Can anyone explain how I should go about setting a rate for a ground lease on a piece of undeveloped property that is just under an acre in size?

Tenant would be a global corporation. Property sits in a well trafficked area on two major arteries in the city.

Going to sit with these people in the next few days and I want to have some basic ideas of what to say when we get to the topic of the ground lease. TIA.

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Swindler42 • 2y ago

NNN lease with tenant paying all taxes insurance and maintenance.

5-8% of the fair market value of the property with 2-3% escalations annually. Let them control it for max 40-60yrs (including options). You can make the rent for years 40+ Fair Market Value but not less than prior terms rent.

This assumes they don't want to obligate LL to do any word or make any improvements / contributions.

Use your attorney to write up the agreement or make comments to theirs.

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The stream of income represented by the terms of the ground lease has a value and the ground rent capitalization method is one way to estimate the market value of the land.

How Ground Rent Capitalization is Calculated

The formula used to "capitalize" ground rent is very simple. It is Annual Income / Capitalization Rate. To understand it works, it is helpful to understand how each of these inputs are derived.

Annual income represents the amount of annual rent, net of operating expenses. In a typical ground rent scenario, there aren't likely to be many operating expenses, but they usually include things like property taxes, insurance, depreciation, and some small amount of maintenance. For example, if the annual ground rent is $150,000 and the operating expenses are $25,000, the number to use in the numerator would be $125,000.

The capitalization rate can be a little bit trickier to figure out, but it is generally a combination of the expected rate of return on the investment and the cap rate on sales of comparable properties. It should be noted that the cap rate has an inverse relationship to land value. A higher cap rate means that investors are demanding a higher rate of return on the asset so they would place a lower value on the property. Alternatively, a lower cap rate means that the land valuation is higher. For the example above, assume a cap rate of 8%

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So, if the annual income is $125,000 and the cap rate is 8%, the estimated value of the property is $125,000 / 8% or $1,562,500.

When to Use The Ground Rent