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Reverse Build-to-Suit: Sale Leaseback Transaction with a Twist

This is the second installment in our series on sale-leaseback transactions, which have been instrumental in fostering the growth of numerous retail businesses by leveraging real estate assets as a significant source of capital. If you haven't already, check out part one where we break down the [fundamentals of sale-leaseback transactions](#).

Introduction to Reverse Build-to-Suit

A reverse build-to-suit is a specialized real estate mechanism where the tenant develops and builds out the leased property to support the tenant's use. This is a "reverse" of the common build-to-suit model, where a landlord constructs the property to meet the tenant's specific needs. Reverse built-to-suit transactions can be coupled with a sale-leaseback transaction to provide what effectively amounts to construction financing. The seller/tenant transfers raw land to the buyer/landlord, then leases the property back to the seller/tenant (as in a conventional sale-leaseback), and then the landlord funds the build-out by financing the construction, which financing is repaid as rent from the seller/tenant.

A reverse built-to-suit transaction can unlock capital for a seller/tenant who may not be able to access construction financing otherwise. It offers a strategic solution for businesses looking to optimize their resources and develop property efficiently. This alternative transaction is particularly effective when the tenant has its own construction department, a company, or a conceptual project that has been previously implemented, and maintains good relationships with trusted general contractors.

Reverse Built-to-Suit Process and Documentation

Generally, the raw land value is paid at closing by the landlord as consideration for the purchase of the property. The tenant then

manages construction and development of the property. There are two alternatives for financing such construction. First, the tenant can initially fund construction and then seek reimbursement through construction draws based on certain parameters set by the landlord, whether upon final completion or at various construction intervals. Alternatively, the landlord may make direct payments to the general contractor on behalf of the tenant following payment requisitions and delivery of required documents to the landlord—for example, lien waivers and certificates of completion.

The documentation required for a reverse built-to-suit transaction is similar to that of a sale-leaseback transaction and includes a purchase and sale agreement, a lease agreement, *and* an additional agreement between the landlord and tenant governing the construction financing and disbursement of proceeds. The disbursement agreement is typically entered into simultaneously upon closing of the sale-leaseback.

Key Considerations in Build-to-Suit Transactions

When engaged in a reverse build-to-suit, several critical considerations must be addressed:

- **Timing of construction and mechanic's liens:** It is vital to consider the construction timeline meticulously to avoid any lapses or issues with mechanic's liens (or other lien against the property for nonpayment of services or materials) and coverage of mechanic's liens in a title policy.
- **Permits and zoning:** Obtaining the necessary permits and approval of any use if required by the zoning code is fundamental to the ability to begin construction, but it also may be a condition of purchase by the buyer/landlord.
- **Plans, general contract, and construction monitoring:** All construction plans and contractual documents should be thoroughly reviewed and agreed upon by the landlord and tenant to prevent future disputes. In many reverse built-to-suit scenarios, the landlord may wish to be involved in the construction process. This involvement can range from hiring a consultant to manage the project to using the landlord's

own employees for site visits and status calls.

- **Change orders and force majeure:** Provisions for change orders and force majeure (which governs the treatment of events outside of the control of the parties that are likely to impact the timing of construction) must be negotiated to handle such possibilities effectively. Generally, under a reverse build-to-suit, the tenant is responsible for any additional costs of construction and may not be able to obtain additional financing from the landlord to cover such unexpected expenditures.
- **Put agreement:** The parties may consider entering into a “put agreement” in which the landlord is obligated to sell the property to the tenant in the event of certain defaults, such as failure to timely obtain permits or complete the construction of the improvements. Put agreements protect both the landlord and tenant. The landlord is made whole by the tenant being obligated to pay the landlord a purchase price equal to the landlord’s investment in the land and improvements (including fundings made to the tenant under the disbursement agreement). And the tenant, in turn, is able to take ownership of the property and any value it has created through the development process, including investments in the property that were not reimbursed or funded by the landlord.

A reverse build-to-suit offers a structured and efficient way for tenants and landlords to collaborate on construction projects, ensuring both parties can achieve their investment and operational goals. By understanding the key components and considerations, engaging in thorough planning, and maintaining clear communication, reverse build-to-suit transactions can be a highly effective real estate strategy. To learn more, please reach out to the authors or any attorney with Frost Brown Todd’s [Retail and Shopping Center Finance](#) industry team.

Be on the lookout for future articles in this series as we continue to explore other facets of sale-leaseback transactions, including legal due diligence issues and potential risks, structural and compliance challenges specific to transactions

involving institutional capital, such as private equity and real estate investment trusts (REITs), M&A considerations, and lender-related concerns.

Check out other articles in this series:

- [Breaking Down Sale-Leaseback Transactions | Part 1](#)
 - [How Investors Use 1031 Exchanges and Sale-Leasebacks to Maximize Returns and Preserve Capital | Part 3](#)
 - [Sale-Leaseback Due Diligence Considerations | Part 4](#)
 - [Integrating Sale-Leaseback Transactions with Mergers and Acquisitions: A Value-Maximization Strategy | Part 5](#)
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