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Tax Aspects of Modern Sale-Leasebacks of Real Property

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The modern ground lease appears to have gotten started with Safehold's initial public offering in 2017. As of August 18, Safehold's market capitalization was $2.78 billion, according to MarketWatch. The adoption of this "new" ground lease has accelerated as others have entered the space. Real estate investment firm Montgomery Street Partners launched a private real estate investment trust called GLR (short for ground lease REIT), which has $1.5 billion of investment capacity for ground lease transactions.[2] And Ares Management Corp. joined London-based global investor Regis Group amid the pandemic in late 2020 to launch Haven Capital, a private ground lease investment vehicle.

In the past, ground leases were bespoke affairs that often had fair market value rent resets. However, "over the last few decades, [ground leases] developed a bad reputation, as many real estate partnerships on high-profile assets in New York, like the Chrysler Building, the Lipstick Building and Lever House, went south, due to inherent, structural issues with the lease that were bound to materialize."[3] Often, older ground leases "were improperly sized to the value of the property and didn't exhibit a predictable cash flow stream."[4]

In place of this traditional ground lease, the modern ground leases are noteworthy in that they are generally sale-leaseback transactions with the following characteristics:

- they are sized to around 30 to 40 percent of the total combined value of the real property (the upfront payment);
- the initial annual rent is sized to a percentage of the upfront payment from the landlord-purchaser to the tenant-buyer (for example, 3.5 percent of the upfront payment);
- rent resets every 10 or 20 years based on the percentage change in the consumer price index;
- there are fixed rent escalations (for example, 2 percent annually); and
- for some transactions, there is an option for the tenant to buy back the property (a repurchase option).[5]

Abraham Leitner and Jonathan Stein examine fundamental tax issues raised by the evolving economics of modern sale-leasebacks, including the preferred tax treatment of lessors and lessees in this article for Tax Notes.

Click here to read the full article on Tax Notes.

[1]Cited in Mack Burke, “The Modern Ground Lease’s Proliferation Amid Covid-19,” *Commercial Observer*, Mar. 16, 2021.

[2]Business Wire, “Montgomery Street Partners Raises $500 Million in Private Follow-On Offering for The Ground Lease REIT Inc.,” May 16, 2022.

[3]Burke, *supra* note 1

[4]*Id.*

[5]*See, e.g.*, Montgomery Street Partners PowerPoint, “The GLR Ground Lease: A Compelling Financial Solution” (Apr. 2021).