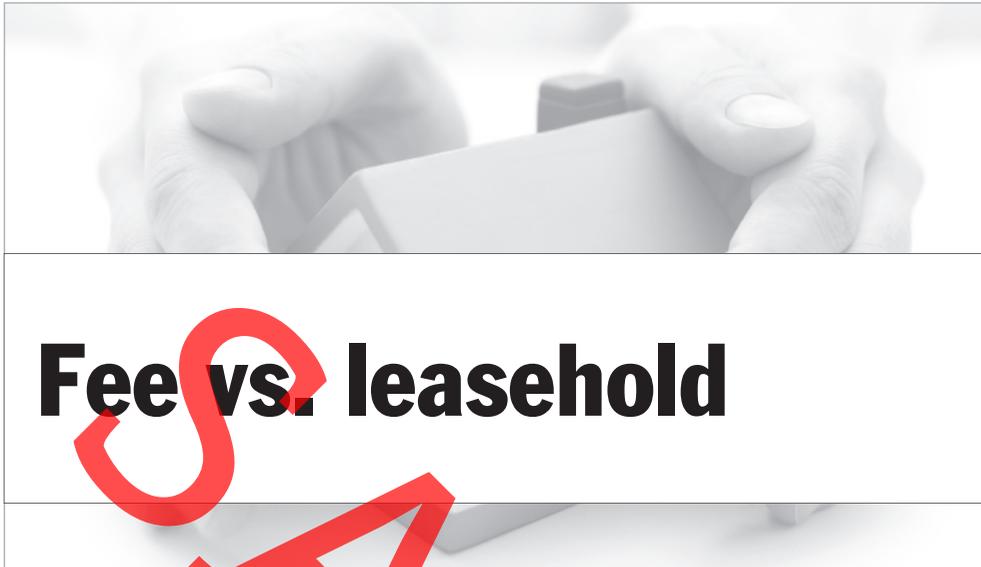


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**Real Estate
Property
Management**

Sixth Edition



Fee vs. leasehold

Chapter 1



After reading this chapter, you will be able to:

- identify the different possessory interests held in real estate, and the rights and obligations associated with each;
- distinguish the individual rights which collectively comprise real property;
- identify the different types of leasehold interests held by tenants;
- understand leasehold interests which convey special rights, such as a ground lease, master lease or sublease.

Learning Objectives

estate

fee estate

fixed-term tenancy

ground lease

impairment

leasehold estate

legal description

life estate

master lease

parcel

profit a prendre

sublease

tenancy-at-sufferance

tenancy-at-will

Key Terms

Real estate, sometimes legally called *real property* or *realty*, consists of:

- the land;
- the improvements and fixtures attached to the land; and
- all rights incidental or belonging to the property.¹

A matter of possession

¹ Calif. Civil Code §658

parcel

A three-dimensional portion of real estate identified by a legal description.

legal description

The description used to locate and set boundaries for a parcel of real estate.

A **parcel** of real estate is located by circumscribing its **legal description** on the “face of the earth.” Based on the legal description, a surveyor locates and sets the corners and surface boundaries of the parcel. The legal description is contained in deeds, subdivision maps or government surveys relating to the property.

All permanent structures, crops and timber are part of the parcel of real estate. The parcel of real estate also includes buildings, fences, trees, watercourses and easements within the parcel’s boundaries.

A parcel of real estate is three dimensional. In addition to the surface area within the boundaries, a parcel of real estate consists of:

- the soil below the parcel’s surface to the core of the earth, including water and minerals; and
- the air space above it to infinity.

For instance, the rental of a boat slip includes the water and the land below it. Both the water and land below the boat slip comprise the real estate, the parcel leased. Thus, landlord/tenant law controls the rental of the slip.

In the case of a statutory condominium unit, the air space enclosed within the walls is the real estate conveyed and held by the fee owner of the unit. The structure, land and air space outside the unit are the property of the **homeowners’ association (HOA)**.

Possessory interests in real estate

estate

The ownership interest a person may hold in real estate.

The ownership interests a person may hold in real estate are called **estates**. Four types of *estates* exist in real estate:

- *fee estates*, also known as *fee simple estates*, *inheritance estates*, *perpetual estates*, or simply, *the fee*;
- *life estates*;
- *leasehold estates*, sometimes called *leaseholds*, or *estates for years*; and
- *estates at will*, also known as *tenancies-at-will*.²

In practice, these estates are separated into three categories: *fee estates*, *life estates* and *leasehold estates*. Estates at will are considered part of the leasehold estates category. Leasehold estates are controlled by landlord/tenant law.

Fee estates: unbundling the rights

fee estate

An indefinite, exclusive and absolute legal ownership interest in a parcel of real estate.

A person who holds a **fee estate** interest in real estate is a fee owner. In a landlord/tenant context, the fee owner is the landlord.

Editor’s note — If a sublease exists on a commercial property, the master tenant is the “landlord” of the subtenant.

A fee owner has the right to possess and control their property indefinitely. A fee owner’s possession is exclusive and absolute. Thus, the owner has the

² CC §761

Consider a fee owner who grants separate fee interests in their property to two individuals. One individual receives the land's surface and air space rights. The other individual receives the subsurface oil and mineral rights.

The surface owner claims title to the entire parcel of real estate should be vested — quieted — in their name. The subsurface owner objects, claiming the surface owner's real estate interest is less than the entire fee estate in the property.

Here, the surface owner's fee interest in the parcel of real estate is separate from the subsurface ownership and possession of the oil and mineral rights. Also, they are not co-owners of the real estate. Both owners hold an individual fee estate in mutually exclusive and divided portions of the same parcel. [In re Waltz (1925) 197 C 263]

Case in point

Separation of
fee interests

right to deny others permission to cross their boundaries. No one can be on the owner's property without their consent, otherwise they are trespassing. The owner may recover any money losses caused by the trespass.

A fee owner has the exclusive right to use and enjoy the property. As long as local ordinances such as building codes and zoning regulations are obeyed, a fee owner may do as they please with their property. A fee owner may build new buildings, tear down old ones, plant trees and shrubs, grow crops or simply leave the property unattended.

A fee owner may occupy, sell, lease or encumber their parcel of real estate, give it away or pass it on to anyone they choose on their death. The fee estate is the interest in real estate transferred in a real estate sales transaction, unless a lesser interest such as an easement or life estate is noted. However, one cannot transfer an interest greater than they received.

A fee owner is entitled to the land's surface and anything permanently located above or below it.³

The ownership interests in one parcel may be separated into several fee interests. One person may own the mineral rights beneath the surface, another may own the surface rights, and yet another may own the rights to the air space. Each solely owned interest is held in fee in the same parcel. [See Case in point, "Separation of fee interests"]

Separate
interests

In most cases, one or more individuals own the entire fee and lease the rights to extract underground oil or minerals to others. Thus, a fee owner can convey a leasehold estate in the oil and minerals while retaining their fee interest. The drilling rights separated from the fee ownership are called **profit a prendre**.⁴

profit a prendre
The right to remove
minerals from
another's real estate.

Profit a prendre is the right to remove profitable materials from property owned and possessed by another. If the profit a prendre is created by a lease agreement, it is a type of easement.⁵

³ CC §829

⁴ *Rousselot v. Spanier* (1976) 60 C3d 238

⁵ *Gerhard v. Stephens* (1968) 68 C2d 864

Life estates and the life tenant

life estate

An interest in a parcel of real estate lasting the lifetime of the life tenant.

A **life estate** is an interest in a parcel of real estate lasting the lifetime of an individual, usually the life of the tenant. *Life estates* are granted by a deed entered into by the fee owner, an executor under a will or by a trustee under an inter vivos trust.

Life estates are commonly established by a fee owner who wishes to provide a home or financial security for another person (the life tenant) during that person's lifetime, called the controlling life.

Life estates terminate on the death of the controlling life. Life estates may also be terminated by agreement or by merger of different ownership interests in the property.

For example, the fee owner of a vacation home has an elderly aunt who needs a place to live. The fee owner grants her a life estate in the vacation home for the duration of her lifetime. The aunt may live there for the rest of her life, even if she outlives the fee owner who granted her the life estate.

Although the aunt has the right of exclusive possession of the entire parcel of real estate, the fee owner retains title to the fee estate. Thus, the conveyance of a life estate transfers a right of possession which has been "carved out" of the fee estate. This is comparable to possession under a leasehold estate since it is conveyed for its duration out of a fee estate. Unlike a lease, a life estate does not require rent to be paid.

On the aunt's death, possession of the property reverts to the fee owner, their successors or heirs. The right of possession under the life estate is extinguished on the aunt's death.

The holder of a life estate based on their life has the right of possession until death, as though they were the owner in fee. The holder of a life estate is responsible for taxes, maintenance and a reasonable amount of property assessments.⁶

The life estate improves or impairs the fee

impairment

The act of injuring or diminishing the value of a fee interest.

The holder of a life estate may not *impair* the fee interest.⁷

For instance, the holder of a life estate may not make alterations which decrease the property's value, such as removing or failing to care for valuable plants or demolishing portions of the improvements or land.

Conversely, the owner of the life estate has the right to lease the property to others and collect and retain all rents produced by the property during the term of the life estate.

In addition, a life tenant is entitled to be reimbursed by the fee owner for the fee owner's share of the costs to improve the property.

⁶ CC §840

⁷ CC §818

Leasehold estates, or *tenancies*, are the result of rights conveyed to a tenant by a fee owner (or by the life estate tenant or master lessee) to possess a parcel of real estate.

Tenancies are created when the landlord and the tenant enter into a rental or lease agreement that conveys a possessory interest in the real estate to the tenant.

The tenant becomes the owner of a leasehold with the right to possess and use the entire property until the lease expires. The ownership and title to the fee interest in the property remains with the landlord throughout the term of the leasehold. The landlord's fee interest is subject to the tenant's right of possession, which is carved out of the fee on entering into the lease agreement.

In exchange for the right to occupy and use the property, the landlord is entitled to rental income from the tenant during the period of the tenancy.

Four types of leasehold estates exist and can be held by tenants. The interests are classified by the length of their term:

- a **fixed-term tenancy**, simply known as a *lease* and legally called an *estate for years*;
- a **periodic tenancy**, usually referred to as a *rental*;
- a **tenancy-at-will**, previously introduced as an *estate at will*; and
- a **tenancy-at-sufferance**, commonly called a *holdover tenancy*.

A *fixed-term tenancy* lasts for a specific length of time as stated in a lease agreement entered into by a landlord and tenant. On expiration of the lease term, the tenant's right of possession automatically terminates unless it is extended or renewed by another agreement, such as an option agreement. [See Figure 1, Form 552 §2]

Periodic tenancies also last for a specific length of time, such as a week, month or year. Under a periodic tenancy, the landlord and tenant agree to automatic successive rental periods of the same length of time, such as in a month-to-month tenancy, until terminated by notice by either the landlord or the tenant.

In a **tenancy-at-will** (also known as an *estate at will*) the tenant has the right to possess a property with the consent of the fee owner. Tenancies-at-will can be terminated at any time by an advance notice from either the landlord or the tenant or as set by agreement. Tenancies-at-will do not have a fixed duration, are usually not in writing and a rent obligation generally does not exist.

A **tenancy-at-sufferance** occurs when a tenant retains possession of the rented premises after the tenancy granted terminates. [See Chapter 3]

Leasehold estates held by tenants

leasehold estate

The right to possess a parcel of land, conveyed by a fee owner (landlord) to a tenant.

Types of leaseholds

fixed-term tenancy

A leasehold interest which lasts for the specific lease period set forth in a lease agreement. A fixed-term tenancy automatically terminates at the end of the lease period. [See RPI Form 550 and 552]

tenancy-at-will

A leasehold interest granted to a tenant, with no fixed duration of rent owed. A tenancy-at-will can be terminated at any time by an advance notice from either party.

tenancy-at-sufferance

A leasehold interest held by a tenant who retains possession of the rented premises after the termination of the tenancy. [See RPI Form 550 §3.3]

Figure 1

Excerpt from Form 552

Commercial Lease Agreement

Gross — Single Tenant

2. TERM OF LEASE:

2.1 The lease granted commences _____, 20____, and expires _____, 20____.

a. The month of commencement is the anniversary month.

2.2 The lease terminates on the last day of the term without further notice.

2.3 If Tenant holds over, the monthly rent will be increased to 120% of the monthly rent applicable immediately preceding the termination of this lease agreement, prorated at 1/30th of the monthly rent for each day until the Premises is delivered to Landlord.

2.4 Tenant may surrender this lease only by a written surrender agreement with Landlord. [See RPI Form 587]

2.5 This lease agreement is a sublease of the Premises which is limited in its terms by the terms and conditions of the attached master lease agreement.

Leaseholds conveying special uses

In addition to the typical residential and commercial leases, you will find *special use* leases.

Oil, gas, water and mineral leases convey the right to use mineral deposits below the earth's surface.

The purpose of an *oil lease* is to discover and produce oil or gas. The lease is a tool used by the fee owner of the property to develop and realize the wealth of the land. The tenant provides the money and machinery for exploration, development and operations.

The tenant pays the landlord rent, called a *royalty*. The tenant then keeps any profits from the sale of oil or minerals the tenant extracts from beneath the surface of the parcel.

ground lease
A leasehold interest in which rent is based on the rental value of the land, whether the parcel is vacant or improved.

A **ground lease** on a parcel of real estate is granted to a tenant in exchange for the payment of rent. In a *ground lease*, rent is based on the rental value of the land in the parcel, whether the parcel is vacant or improved. Fee owners of vacant, unimproved land use leases to induce others to acquire an interest in the property and develop it.

Ground leases are common in more densely populated areas. Developers often need financial assistance from fee owners to avoid massive cash outlays to acquire unimproved parcels. Also, fee owners of developable property often refuse to sell, choosing to become landlords for the long-term rental income they will receive.

An original tenant under a ground lease constructs their own improvements. Typically, the tenant encumbers their possessory interest in a ground lease with a trust deed lien to provide security for a construction mortgage.

master lease
A leasehold interest which grants a master tenant the right to sublease a property in exchange for rent paid to the fee owner.

Master leases benefit fee owners who want the financial advantages of renting fully improved property, but do not want the day-to-day obligations and risks of managing the property.

For instance, the fee owner of a shopping center and a prospective owner-operator agree to a master lease.

As the master tenant, the owner-operator will collect rent from the many subtenants, address their needs and maintain the property. The master tenant is responsible for the rent due the fee owner under the master lease, even if the subtenants do not pay their rents to the master tenant.

The *master lease* is sometimes called a *sandwich lease* since the master tenant is “sandwiched” between the fee owner (the landlord on the master lease) and the many subtenants with their possession under subleases.

The master lease is a regular, commercial lease agreement form with the clauses prohibiting subletting removed. A **sublease** is also a regular, commercial lease agreement with an additional clause referencing the attached master lease and declaring the *sublease* subject to the terms of the master lease. [See Figure 1, Form 552 §2.5]

sublease
A leasehold interest subject to the terms of a master lease.

Another type of special-use lease is the *farm lease*, sometimes called a *cropping agreement* or *grazing lease*. Here, the tenant operates the farm and pays the landlord either a flat fee rent, a percentage of the value of the crops or livestock produced on the land.

Editor’s note — For simplicity, the remainder of the book will treat the landlord as the fee owner, unless a sublease is specifically referenced. Fee owners will be referred to as “landlords,” or, if a distinction is required, simply as “owners.”

The ownership interests a person may hold in real estate are called estates. Four types of estates exist in real estate:

- fee estates;
- life estates;
- leasehold estates; and
- estates at will.

In practice, estates at will are considered leasehold estates. Leasehold estates are controlled by landlord/tenant law.

Four types of leasehold interests exist and can be held by tenants:

- fixed-term tenancies;
- periodic tenancies;
- tenancies-at-will; and
- tenancies-at-sufferance.

Chapter 1 Summary

A fixed-term tenancy lasts for a specific length of time as stated in a lease agreement entered into by a landlord and tenant. On expiration of the lease term, the tenant's right of possession automatically terminates unless it is extended or renewed by another agreement.

Periodic tenancies last for a specific length of time. Under a periodic tenancy, the landlord and tenant agree to automatic successive rental periods of the same length of time, such as in a month-to-month tenancy, until terminated by notice by either the landlord or the tenant.

Under a tenancy-at-will, the tenant has the right to possess a property with the consent of the fee owner. Tenancies-at-will can be terminated at any time by an advance notice from either the landlord or the tenant or as set by agreement. Tenancies-at-will do not have a fixed duration.

A tenancy-at-sufferance occurs when a tenant retains possession of the rented premises after the tenancy granted terminates.

In addition, several special use leases exist, including ground leases, master leases and subleases.

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