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Agreements Clarify Lender-Tenant Issues, Part II

In the May issue, we discussed how a subordination, non-disturbance and attornment agreement serves three primary purposes from a lender's perspective: (1) it confirms that the subject lease is subordinate in priority to the lender's mortgage; (2) it ensures that the subject lease will not terminate on a foreclosure sale; and (3) it provides a mechanism for the tenant to recognize the lender as its landlord at the appropriate time. The quid pro quo for the tenant is an assurance that the lender will not disturb the tenant's possession of the demised premises as long as the tenant is not in default under its lease or the SNDA. These general purposes are well-recognized and rarely disputed.

This month, we will discuss the other five provisions.

With the next provision, a lender will require a restriction on the tenant's ability to pay rent to the landlord more than one month in advance. This restriction is important to the lender because if the lender is forced to foreclose during the prepaid period, then the lender would not have the benefit of the funds that were prepaid to the ousted landlord and the demised premises would not generate any cash flow for the lender during the remainder of the prepaid period. A restriction gives the lender some assurance that its collateral will continue to generate cash flow following any necessary foreclosure. On the other hand, the landlord and

not have to recognize the prepaid rent on foreclosure.

A lender will often require an additional notice and cure period for any landlord default. The lender wants to protect its collateral by ensuring that the tenant's remedies will not be exercisable until the lender has had an opportunity to cure the subject default. Ideally, this notice and cure period would be added to the end of the landlord's notice and cure period.

This would allow the lender to take a wait-and-see approach prior to curing the default (on the landlord's failure to do so). The tenant may object to this provision because it would delay the exercise of its negotiated remedy for the landlord default.

As a middle ground, the lender may be willing to allow its notice and cure period to run concurrently with the landlord's. This approach would not only address the tenant's concerns by eliminating any delay, but also would address the lender's concerns by providing the opportunity to proactively address any default issues. While a wait-and-see period would be preferable to the lender, a concurrent cure period will, at the very least, give the lender some warning regarding any potential default issues with respect to its collateral.

Third, a lender will look for an agreement from the tenant to pay rent directly to the lender if the lender demands such payment. This would allow the lender to, essentially, step into the shoes of the landlord from a payment perspective much

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Disputes arise, however, when lenders attempt to go beyond the general purposes of the SNDA and require additional lender-protective provisions. In May we discussed the first two provisions: (1) an agreement that the lender will not be liable for any of the landlord's defaults prior to foreclosure and the tenant cannot exercise any setoff, defense or counterclaim for anything that occurs prior to foreclosure and (2) a restriction on the tenant's ability to modify the lease without the lender's consent.

the tenant will generally disfavor a prohibition on prepaid rent because it removes one of the key tools in a lease negotiation and it could prohibit the advance payment of common area maintenance charges, taxes and insurance premiums, which are usually set up to allow a level payment despite the uneven expenses.

A potential compromise is to allow rents to be prepaid, but eliminate the lender's liability for the prepaid rents. In other words, prepaying rent would be permissible, but the lender would

more quickly than in a foreclosure situation. A tenant may be reluctant to provide such an agreement because of the possibility of paying the lender and still being liable to the landlord.

The best way around this issue is to require the landlord to authorize the payment to the lender on the lender's demand and release the tenant from any liability to the landlord for following the lender's instructions.

Fourth, a lender will require a provision exculpating it from liability in connection with a security deposit unless it is paid to the lender. The lender is guarding against being required to come out of pocket, following a foreclosure, to either reimburse the tenant for all or a part of the security deposit on lease termination, or resolve an issue that would have been otherwise covered by a security deposit. On the other hand, the tenant

does not want to forfeit its security deposit on foreclosure or, effectively, pay its security deposit twice. The easiest solution is to require the landlord to pay over all security deposits to the lender to be held in escrow.

Finally, a lender will require that the loan documents control as to casualty and condemnation. The lender wants the ability to control the post-casualty/condemnation situation to ensure that the collateral is protected and the loan is paid with the proceeds from any casualty insurance or condemnation award. The tenant will oppose this approach in an attempt to protect its leasehold interest and bargained-for position — especially if the tenant has made a significant investment in the property. Often, however, the loan documents and the lease are not entirely inconsistent.

In many cases, both parties desire restoration of the premises. In such a situation, the lender may be willing to relent if the provisions of the lease are palatable, and the tenant has agreed not to modify the lease within the other provisions of the SNDA. In most situations, even if the lender agrees to follow the lease provisions regarding restoration, the lender will require control of the proceeds.

While the general purposes of the SNDA are typically acceptable to lenders and tenants, additional lender-protective provisions can be contentious and can result in protracted negotiations. Nonetheless, compromises that will facilitate mutually satisfactory completion of the agreement can be found by analyzing the underlying interests of the parties. **BN**