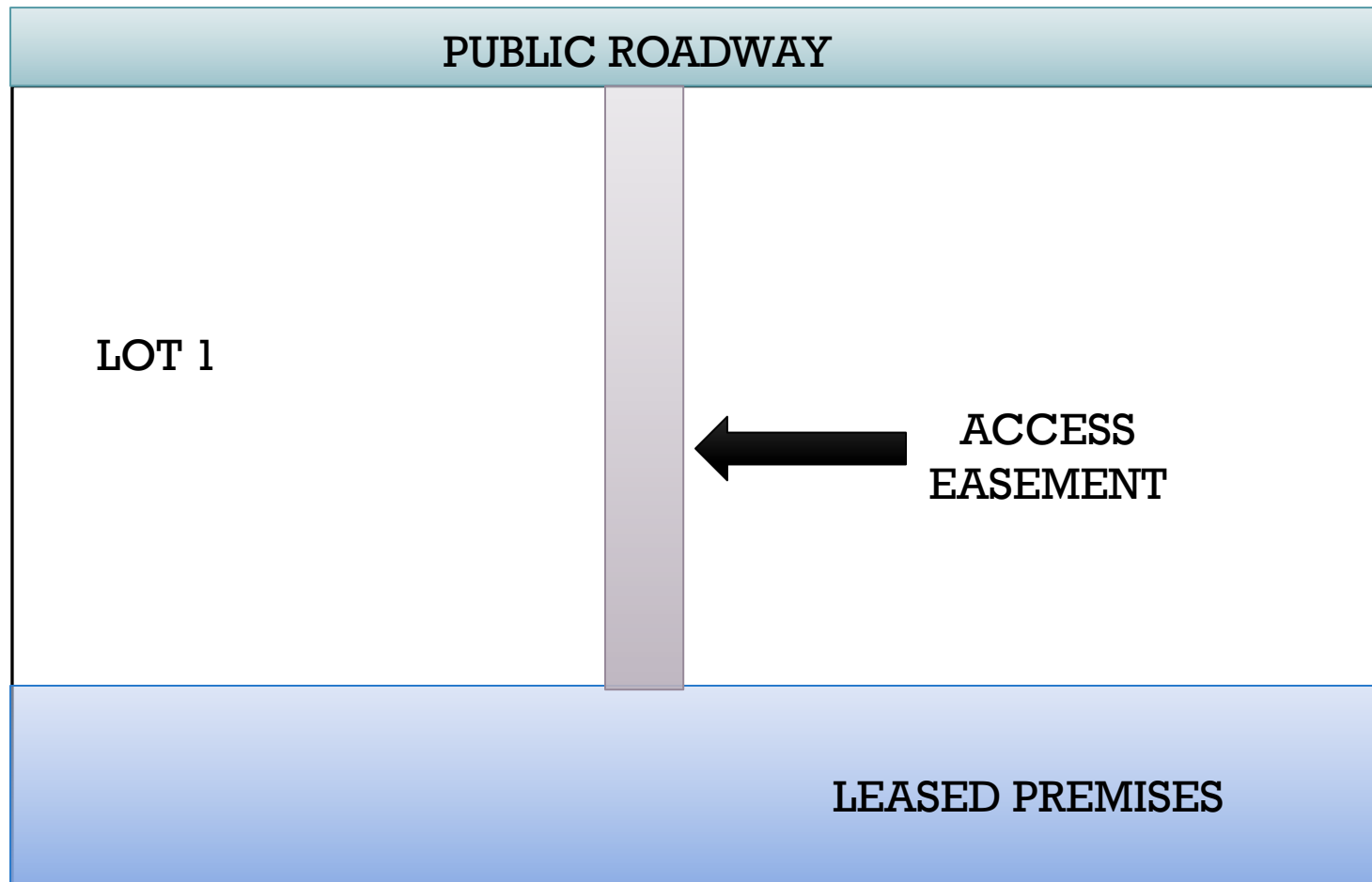


- Exclusive use sidebar.
- A landlord leases a “pad” in a shopping center to tenant Burger Baron, a fast-food chain.
 - Is a “pad” an insurable legal description of the leased premises?
- Our title report covers the entire shopping center, and includes exceptions for recorded leases to other tenants, including to Sandwich Shop.
 - The proposed insured Burger Baron Buyer objects to the exception to the lease for the Sandwich Shop.
 - The Sandwich Shop is not part of tenant’s “pad” (leased premises).
 - However, upon our review: the lease to Sandwich Shop grants an **exclusive use of Landlord’s premises** to sell sandwiches to Sandwich Shop.
- May we remove the exception for the lease to Sandwich Shop?

Access

- If the leased premises is less than the fee parcel, is there a right of access?
- A private easement (over Landlord's property) may be in order if the leased premises does not abut a physically open public ROW
 - Depicted next slide
- In this scenario, you may be asked to insure the access easement in addition to the leasehold estate.
 - OTIRO 217.1
- Frequently a problem in energy leases.





Lot 1 is also owned by Landlord of Leased Premises.

If *Landlord's* access is also by private easement, does Lessee's use of the easement constitute overburdening?

Recording & Mortgaging

Recording

- The lease or a memorandum of the lease should be recorded.
- This provides constructive notice of the leasehold interest.
- A lease that is for over a period of one (1) year is a conveyance, and is an interest in real property, and must be in writing. ORS 93.020.

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?

Examining the Leasehold Interest



- **As when a fee interest or an easement interest is insured, it is important to perform a title 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 prelim should describe a leasehold interest.
- This includes scenarios where you will be insuring an assignment of an existing lease.

Schedule A: New Lease

- If the lease is being created as part of the current transaction, Schedule A of the prelim should describe the fee estate.
 - Exception: If asked to insure a sub-lease.
 - Why?
- A pro forma policy can be extremely helpful in this scenario because both the Insurer and the customer can see (prior to closing) what the policy insuring the leasehold interest will look like.



Requirements to insure new leases, cont'd.

- **Commencement of new leases.**
- **To be insured, a lease must have a definite date of commencement.**
- **Leases commencing in the future?**
 - **A new lease may not commence until the happening of some future event (i.e. tenant's completion of improvements).**
 - **In which case the LL and T should sign a memo of commencement. We can insure at that time.**



Conveyance of Existing Leases

- If the leasehold interest to be insured is pre-existing, there must be a proper conveyance document for that interest in the record.
 - An assignment or even a deed is acceptable.
 - Don't forget to confirm proper authority for conveyance.
- Any Deed of Trust or Mortgage that encumbers the leasehold should be addressed prior to the conveyance.
 - Subject to or assumed.
- What is the effect of an assignment by Landlord without a transfer of the underlying lease?

Terms & Conditions

- The policy insures that the lease is valid and creates a real property interest. It should not insure that the Lessor or Lessee are in compliance with the contractual terms of the lease.
 - Exception: possible expiration of the lease. The lease needs to be in effect when insured.
- We formerly included an exception for the terms and conditions of the lease in the policy.
- No longer necessary under 2021 policies: (next slide)

2021 Policy
forms
exclusion
for terms
and
conditions
of lease

Policy Number:

SCHEDULE B

EXCEPTIONS FROM COVERAGE

Some historical land records contain Discriminatory Covenants that are illegal and unenforceable by law. This policy treats any Discriminatory Covenant in a document referenced in Schedule B as if each Discriminatory Covenant is redacted, repudiated, removed, and not republished or recirculated. Only the remaining provisions of the document are excepted from coverage.

This policy does not insure against loss or damage and the Company will not pay costs, attorneys' fees, or expenses resulting from the terms and conditions of any lease or easement identified in Schedule A, and the following matters:

New Leases



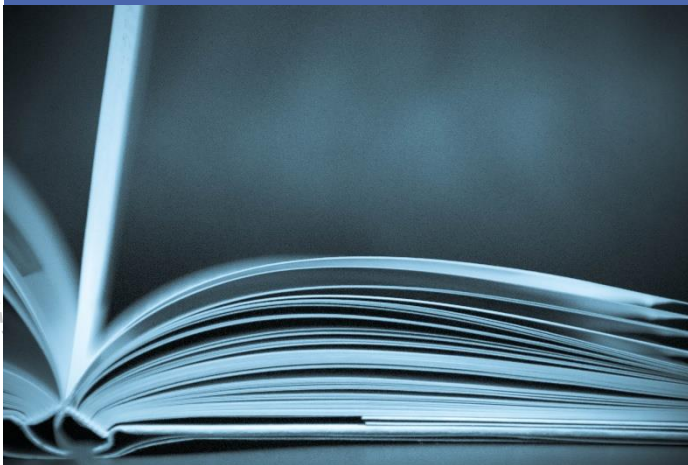
- If the lease is newly created, any lender(s) encumbering the fee interest should consent to the new lease.
- The lender's interest in the real property pre-dates the lease, so it could foreclose out the leasehold.

Other Exceptions

- Add mortgages and liens affecting the leasehold estate.
- Mortgages and liens affecting the fee estate.
 - May be able include a note “affects fee interest only”.
- Encumbrances affecting the fee estate (e.g. easements, other leases)
 - Easements: the leased area may not be affected by them, so they could be removed.
 - Leases: because they may contain conflicting exclusive use clauses, review carefully.

Read the Lease

- The lease should be reviewed prior to issuing a leasehold policy.
- Even if there is only a Memorandum of Lease recorded.
 - Request a copy of the full lease agreement and amendments for review.
- When reading the lease, confirm:
 - That the lease has commenced, has not expired, and is not of indefinite duration (why not indefinite?)
 - That the lease contains grant language such as “lease” “demise” “let” or “rent”.
 - Insufficient: “permit” or “license”



Read the
Lease,
cont'd.

- **Confirm the Lessor:**
 - Owns insurable fee title
 - Is named in the Lease
 - Is a legal entity
 - Executes lease properly
 - Acknowledged signature
- **Lessee:**
 - Same requirements except:
 - Doesn't hold fee title.
 - Doesn't need signature acknowledged.
- **Contains sufficient description of leased premises.**
 - If insufficient description of premises (pad or space lease):
 - Include exception and obtain underwriting approval.

Read the Sublease

- **If insuring a sublease:**
 - The process above must be completed for the underlying lease as well (say, ground lease).
- **Additional sublease requirement:**
 - The duration of the sublease must not exceed the duration of the underlying (ground) lease.
 - Why not?
- **Feels like a deep dive:**



Review for options to purchase

- Any option of the tenant to purchase the lessor's fee, although contained in the lease, is a *separate interest* from the leasehold.
- Create a separate Schedule B exception for an option to purchase or a right of first refusal found in the lease, whether the report describes the fee or leasehold estate.
- Options to purchase are not normally insurable.
 - Exceptions occasionally made.
- Any subordination of the lease should explicitly include the option / ROFO rights as well.

Consider a Recharacterization Exception



- A lease that contains terms and conditions that render it a financing vehicle may trigger a need for a recharacterization exception.
- **Sale/Leaseback:**
 - Fee owner A sells the property to B.
 - A remains in possession and pays rent to B.
 - A may also take out a leasehold mortgage.
- The recharacterization exception would prevent the Insurer from being responsible for loss or damage should the lease be characterized as a mortgage upon a BK filing (due to the structure of the transaction).

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.
- The improvements may be separately taxed as real property.

Severed Improvements

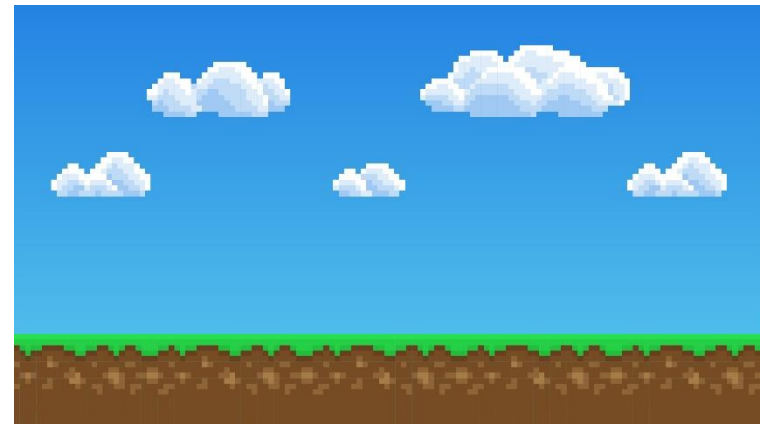
- **Think in layers of ownership**
 - → Fee title to severed improvement (held by same entity as lessee)
 - → Leasehold to ground lease
 - → Fee title to underlying estate

**Severed
Improvement**



Severed
Improvement

**Ground lease
Underlying Fee**



Severed Improvements



- The legal description may include a leasehold interest in the land on which the improvements sit, and a fee interest in the improvements themselves.
 - **Ground lease** – Lot 1 excepting therefrom the building and improvements located thereon;
 - **Severed Improvements** – The building and improvements located on Lot 1.
- Requirement: constructive severance, either through memo of lease or deed.
- Why? We only insure interests in the public record and
- ORS 86.040 presumption that when land and improvements are owned by the mortgagor, the improvements are subject to the lien of the mortgage
- If improvements are severed, it is always important to address access rights.
- Common problems – no constructive severance; incomplete chain of title

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 prelim will report on the interest held by the Ground Lessee.



Policy Amounts

- Filed rate manual may establish rating structure.
 - In Oregon, same rates Owner's or Loan Policy. Rating Manual 3.001 and 4.001.
- Owner's Policy insuring leasehold interest
 - Typically the value of the lease
 - The ALTA 13-06/OTIRO 213-06 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.
- Leasehold Loan Policy
 - Amount of loan (if single site) or amount of loan allocated to site (if multiple sites).
 - ALTA 13.1-06/OTIRO 213.1-06.

ALTA 13 Series

- 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, the ALTA 13.1-06 is intended to be issued with the loan policy.

OTIRO 213/ ALTA 13 Series

These endorsements modify the policy jacket by:

- Including the definition of a leasehold;
- Modifying the calculation of damages;
- Defining the value of the estate.
- They also add additional items taken into consideration in determining loss, such as costs related to obtaining a new lease, relocation expenses and the cost of tenant improvements.
- In Oregon, no charge for either endorsement.

Estoppel

- It is extremely important when insuring a leasehold interest to request a Landlord Estoppel from the Lessor.
- The Estoppel should confirm that the lease is in full force and effect.
- Any additional documents that are referenced in the Estoppel should be reviewed prior to insuring (especially if those documents do not appear in the public record).

Estoppel

- **Form should indicate –**
 - 1. the [sub]lease is the only [sub]lease or agreement between the parties;
 - 2. all amendments or modifications are identified;
 - 3. rents are paid current;
 - 4. options to renew or extend the [sub]lease, if any, are confirmed; and
 - 5. the [sub]lease is otherwise current and not in default.
- **No Estoppel – Add Exception**
 - Any defect in or invalidity of, or other matter relating to the lease referred to in Paragraph[s] ___ of Schedule ___ herein that could be ascertained by making inquiry of the [sub]lessor[s] of the [sub]lease[s] thereof.

Insuring Fee Estate Subject to Lease and SNDAs

- Raise exception for lease(s).
- No need to raise leasehold mortgage as exception if the lease is excepted.
 - However, I like adding sub-note –The present ownership of said [sub]leasehold and other matters affecting the interest of the [sub]lessee are not shown herein.
- 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.
 - Example of supposedly self-subordinating language, next page.

to Tenant (the “Existing Lender SNDA”). This Lease and Tenant’s interest and rights hereunder are and shall be subject and subordinate at all times to the lien of any first mortgage created on or against the Premises, and all amendments, restatements, renewals, modifications, consolidations, refinancing, assignments and extensions thereof, provided that Landlord and the holder of such mortgage have executed, acknowledged and delivered to Tenant a commercially reasonable Subordination, Attornment and Non-Disturbance Agreement (“SNDA”) that provides that: (a) this Lease shall not be terminated, nor shall Tenant’s possession of the Premises and other rights hereunder be disturbed, including, without limitation, Tenant’s rights of self-help and offset and in any proceeding to foreclose the mortgage or in any other action instituted in connection with such mortgage, (b) Tenant shall not be named as a defendant in any foreclosure action or proceeding which may be instituted by the holder of such mortgage, (c) in the event of casualty or condemnation, the holder of the mortgage agrees to make available the insurance and condemnation proceeds for the repair and restoration of the Premises by Landlord in accordance with Sections 15 and 16 of this Lease, (d) Tenant shall have the right at any time to prepay any portion or all of any allowances provided herein, and (e) if the holder of the mortgage or any other person acquires title to the Premises through foreclosure or otherwise, the Lease shall continue in full force and effect as a direct lease between Tenant and the new owner, and the new owner shall assume and perform all of the terms, covenants and conditions of the Lease (including, without limitation, any commercially reasonable lien waivers previously signed by Landlord). Tenant agrees upon demand delivered to Tenant pursuant to Section 36(c) below to execute, acknowledge and deliver any such SNDA in a form otherwise acceptable to Tenant, provided that no such instrument shall alter Tenant’s rights and obligations under this Lease. Notwithstanding the foregoing, any such holder may at any time subordinate its mortgage to this Lease, without

Two sentences in this paragraph.

Is it really self-subordinating to the lien of an incoming refinance mortgage?

Old Leases on Record

Underwriting considerations for removal:

- Lease Term
- Option to extend
- Tenant status (internet search)
- Possession
- Affidavit from property owner that lease has been terminated
- Landlord executed termination of lease to remove interest from record
- ALTA 34-06 Endorsement
 - Provides coverage against enforcement, including defense costs, as well as marketability coverage if:
 - Contractual condition to deliver marketable title and
 - No title company will provide coverage



Merger

- Non-merger of the fee and leasehold should always be presumed.
- If there is a merger of the fee and lease interests prior to the end of the lease term, all matters encumbering either interest continue to affect the property.
 - E.g. leasehold mortgages would continue to show.

Merger

- Sample Non-merger clause from a ground lease:

6.4.2 Nonmerger. This Lease will not terminate as to a Permitted Leasehold Mortgagee because of any conveyance of Tenant's leasehold interest to Landlord, or of the Landlord's Fee Estate, or Landlord's interest under this Lease to the Tenant. Accordingly, even if this Lease and the Fee Estate in the Premises are commonly held, they will still remain separate and distinct estates. They will not merge without consent by all Permitted Leasehold Mortgagees, which consent will not be unreasonably withheld. Nothing contained in this Section may be deemed as impairing or otherwise limiting Landlord's rights to terminate this Lease as expressly provided herein or to extend the Term beyond the Termination Date.

The background features several concentric, curved lines in shades of gray, some solid and some dashed, creating a sense of motion and depth. A large, dark blue rectangular area is positioned on the left side of the slide, containing white text.

Disclaimer and Acknowledgment

Nothing in this presentation shall constitute legal advice or a binding offer to insure under certain conditions.

Thanks to ALTA and Megan Powell for an earlier version of this presentation.



Questions?