

LEASE OF STATE-OWNED LAND FOR CONSTRUCTION OF RESEARCH BUILDING AT UNIVERSITY OF NORTH DAKOTA

This memorandum is in response to questions from the interim Government Finance Committee regarding the lease of land located on the University of North Dakota (UND) campus for the construction of a building by the University of North Dakota Research Foundation (Foundation). Specifically, the following questions were asked:

- Are there statutory provisions regarding the construction of privately owned buildings on state property?
- What rights does a lender have with respect to mortgages or other encumbrances on a privately owned building constructed on state land?
- Would the state be required to lease a building to a lender if the lender took possession of the building?
- If the state leased the building to a lender that took possession of the building, what limitations would there be on the lease terms?

LEASE TERMS OF RESEARCH FACILITY PROPERTY

In November 2006, the State Board of Higher Education and UND entered a ground lease ([appendix](#)) with the Foundation, through which the Foundation leased property at UND on which the Foundation agreed to construct and operate a research enterprise and commercialization facility. The Foundation was a nonprofit organization created for the purpose of assisting UND in research, educational, and training programs. The Foundation provided notice to the Attorney General in September 2013 of its intention to sell its assets and dissolve "as it is currently unable to meet its debt obligations."

Under the lease agreement, the lease would extend until October 1, 2036, and the Foundation would have the option to renew the agreement for an additional two 10-year terms. The base rent for the length of the agreement was established as \$1 per year. All costs of construction, improvement, and repair of the facility were the responsibility of the Foundation. The agreement provided that the Foundation may not sublease or assign any of the premises without the consent of the State Board of Higher Education and UND. The agreement further provided that the Foundation may negotiate and obtain loans which may be secured by a mortgage on the improvements to the property, but if the Foundation were to encumber the land, UND could terminate the agreement.

The lease authorized UND to terminate the lease if the Foundation defaulted on any terms of the lease and the Foundation failed to cure the default within 10 days of notice of the default. In addition, UND was authorized to terminate the lease immediately upon the filing of a petition to declare the Foundation bankrupt, the making by the Foundation of any general assignment for the benefit of creditors, or the abandonment of the premises by the Foundation. Under the provisions of the lease, the Foundation was required to return the property to UND clear of any designated improvements above ground level or, with the mutual consent of UND and subject to legislative authorization, transfer title to the improvements to UND free and clear of all liens, encumbrances, and security interests.

LEASE OF STATE-OWNED PROPERTY - CONSTRUCTION OF BUILDINGS

There are no statutory provisions that specifically address the construction of a building by a private party on land leased from the state. However, the 2003 Legislative Assembly adopted Senate Bill No. 2261, which authorized state agencies and institutions and political subdivisions to enter long-term leases and leaseback transactions. The portion of the bill relating to state agencies and institutions was codified as North Dakota Century Code Section 54-01-27. That section authorizes a state agency or institution to enter agreements to lease property belonging to the state. Under that section, the board or executive officer of the state agency or institution may enter a variety of agreements, including a "lease, sublease, purchase agreement, lease-purchase agreement, installment purchase agreement, leaseback agreement, or other contract, agreement, instrument, or arrangement pursuant to which any rights, interests, or other property are transferred to, by, or from any party to, by, or from one or more parties, and any related documents entered or to be entered, including any operating agreement, service agreement, indemnity agreement, participation agreement, loan agreement, or payment undertaking agreement entered as part of a long-term lease and leaseback transaction." Senate Bill No. 2261 also created Section 15-10-40, which requires the State Board of Higher Education to use revenue earned from long-term lease and leaseback transactions under Chapter 54-01 for the repair and upkeep of campus buildings commonly referred to as deferred maintenance projects.

Although likely not applicable to the question at hand, one other provision of note is Section 15-10-12.1. That section allows the State Board of Higher Education to authorize campus improvements and building maintenance

on land under the control of the board which are financed by donations, gifts, grants, and bequests if the cost of the improvement or building maintenance is not more than \$385,000. The consent of the Legislative Assembly is required for construction of any building financed by donations, gifts, grants, and bequests and for campus improvements or building maintenance financed by donations, gifts, grants, and bequests if the cost of the improvements or maintenance is more than \$385,000.

RIGHTS OF LENDER

There does not appear to be statutory or case law in this state, which directly addresses the rights of a lender that has a security interest in a building on land owned by a third party. However, generally, a lender that provides a loan to finance a building that is built on leased property holds the collateral subject to the terms of the lease. (See, 49 Am. Jur. 2d *Landlord and Tenant* § 1004.) During the term of the lease, the lender may continue in possession of the building, subject to the terms of the lease. However, upon termination of the lease, the lender's security interest in the property is extinguished.

SUMMARY

- The Foundation had the right to obtain a loan secured by the facility but was prohibited from encumbering the land.
- A lender with a security interest in the building could assume possession of the building, but only subject to the terms of the lease to which the Foundation was bound and subject to the approval of the State Board of Higher Education and UND.
- If the Foundation or an assignee lender had defaulted on terms of the lease or if any of the conditions were present to allow UND to exercise its right to immediately terminate the lease, UND would have had the right to demand that the building be removed from the property or could have negotiated other terms with the lender.

ATTACH:1