Techniques For A Developer To Structure "For-Sale" Apartments In A Leasehold Project

Joshua Stein

Here's how a ground lease—and a leasehold condominium—can provide a solid foundation for a "for sale" apartment development.

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IF AN APARTMENT PROJECT relies on a ground lease structure, can the developer sell individual apartment units to individual owners? Or does the use of a single ground lease for an entire building (or for the apartment component of a larger building) preclude individual apartment sales?

These questions cause concern and trepidation among lawyers and their clients in structuring development projects from coast to coast. That's particularly true for mixed use or government-assisted projects, or other projects driven by nonprofit owners.

The answers to these questions are not simple, but a developer and its counsel will usually like the answers. This article offers some analysis, suggestions, and options for anyone trying to structure a for-sale apartment building that uses a leasehold estate as its legal foundation. Rather than seek to define a single "best way" to structure a project of this type, though, the following article only offers some suggestions and ideas to consider and discuss in structuring any particular project, and introduces some issues counsel will need to consider.

This article starts from the following set of somewhat typical facts.

A non-profit institutional property owner (the "Owner") owns land (the "site") near its main campus headquarters. Both the headquarters and the site are prime coastal locations, with commanding ocean views and excellent transportation. They represent about a third of Owner's entire real estate portfolio.

Owner takes a very long-term view of its real estate ownership, a commercial activity that it regards as secondary to its charitable, educational, governmental, public service, or religious goals (its "mission"). Today, Owner does not believe it needs the site for its mission. At some point in the distant future, Owner may very likely want to expand its headquarters onto the site or construct related facilities on the site, such as a conference center, library, athletic field, or special-purpose facilities, to try to better serve its mission.

The site was not easy to acquire. Owner wants to retain unquestionable long-term control of the site. For the moment, Owner wants to develop on the site a mixed-use commercial project (the "project"). The project will contain a high-end mall; parking; rooftop parks; an athletic club; quasi-public circulation areas; residential towers (the "Towers"), each, if possible, containing for-sale apartment units (the "units"); a supermarket; a high-end wine bar; and other facilities.

This article explores Owner's agenda and goals, some ownership structures that Owner might consider for the Towers and the units, and some (but certainly not all) advantages, disadvantages, and practicalities of those various options.

The article concludes by suggesting a path Owner might best take for the project, although any other option suggested here may also make sense for any particular project.

OWNER'S GOALS • In defining any ownership structure for the units, Owner wants to achieve at least these goals:

- *Long-term ownership.* Owner wants to ensure that it has a long-term ownership interest in the site, so that "we will never have to assemble it again";
- *Adverse legislation.* Owner fears legislation that would entitle holders of long-term leaseholds to acquire the underlying fee estates based on considerations of "fairness," "public policy," and the like. Owner is well aware of Hawaii's various "leasehold conversion" statutes, which allowed ground tenants to acquire the underlying fee estates at prices that allegedly reflected their fair market value. Owner does not want to find itself the victim of the next such legislative improvement of land tenure. (This article discusses the Hawaii experience below, along with the court cases that validated it);
- *Control.* Given the site's proximity to Owner's main campus headquarters, Owner wants to prevent site occupants from taking actions that could cause controversy, embarrassment, annoyance, interference, or bad publicity for Owner, or would disserve Owner's mission. Therefore, Owner wants some ability to control what people do on the site;
- *Marketing.* Any ownership structure for units should pass without objection in the unit market (including the market for unit mortgages), so Owner will not find its marketing program impaired as a result of the unit ownership structure;
- *Future community relations and public relations.* Owner wants to avoid future financial surprises for owners of individual units (the "unit owners"), because these may produce bad publicity and complaints, or even political pressure within Owner's various internal constituencies.
- *Mission-related use.* Owner may want to retain some units for purposes related to its mission, such as to provide housing for its leaders, visiting scholars, or management;

- *Simplicity.* To the extent that Owner can keep the site's ownership structure simple—with as few layers, moving parts, and documents as possible—this will save money; reduce the likelihood of inconsistencies, mistakes, and issues; prevent delays; and help Owner achieve its other goals.

In considering how to structure the project, Owner will need to consider each of these goals as well as some others (in particular, tax issues, which this article totally disregards).

POSSIBLE OWNERSHIP STRUCTURES

• Owner might consider one or more of these ownership structures.

Whole-Building Ground Leases ("Tower Leases")

Owner could ground lease each Tower to an Owner affiliate (a "Tower Tenant"). Each Tower Tenant would ultimately both:

- Subject its interest in its Tower lease to a condominium regime; and
- Assign its Tower lease (whether before or after condominiumization) to an "Association."

(As a variation, Owner might enter into a single Tower lease for all Towers with a single Association. In that case, however, extra issues and complexity within the condominium might outweigh the benefits of a single Tower lease.) Purchasers would buy units within the condominium regime that governs their Tower. Tower leases could include any or of the following elements, all as appropriate under the circumstances:

- *Prepaid rent.* Some or all rent could be prepaid;
- *No adjustment.* The rent will not be subject to future adjustment, or any future adjustments will be minimal and predictable. No surprises;
- *No termination.* Upon any tenant default, the landlord will have meaningful remedies against the Association and even against unit owners, but those remedies will include no right to terminate a Tower lease. That fact should, in and of itself, mitigate most concerns and risks (particularly to a mortgage lender) that arise from using a ground lease in place of fee ownership. (To a mortgage lender, the single most important attribute—and peril — of any ground lease consists of the fact that the landlord can terminate the ground lease for default.) Even without the risk of premature termination, though, a ground lease still has an expiration date—a date when everything ends and everything reverts to the landlord. As long as the parties can plan for the expiration date and it can't come by surprise, they ought to be able to live with it;
- *Casualty and condemnation.* Although a Tower lease will be terminable on casualty or condemnation, these termination rights will contain typical lender protections. Also, each Tower lease will strongly lean toward reconstruction and restoration regardless of the scope of any casualty or condemnation. This bias is quite common in mixed-use projects, both leasehold and fee-owned; and
- *Fully financeable.* The Tower lease terms will facilitate both financing of the entire leasehold (e.g., by the Association, if state law facilitates it) and financing by individual unit owners.

Some of the preceding characteristics of the Tower lease would make sense only for a nonprofit Owner of the type assumed here. A private sector investor might not tolerate such terms.

Single-Unit Ground Leases

Owner could lease each unit to its unit owner by entering into a separate ground lease with each unit owner, on the same terms as the Tower leases, as applied to individual units (the "unit leases"). Unit leases could include these elements:

- *Role of Association.* All unit owners—as tenants under unit leases—would appoint the Association as their agent for all dealings with Owner.

Association would handle billing (if any) and all other aspects of the landlord-tenant relationship. But any unit owner would be responsible only for its own defaults;

- *Combination.* Owner could initially use a single Tower lease for each Tower (or, less desirably, the Towers as a group, as noted). Once the project was complete or if certain conditions were satisfied, a Tower lease would terminate (or be chopped up into little leases, one for each unit) and unit leases could take its place. (Tower lease(s) and unit lease(s) are referred to collectively as "lease(s)");
- *Estate for a Term of Years.* Instead of using a Tower lease, Owner could convey each Tower to an Association, or each unit to a unit owner, in fee simple but terminating on a fixed date (e.g., after 100 years). The grantee would own a "term of years" in and to its Tower or unit. That "term of years" could then be sliced and diced in any way this article suggests. An "estate for a term of years" is much like a prepaid ground lease;
- In the handful of states that have adopted the Uniform Common Interest Ownership Act (or similar condominium statutes) state law requires the functional equivalent of Unit Leases. Section 2-106 of the Uniform Act says that if any particular Unit Owner pays its share of the rent under a Tower Lease, then any termination of the Tower Lease can't terminate that particular Owner's interest in the project. In effect, the Owner loses the benefit of having an entire building as "collateral," and instead must be willing to proceed as if each unit were demised under a Unit Lease.

Single-Unit Subleases

Instead of subjecting the entire leasehold to a condominium regime, the Associations could sublease units to unit owners, through subleases similar to the proposed unit leases.

Cooperative Corporation (a "Co-op")

Each Association could consist of a co-op, which would hold its own Tower lease and then issue corporate shares and proprietary subleases to each unit owner. Each co-op would have a board of directors, running its own Tower. The board might have the right to approve unit transfers.

Fee Estate With Repurchase Option

Owner could convey to each unit owner a fee estate in and to the particular unit. Owner would reserve the right to repurchase the unit at specified date(s) (e.g., 50 years after initial conveyance and every 25 years thereafter). This repurchase option would probably be at fair market value ("FMV"). As is always true, defining "FMV" would require great detail and thought. Would it assume fee ownership? A long-term leasehold? A leasehold with a 30-year remaining term? On what terms? Some other formula? All of this is manageable. Real estate lawyers manage it all the time. The key is to recognize the issue and draft in a way that defines fair market value with absolute clarity. (The pricing formula might—or might not—set a "floor" equal to the amount secured by any bona fide first mortgage on the unit provided, for example, that the loan did not exceed 80 percent of the value when closed.) If Owner decided to structure a fee estate with a repurchase option, here are some issues Owner would want to consider:

- *Timing of exercise.* The documents could allow Owner to postpone any option exercise date, perhaps for decades at a time. Over time, Owner could use this right to protect unit owners from the instability that such a purchase option might create;
- *Notice period; effect of exercise.* The documents could require a very long notice period (e.g., 25 years) of any exercise of Owner's repurchase option. If Owner ever chose to exercise its option, this could impair marketability of units during the notice period. Therefore, the

documents might give unit owners the option to "put" their units to Owner at FMV during that time. In that case, Owner would need to plan ahead for multiple acquisition of multiple units over a long period, including the possible need to rent them out on an interim basis. Would such rentals make financial sense?

- *Pricing for "put."* Any "put" right would require Owner to pay fair market value for units, considered as if Owner had not exercised its repurchase right. As noted, the definition of fair market value creates a huge minefield for any ground lease or other long-term interest in real property.

"Trust" Structure

Owner could establish a "trust" to hold lease(s) or fee estates along the lines suggested above, or some combination. The "trust" documents would create beneficiaries and rights designed to give unit owners and their lenders the package of protections they need (much like the rights of a Co-op shareholder/lessee), but only for the period contemplated. Owner would also be a beneficiary of the trust and would automatically be entitled to the rights contemplated above, when and as provided for above. A "trust" of this type would amount to a variation on the theoretical "trust" established under a "deed of trust." If set up correctly, a "trust" structure might give Owner some benefits from the fact that a "trust" cannot file bankruptcy. The structure might also underscore the limited nature of the rights of unit owners. One could also structure such an arrangement instead as a limited liability company with various classes of members.

COMMENTS ON PARTICULAR OWNERSHIP STRUCTURES • The preceding ownership structures all raise a number of issues, including "pros" and "cons" of each. These issues would include the following points, some of which may apply not only to the option indicated but also (to some degree) to some of the others.

Tower Leases (And Unit Leases As Appropriate)

- *Familiarity.* Ground leases are familiar creatures throughout the United States, although this is somewhat less true of "leasehold condominiums."
- *Surprise Prevention.* In its marketing materials and documentation, Owner can and should fully disclose and announce that the transaction relies on leases, all of which will terminate on a date certain. Some suggestions:

__ Clear termination date. All documents should clearly state the termination date as a specific calendar date, not a more typical defined term that cross-references an interacting maze of a dozen or more other defined terms. No one should ever be able to say the actual termination date was buried in legal complexity;

__ Document titles. The name of each significant document might even include a reminder, right under the heading, such as: "(Expiration Date: December 31, 2110)";

__ Disclosure of effect on value. The offering materials should disclose how this structure might affect the long-term value of units. Disclosures of this type are common for apartment sales materials in New York and other states with significant disclosure requirements for sales of condominium units or timeshares;

__ Conveyance documents. The governing documentation should require that any future conveyance documents include a disclosure/reminder of the termination date, and that unit owners countersign this disclosure/reminder when they acquire their units;

__ No surprise. Generally, unit owners should not be able to claim surprise.

Risk Of "Leasehold Conversion"

Any leasehold structure carries with it the potential that some governmental authority may decide the leaseholders would be better off if they also owned the fee estate, a decision that the Hawaii legislature made about 40 years ago. This article discusses the Hawaii legislation separately below.

Declining Value

In the last 30 or so years of any lease, it becomes a "wasting asset." Its value automatically declines every year, based on the shorter remaining lease term, even if the lease does not require payment of rent. This will impair marketability and financeability during those years, and cut the unit owner's incentive to repair and maintain the unit (particularly capital items). Owner might address this risk by building into any lease measures like:

- A streamlined structure for the parties to agree to extend the lease and to price the extension period;
- Equitable allocation of capital expenditures made near the end of the lease; and/or
- If any lease is not extended, then an option or obligation for Owner to buy back units at FMV. Any such repurchase would be fundamentally inconsistent with the usual structure of any leasehold transaction, in which Owner always receives back the leased asset, "for free," at the end of the lease. Owner probably does not need to offer such measures as part of the initial marketing of the project, because initial unit owners will rarely pay all that much attention to the distant future expiration of any lease.

Lease Preservation

Owner should structure any lease to minimize any risk that the Association might default on ground rent payments, or otherwise default on or lose the lease. For example, the Association could maintain a two-year cash reserve dedicated to pay ground rent. The Association would have all the usual powers to collect assessments, including the right to enforce liens against delinquent unit owners. The Association could engage a third-party management company whose responsibilities would include committing to pay ground rent if the Association suffered a temporary liquidity crisis. (The manager would act in part like a liquidity provider in a securitization, injecting quick cash when needed to prevent a default, based on a determination that the cash would be recoverable in the short term. Such measures would give unit lenders more comfort.) If any such "liquidity provider" were creditworthy, that might give Owner comfort that would justify forgoing a right to terminate the lease for monetary defaults.

Nonterminability

As suggested above, Owner might make lease(s) nonterminable upon default (particularly a nonmonetary default). The lack of a termination right would vary dramatically from "industry standard," but may make sense under these facts. Owner will have already collected all its rent. Owner's main concern relates to long-term site control and receiving back the site at the end of any lease term. Owner is not so much motivated by the investment potential of any lease or the ability to prematurely "get back" the site.

Everyone always assumes that any tenant's default under any lease should allow the landlord to terminate, but why should that always be true? On the other hand, the lease(s) will contain nonmonetary covenants, such as maintenance obligations, restoration obligations, and operating rules (e.g., no banners, whether or not controversial, hanging out windows). Will Owner be satisfied with the right to enforce those covenants and obligations solely through injunctive relief and claims for damages? Should Owner insist, for example, on having at least a senior lien on the leasehold estate under any lease, to secure performance of nonmonetary

covenants? Or should Owner have a right to terminate a lease if a court determines, beyond right of further appeal, that the tenant is in default beyond applicable cure periods? (Most leases purport to give the landlord a king-like power to "terminate" a lease as soon as the tenant defaults, typically beyond some short cure period. In practice, unless the tenant intends to abandon the lease or the default is absolutely clear-cut, substantial, and monetary, the courts may vitiate the landlord's king-like termination power by preserving the lease until the court decides whether the tenant actually defaulted.) Any Owner will want to consider questions like these as it structures the project.

Unit Leases

- *Fee forfeiture.* If the project faces any meaningful risk of "leasehold conversion" (a la Hawaii), the risk may be slightly higher for unit leases, because the legislators could readily identify a single fee owner that is allegedly "oppressing" a specific single leaseholder. With a Tower lease, the alleged "oppression" may become less tangible and direct.
- *More paper.* The use of unit leases would multiply the amount of paper required for the transaction, and hence Owner's transaction costs and likelihood of mistakes or inconsistencies. Would the change increase marketplace acceptance of the units? If so, this could justify the incremental cost and much more. Owner might mitigate some of the cost by recording a "master document" to act as a template for all unit leases (if state law permits). Each unit lease would, for the most part, merely incorporate by reference the recorded "master document."

"Estate For A Term of Years"

- *Fee vs leasehold.* A "fee simple" estate, even if time-delimited, may be more appealing than a leasehold. Both suffer from the same fundamental infirmity, though: a termination date.
- *Local law.* Does state law where the project is located recognize an "estate for a term of years"?
- *Nonterminability.* The essential fact of an "estate for a term of years" is that it cannot be terminated. It represents absolute ownership through the termination date. This may be why most landlords don't like them. An Owner like this one, in contrast, should not care.

Single-Unit Subleases

- *Market understanding.* Will unit owners understand what a sublease is? Will it make them even more nervous than might a ground lease?
- *Nondisturbance.* Owner might agree to "recognize" and "nondisturb" any subtenants if their underlying Tower lease expired or terminated for default. At that point, the subleases would become unit leases, or Owner would enter into a new (direct) unit lease with the unit owner. A typical Owner might hesitate to grant such protections (because of fear of litigation, complexity, disputes, and so on), but this Owner has different motivations and may well decide to offer such protection. Nondisturbance arrangements are quite common in the world of real estate. Once Owner starts granting nondisturbance protections, Owner will need to consider the fact that any subtenant will not only need to have its occupancy rights protected under its sublease, but will also need comfort that its interests in the rest of the project and all project amenities will remain in place and available.

Cooperative Corporation

- *New and unusual.* A Co-op, though common (and commonly hated, at least by many) in New York, is rare outside New York. Assuming

Owner's site is outside New York, does Owner want to break new ground?

- *Legislative risk.* The use of a Co-op may somewhat mitigate the risk of "leasehold conversion" legislation, because the poor oppressed unit owners would be one further step removed from Owner, and the alleged oppression would be somewhat more difficult to explain and identify.

Fee Estate With Repurchase Option

- *Rule against perpetuities.* A repurchase option may create issues under the "Rule Against Perpetuities" or other legal principles that disfavor long-term interests in real property that are not fully defined and vested. In the author's experience, these problems can almost always be solved by identifying them and drafting (or sometimes structuring) around them. Failure to identify them, however, can create a disaster.
- *Bankruptcy issues.* A repurchase option may conceivably be deemed an "executory contract," subject to rejection in bankruptcy. If Owner wishes to go down this road, bankruptcy issues would require further exploration.
- *Other.* Owner would also need to explore general state law issues regarding "enforceability" of an option to purchase, as well as any tax issues the arrangement might create.

Newness And Complexity

For better or worse, any investor in real property, and its counsel, will typically shy away from anything new, different, or complicated. Some of the structures suggested here might readily be considered new, different, or complicated. That consideration alone may rule out some of them, although everything depends on circumstances and local history and experience.

SOME HISTORICAL BACKDROP: THE RISK OF "LEASEHOLD CONVERSION" (HAWAII LEGISLATION) • Any discussion of using leases for a project anywhere in the United States takes place in the shadow of some "leasehold conversion" legislation that the Hawaii legislature enacted in 1967. That legislation, broadened in 1975, was called the "Hawaii Land Reform Act" (Hawaii Revised Statutes 516). It gave leaseholders the right to acquire the fee estates of their lessors, allegedly at "fair market value," through the exercise of the state's powers of eminent domain. The U.S. Supreme Court upheld the constitutionality of the Hawaii legislation in *Hawaii Housing Authority v Midkiff*, 467 U.S. 229 (1984), a leading precedent heavily relied upon in the recent *Kelo* eminent domain case in Connecticut.

Risk Mitigation

To mitigate the risks of "leasehold conversion" legislation at the site, Owner might consider the following:

- *Investment vs mission property.* The risk of any eminent domain is probably higher for investment property than for property Owner has dedicated toward its mission. Owner may, however, have trouble identifying a mission-related use for fee estates underlying long-term ground leases. If Owner has mission-related plans for the site after the leases terminate, Owner may want, as a form of "insurance policy," to document those plans in the project documents. Owner could also seek to ensure that the fee estate remains owned by an entity that is directly related to Owner's mission, as opposed to a more "business" oriented entity. The former type of entity may amount to a less attractive target for eminent domain or "leasehold conversion";
- *Watch your flank.* Like any other property owner, Owner should watch political trends and threats affecting its property. Owner should

act quickly and preemptively to try to "head off" any well-intentioned plans to redistribute Owner's fee interest in the site;

- *Higher fair market value.* Owner might seek to establish facts to support the highest possible value for Owner's interest in the site. For example, Owner might reconsider having the rent prepaid. On the other hand, prepaid rent eliminates any risk of future "unconscionable rent increases," leaving only the fully disclosed inevitability of lease termination at some fixed future date;
- *Lease drafting.* The lease(s) might seek to anticipate any "leasehold conversion" legislation by giving Owner an option to terminate the lease(s)—by paying fair market value—if any such legislation were ever enacted. Although such a provision should do no harm, most legislation that seeks to rewrite marketplace relationships also purports to invalidate any private contractual measures that "try to get around" the legislation. The fact that an Owner will pay fair market value to the "victimized" tenant might help, though.

Although any of these measures might mitigate the problem, the risk of eminent domain of any sort ultimately cannot be removed from any real estate transaction. It goes with the territory, whether a transaction is structured as a leasehold, fee-owned, or in any other manner. Any governmental authority can assert eminent domain against any interest in real estate that any politicians who listen to their constituents can be persuaded to destroy. It is ultimately a political risk. Owner can probably not structure around the risk, but can certainly seek to mitigate it through measures suggested here.

OTHER CONSIDERATIONS • Regardless of how Owner ultimately decides to structure the project, Owner will also need to consider a few other structural issues that go beyond whether to uses leases, what they might say, and how they might affect units. Those additional issues would include at least the following.

Reciprocal Easement Agreement

The interests of all unit owners and Associations will be subject to (and largely defined in) one or more reciprocal easement agreement(s), declaration(s), or set(s) of covenants, conditions and restrictions (any of the foregoing, including any related bylaws, an "REA"). Owner would need to record the REA before any lease(s), other transfer documents, mortgages, or other liens. The REA could provide for the following, and might raise these issues:

- *Repurchase option.* Owner may reserve a right to repurchase any or all of the site under certain circumstances, such as enactment of leasehold conversion legislation or occurrence of a major casualty or condemnation. Any such repurchase option would probably require payment of fair market value;
- *Master association.* The REA will provide for an overall association or other entity (the "Master Association") to govern the site and operate any common elements. A separate Association will operate each Tower. As a practical matter, the individual Tower Associations may amount to nothing more than bookkeeping entries in the Master Association's books and records;
- *Use restrictions.* The REA will prohibit all site occupants from doing objectionable things, such as hanging window banners, making excessive noise, smoking in common areas, and so on. The REA will probably not restrict who may live in the units or what they may do within their units (other than restrictions typical of a "garden variety" common ownership interest structure). If Owner chooses to dedicate certain units or other parts of the project to Owner's mission, the REA may contain appropriate protections for all parties;

- *Beneficiary.* Owner will be a party to the REA and entitled to enforce it. Owner may also want to give certain of its affiliates similar rights. Exactly how to accomplish this goal will primarily reflect tax and state law considerations;
- *Obligors.* Although the REA will bind all parties with an interest in the site, it will also require that all Association documents and unit documents (however structured) contain provisions obligating all Associations and unit owners to comply with the REA, and not to transfer their interest in the project unless: (a) the transfer complies with any requirements in the REA, and (b) the transferee agrees to comply with the REA. The second requirement reflects the practicalities of many state-law limitations on whether any covenant can "run with the land";
- *Nonmonetary covenants.* The REA may provide a good vehicle for nonmonetary covenants and rights and remedies for breach. These might include, for example, a lien for noncompliance. The enforcement procedures for any such lien would need to ensure ample notice to all mortgagees, as well as a protracted foreclosure procedure much like that for unpaid real estate taxes. This process will be slower (and much "safer" for a lender) than a typical lease termination mechanism. Hence lenders may prefer it;
- *Bankruptcy.* Although an REA would probably not face rejection in bankruptcy, this issue may require further consideration depending on the facts of any specific transaction, particularly to the extent that the REA goes beyond traditional affirmative and negative covenants regarding real property.

Master Condominium

As an alternative to the REA, Owner may subject the entire site to a master condominium regime, containing a separate unit for each Tower, as well as other units for the various other major uses. The master condominium regime would generally incorporate the same terms as a possible REA. Some lenders may prefer such a structure to an REA.

Common Elements

The project will include common elements that serve all (or at least more than one of the) Towers, owned and operated by a Master Association under the REA, or similar entity. In structuring the project, Owner may want to consider the following points about the common elements:

- *Minimization.* Owner will probably prefer to minimize the need for the Master Association (or, for that matter, any other Association) to manage and operate amenities. Such management and operation creates higher monthly carrying costs, complaints, management burdens, and a need for more attention on every level, i.e., overall friction. Where possible, Owner will probably be well advised to convert any particular amenities (e.g., a health club) into a stand-alone condominium or leased unit to be owned, leased, and operated separately, as a profit center for someone rather than as a management burden;
- *Market segmentation.* If units are sold to different segments of the market, unit owners may not want to share amenities or lobbies.
- *Overall strategy.* Owner may want to make an early policy decision to try to minimize common elements, for reasons suggested above. Where common elements cannot be avoided, Owner may still want to try to incorporate as much space as possible into individual project components, making the owner of that component responsible for operating the particular space (perhaps with reimbursement rights via a Master Association). The less the Master Association actually does, the better.

Third-Party Owner

Owner may engage a developer or marketing company to help with: (a) construction (and responding to any construction defects litigation); (b) unit marketing; and/or (c) long-term management of Tower leases, unit leases, REA, etc. The use of such an entity would provide a "buffer" between an Owner entity (and its various constituents) and private unit owners. This "buffer" would make it easier to operate the project on a businesslike basis. One more layer would separate the project from unhappy unit owners, who might try (and might still try) to use Owner's internal political channels to voice their complaints. As a variation on this theme, Owner or a related entity might provide construction financing to a third-party developer.

Fractionals And Timeshares

The project may include fractional ownership units and/or timeshare units. Regulatory restrictions for such projects will often be significantly more burdensome than for "pure" condominiums (condominia?), and will sometimes also suffer federal regulation, but fractional and timeshare projects are still quite common throughout the united States. Owner could add fractionals and/or timeshares to the mix regardless of which ownership structure Owner employed. Timeshare and fractional buyers are, if anything, probably less interested in (or concerned about) underlying ownership structures than condominium buyers might be. They may, however, represent a higher (or lower) "market segment" than pure unit owners. Moreover, they might more likely purchase for "vacation" ownership as opposed to "year-round" ownership. For all these reasons, they may have higher (or lower) expectations on amenities, finishes, furnishings, and the like. The existence of timeshare, fractional, or "second home" buyers may change the flavor of the project and its populace, perhaps discouraging the purchase of units by full-time residents. Thus, before going down that road, Owner will want to consider all possible consequences. Owner may decide to segment the project between full-time Owners and other types of Owners.

Secondary Market Requirements

Any ownership/leasing structure should be tested against the standards of the secondary market (e.g., Fannie Mae).

Condominium Regulatory Concerns

State condominium regulations often require Owner to give up Association control at a particular stage in unit sales. What happens if Owner or its affiliate happens to own many units for its own use and occupancy (or for use and occupancy by its personnel)? If Owner or its affiliate owns a majority of units through its ordinary ownership and investment activities, would Owner still need to give up control? Owner will want to consider these and other regulatory issues with local counsel.

Unit Pre-Emptive Rights

Does Owner want to obtain a "right of first refusal" or "right to match" for any unit sales within the project? Typically, measures like these will impair saleability and hence impair value, but Owner might structure them in a way to mitigate those consequences.

Parking

Unit owners will park their cars within the project garage, not part of any Tower(s). How best can Owner ensure that the unit owners have the permanent right to use their specific parking spaces? A condominium may be overly complex. A permanent license or easement may work. In any case, Owner will probably want a third-party garage company to operate the garage. Owner will want to consider these issues further. In a mixed-use project, Owner may find that different components have incompatible (or at least competing) expectations for the use of parking. Owner may ultimately

need to slice and dice the parking in a manner not all that different from the rest of the project.

HOW TO STRUCTURE THE PROJECT

• Although many of the options described above are interesting and some are creative, any Owner will probably be well advised—at least in the first instance—not to stray from the "usual" and "typical" way that one would expect any project like this one to be structured: multiple Tower leases held by multiple Associations, with each unit owner holding a condominium unit within a leasehold. The "marketplace" would also probably expect to see an REA (or perhaps a master condominium regime) in place, before the various Tower leases, to define the relationship among project components. The risk of "Leasehold conversion" seems fairly similar to any risk of eminent domain, and Owner should probably not make it the driving force, or even a major force, in structuring the project. Every investor in real estate faces the risk that some future politicians will decide they have a better idea for how privately owned real property should be owned or used. "Leasehold conversion" just amounts to a variation on that theme.

From that starting point, Owner may want to adopt these extra measures (as well as some of the others suggested above):

- Full disclosure of the lease termination date, as suggested above.
- A repurchase option at FMV within the REA, triggered by specific adverse events.
- To the extent reasonable and possible, integrate mission-related uses and ownership into the future for the project, in a clear and unambiguous way.

With these measures, Owner should be able to satisfy itself that a ground lease—and a leasehold condominium—can provide a solid foundation for a "for sale" apartment development. Owner could also reach a similar result through other alternatives this article suggests. Some of those alternatives vary quite dramatically from industry standards, though, and hence may invite objections.

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