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The Reversionary Process: When What Was Once Theirs, Becomes Yours

- Improvement reversion at the end of a long-term ground lease is like most things in life - a mixed bag, neither Fish nor Fowl and a definite Maybe.
- You never know what it is your going to get until you take possession. A hangar that looks good from the outside can turn into a money pit.
- Because of their more public oriented use, FBO properties tend to be in worse condition on reversion than corporate facilities.
- Determining a rental rate for both land and improvement for a tenant wishes to remain in the structure can be one of the most difficult negotiations to conduct.
- Lease provisions that give the lessor the option of taking title to a structure or requiring the lessee to demolish it are fine in theory, but its rare that a departing tenant takes the time and expense to return the site to virgin condition.
- The onset of reversion may be most valuable as a tool to increase the ground rent and or get a cash payment in return for a ground lease extension.

One of the most common phrases uttered relating to airport property is "the improvement reverts to the airport at the expiration of the ground lease". When the airport owner takes possession of improvements, it is generally at the end of a long-term ground lease which has provided a steady stream of rental payments. The practical nature of reversion indicates that it is a more complex challenge for the airport owner than merely signing the papers and accepting the keys from the prior owner. Owning what can be a large, potentially complicated building and related site improvement can create a number of challenges. Many airport managers report that the reversion process, while sounding good, creates a number of headaches and expenses which have altered their perception of the process' overall desirability.

There are two basic types of reversionary scenarios. The first relates to a long term lessee is surrendering title to the structure and does so with the intention of continuing a presence on the airport. The second type relates to a building which is turned over to the airport owner as a result of both the expiration of the ground lease and the lessee's departure. The latter of the two situations is by far the most complex for the airport owner.

When you're losing a tenant but gaining an improvement, the basic challenge is to determine what, if any, modifications need to be made in the property, and then try to lease it. It is difficult to make any vacant property look appealing the day after it is abandoned by a tenant. Hopefully your lessee will have implemented preventive maintenance, and you have monitored closely the overall condition of the structure. The first major challenge is to inspect the property and ascertain the overall condition of the building. This means ignoring the debris and desultory impression that most any structure will give after a tenant has moved out. The essential building systems such as HVAC, the operational integrity of the hangar door system, the condition of any office space and the condition of exterior improvements such as aircraft ramp and vehicle parking area are particularly critical.

Not surprisingly, the best maintained properties tend to be corporate hangars. This is due to the fact that the property serves a very narrow and limited function. Fixed base operations serve a much broader role on the airport, and tend to naturally exhibit much more wear and tear when the airport finally takes possession.

Physical depreciation inflicted on the arrival and departure Lounge, the traffic which may have been generated on the adjacent ramp area and the maintenance work which took place in the hangar and the shop area all tend to exhibit evidence of hard use. FBOs are also less free with their money in terms of keeping a structure in good shape and must allocate their cash differently than the average corporate operator.

In anticipation of the departing tenant, the airport should allocate a modest sinking fund to cover expenses which may be necessary to bring the property up to leaseable condition. This can begin by anticipating the reversion as early as five years before the fact and recognizing that some amount, however moderate, may be necessary to correct problems found in the property. A detailed engineer's inspection one to two years before you gain possession is money well spent.

If a tenant is interested in staying on at the airport, then the reversionary process becomes a simpler process. The tenant who wishes to continue to occupy the structure will impose much less burden on the airport with regard to repairs and maintenance. The main challenge relates to agreeing to a rental rate. Because a tenant has built and occupied the structure for a period of time, the tenant's perception of value may be somewhat out of touch with the rental market for the type of property it occupies. Additional problems can be caused by growth of the airport which has affected the Highest and Best Use of the property. A hangar which at one time was most valuable as an FBO hangar, may command much higher rentals if converted to corporate occupancy. This is a decision airport management has to make in determining where the most value can be obtained. FBOs are reluctant to match corporate hangar rental rates, and this will generally destroy the economic viability of the property location as an FBO. If the airport elects to maintain a use consistent with the previous occupancy,

comparable rentals can be gathered by examining similar type property at other airports and getting an overall feel for the market. The process can be long and sometimes contentious, but if both parties are sufficiently motivated, a fair deal is generally worked out.

The complexities and the potential problems which can result from inheriting a fuel farm is a subject for a book, not a newsletter. Suffice it to say if a property reverts with an older fuel farm, airport management will be faced with a number of options, some of them distinctly unpleasant and expensive.

Some airport managers are extracting value through the extension of underlying ground leases. In this way, an airport can often increase the rental rate through renegotiations, and a tenant can enjoy the benefits of ownership for a longer period of time. This can be particularly useful when a tenant wishes to make improvements to a property and amortize them. Since the average ground lease made today is approximately 10 years longer than ground leases made 10 to 15 years ago, the extension of a ground lease term is favorably viewed by most airside tenants. This is particularly true for those which obtain long-term financing on their improvements.