

Ten Important Issues to Consider for a Balanced, Marketable and Financeable Greenfield Solar Ground Lease

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Renewable energy development is experiencing a gold rush of sorts in many parts of rural America, fueled by increasingly favorable solar power economics and the availability of federal and state tax credits and other local development authority incentives. With cost benefits and efficiencies gained in many cases by constructing a new solar electric generating facility (a **“Project”**) close to the existing transmission or distribution network, many commercial solar developers (**“Developers”**) are approaching multi-generational farmers and legacy landowners (**“Landowners”**) with long-term proposals to give up farming, timber and other historical uses of their real property (the **“Property”**) for a new kind of enterprise comprised of solar panels, inverters and collection systems. Developers and Landowners should each be aware of the other’s core concerns when negotiating real property site control agreements that can provide substantial benefits to both parties throughout the various stages of their relationship. To that end, the parties should consider the following ten important issues to ensure their Project site control agreements are marketable and financeable, but also balanced with adequate Landowner protections in consideration of their often long-standing ownership and historical uses of the Property.

1. Consider a Solar Option with the Form of Proposed Solar Lease Attached.

To limit risk during the early stages of Project development, a Developer will often structure the site control agreement for a proposed Project as an option to lease

agreement (a “**Solar Option**”), rather than a binding, long-term solar lease agreement (a “**Solar Lease**”). A Solar Option provides the Developer an exclusive option to require the Landowner to enter into a binding Solar Lease for the Property at some future date in its sole discretion, instead of locking the Developer into a long-term agreement that may contain significant payment obligations at the beginning of its Project development cycle. At this early stage, the Developer has probably not had the opportunity to complete critical development activities including Property due diligence. During the option term (the “**Option Period**”), the Landowner is often permitted to continue its existing uses of the Property while the Developer completes necessary due diligence and satisfies other conditions to moving forward with Project construction. A Solar Option should include, ideally as an attached exhibit, the final, mutually acceptable form of Solar Lease that will bind the parties if the Developer elects to move forward with construction. Once a Developer completes necessary early-stage development requirements such as securing a power purchase agreement (“**PPA**”) for the Project’s output, it can then freely exercise the Solar Option and commence to lease the Property from the Landowner without risk of delay or further negotiations with the Landowner.

Another important reason a Developer may prefer to enter into a Solar Option instead of immediately entering into a Solar Lease is that, in some jurisdictions, merely executing or recording a Solar Lease can trigger negative tax and property assessment implications that may not apply when executing or recording a Solar Option. Before entering into any type of real property use arrangement, a Developer should first discuss with the Landowner whether the Property is then enrolled in any federal, state or local preferential tax or covenant programs tied to the existing use of the Property. In cases where all or part of the Property is actively enrolled in a program, the Parties should determine if and when any change in use to solar generation would negatively impact the program or any preferential economic treatment of the Property, what the ramifications would be, including any applicable penalties or roll back taxes, and who will be responsible for those additional costs.

2. Use the Option Period To Complete Early Stage Development Requirements.

Developers use the Option Period to evaluate the Project’s suitability and to conduct further due diligence on the Property, including studying the local permitting and regulatory structure, reviewing the Property’s environmental attributes and otherwise finalizing the Project’s design. During this period, Landowners often permit the Developer to conduct only specific, non-invasive inspections of the Property, deferring more invasive inspections of, and activities on, the Property until the Solar Lease commences and all of its protective provisions become available to the Landowner. These protective provisions typically include requirements for the maintenance of certain Developer insurances, establishment of the Developer’s standard of care, and other Developer covenants in favor of the Landowner, many of which are often

supported by an indemnity. Developers, on the other hand, will seek as much latitude as possible during the Option Period so that they may conduct a wide range of due diligence activities aiming to reduce the risk of entering into long-term arrangements without knowing the potential development risks that may arise.

In addition to expressly clarifying the Developer's access and use rights during the Option Period, the parties should also address in detail which uses the Landowner would be permitted to continue on the Property before the lease term commences. These may include farming, growing timber, livestock grazing and recreational activities that permit the Landowner to continue its enjoyment of the Property while still affording the Developer access to the Property to complete its preliminary work. Developers will want to restrict any third-party rights to use the Property, in both scope and duration, so that the Developer's efforts are not impeded and any risk of delays in starting Project construction is minimized.

A Solar Option usually has an Option Period that ranges between three and five years and is structured so that the Developer pays the Landowner one or more fees (often payable annually) during the Option Period, the breach of which obligation would ordinarily permit the Landlord to terminate the Solar Option prior to the end of the Option Period. The fee may be fixed or escalate annually. Some Solar Options, however, are structured to require only a fixed, one-time payment made on the effective date of the agreement. The length of the Option Period may also vary from jurisdiction to jurisdiction based on the anticipated time the Developer may require to secure a PPA or to complete fundamental due diligence, permitting, and other development activities.

One of the most critical issues for a Developer in the Solar Option is its right to terminate without penalty at any time during the Option Period if it determines the proposed Project is not feasible. While Landowners will often agree to allow Developers to have sweeping termination rights during the Option Period, Landowners will not usually agree to reimburse Developers for any Solar Option payments they have already made unless the reason for termination is due to the fault or misrepresentation of the Landowner.

3. Carefully Due Diligence Real Property Title Issues.

Before it exercises its right to lease under the Solar Option (and preferably early in the Option Period), it is critical for a Developer to analyze all material real estate ownership rights to the Property. This examination should include a title search and close review of all title documents affecting any portions of the Property to determine whether any third-party rights might adversely affect the development or use of the Property. Unlike wind projects, the structures that comprise a solar development are typically very concentrated on the Property due to the compact installation of the solar

panel strings and blocks. Consequently, any third-party rights affecting even a small portion of the Property could have a significant impact on the Project and put its marketability and the Developer's ability to obtain financing in jeopardy.

To this end, Developers usually work closely with title companies and real estate attorneys prior to or during the Option Period to examine title to the Property as reflected in the public record. This effort includes ordering searches on all access, transmission and other easement areas necessary for the Project. In particular, a Developer should carefully review and evaluate mineral and other subsurface ownership rights in light of the proposed development plan for the Property.

Title coverage can also play an important part in minimizing real property related risks of the Project. In addition to any specific exceptions listed in a title commitment that could restrict the use of the Property, a Developer should also closely review and discuss with its title representative and real estate counsel any general exceptions to title coverage the title company may attempt to take, including exceptions for mechanic's liens, survey matters, unrecorded agreements, and mineral rights. These exceptions can render title coverage meaningless if not properly limited or endorsed over. In that regard, Developers and their counsel should be very familiar with the ALTA 36 series of endorsements, which offer additional title coverage to the policy and are designed specifically for energy projects such as solar generation facilities.

While searching title to the Property, the Developer should also discuss with the Landowner whether it is aware of any unrecorded liens or other encumbrances (including verbal or written agreements with third parties) affecting the Property. Title companies are usually unable to discover and identify these types of unrecorded claims or agreements by searching the public record and will therefore include them as part of a general exception in their title commitments and final policies, creating gaps in their title coverage. As a result, Developers usually require Landowners to make an affirmative representation in the Solar Lease (and often in an Owner Affidavit for the benefit of the title company) that no such unrecorded agreements or encumbrances affecting the Property exist.

4. Understand How PPAs Affect Your Solar Lease Term.

Developers must ensure that the term of the Solar Lease matches or exceeds the term of the Project's PPA, taking into consideration the specific milestones in the PPA and Solar Lease that trigger commencement of the term. Banks or other entities providing debt financing for the Project (each, a "Lender") will also want to ensure that the term of the Solar Lease extends well beyond the maturity date of its loan to the Developer, with a significant buffer to permit the Lender to refinance the loan if desired during the Solar Lease term. A Solar Lease term of between twenty and thirty years usually satisfies these requirements. In addition, a Developer will also typically require an

option to extend the Solar Lease term for one or more renewal or extension periods (a “Renewal Period”) exercisable by the Developer in its discretion. The duration of each Renewal Period is typically the same and commonly consists of a five year period, commencing upon the completion of the initial Solar Lease term or the preceding Renewal Period. Landowners usually agree to these renewal terms so long as the Developer is not in material default under the Solar Lease at the time the Developer exercises its option for a Renewal Period.

5. Agree on Broad Developer Permitted Uses and Easements.

Landowners and Developers often agree in the Solar Lease to a broad set of permitted Developer uses that relate to those activities which are reasonably necessary for a Developer to develop, construct, test, operate, maintain and remove the Project. Additionally, Developers often require Landowners to grant certain easements in the Solar Lease that ensure the Developer will enjoy unobstructed solar radiance on the Property, the siting of necessary transmission and interconnection facilities, unrestricted pedestrian and vehicular access on the Property and to the Project, installation of necessary fencing and roads, and trimming of any vegetation that could cause shading of the Project.

In comparison, real property developers in other industries often require unrestricted rights to use the property “for any lawful purpose,” thereby enhancing the likelihood that the leasehold interest will be financeable by permitting Lenders to step in and easily transfer the Developer’s leasehold interest to a third party, which transferee would be free to make whatever use of the property it desired. While that position may maximize the marketability of the ground lease, Developers in the solar market should agree to reasonably limit their use of the Property to activities related to solar power generation and transmission to accommodate the concerns of Landowners who may have specific views about how their Property should be used. These Landowners often reside adjacent or very near to the Property and may have historical connections with the Property and its improvements. Similarly, Lenders should be satisfied if the Solar Lease provides broad solar use rights so long as Lenders are granted a right to enter the Property, to step into the Developer’s shoes upon any Developer default, and to freely (without consent restrictions) assign the Solar Lease and transfer the Project to a third party.

6. Establish Predictable Rents and Escalation.

In exchange for the right to occupy the Property and develop the Project after the Option Period, the Developer will be required to pay rent to the Landowner during the term of the Solar Lease. Solar Lease rents may substantially exceed any rents or other cash flows the Landowner would otherwise receive from the existing Property uses. Given the somewhat speculative long-term prospects of the discretionary Solar Option structure, it is often the prospect of securing the predictable, multi-year cash flow

stream from the Solar Lease rental payments that entices the Landowner to abandon its existing use of the Property and enter into such an arrangement in the first place.

Under typical Solar Leases, rent is often calculated on a per-acre basis, and the Developer is given the flexibility during the Option Period to reduce the overall acreage that it will ultimately lease. The rent provision often includes an annual escalator, which is a negotiated escalation mechanism that increases the applicable rental amount each year. This escalator is typically expressed as a percentage increase over the prior year's rent. Escalation can be fixed, based on an index (which can be much less predictable), or tied to the Developer's achievement of certain Project development milestones.

7. Limit Defaults and Expand Cure Rights.

Solar Leases typically obligate Landowners to provide Developers with written notice of any Developer defaults (of which the Landowner becomes aware) and an opportunity to cure such defaults. This enables the Developer potentially to preserve the significant investment it and its Lenders have made in the Project. Lenders will also commonly require that separate and concurrent notice of any Developer defaults be delivered to any Lenders of which the Landowner has been given notice, and they will insist that the Landowner permit any such Lenders to have an additional, independent and extended right to cure that default after the Developer's specified cure periods have expired, regardless of whether or not the Developer attempts to cure the default in its own right. This additional period to cure Developer defaults is an important Lender protection beyond just preserving the Developer's leasehold estate under the Solar Lease because it also affords the Lender time to initiate foreclosure proceedings under its mortgage or similar security instrument (a "**Mortgage**").

Without the rights to receive notice of Developer non-performance, to step in and cure Developer defaults and, if necessary, to foreclose on the Mortgage and take possession of the Property, the Lender would risk the loss of its collateral, including the leasehold estate granted to the Developer by the Landowner. Thus, the notice and step-in rights are among the most important protections Lenders require, without which a Solar Lease would not be financeable. Landowners usually become comfortable with these additional Lender rights if a requirement also exists for the Lender to cure any payment defaults that may exist. With this protection, Landowners can be assured that their rental cash flows will continue even if other aspects of the Solar Lease remain in default. Further, if a Landowner continues to receive rental payments from the Lender as they become due, the Landowner would ordinarily be comfortable waiving certain non-monetary defaults that by their very nature are personal to the Developer and therefore incapable of being cured by a Lender.

8. Narrow Landowner Termination Rights.

The continuation of the Solar Lease for the duration of its term is of critical importance to both Lenders and Developers because if a Developer's leasehold or other real property interest is terminated or expires, the Lender's security for its loan either ceases to exist or is severely diminished. Therefore, Developers will often heavily negotiate, and may seek to limit or remove altogether, any proposed Landowner termination rights to ensure the Solar Lease will be marketable and financeable. If termination by the Landowner is limited only to situations where the Developer has materially deviated from its permitted uses under the Solar Lease and such non-permitted use continues after the Landowner has provided notice and an opportunity to cure, the parties can achieve a balance between the Developer's and Lender's need to ensure the continuation of the Solar Lease and the Landowner's interest that its Property is used only for the purposes the parties intended when they entered into the Solar Lease.

9. Negotiate Broad Assignment and Sublease Rights.

Developers and their Lenders will often require broad assignment and sublease rights in the Solar Lease (without the Landowners' consent or approval whenever possible) to ensure that the Developer can easily transfer the Solar Lease to an affiliate or an unrelated third party. Broad assignment and sublease rights also permit the Lender, in the case of step-in and foreclosure, to freely transfer and assign the Developer's rights and obligations under the Solar Lease to any third party. These are critical Lender rights, and the Solar Lease will not be financeable without these added rights.

Agricultural and other generational Landowners are often uncomfortable agreeing to such broad assignment and sublease rights without assurances that the assignor or sublessee adequate solar development and operation experience, will continue to pay the rent as it becomes due, and has the financial ability to remove the improvements at the end of the Solar Lease term if required by Landowner. In these cases, Landowners ordinarily become comfortable allowing assignment to a company that is affiliated with Developer, without any right to consent.

The Landowner may, however, seek reasonable restrictions on assignments to unrelated third parties, with exceptions. The Landowner will often permit third-party assignments without its consent if the potential assignee is replacing the Developer as party to the Project's PPA, in which case such replacement entity will continue to receive the predictable cash flows generated by the Project's output and would therefore have financial wherewithal and be financially incentivized to act as a good partner with the Landowner. Similarly, the Landowner will typically agree to third party assignments without its consent if the potential assignee can prove it has the industry experience and access to capital necessary for it to complete the construction, operation and eventual removal of the Project during the Solar Lease term.

In addition to broad assignment and sublease rights, Developers will also want assurances that they will be released from prospective liability under the Solar Lease after they assign their leasehold rights. As conditions to the assignment, Landowners should require that the Developer provide them with an executed copy of the assignment and assumption agreement (or other instrument) documenting the new entity's assumption of the Developer's rights and obligations under the then-effective Solar Lease and that the Developer remain liable for all liabilities and obligations accruing on or prior to the effective date of the assignment. Further, the parties should determine whether any bonds or other security instruments supporting the Developer's Project obligations must be assigned or replaced in connection with the assignment.

10. Include Standard Lender Protections to Make the Solar Lease Financeable.

As noted above, the bundle of rights and obligations documented in the Solar Lease enables Lenders to value the leasehold interest for purposes of making the loan and to protect their rights through foreclosure on the leasehold interest if required. As such, Developers typically require Landowners to include in the Solar Lease several often lengthy provisions for the benefit of their Lenders. These include Lender notice and cure rights as discussed above, limitations on lease modifications or terminations without Lenders' prior approval, subordination, and certain other Lender rights and requirements discussed in greater detail below. These Lender requirements have become accepted as an industry standard, and if they are not initially included in the Solar Lease, a Lender will typically require an estoppel agreement or an amendment to the Solar Lease containing these protections before the Lender will close financing for the Project.

Limit Lease Modifications or Amendments without Lender's Consent

Lenders will require that the Solar Lease include language prohibiting amendments, modifications, terminations, surrenders or cancellations of the Solar Lease without the Lenders' prior written consent. This type of restriction is often acceptable to Landowners, but in many cases it is appropriate to carve out from such restriction any modifications that do not materially impair the value of the Solar Lease, the Developer's or the Lenders' rights thereunder, or the Lenders' secured position with respect to the Solar Lease and the Project.

Address New Lease Rights

The terms of the Solar Lease may provide that it will terminate upon the bankruptcy of the Developer, and in certain other cases of Developer default. As explained above, the risk of termination of the Solar Lease is of critical importance to the Lender because the real property interests created pursuant to the Solar Lease are an important part of the collateral securing the Lender's loan to the Developer. Consequently, the Lender will often require that the Solar Lease include provisions obligating the Landowner to enter into a new Solar Lease with the Lender, if requested, on the same terms and conditions

as in the original Solar Lease, and with the same priority as the original Solar Lease with respect to other interests in and encumbrances on the Property. Provided the Lender is required to pay the Landowner's reasonable costs and expenses to document this new Solar Lease with Lender, and the new Solar Lease continues only for the unexpired term of the original Solar Lease and upon the same general terms, Landowners should consider agreeing to this Lender requirement as it preserves the status quo on the Property and ensures continuation of the rental payment stream to the Landowner that was otherwise due under the original Solar Lease.

Non-Disturbance Agreements and Estoppels

Developers should determine whether there are any Mortgages or other monetary liens or encumbrances affecting the Property as part of their ongoing due diligence efforts. Depending on state law, these liens or encumbrances on the Property's fee interest may have priority over the leasehold interest. Consequently, Developers and their Lenders customarily require Landowners and the holders of any Mortgages, liens or other monetary encumbrances to remove, subordinate or enter into non-disturbance agreements with the Developers and Lenders so that their leasehold interest in the Property will not be restricted or wiped out by these liens or encumbrances. It is also customary for the Solar Lease to require that the parties provide estoppel agreements to any Lenders or prospective purchasers upon reasonable written request and within a reasonable timeframe in order to verify material Solar Lease terms and to ensure there are no ongoing uncured defaults under the Solar Lease affecting the Property.

In addition to considering these ten important general issues (with the acknowledgement that there are many other important general issues not touched upon in this article), each Project and Property will also have its own unique real property and other development concerns that will need to be addressed in the Solar Lease or other site control agreement. These issues will of course impact the representations and warranties, indemnifications, disclosures and other provisions in the Solar Lease and other Project agreements. Ultimately, however, Developers need a marketable and financeable Solar Lease, and Landowners want a predictable rent stream and a good partnership with Developers that accommodates their unique property concerns and affords protections that are appropriate to development of a greenfield property with long-term Landowners vested in the land and surrounding community.