



ACRELive! Presents:

Subordination, Nondisturbance and Attornment Agreements: The Lender vs. The Tenant

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Our Story

TWO'S COMPANY AND THREE'S A CROWD

By: Ed and Searle

(A Cautionary Tale)

The Beginning

A Long, Long Time Ago,
when things were simpler and nicer
(in October 2016 [?])

Landlord and Tenant entered into a Lease.
The Lease had all of the provisions a lease
between two businesses would have been
expected to have.

Tenant Improvements

The premises were not built out for Tenant, and Tenant wanted to make the premises really nice.

Tenant did not have the funds to pay for all of the improvements it had in mind.

So Landlord agreed to pay for the construction costs ... in exchange for increasing the rent over the originally negotiated amount.

No Mortgage Encumbered the Property

Landlord owned the property free and clear.

Landlord and Tenant had not thought about including in the Lease any provision that related to the relationship with them and a future lender to Landlord.

Lease Didn't Consider a Lender

The Lease did not contain:

- 1. A provision that addressed a future lender.
- 2. A provision that said the Lease would be subordinate to any future mortgage on the property.
- 3. A provision that added to item 2, a clause that said that no matter what happened in connection with a mortgage, Tenant's rights under the Lease would not be affected so long as Tenant was not in default.
- 4. An SNDA as an Exhibit.

A Lender Enters the Scene

- ❖ Then Landlord decided to borrow against the project.
- ❖ Lender said it wanted to put a mortgage on the property.
- ❖ Lender did due diligence on the Tenant and was satisfied as to Tenant's creditworthiness
- ❖ Then Lender reviewed the Lease, and ...

Lender Issues

- Lender wanted its mortgage to control all matters regarding the property.
- Lender didn't want to have to pay for the Landlord's construction obligations if Lender became the landlord.
- There were "a few" provisions in the Lease that Lender wanted to change.
- There were "a few" provisions that Lender liked to see in leases that were not in the Lease.
- Landlord wanted to be sure that Tenant agreed the Lease was in the form as Landlord had represented, and that neither Landlord nor Tenant was in default.

Form of SNDA

The SNDA that was added as an exhibit to the Lease was not as robust as the Lender wanted.

Does our Story Have a Happy Ending?

Let's see how this fits into the rules about
Subordination,
Non-
Disturbance, and
Attornment and Agreements

What are SNDAs?

Documents that contain:

- Subordination
- Non-Disturbance
- Attornment
- Additional Provisions
 - Estoppel Certificate
 - Agreements/Modifications to the Lease

Who are the Parties to an SNDA?

- Usually SNDAs are made by Landlord, Tenant, and Lender
- Sometimes, only Lender and Tenant are the parties, and Landlord joins in to evidence its consent
- If the Lease is guaranteed, any Guarantor should consent to the SNDA

Subordination (I)

- What is the priority of Lease vs. Mortgage?
- Basic Rule:
First in time is first in right
- May be modified by agreement of the parties --
 - There may be a provision in the Lease stating the Lease will be subordinate to future mortgages
 - The parties may enter into an SNDA

Subordination (2)

The Lender will often (but not always) want the Lease to be subordinate to Lender's mortgage or deed of trust

- including to any future advances
- Including to any modifications

Effects of Subordination

- Provisions of the senior instrument control --
 - Casualty and use of insurance proceeds
 - Condemnation proceeds
- Lender may want some but not aspects of subordination to be in effect

Continuation of Lease after a Foreclosure Sale (I)

- If the Lease is superior, a foreclosure sale does not affect the Lease -- except that Tenant has a new landlord
- If mortgage is superior, a foreclosure sale terminates the Lease -- but some states have provisions enabling Lender to designate which leases will survive a foreclosure sale
- Loan documents may permit Lender to make a subordination election
(Lender wants to “pick and choose”)

Continuation of Lease after a Foreclosure Sale (2)

- Case Law:

- *Dover Mobile Estates v. Fiber Form Prods.*, 220 Cal.App. 3d 1494 (1990) – subordinate lease terminated upon foreclosure.
- *Principal Mut. Life Ins. Co. v. Vars, Pave, McCord & Freedman*, 65 Cal. App. 4th (1998) – lender could not unilaterally subordinate deed of trust to lease.
- *Vallely Inv., L.P. v. BancAmerica Commercial Corp.*, 88 Cal.App.4th 816 (2001) – discussing situations where lien foreclosure does not automatically terminate leases.

Continuation of Lease after a Foreclosure Sale (3)

In New York, if a tenant under a subordinate lease is not named in a foreclosure sale, the lease continues after foreclosure.

Green Point Savings Bank v. DeFour, 162 Misc.2d 476 (Sup. 1994); *Empire Sav. Bank v. Towers Co.*, 54 A.D. 2d 574 (1976)

Continuation of Lease after a Foreclosure Sale (4)

MD Real Property Article §7-105.6(c):

(1) If the required advertisement of sale so discloses, a foreclosure sale shall be made subject to one or more of the tenancies entered into subsequent to the recording of the mortgage or deed of trust or otherwise subordinated thereto.

(2) Any lease so continuing is unaffected by the sale, except the purchaser shall become the landlord, as of the date of the sale, on ratification of the sale.

Non-Disturbance (I)

- **Non-Disturbance** is the key provision for a tenant when the lease is subordinate to the mortgage
- Permits a lease to continue after a foreclosure sale even though the lease was subordinate to the mortgage that is foreclosed
- Sometimes called “Recognition,” which may be a better term because this speaks to respecting ALL rights of the tenant under the Lease, not merely the right to possession

Non-Disturbance (2)

- Often extends to a deed-in-lieu
 - but a deed-in-lieu would not terminate a lease
- May be premised on Tenant's not being in default under lease or Tenant's never having been in default
- Landlord may agree to use commercially reasonable efforts to obtain a non-disturbance agreement

Attornment (I)

The last letter of SNDA is for **Attornment**

- The act of Tenant agreeing to become tenant of the holder of the remainder or reversionary estate
- “Attornment” is an ancient doctrine and has the same root as “attorney”
 - which means one who is appointed to act for another

Attornment (2)

- In an SNDA, Tenant agrees to be bound by the terms of the Lease
 - to any person who acquires the remainder or reversion
 - including a purchaser at a foreclosure sale or other proceedings under the loan documents
 - may be Lender, an affiliate of Lender, or a third party

Attornment (3)

- State law may provide that transferees of the reversion in leased property are entitled to the same rights and are subject to the same obligations as the original landlord.
- Maryland Code, Real Property Article, § 8-101 and RP § 8-104 provide that attornment is not necessary.

Attornment (4)

Cases:

- *Principal Mut. Life Ins. Co. v. Vars, Pave, McCord & Freedman*, 65 Cal.App. 4th (1998) – attornment agreement in subordinate lease required parties to enter into new lease after foreclosure sale.
- *Miscione v. Barton Development Co.*, 52 Cal.App. 4th 1320 (1997) – attornment agreement reversed the priorities of lease and deed of trust (holding has been limited).

Additional Provisions to an SNDA (I)

Estoppel Certificate (A)

- Identify the Lease, all amendments, and all collateral documents
- State the Commencement Date and the Termination Date of the Lease
- Acknowledge that Landlord does not have any remaining obligations (including construction)
- State what security deposit has been posted

Additional Provisions (2)

Estoppel Certificate (B)

- Acknowledge that all conditions precedent to the commencement of the Lease have occurred
- Assert that Tenant is not in default under the Lease
- State that Landlord is not in default under the Lease
- State that Tenant has no claims against Landlord and no offsets under the Lease
- Represent that Tenant has not assigned, sublet, or encumbered the leasehold interest

Additional Provisions (3)

Estoppel certificate (C)

- State the amounts Tenant is paying and through what dates they have been paid:
 - for basic rent
 - for percentage rent
 - for CAM or other charges
 - for real property taxes

Additional Provisions (4)

Estoppel certificate (D)

- State whether Tenant has any option in the Lease or otherwise:
 - to renew
 - to take additional space
 - to purchase
- State whether Tenant has exercised any of its options

Additional Provisions (5)

Estoppel Certificate (E)

- Lender wants a certification by Tenant that it --
 - has always used the property in accordance with the Lease
 - has not created any environmental issue

Additional Provisions (6)

Notices to Lender

- Provide that Lender is entitled to all of the notices to which Landlord is entitled
- Provide that Lender will have a stated time, the same time as landlord, or an additional time to cure defaults
- Provide that Lender will have the time to exercise its remedies against Landlord (as its borrower) and then the time to cure Landlord's defaults under the Lease
- Provide that the Lease will not be terminated for events that Lender cannot cure (e.g., Landlord's bankruptcy)

Additional Provisions (7)

After the foreclosure sale

- Lender wants Tenant to agree:
 - (a) Lender (or other successor to Landlord) has no liability to Tenant for any act or omission of the original landlord

Additional Provisions (8)

No liability for prior landlord's acts

- Possible compromise:
 - Tenant may forego ability to terminate the Lease
 - Tenant will agree to limit its remedies to the right to offset damages against rent
 - Perhaps the offset will be limited to ___% of base rent

Additional Provisions (9)

After the foreclosure sale

- Lender wants Tenant to agree:
 - (b) Lender has no liability to return Tenant's security deposit except to the extent that Lender has actually received it

Additional Provisions (10)

No liability to return security deposit Lender has not received

- Possible compromise:
 - Lender could hold the security deposit from the beginning
 - A third party could hold the security deposit
 - The security deposit could be in the form of a letter of credit or other credit enhancement

Additional Provisions (II)

After the foreclosure sale (a)

- Lender wants Tenant to agree:
 - (c) any offset or claim that Tenant may have against Landlord will not apply to Lender
 - This would put all of the risk of a defaulting landlord on Tenant, and many Tenants will find this objectionable

Additional Provisions (12)

After the foreclosure sale (b)

- Lender wants Tenant to agree:
 - (d) Lender (or other successor to landlord) is not bound for more than one month's rent paid in advance
 - This is a reasonable request except for student housing, self-storage, and senior housing deals.

Additional Provisions (13)

After the foreclosure sale (c)

- Lender wants Tenant to agree:
 - (e) Lender is not bound by any amendment to the Lease made without consent of Lender
 - (f) Lender is not bound by any assignment or sublease to the Lease made without consent of Lender
 - NOTE: Although asking a Tenant to agree not to amend the Lease without Lender's consent may be reasonable; asking Tenant to give up a right to assign or sublet is not.

Additional Provisions (14)

After the foreclosure sale (d)

- Lender wants Tenant to agree:
 - (g) Tenant will pay rent to Lender upon written notice from Lender
(without confirmation from Landlord)

Additional Provisions (15)

After the foreclosure sale (e)

- Lender wants Tenant to agree:
 - (h) Lender will not be required to pay any tenant improvement allowance or be bound by any construction warranties made by Landlord
 - But tenant improvement allowances are essentially repaid by a component of the rent

Additional Provisions (16)

Unpaid Tenant Improvement Allowance

- So in compromise:
 - the rent may be reduced if Tenant will have to pay for its improvements, or
 - Landlord may be required to post funds in escrow, or provide a guaranty, or include a right to offset in the Lease

Additional Provisions (17)

Limitation of Liability

Lender wants Tenant to agree to --

- (i) Limitation of Landlord's liability to its interest in the property and only when it owns the property

- (ii) Lender is looking ahead for when it may become the Landlord

Additional Provisions (18)

Future agreements

Lender wants Tenant to agree:

- Tenant will execute estoppel certificates from time to time
- Without Lender's consent
Tenant will not surrender, cancel, or terminate the Lease
-- except upon an uncured default of Landlord

Additional Provisions (19)

Lender's “Clean up” of the Lease

Lender may want Tenant to

- waive options
- waive co-tenancy requirements
- release Lender from environmental requirements
- waive warranties made by Landlord

SNDAs for Different Interests in a Property

Other parties may have various interests in the property, including:

- ground lessees and
- sublessees

The tenant or subtenant will also want similar rights and assurances all the way up the chain – such as from the ground lessor and ground sublessor.

Who Needs an SNDA? (I)

Lender

- wants its loan documents to control – but the Lease may already have been subordinated, so Lender may not need a traditional SNDA
- wants the “additional provisions”

Who Needs an SNDA? (2)

Tenant

- wants the assurance that if its landlord defaults under its loan, the Lease will continue unaffected (except that Tenant will have a new landlord)

Who Needs an SNDA? (3)

What Can a Tenant Do

- to get the beneficial portions of an SNDA
- without the burdensome ones
- and to minimize its expenses and risks?

Who Needs an SNDA? (4)

What Can a Tenant Do?

- Prepare an SNDA and attach it to the Lease
- Hope that the Lender accepts it
- This may reduce legal fees
- Provide that the Tenant will not be joined in a foreclosure action (unless it is a necessary party)

Who Needs an SNDA? (5)

Landlord / Loan Borrower

- does not care about the SNDA
*... the provisions of an SNDA
become operative after Landlord
has defaulted under its loan*
- wants to get the SNDA signed quickly and
without expenditure of too much money

QUESTIONS & ANSWERS ?