



Question of the Month: Why ground lease and why now? - Q&A with Skyline Properties CEO, Robert Khodadadian

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New York, NY The New York Real Estate Journal caught up with Robert Khodadadian, Skyline Properties' founder, and CEO, for an overview on why the current market conditions have led to the recent resurgence of ground leasing in the city. Skyline Properties is a commercial real estate advisory firm. Traditionally, Skyline focuses on off-market investment sales, but over the last few years, Khodadadian and his team have garnered attention guiding owners and tenants through the sophisticated yet lucrative process of ground leasing.

What is a ground lease?

Khodadadian: Simply put, a ground lease is a long-term net lease of land between an owner (ground lessor) and a tenant (ground lessee). Among other things, this arrangement allows property owners to maximize their asset's upside potential without incurring the expenses associated with a conventional sale, such as capital gains tax.

What inspired you to start introducing owners to the concept of ground leasing?

Khodadadian: As the market evolved, we wanted to find a way to help both investors and owners make money on deals, so we looked to see how deals were structured in the past to guide us. We came to understand how well ground leases work for both parties, so we began reintroducing this concept with our creative approach, and it's been producing long-term positive outcomes for everyone who's gone down this road with us.

Are most owners familiar with ground leases? How do they respond when you explain how they work?

Khodadadian: Most owners either don't know anything about ground leasing or they've only heard part of the story, so we created an informational website (Groundlease.nyc) to help educate them. The way ground leases are structured opens opportunities for owners who don't want to sell but are still open to doing a deal. Ultimately, owners should understand that a ground lease is just like any other type of real estate transaction in that both sides of the table need to feel like they're making a deal that works for them.

On the other side of the equation, an investor who's looking to purchase an office property south of 96th St. in Manhattan should understand that there are only roughly 1,571 office buildings that are

over 20,000 s/f, which means there's a finite amount of inventory. This knowledge helps tenants approach deals creatively as well.

Who should consider a ground lease?

Khodadadian: Ground leases make the most sense for long-term property owners who aren't prepared to make the necessary capital improvements required to maximize their property's upside potential. Someone who owns a plot of land, a property with significant air rights, doesn't want or need to build, or someone who wants to ensure that their property remains in the family to produce generational income would also benefit from considering a ground lease.

How do owners benefit from ground leases?

Khodadadian: The property title never transfers to the tenant; therefore, the owner stays the owner of the property while generating income on the property. The owner is not responsible for capital gains tax, unless there is an upfront payment, and in some cases the owner is eligible to avoid transfer tax payments. The property also remains in the family, which means the asset will generate a hassle-free income stream for generations to come.

The ground lessee (the tenant) is responsible for all the management, costs, and expenses of the leased property. By making capital improvements to the existing structure or in the case of a development site, constructing a new building the ground lessee will maximize the potential and improve the property. Many ground leases contain a reversionary clause, which transfers any improvements made by the tenant to the landlord at the end of the lease.

How do tenants benefit from a ground lease?

Khodadadian: Many developers and commercial tenants have long been faced with property owners who ask for a price that isn't supported by comparable deals. The owners are emotionally attached to the asset, and they'd rather sit on it than do a deal that makes sense for both parties. The tenant's basis is significantly reduced because they don't need to invest upfront capital for a purchase. If an owner is unwilling to sell, a ground lease can still get a deal done that will give them long-term access to prime locations.

Are ground leases complicated?

The more knowledge each party brings to the transaction, the smoother it will go. To that end, our real edge at Skyline is our personal relationships with the most sophisticated real estate investors. For owners, this translates into not wasting time and getting a deal done correctly. Ground leases are considered sophisticated and complex transactions. If done correctly, ground leases can be tax efficient and protect both the landlord and the tenant.

What asset classes can be ground leased?

Khodadadian: Technically, you can ground lease any asset class, but most commonly vacant land, industrial properties, office buildings, residential buildings, and hotels are ground leased. An example of recent ground lease transactions in New York City include: SL Green leased 885 Third Ave., “The Lipstick Building”, to Ceruzzi Holdings; Extell Development signed a 99-year lease for Goldman-owned properties at 516 East 14th St., 530 East 14th St. and 222 Ave. A; and Skyline closed 236 5th Ave. with The Kaufman Organization.

Is the owner stuck once the ground lease is in place?

Khodadadian: Since the title to the property never transfers to the tenant, the owner retains the right to mortgage the leased property or sell it. In fact, the owner can borrow more money from the bank once the ground lease is in place because often their net income has increased substantially.

Once the tenant has committed to a ground lease, are they trapped?

Khodadadian: The ground lease tenant retains the option to mortgage their lease or assign the lease to a new tenant. It's also worth mentioning that since the tenant is not on the title, the owner is not responsible for any debt they incur, so if the tenant default on the debt, the landlord isn't held accountable.

What makes an appropriate ground lease tenant?

Khodadadian: Ground leases can be thought of as long-term partnerships. Therefore, it's vital that landlords have partners who are knowledgeable about ground leases to provide the owner with tax efficient structures. The tenant also needs the financial ability to perform the renovations or development in the timeframe outlined in the lease. When picking a ground tenant, owners should look for tenants who are willing to provide personal guarantees for the work they are saying they are going to do, and they should obtain a comprehensive understanding of the tenant's financial history including defaults.

Can you give us a forecast for ground leases in New York City in 2018 and beyond?

Khodadadian: I believe that ground leases are the future for real estate in New York City. Due to the current state of the market ground leases are becoming the most tax efficient way for long-term or generational property owners to get a deal done.