Recitals

All references in the recitals to the Lessor’s charitable purpose should be consistent with Lessor’s corporate purposes as stated in its Articles of Incorporation and represented to the IRS. The Model recitals assume that the terms on which the land is Leased (providing for protection of the environment, etc.) are in fact consistent with the charitable purposes of the Lessor. It should not be assumed, however, that the transaction itself, which provides certain benefits to a farm business, will be recognized by the IRS as a charitable activity. For this reason, the Model Lease states explicitly (in section 5.3) that the farmer will pay a “market rate” (not subsidized) Lease fee.

The recitals should accurately describe the purposes of the transaction—including the Lessor’s purpose of preserving affordable access to farmland and improvements through the “resale restrictions.” The recitals should then highlight the Lessee’s understanding and acceptance of all such purposes.

Article 1: Letters of Stipulation and Acknowledgement

The Letter of Stipulation and the Letter of Acknowledgment are designed to provide further evidence that the Lessee understands the transaction and enters into it willingly. The sample Letter of Stipulation attached to the Model Lease should be adapted by Lessees to describe their personal situation and motivation. The sample Letter of Acknowledgment can also be modified to suit the particular circumstances of the transaction.

Some people involved in drafting a ground lease may feel that a Letter of Stipulation is not necessary—especially if the lessees have been involved in negotiating the terms of the lease, as may be the case with original lessees (the first farmers to enter into the lease agreement). However, while it may be true that a Letter of Stipulation is a redundant addition to the lease for people already as familiar with the lease as the original lessees may be, the Letter is an important means of checking and confirming the understanding of the lease by future lessees who have not been a party to the process of drafting the document. It would therefore be a mistake to eliminate this feature from the ground lease simply because it is not necessary in the case of the original lessees.

Article 2: Demise of Leased Premises

2.1 Premises: The legal description of the Leased Premises should include any easements or other rights that are appurtenant to the Leased Premises, including rights to use utilities serving the Improvements and rights of access for the purpose of maintaining and repairing these utilities.

If the rights conveyed are limited in any way by a conservation easement, covenant, mortgage, or other restrictive agreement, the document whereby rights are withheld from the Lessor (and therefore must be withheld from the Lessee) should be referenced here and attached to the Lease as an exhibit—as in the Model. Be sure to remove this reference if no such rights are held by another party.

2.3 Reservation of Mineral Rights: This section can be modified as you see fit. The provisions regarding the “disruption to the Lessee” can be specified in greater detail as deemed appropriate. Or you may choose to include language prohibiting any extraction of minerals by Lessor without written permission from Lessee. In cases where a conservation easement prohibits the removal of minerals entirely or in part, this fact should be acknowledged in defining the nature of the mineral rights that Lessor retains.
Lessee’s right to remove minerals for use on the premises may be expanded to include not only water but sand, gravel and similar material for construction and maintenance of permitted farm roads, etc.

Article 3: Duration of Lease

3.1 Principal Term: The 99-year term established here is typically the longest term allowable without raising a question of whether the interest being transferred could be deemed a fee-simple interest. However, you should confirm that a 99-year Lease with an option to renew for an additional 99-year period does not in fact raise such a question in the state whose laws apply to the transaction. In some states a shorter term may be advisable.

3.2 Lessee’s Option to Extend: The option to extend is intended to give the lessees tenure that is as close to perpetual as possible. Ninety-nine years is a long time, but, as some ground lessees have experienced, it is a period of time that does eventually end. The requirement that Lessor notify Lessee of the impending expiration is intended to ensure that the Lessee (who, after 99 years, will be an heir or other assignee of the original Lessee) is aware of the option to extend and understands what must be done in order to exercise it.

3.3 Change of Lessor; Lessee’s Right to Purchase: Note that the Lessee’s right of first refusal to purchase the Land is here triggered only in the event of a proposed sale to an individual or private entity that does not share the charitable goals of the original Lessor. The Lessor’s fee interest in the property can be transferred from one charitable non-profit or governmental stewardship institution to another without triggering the right.

Note that Exhibit D: FIRST REFUSAL serves to specify the details of the right of first refusal both for the Lessee in the situation described in this section and for the Lessor in the situation described in section 14.5.

Article 4: Use of Leased Premises

4.1 Permitted Use: The Model Lease permits (except as otherwise restricted) use for “residential, agricultural, or educational” purposes. The definition of agricultural use may be replaced by a statutory definition for the state in question. If residential use is not intended, you will want to eliminate that category of permitted use. Other purposes (e.g., “educational” or “scientific”) may be cited as well. The reference to the conservation easement should be eliminated if there is no such easement, or should be modified if there is an otherwise named document that affects permitted uses and development.

4.2 Requirements and Restrictions: Note that the Exhibit E: REQUIREMENTS AND RESTRICTIONS that is attached to this Model Lease is a sample, not a model in all respects. See the “Menu” presented in Appendix 5 to help you identify and define those possible requirements and restrictions that are appropriate for your Lease. Such exhibits will vary greatly, but all should lay out some process for the modification or updating of the Requirements and Restrictions from time to time without amending the body of the Lease itself.

With some Leases, the Requirements and Restrictions Exhibit may include or be replaced by a “Land Use Plan” (or “Farm Plan” or otherwise named plan) that applies different requirements and restrictions to different portions of the Premises.

4.3 Agricultural Income Requirement: This requirement is defined in the Requirements and Restrictions Exhibit rather than in the Lease itself so that it can be more easily adjusted as economic
conditions change, but it is specifically referenced here in the Lease itself because of its importance and unusual nature.

4.4 Occupancy: The first paragraph of this section is based on the assumption that there is a permanent single-family home on the Premises and that its intended use is to provide practical, affordable housing for the family that is farming the Leased Premises. The entire section must of course be eliminated if there is no housing and residential use is not permitted. The section may need to be modified depending on the number and nature of existing residential buildings and the type of residential facilities that may be developed in accordance with Article 7. If there is more than one permanent single-family home on the Premises, this section may require that Lessee occupy one of them, and that the other be occupied by other persons who are employed in farming the Premises. Or you may permit other combinations of occupancy of such multiple residences—e.g., occupancy of one residence by a retired farmer—or you may allow the Lessee to rent out one residence without restrictions to generate income.

You may wish to modify the number of months that Lessees are required to occupy the Premises each year (stated in the Model as 10 months).

You may also want to add, as a separate section of this article, an explicit provision for a “leave of absence” for the Lessees, when they will be freed from both the occupancy requirement stated in this section and the agricultural income requirements stated in section 4.3. (As noted in Chapter 4, the Caretaker Farm lease contains a provision for such a leave of absence.)

The second paragraph of this section may need to be eliminated or modified depending on whether the development of new residential structures is permitted (see section 7.4 Development of New Permanent Structures).

4.5 Written Consent for Other Uses: The requirement that Lessor must respond to a request within 30 days is intended to encourage a timely response; however, it does not create the kind of pressure on Lessor that would be created if failure to respond in 30 days were treated as automatic approval (which is possible). Alternative approaches include provision for a “Failure to Respond Notice” from Lessee to Lessor after 30 days, with Lessor then given an additional period of time in which to respond and with failure to respond within this additional period then deemed to be automatic approval.

Again note that the reference to the Conservation Easement must be removed if there is no such easement, or modified if there is a similar document identified by another name.

4.8 Inspection: You may have reason to modify the limitations on the Lessor’s right of inspection.

Article 5: Ground Lease Fee

5.1 Ground Lease Fee: There are two possible ways of structuring the ground Lease fee. One is to define the fee as the sum of several components, including the Lessor’s direct costs—typically taxes on the land (but not taxes on the Lessee-owned improvements) and sometimes the cost of insurance—as well as a “land use charge” and perhaps an “administrative charge.” The other approach—the one taken in the Model—is to assign the responsibility for annual costs such as taxes and insurance directly to the Lessee (see sections 6.1 and 9.4) and to establish the Lease fee as a single charge based on the net fair rental value of the land (excluding taxes, etc.) as restricted by the terms of the Lease (see section 5.3). An obvious advantage of the latter approach is that the Lessor is relieved of the administrative burden of annually adjusting the Lease fee to account for varying tax bills and then notifying the Lessee of the new amount.

5.2 Payment of Ground Lease Fee: The second paragraph explicitly provides for collection of any unpaid ground Lease fees by Lessor out of the Lessee’s proceeds when the Improvements are sold. It should be noted that the Lessor must provide...
formal notice of default to the Lessee in such circumstances to ensure the enforceability of this provision.

5.3 Calculation of Ground Lease Fee: It is important to note that an organization that is tax-exempt under section 501(c)(3) of the Code is generally required to charge market-rate (i.e., not subsidized) rents to Lessees that are not charitable entities and do not use the property primarily for purposes recognized by the IRS as charitable. This section therefore identifies the several special factors taken into consideration in establishing the fair rental value of the premises under the terms of this relatively unconventional long-term Lease. The fair rental value of land that can be used only for agricultural purposes may be substantially lower than the fair rental value of the same land if it can be used for other purposes. Fair rental value of such land must be established by comparison with rents actually paid by farmers for agricultural land in the local real estate market. Ironically, the markets where land prices are the highest (as a result of non-agricultural use) are sometimes markets where it is possible to rent farmland for low rates (see the example of Roxbury Farm, described in Chapter 3). In these markets, the owners of “estates,” wanting to see their fields kept open, often rent them to farmers for little or no money (though generally not on a long-term basis).

5.4 Periodic Adjustment of Ground Lease Fee: Although the Model does not do so, you may want to limit the percentage by which the Ground Lease Fee can be increased to the percentage by which a consumer price index has increased since the existing rate was established.

5.5 Adjustments to Reflect Removal of Restrictions: This section is particularly important if it is possible that significant Lease restrictions (particularly regarding use, occupancy, and resale of improvements) may be removed as a result of foreclosure of a leasehold mortgage (see section 8.3). When significant restrictions are removed, the fair rental value can increase substantially, and it is reasonable that the Lessor (whose ability to accomplish its essential purposes with regard to the land has been weakened) should then be able to charge the increased fair rental amount. This section of the Model Lease specifically addresses the possible removal of any provisions of Articles 4, 10 and 11, but you should consider whether there may be provisions elsewhere in the Lease that should also be included.

5.6 Late Payment: The effect of this section is that, if payment of the Lease fee is more than 30 days late, interest can be charged from the date the payment was due. Any potential interest is waived for payments that are less than 30 days late.

Article 6: Taxes and Assessments

The Model Lease assigns responsibility for taxes on both the Leased Premises and the Improvements directly to the Lessee (but retains the right to pay delinquent taxes on the Lessee’s behalf and to be reimbursed by Lessee for such payment). The alternative, as noted in connection with section 5.1 above, is for the Lessor to retain responsibility for the taxes on the Leased Premises (but not the Improvements) and to pass this cost onto the Lessee as part of the Ground Lease Fee.

Article 7: Improvements

7.2 Purchase of Improvements by Lessee: In most jurisdictions, permanent structures on leased land are considered real (rather than personal) property and are normally conveyed by a deed, as provided in this section of the Model. However, some improvements—particularly those that are more readily transportable—may be considered personal property that must be conveyed with a bill of sale. In a few jurisdictions, you may find that even permanent structures on leased land are considered to be personal property, the transfer of which can be documented by a bill of sale but not a deed.

This section 7.2 and Exhibit F: DEED would not be applicable if the Lessee is the prior owner of the land
and improvements, and has retained continuous ownership of the Original Improvements while selling and leasing back the Land. The initial ground Lease and its exhibits should be adjusted in this case to indicate the basis of Lessee’s claim to the Original Improvements and the nature of those Improvements. (When the initial Lessee eventually transfers the Original Improvements to a succeeding Lessee, the ground Lease for that succeeding Lessee should be readjusted to include the provisions of this section 7.2.)

This section 7.2 must also be eliminated or adjusted if there are no Improvements when the Lease commences (but should be re-introduced for a succeeding Lessee who purchases any Improvements developed by a previous Lessee).

Note that it is important that the nature and quantity of the Original Improvements be clearly identified—if not in a schedule attached to the deed then in a separate exhibit to the Lease. Items identified as Original Improvements being purchased by the Lessee may include not only buildings but such items as septic systems, wells, irrigation systems, orchards, vineyards, and perhaps other perennial plantings.

7.3 – 7.4 – 7.5 Alteration or Development of Improvements: Lessee’s right to alter existing improvements (7.3) is here treated separately from Lessee’s right to develop new permanent structures (7.4). Section 7.5 deals with the question of when Lessor’s approval—and, in some cases, approval by the holder of a conservation easement—is required for either alteration or new construction. The Model Lease requires Lessor’s approval for the development of all new permanent structures, and for alterations that either expand or alter the exteriors of existing structures or will house or facilitate uses not explicitly permitted by the Lease.

An alternative approach to the question of Lessor’s approval is to require approval of all alteration and construction except for a specified list of work for which approval is not required (e.g., construction and repair of fences, routine repairs to existing structures, etc.).

Yet another approach is to establish (within an attached land use plan or other exhibit) limitations on the exact location and/or size of new permanent structures, but not to require specific Lessor approval of new construction that complies with these limitations.

In some circumstances you may have reason to establish separate guidelines for development of residential and agricultural improvements. You may want to limit residential development specifically to what is required to meet the housing needs of the farmer-Lessee’s family—or perhaps to the needs of the Lessee’s family and others who are employed on the Premises—whereas you may want more flexible guidelines for development of agricultural improvements, the nature and extent of which may change over time.

7.7 Prohibition of Liens: This section is designed to prevent Lessor’s long-term ownership and control of the Land from being compromised by either a lien attaching to Lessor’s title to the Land or a lien on the Improvements and Leased Premises that is allowed to remain in place. Because tradesmen who are owed money for work they have done on the Improvements have a right to file liens on the Lessee’s interest in the Improvements and Leased Premises, this section obligates the Lessee to take one or another action to remove such liens within 60 days of their filing.

7.9 Disposition of Improvements Upon Expiration of Lease Term: This section includes two distinct provisions: (1) it provides for the ownership of permanent Improvements to pass from Lessee to Lessor upon the expiration or termination of the Lease; and (2) in the case of expiration, it requires Lessor to purchase these Improvements from Lessee for the applicable Purchase Option Price. It is important to note that, as presented here, this section does not obligate Lessor to pay for Improvements surrendered to it if the Lease is terminated for any reason before the expiration of its full term. You may wish to modify the language so that Lessor is obligated...
to pay for the Improvements in the event of “sooner termination” as well as in the event of expiration.

If the Lease were silent on the question of the disposition of the Improvements, the Lessee might, in certain jurisdictions, be able to “sever” permanent Improvements from the Leased Premises and move them elsewhere. As it stands, the final paragraph permits the removal only of improvements that are not permanently installed on the Premises.

Article 8: Financing

8.1 Permitted Mortgages: All mortgages on the Improvements and the Lessee’s leasehold interest in the Premises must be approved by the Lessor. The Lessor may choose not to approve certain mortgages if it finds that they threaten the long-term interests of either Lessee or Lessor. However, the Lease requires the Lessor to approve those mortgages that qualify as “Standard Permitted Mortgages” as defined in Exhibit G: PERMITTED MORTGAGES. The rationale for this approach is that the Lessee should not be denied access to mortgage financing as long as Lessor’s control of the Land is not threatened by possible foreclosure and as long as Lessor has certain opportunities to deal with the consequences of a mortgage default by the Lessee. However, some Lessors may want to retain the right to approve or reject all mortgages on a case-by-case basis—in which case the clause relating to Standard Permitted Mortgages would be omitted.

Note that the Lease itself does not automatically implement the terms and conditions of a Standard Permitted Mortgages as defined in Exhibit G. These terms and conditions must be explicitly established in the mortgage document or (as is much more likely) in a separate agreement that is signed by the mortgagee as well as by the Lessee (and by the Lessor if the agreement also includes commitments by the Lessor that are not included in the Lease itself). In the case of community land trust residential leaseholds (with which there is much more experience than there is with agricultural leaseholds), it is common for the CLT to negotiate an agreement with a potential mortgagee specifying mortgage terms and conditions that differ from those of the Standard Permitted Mortgage but that, in the view of the CLT, provide adequate protection for the CLT’s interests.

8.2 Rights of Permitted Mortgagee: These rights, defined in Section B of Exhibit G, represent protections that most mortgagees would quite reasonably insist upon and that do not entail major concessions by Lessor or Lessee.

8.3 Removal of Certain Provisions Pursuant to Foreclosure: This section provides that the Article 10 resale restrictions shall be deleted, upon Mortgagee’s request, in the event of a foreclosure sale by a Permitted Mortgagee, or the delivery of a deed in lieu of foreclosure to a Permitted Mortgagee. Virtually all conventional lenders will require such deletion and many will also require the deletion of occupancy requirements and certain use restrictions contained in the Lease. Removal of these additional restrictions should be negotiated on a lender-by-lender basis. Any such negotiated modifications should be included in a rider to the Ground Lease, which should explicitly state that such modifications apply only to the specified mortgage and are not to become permanent provisions of the Lease.

8.4 Amendments Subject to Approval by Permitted Mortgagee: This is another provision that most mortgage lenders will insist on. Since the Leasehold interest is a component of the mortgagee’s collateral, the mortgagee has an obvious interest in making sure that the value of that collateral is not diminished by amendments to the Lease.

8.5 Lessor’s Right to Proceeds in Excess of Purchase Option Price: This section prevents the Lessee from unfairly benefiting in “surplus moneys proceedings” where the Purchase Option Price is less than the proceeds from the sale of the Improvements and leasehold interest following the removal of Lease restrictions in connection with a foreclosure.
Article 9: Liability, Insurance, Damage and Destruction, Eminent Domain

9.1 – 9.2 – 9.3: These sections are concerned with assigning responsibility and liability as completely as possible to the Lessee, and with protecting the Lessor against, or reimbursing the Lessor for, costs that should be borne by the Lessee as the responsible party.

9.4 Insurance: Some may say that the decision to insure or not insure the Improvements against loss or damage should be left to the owner, the Lessee. The assumption here, however, is that the Improvements are a necessary part of the farmstead that is to be preserved for future as well as present farmers. The Lessee is therefore required to insure them. You may wish to modify the requirement if at least some of the Improvements are not considered a necessary part of the farmstead.

Even if the above insurance requirement is modified or eliminated, however, the requirement, stated in the second paragraph, that the Lessee maintain liability insurance covering the Leased Premises and Improvements provides essential protection for the Lessor as well as Lessee and should not be eliminated. You will need to determine the initial dollar amounts of coverage to be required. It is possible to specify that periodic adjustments of the required amounts are to be based on changes in a consumer price index. The Model Lease does not take this approach—instead defining the basis for adjustments in more general terms on the assumption that a variety of possible changes other than changes in average consumer prices are more likely to affect the extent of the Lessee’s liability. It should be noted, however, that the approach taken in the Model will require Lessor and Lessee to agree on the appropriate amount of any adjustment.

9.5 Restoration Following Damage or Destruction: This section is based on the assumption, noted above, that the Improvements are generally necessary to the future usefulness of the farmstead and should be restored if at all possible. The Lessor does not want the Lessee to be able to take the insurance proceeds in cash, terminate the Lease, and leave behind a no-longer-functional farmstead. However, the section does permit the Lessee to terminate the Lease if the insurance proceeds are found to be less than 80% of the cost of restoration and if the Lessor is unable to negotiate an adjustment that will yield proceeds of more than 80% of the cost of restoration. In the event that the Lease is thus terminated, the amount of insurance proceeds paid to the Lessee (and Lessee’s mortgagee) cannot exceed the Purchase Option Price as determined according to the provisions of Article 10. Any excess is to be paid to the Lessor.

9.6 Alternative Response to Damage or Destruction: This section—which you may or may not choose to include in your Lease—gives the Lessee a degree of freedom in deciding how the insurance proceeds can best be used to improve the utility of the farmstead. The assumption here is that the damaged Improvements may be functionally obsolete and/or may contribute less to the current farming operation than would other Improvements in which the insurance proceeds might be invested. (For instance, the restoration of an old dairy barn would not make sense if the farm is no longer a dairy farm.)

9.7 Eminent Domain and Public Dedication: The taking of all or part of the Premises by eminent domain is unlikely but possible. It is important that the Lease spell out the rights of the two affected parties in case such an event does occur.

If the Premises are taken in their entirety or if so much is taken that the parties agree that the remainder will no longer serve the Lessee’s purposes, the section provides for termination of the Lease, with any monetary award up to the amount of the Purchase Option Price to be allocated to the Lessee, and the balance, if any, to go to the Lessor.
If the parties agree that the remaining Premises will still serve the purposes of the Lessee, the parties are asked to negotiate a fair allocation of the award between them. This broadly stated provision is based on the assumption that so many possible combinations of circumstances could affect such an allocation that there is no practical way to prescribe a specific method of determining what will be fair in all cases. If the parties cannot agree on this matter, arbitration is called for.

9.8 Reassessment of Rental Value: If you prefer, you can move this section to Article 5, which deals with other adjustments to the Ground Lease Fee.

9.9 Relocation of Lessee: This provision may be omitted by some on the grounds that it is so vague that it provides no real protection for a displaced Lessee, and by others on the grounds that it creates an obligation on the part of the Lessor that is unreasonably vague. As stated here the intent is to establish the general principle that the Lessor should do what can reasonably be done, but the Lessor has great discretion in determining what is reasonable.

Article 10: Transfer, Sale or Disposition of Improvements

Note: If there is a conservation easement on any part of the Premises and if the holder of the easement also holds a purchase option, it should be determined whether that purchase option would be triggered by a transfer of Lessee’s interest in the Leased Premises. If it is determined that this is the case, this article should be modified so that the Lessor’s purchase option—and the process related to its exercise—will be triggered in any situation where the option held by the holder of the easement has been triggered and is then waived or expires. (Or an agreement to subordinate the easement holder’s option to the Lessor’s option should be negotiated with the easement holder.)

10.1 Intent: The statement of intent in this section of the Model Lease should be reviewed and adapted to make sure that it accurately states the intent of your particular lease. The final sentence in this section makes it clear that, “The provisions of this Article 10 do not apply to any property of the Lessee that does not rest upon a permanent foundation or is not otherwise permanently installed on the Premises and that… is not considered part of the Improvements.” Any arrangements for the sale of such moveable property should be made separately from the arrangements described in this article for the sale of the Improvements.

10.2 Transfers to Qualified Persons: It should be emphasized that this Model Lease gives the Lessor very substantial control over the resale of Lessee’s Improvements. The Lessor’s control does not end with its ability to exercise its option to purchase the Improvements for a limited price. Even if the Lessor does not exercise this option and the Lessee then proposes to sell to another buyer, the Lessor still has a right to review and, potentially, to reject the price being charged and/or the proposed buyer. The price in such cases is not permitted to exceed the Purchase Option Price. And the buyers must demonstrate that they are “Qualified Persons.”

In the Model, the means by which the buyer’s qualifications are to be demonstrated is the “Qualification Letter” as described in this section and section 10.8. You may wish to describe the required contents of this letter differently. You may also want to allow qualifications to be demonstrated in other ways. For instance, you might allow prospective transferees who are already actively farming to demonstrate that they are Qualified Persons by submitting tax returns showing that some specified percentage of their total income consists of farm income.

Of course it is also possible to eliminate the requirement that the qualifications of prospective transferees be demonstrated, and thereby allow Lessees to sell the Improvements to whomever they wish if the Lessor does not exercise its Purchase Option. If, in such circumstances, the Lease permits the Lessee to sell the Improvements to any party without Lessor’s prior approval, the Lease should then obligate the Lessor to allow assignment of the
Lease or offer a similar Lease to the purchasing party regardless of whether the Lessor considers that party to be “qualified.” Of course the Lessor retains the right to terminate the new Lease in the event of a default—such as might result from the new Lessee being in fact unable to comply with all the terms of the Lease, including such terms as the “agricultural income requirement.”

Yet another approach is to require that prospective buyers submit letters of stipulation and acknowledgement indicating that they understand the terms of the Lease but not to require that they submit a Qualification Letter or otherwise document their ability to comply with those terms. With this approach the Lessor would be obligated to allow assignment of the Lease or offer a similar Lease to the purchaser if acceptable letters of stipulation and acknowledgement have been submitted.

10.3 Transfer to Lessee’s Heirs: This section gives the Lessor the same degree of control over the transfer to heirs as is given by section 10.2 regarding other transfers. In both cases the prospective transferee must submit a Qualification Letter as well as Letters of Stipulation and Acknowledgement. If you decide not to require prospective purchasers to submit Qualification Letters, you will presumably want to modify this section 10.3 so that heirs are not subject to such a requirement either.

It should be emphasized that what is addressed in this section is not whether heirs can inherit the value of improvements on the Leased premises but whether they will be permitted to retain and use the improvements as ground Lessees. As it stands, the section obligates the Lessor to allow an assumption of the Lease by the heirs only if Letters of Stipulation and Acknowledgement and a Qualification Letter have been submitted and approved.

10.4 Lessee’s Notice of Intent-to-Sell: In providing for the “Intent-to-Sell Notice” it is reasonable to provide—as in the second sentence of this section—for situations where the Lessee does have a prospective buyer in mind. Because the Lessor’s intent is normally not to acquire the Improvements for their own sake but to see that the Improvements and the Leasehold are passed on to another Qualified Person, it is in the Lessor’s interest to know of the existence of a potentially qualified buyer as soon as possible. An alternative approach to situations where the Lessee has identified a prospective buyer is described below following the commentary on section 10.6.

The sequence and content of the sections that follow may vary depending on the type of resale formula that is used and depending on whether “Lessee’s right to designate a prospective buyer” is explicitly recognized as in the “Alternative Approach” described below.

10.5 Appraisal: The appraisal process described in this section is suitable for the simple “as-restricted appraisal-basis resale formula” that is presented in the model but would need to be modified for other types of resale formulas (see Chapter 10: Resale Formula Design). For instance, if a formula is used that distinguishes between the valuation of the Improvements originally purchased by the Lessee and Improvements later developed by the Lessee, the appraiser would need to establish these values separately. You would therefore add to this section a stipulation such as the following,

The Appraisal shall separately state the amounts of value contributed by (a) the Original Improvements as identified in section 7.2 above and (b) any Improvements subsequently developed by Lessee (the Subsequent Improvements).

If the resale formula calls for a “replacement cost” appraisal, this section should be modified to provide specifically for the application of this appraisal method (see Chapter 10: Resale Formula Design).

If a “cost-basis” resale formula is used, you should eliminate the section (presently 10.5) requiring an appraisal at the front end of the resale process. If the Purchase Option Price is defined as the lesser
of the Lessee’s cost or the appraised value of the Improvements, you should modify the present section 10.7 (Purchase Option Price), and should include in that section provision for an appraisal at the Lessor’s discretion, as suggested in the commentary on section 10.7 below.

10.6 Lessor’s Purchase Option: This section establishes the existence of the Purchase Option and the process for exercising it. It is important to define the steps of this process clearly and, for each step, to establish clear time limits that are reasonably workable for all parties. Depending on what is reasonable for your situation, you may want to modify the time limits stated here.

Regarding the last paragraph of the section, it should be noted that if the Lessee has recommended a prospective buyer and the prospective buyer has been approved as a Qualified Person, then the Lessor may either exercise the option and assign it to that buyer or simply notify the Lessees that the option will not be exercised and that he or she is free to sell directly to the approved buyer.

Alternative Approach: Lessee’s Right to Designate a Buyer. As it stands, the Model allows the Lessee only to recommend a prospective buyer in the course of giving notice to Lessor of intent to sell (section 10.4). In section 10.6 Lessor is then required to “make reasonable efforts to arrange for the assignment of the Purchase Option to such person, unless Lessor determines that the recommended buyer is not a Qualified Person or that its charitable mission is better served by transfer of Lessee’s interest to another party. An alternative approach to this matter gives the Lessee a “right to designate a buyer”—before the Lessor can exercise the Purchase Option—provided the price does not exceed the Purchase Option Price and provided that it can be documented that the prospective buyer is a Qualified Person. Possible language for this approach is presented below.

10.6 LESSEE’S RIGHT TO DESIGNATE A BUYER: Lessee may, no later than ten days following the determination of appraised value in accordance with section 10.5 above, notify Lessor in writing that Lessee has identified a prospective buyer. If Lessee has thus identified a prospective buyer, then, within thirty (30) days of receipt of the Appraisal (or, if a second appraisal is commissioned, no later than ten days following receipt of a copy of the second appraisal), Lessee shall furnish to Lessor, or cause to be furnished to Lessor, the following documents: (1) a letter of stipulation from the prospective buyer in form and substance similar to that presented in Exhibit A: LETTERS OF STIPULATION AND ACKNOWLEDGMENT attached hereto; (2) a Qualification Letter (as defined in section 10.2 above) and (3) a statement of the price and other proposed terms of sale.

No sale or other disposition shall be effective unless and until Lessor, within thirty (30) days of receipt of all of the documents listed in the paragraph above, confirms in writing that the prospective buyer is a Qualified Person who understands and accepts the terms of the Lease and that the price and other terms of sale are consistent with the terms of the Lease. Lessor’s confirmation shall not be unreasonably withheld. If Lessor determines that the proposed buyer or proposed sale are not permitted under the terms of the Lease, then Lessor shall respond with written notice to Lessee of this determination. If Lessor fails to respond in writing within thirty (30) days of its receipt of the required documents, such failure shall be deemed to constitute approval of the sale.

Upon receipt of Lessor’s approval as described above, Lessee may proceed to sell the Improvements and assign the Lease to the prospective buyer. Lessee shall complete such sale and assignment within ninety (90) days of receipt of approval of the proposed sale.

10.7 LESSOR’S PURCHASE OPTION AND AGREEMENT TO COOPERATE: Upon receipt of an Intent to Sell Notice from Lessee, Lessor shall have the option to purchase said Improvements (the Purchase Option) at the
Purchase Option Price calculated as set forth below, unless Lessee has identified a prospective buyer and is proceeding to seek approval of such buyer and to sell to such buyer in accordance with the provisions of Section 10.6 above. The Purchase Option is designed to further the purpose of preserving the affordability of the Improvements for succeeding Qualified Persons while taking fair account of the investment of labor and capital by the Lessee. Lessee and Lessor agree to cooperate in furthering such purposes by facilitating the sale of the Improvements to a Qualified Person. Such purposes are understood to be accomplished, without Lessor having otherwise exercised the Purchase Option, if the Improvements are sold, in accordance with Section 10.6 above, to a qualified buyer identified by Lessee. Lessor shall not exercise the purchase option directly during such time as Lessee is proceeding to sell to a prospective buyer in accordance with Section 10.6.

10.8 EXERCISE OF LESSOR’S PURCHASE OPTION: Lessor may exercise the Purchase Option within a forty-five (45) day period beginning ten days after the determination of appraised value in accordance with section 10.5 above, unless Lessee has, by such time, given notice identifying a prospective buyer. If Lessee has identified a prospective buyer but for any reason the sale to such prospective buyer cannot be completed, then Lessor may exercise the Purchase Option within a forty-five (45) day period beginning at such time as it is established that sale to such prospective buyer cannot be completed. In either case, to exercise the Purchase Option, Lessor shall, within the applicable forty-five-day period, notify Lessee in writing of its election to purchase the Improvements (“Notice of Exercise of Purchase Option”).

If Lessor gives Notice of Exercise of Purchase Option to Lessee, Lessor shall then complete the purchase of the Improvements within ninety (90) days of the date on which it gives such notice. If Lessor either fails to give such notice within the time permitted or fails to complete the purchase within the time permitted, Lessee may sell the Improvements as provided in Section 10.9 below.

Purchase of the Improvements pursuant to the Purchase Option may be accomplished by Lessor’s giving Notice of Exercise of Purchase Option and thereupon assigning the Option to a Qualified Person who then completes the purchase of the Improvements within ninety days of the date of the exercise of the purchase option. The time permitted for the completion of the purchase of the Improvements may be extended by mutual agreement of Lessor and Lessee.

[From this point you can proceed with the section describing the Purchase Option Price, which would become 10.9—with subsequent sections also re-numbered.]

Another Alternative Approach: Purchase Option Triggered by Purchase and Sale Agreement with Third-Party. With this quite different approach—a version of which is used in the Model Easement presented in Chapter 8—the Lessee (or Grantor in the case of an easement) does not give notice of intent to sell until after entering into a purchase and sale agreement with a third party. A copy of the agreement must be included with the notice of intent to sell, and the Lessor (or Grantee) then has an option to purchase for the lesser of the agreed-upon price or the Purchase Option Price. If the Lessor does not exercise the Purchase Option, the Lessee is free to sell to the third party on the agreed-upon terms.

10.7 Purchase Option Price: With the resale formula used here, the definition of the Purchase Option Price is simple: the Option Price equals the As-restricted Market Value of the Improvements determined by an appraisal carried out in accor-
dance with section 10.5. Regarding other approaches—and language that may be used to establish them in a lease—see Chapter 10: Designing Resale Formulas, and the appendices referenced in that chapter.

**10.8 If Purchase Option Expires**: This section lays out the process by which, when the option is not exercised, a prospective buyer is to be approved as a Qualified Person. If you have adopted the alternative approach described above giving the Lessee the right to designate a buyer before the Lessor’s Purchase Option is triggered, then the process for approving a Qualified Person will already have been presented and you can condense this section (here 10.8) to eliminate redundancy.

**10.9 Lessor’s Power of Attorney to Conduct Sale**: Although you may wish to modify the period of time that must pass before the Lessor’s power of attorney is triggered, it is important for the Lessor to have the power, at some point, to intervene in the kind of situation described here to see that the improvements are passed on to someone who will use and maintain them and care for the land appropriately. Without this power of attorney, the Lessor could still declare the Lessee in default for failing to comply with the occupancy and/or agricultural requirements of the Lease and could then proceed through the due process described in article 12 to terminate the Lease and take possession of the improvements as permitted by section 7.9. At least in some situations, however, the power of attorney can provide a less time-consuming and expensive and less adversarial way of resolving the situation.

**10.10 If Transfer Entails Seller Financing or Installment Purchase**: This section has been added in order to clarify the application of the Purchase Option Price in cases where the price is paid over time rather than as a lump sum at the time title is transferred. In such cases the Purchase Option Price is defined as a price that does not exceed the present value of the scheduled stream of payments.

---

**Article 11: Assignment and Sublease**

This article prohibits any transfer of the Lessee’s rights under the Lease that is neither permitted by the terms of Article 10 (whatever terms you have established in drafting Article 10) nor otherwise permitted by Lessor’s specific written approval.

The article further establishes (a) that all of the terms of the Lease are to be binding on any approved assignee or sub-lessee; (b) that the rental fee charged a sub-lessee is not to be more than that amount charged the Lessee by the Lessor, plus an amount approved by Lessor to cover the rental of the Improvements; and (c) that a Lessee who assigns the Lease to a purchaser of the improvements cannot charge an assignment fee that would raise the total amount paid to the seller above the amount of the Purchase Option Price.

Note: If your Lease specifically permits leaves of absence for Lessee (the possibility of which is suggested above in the commentary on section 4.4), then this Article 11 should specifically permit Lessee to sublease the Premises during such leaves of absence.

---

**Article 12: Default**

In the event of serious violations of the terms of the Lease by the Lessee, termination of the Lease becomes an important potential remedy for the Lessor, with potentially very damaging consequences for the Lessee. It is therefore important to clearly define and limit the process by which such a violation can lead eventually to termination and eviction.

**12.1 & 12.2 Monetary and Non-Monetary Defaults by Lessees**: These sections give a Lessee (and Lessee’s permitted mortgagee) a right to cure a default within a specified time after Lessor has notified Lessee of the default. Note that the time allowed for the cure of non-monetary defaults (60 days) is here greater than the period allowed for monetary defaults (30 days), since the physical
process of curing non-monetary defaults can be time-consuming. Furthermore, section 12.2 permits still more time to cure a non-monetary default when a Lessee is proceeding diligently to cure the default but cannot complete the necessary process within the 60-day period.

You may want to modify the basic time periods specified in these sections. You may also want to consider specifying longer or shorter cure periods for violations of certain types of requirements or restrictions. For instance, violations relating to the use or storage of hazardous substances that could pose an immediate threat to human health and the environment may warrant shorter cure periods. Violations relating to matters involving long-term cycles such as crop rotation or annual agricultural income requirements may warrant longer cure periods. If such differing cure periods are to be established for violations of certain types of restrictions or requirements, they may best be established in those sections of the Lease where the restrictions or requirements are presented (which is likely to mean that they will appear in an attached exhibit). The existence in other sections of the Lease of such special provisions for longer or shorter cure periods should then be acknowledged in this section 12.2. For instance the first sentence of 12.2 might be amended to read in part: “...within sixty (60) days after notice of such failure is given by Lessor to Lessee and Permitted Mortgagee or within such other period of time as may be stipulated elsew here in this Lease for violations of the specific term or condition in question.”

12.4 Remedies: The section spells out the Lessor’s right, in the event of an uncured default, to terminate the Lease and to seek other remedies to which it may be entitled under the terms of the Lease and/or applicable law. In practice, of course, the Lessor may seek to negotiate one or another sort of compromise with the Lessee who is in default. In pursuing such negotiations, however, the Lessor will want to have the leverage provided by a clearly defined right to more extreme remedies.

12.5 Default by Lessor: Although defaults by the Lessee may be more likely, the Lessor may in fact violate the terms of the Lease by a variety of actions or omissions, and it is important that the Lease address this possibility. As in the case of Lessees who have committed non-monetary defaults, the Lessor that has been notified of a default is given 60 days to cure the default, with a broadly defined provision for additional time if more time is needed to complete the cure process.

12.6 Limitation on Liability: This section limits the Lessee’s right to enforce a claim relating to an alleged violation of the Lease against any of the Lessor’s assets other than the Lessor’s interest in the Leased premises.

Article 13: Arbitration

The arbitration clause provided here is relatively informal and could be developed in more detail. It should be noted that the legal effect of an arbitration provision in a Lease will vary from state to state. Another possible approach to the matter of dispute resolution is to provide initially for a mediation process, with a mediator acceptable to both parties. Arbitration may then be prescribed if mediation fails to resolve the dispute.

Article 14: General Provisions

14.2 No Brokerage: This section may not be necessary in some situations.

14.4 Duration: This section establishes a back-up definition of the duration of the Lessor’s purchase option in case the 99-year term is held to violate the common law “rule against perpetuities” (or statutes deriving from or reflecting this rule), which might limit the enforceability of such an option to the duration of a “life in being plus 20 years.”

14.5 Right of First Refusal in Lieu of Option: Another back-up provision, this section ensures that in the event that the Lessor’s Purchase Option, as
established in Article 10, is stricken by a judge or eliminated in the event of a foreclosure, the Lessor will still have a way to regain control of the Improvements.

14.12 Governing Law: Don’t forget to insert the name of the applicable state.

14.13 Recording: See Appendix 6 for a sample Notice of Lease.

Exhibits

Exhibit A: LETTERS OF STIPULATION AND ACKNOWLEDGMENT
This exhibit is introduced in Article 1. The samples attached to the Model Lease are only samples. Actual lessees and attorneys should modify or replace these sample letters to suit the immediate circumstances.

Exhibit B: PREMISES
This exhibit is referenced in Section 2.1. This exhibit, normally prepared by the land trust’s attorney, defines the land area being leased, as described in the land trust’s deed to the land.

Exhibit C: CONSERVATION EASEMENT
If such an exhibit is called for it is referenced in Sections 2.1 and 4.1. It will consist of a copy of any actually existing easement on the land. If such document is not actually entitled “Conservation Easement” (it could be entitled “Conservation Restriction” or “Agricultural Easement,” among other possibilities), then the actual title should be used in the title of the exhibit.

Exhibit D: FIRST REFUSAL
This exhibit is referenced in Sections 3.3 and 14.5. The model First Refusal exhibit that is attached to the Model Lease is appropriate for either of the two situations described in sections 3.3 and 14.5.

Exhibit E: REQUIREMENTS AND RESTRICTIONS
This exhibit is referenced in Sections 4.2 and 4.3. The sample attached to the Model Lease imposes relatively limited restrictions and requirements. For more examples of the types of requirements and restrictions that might be imposed, see the “Restrictions Menu” in Appendix 5 and the descriptions of actual cases in Chapters 2, 3 and 4. The final section of the Exhibit provides for amendment of the Exhibit by mutual agreement of the parties. It does not spell out a process for reaching such agreement in the relatively elaborate way that such a process is spelled out in the comparable section of the Requirements and Restrictions exhibit attached to the Model Easement (see Chapter 8). You may choose to specify such a process here as well. Note, however, that insuring that any amendment is “consistent with the Statement of Purpose… and shall comply with Section 170(h) of the Internal Revenue Code…” is not the kind of concern here that it is in the case of an easement, through which certain rights are permanently granted to another party and cannot be returned to the grantor. In the case of the ground lease you will normally still want an amendment to be consistent with the basic purpose of the agreement, but the farmer and the land trust do have a right to modify the nature of the agreement in more fundamental ways as long as it remains generally consistent with the land trust’s charitable purposes.

Exhibit F: DEED
This exhibit is referenced in Section 7.2. Different jurisdictions adhere to different conventions in the drafting and formatting of deeds. In any case, it is important that this deed make it explicitly clear that the property being transferred consists of “improvements only,” not the land.

Exhibit G: PERMITTED MORTGAGES
This exhibit is referenced in Sections 8.1 and 8.2. See the commentary on these sections earlier in this chapter.