

Expert Opinion **Real Estate**

## Ground Lease vs. Sale: Key Legal and Business Considerations

Whether a client is a property owner evaluating how best to monetize their land, or a developer deciding how to structure a project, it's important to understand the transactional differences, benefits, and risks of a ground lease versus a sale.

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**Frederick N. Poindexter (L) and Taylor N. Wilson (R) of Saul Ewing. Courtesy photos**

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When it comes to structuring a real estate deal, one of the most fundamental questions is whether the land should be leased under a long-term ground lease or sold outright. At first glance, the distinction may seem simple: a ground lease allows a landowner to retain ownership, and the tenant is permitted to use and improve the land, while a sale conveys fee title to the purchaser. But the legal, financial, and practical consequences of this choice are significant and can shape the future of a property for decades.

This decision isn't only about economics—it touches on control, flexibility, financing, taxes, and long-term planning. Whether a client is a property owner evaluating how best to monetize their land, or a developer deciding how to structure a project, it's important to understand the transactional differences, benefits, and risks of a ground lease versus a sale.

## **Ground Leases Are Back in Focus in Today's Market**

Ground leases have always been an important tool in real estate, but today's market conditions make the analysis especially prudent. With high interest rates and limited financing options, many developers are turning to ground leases to reduce upfront costs and still access prime land. On the other side, institutional and long-term landowners, such as universities, hospitals, religious organizations, and municipalities, often prefer ground leases because they allow the owner to retain the land, exercise some control over its use and development, and generate a revenue stream that offsets capital expenses.

From a legal perspective, ground leases are generally more complex than purchase agreements. They require careful attention to financing ability, rent escalations, mortgagee protections, default provisions, casualty and condemnation scenarios, and rights upon lease expiration. For both landlord and tenant, the decision between leasing and selling isn't just a business choice—it's a long-term legal strategy.

## **Considerations for Landlords/Property Owners: Balancing Long-Term Control Against Immediate Liquidity**

### **Ground Lease**

- ***Income Stream vs. Control:*** A properly structured ground lease provides predictable rental income (often with periodic escalations or fair market value resets), while preserving fee ownership of the land. However, rent escalations must

account for long-term market trends. Owners should carefully negotiate the rent adjustment mechanism, as the method for calculating renewal rental rates can materially affect long-term returns.

- **Reversionary Interest.** At lease expiration, the land, and typically all improvements on the land, revert to the landlord, which can result in significant future value. This is often to the benefit of long-term land holders, but may be a deterrent for a developer.
- **Financing and Subordination.** Lenders will almost always require “financeable lease” provisions, including nondisturbance and cure rights. Assignability of the leasehold interest is also a key consideration, as landowners may want some control over the assignee party, including standards of creditworthiness and operational expertise. Where tenants do obtain financing (secured by a leasehold mortgage), it is most common for the leasehold mortgagee to maintain a priority interest in the improvements, while the landowner’s mortgagee maintains a priority interest in the land. Owners must evaluate whether and to what extent to subordinate their fee interest to leasehold financing and to adjust the rental rates accordingly.
- **Risk Allocation.** The lease must clearly allocate obligations for taxes, insurance, maintenance, and casualty/condemnation events. In a true “net” ground lease, these obligations are pushed to the tenant, minimizing landlord risk. Landlords must also account for the risk of a failed development project by including terms that require financing and guaranties (completion or personal) in place prior to commencement of construction.
- **Liquidity and Exit.** While landlords retain ownership, selling a property subject to a ground lease may limit the pool of potential buyers and depress market value compared to a fee simple sale. Landlords may address this by negotiating termination or acquisition rights, which allow the landowner to terminate or acquire the tenant’s leasehold interest. The flexibility of recapturing the improvements early and unburdening the land must be weighed against the cost of exercising the right.

### Sale/Conveyance

- **Immediate Liquidity.** A conveyance delivers full value to the owner upfront, which can be advantageous where liquidity is a priority.
- **Loss of Control.** Once conveyed, the owner has no ongoing rights other than any restrictive covenants or deed restrictions negotiated at closing.

- **Tax Considerations:** A sale may trigger immediate recognition of capital gains, unless structured as part of a 1031 exchange. Owners must weigh the tax consequences of an outright sale against the deferral benefits of a ground lease structure.
- **Simplicity:** A sale eliminates long-term landlord obligations, tenant default risk, and ongoing management, but at the cost of future upside.

## Considerations for Tenants and Developers: Control and Capital

### Ground Lease

- **Control vs. Ownership:** A ground lease provides long-term control of land without the upfront capital outlay of a purchase, which might also allow a developer-tenant to enter a desirable market or develop a prime location. However, tenants must recognize that improvements will typically revert to the landlord upon lease expiration.
- **Financing:** In the case of leasehold financing, lenders often require predictable lender protections including: a sufficiently long term (generally 50–99 years); mortgagee notice and cure rights; nondisturbance provisions; and assignment rights without unreasonable landlord restrictions.
- **Economic Terms:** Rent obligations and escalation mechanisms can materially impact project feasibility. Furthermore, landlords often have an interest in the completion of the development, in which case, crunched construction timelines or limited control over construction schedules may impact the economic viability of a project.
- **Casualty and Condemnation:** Tenants should negotiate rights to insurance proceeds and condemnation awards, particularly where they have invested heavily in improvements.
- **Exit Strategy:** Selling or subleasing a leasehold interest is inherently more difficult than conveying fee title. Tenants must consider long-term transferability under both the leasehold mortgagee and landlord perspectives when evaluating the structure.

### Sale/Conveyance

- **Ownership Benefits:** Acquiring fee title provides perpetual ownership, the ability to capture appreciation, and full control over redevelopment, financing, and disposition.

- **Financing Advantages:** Lenders strongly prefer fee ownership as collateral, resulting in broader financing options and more favorable terms.
- **Upfront Capital Requirement:** Purchasing land requires a greater initial equity investment, which may not be feasible in a tight capital market.
- **Tax Treatment:** Unlike rent payments, which may be deductible, the purchase price of land must be capitalized and cannot be depreciated. Developers must weigh the tax efficiency of ownership against the deductibility of ground rent.
- **Flexibility:** Ownership eliminates landlord oversight and consent rights, giving the developer greater autonomy in operations, financing, and eventual disposition.

## Transfer Tax Implications: A Shared Concern

Both ground leases and outright sales can carry transfer tax consequences. In the case of an outright sale, a fee simple transfer almost always incurs transfer tax. Although the allocation of transfer tax liability is largely driven by jurisdictional custom, this is sometimes a critical negotiation point that can materially affect deal economics. As for ground leases, in many jurisdictions, a long-term lease (typically 30 years or more, including renewal options) is deemed a transfer of a real property interest for transfer tax purposes. This means that entering into a ground lease can trigger transfer tax obligations similar to a fee conveyance, even though ownership of the fee remains with the landlord.

## One Size Does *Not* Fit All: Choosing the Structure That Fits The Strategy

The decision between structuring a transaction as a ground lease or an outright sale is never one-size-fits-all. Each approach offers distinct benefits and risks, and the right choice depends on the parties' financial goals, long-term strategy, tax posture and risk tolerance. For landowners, the balance often comes down to immediate liquidity versus long-term control and income. For tenants and developers, the choice typically hinges on capital availability, market positioning, financing options and the importance of long-term ownership.

Because these structures create obligations and rights that can last for decades, and often survive multiple ownership changes, it is essential to carefully negotiate and document the terms from the outset. Rent adjustment and renewal provisions, financing protections, casualty and condemnation rights, and reversionary interests are just a few examples of issues that can have significant consequences over time. In today's market, where financing is challenging and creative deal structures are

increasingly important, fee conveyances remain at the center of many real estate strategies, but ground leases are a viable way achieve client goals.

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