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Agreements Clarify Lender-Tenant Issues

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.

Disputes arise, however, when lenders attempt to go beyond the general purposes of the SNDA and require additional lender-protective provisions. These provisions include: (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; (2) a restriction on the tenant's ability to modify the lease without the lender's consent; (3) a restriction on the tenant's ability to pay rent more than one month in advance; (4) an agreement that the tenant will give the lender notice and an opportunity to cure all landlord defaults; (5) an agreement that the tenant will pay rent directly to the lender if the lender demands same; (6) an agreement that the lender will not be responsible for the repayment of any security deposit unless the lender has actually received the security deposit; and (7) an agreement that the provisions of the loan documents governing casualty and condemnation will prevail over the provisions of the lease. The first two provisions and potential compromises based on the underlying interests of the parties follow. The rest of the provisions will be addressed in the June issue.

First, a lender will usually request an agreement from the tenant that, on foreclosure, the tenant cannot hold the lender liable for any default of the landlord and the tenant cannot exercise any setoff, defense or counterclaim for anything that occurs prior to foreclosure. The lender's position is that it has no real control over the landlord, and that it should not be put in the position of

guaranteeing the landlord's obligations. Furthermore, if a foreclosure action is necessary, then the lender is already likely to be suffering losses on the loan. The lender's desired agreement would allow it to avoid any exacerbation of those losses, which may result from accepting liability for the landlord's actions (or inaction) prior to the lender obtaining control of the property. Conversely, the tenant will contend that it should be allowed to realize the benefit of its bargain regardless of whether the landlord or the lender is in control of the property.

To address these divergent interests, the parties may be agreeable to a middle ground where the lender would be responsible for continuing defaults for which the lender has had notice and an opportunity to cure and which adversely affect the quiet enjoyment of the property.

This compromise would limit the lender's liability to only those landlord defaults having the most serious effect on the tenant's ability to conduct business. Other solutions might be available for offsets related to specific obligations of the landlord, such as construction obligations. For instance, a lender might agree to accept liability in these situations if it is holding an escrow sufficient to cover the potential offset amounts. A final alternative would be handling the issue outside of the SNDA by means of a guaranty between the landlord (or principals of the landlord) and the tenant.

Second, a lender will require a restriction on tenant's ability to modify the lease without the lender's consent. From a lender's perspective, such a restriction allows it to protect its collateral and the cash flow of its collateral by giving the lender some control over the leasing relationship. But from a tenant's perspective, obtaining the lender's consent is an unnecessary step that could negatively impact the tenant's agility in the marketplace — a lease modification that is acceptable to its landlord should be acceptable to the landlord's lender as well. Certainly, in the tenant's view, a default under the SNDA (vitiating any benefit the tenant might receive from the SNDA) is a harsh consequence for failure to comply with this easily overlooked technicality.

Instead, the tenant reasons, the constraint should be in

the loan documents with consequences to the landlord as opposed to the tenant. While this may sound reasonable on its face, the ultimate remedy for the landlord's failure to comply with any constraint set forth in the loan documents is usually foreclosure. If the lender has no recourse against the tenant by declaring a default under the SNDA, it could foreclose and find itself in the unfortunate position of serving as a landlord, bound by the terms of an undesirable lease. In certain situations, the lender and the tenant may be willing to compromise

by either agreeing to allow certain modifications without the lender's consent so long as those modifications do not affect the financial terms or the length of the lease or agreeing that any lease modifications would be effective as to the landlord and the tenant, but not binding on the lender following foreclosure. [BN](#)

Learn about the other five provisions in the June issue of *BankNews*.