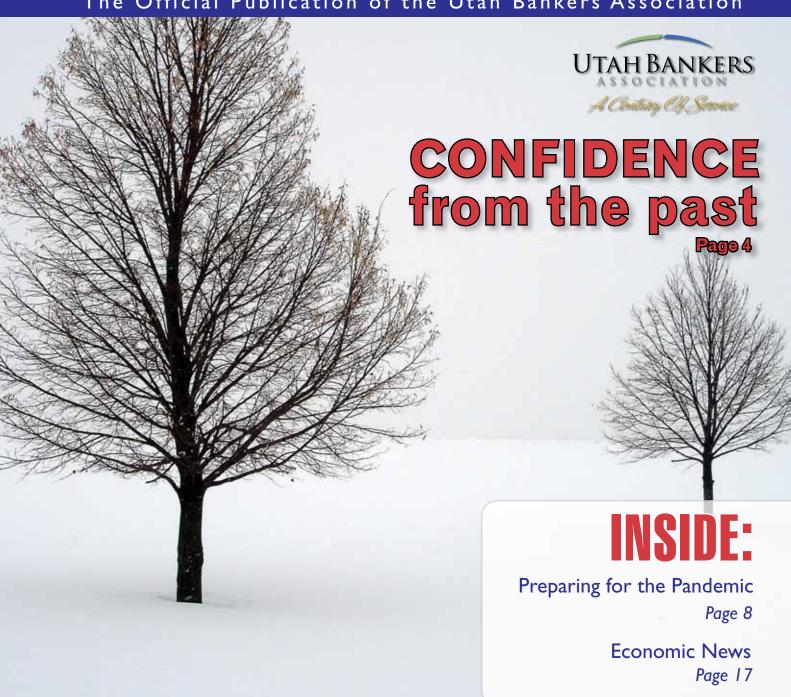
# The Manker

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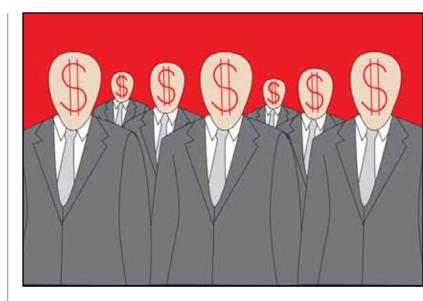
# Round And Round The Mulberry Bush . . .

Subordination, Non-Disturbance and Attornment Agreements

hen underwriting a loan to be secured by commercial land, lenders examine the value of the real property and its improvements. In doing so, lenders are keenly aware that a significant portion of the value of the real property collateral is derived from the capitalization of its rental income which, of course, requires a careful review and understanding of the borrower's tenants and their leases. Both the lender and the tenant have a common interest in seeing that the borrower/landlord's property receives adequate financing, whether for construction of the improvements or long-term financing of the construction costs. However, the lender and tenant also have conflicting interests with respect to the property and the tenant's rights under the lease.

The lender's primary objectives are to ensure that (i) the cash flow from the tenant lease is available to service the debt and that in the event of a borrower default and/or lender foreclosure of the property that the lease and rental payments continue (under Utah law and absent an agreement with the tenant, leases that are junior to a deed of trust are automatically extinguished upon the foreclosure of the deed of trust and the lender takes title free of the leases and all other junior liens), and (ii) the lender does not become liable for the acts or defaults of its borrower under the lease. At the same time, the tenant's objective is to protect its business and investment in tenant improvements and to ensure that its lease remains in effect throughout the contemplated term of the lease, even

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in the event of a borrower default or lender foreclosure – i.e. that borrower's obligations under the lease will be performed either by the borrower or by the lender or other purchaser at foreclosure.

A subordination, non-disturbance and attornment agreement, better known as an "SNDA," is an agreement between the lender, the tenant and the borrower which is intended to address and try to balance the competing needs of the lender and the tenant. In short, the tenant subordinates its interest in the property to the lender's lien, the lender agrees not the disturb the possession of the tenant even if the borrower defaults on its loan as long as the tenant is not in default under its lease, and finally, the tenant agrees to "attorn to" or accept the lender or a purchaser at foreclosure as the successor landlord under the lease.

While it sounds simple enough, few loan documents are more misunderstood and more time consuming and difficult to negotiate, even between knowledgeable and willing parties, often leading the lender in a seemingly endless dance around the proverbial mulberry bush with the tenant and its counsel. Thus, lenders often fail to obtain SNDAs from key tenants or they agree to contractual provisions with tenants which have the effect of expanding the lender's potential liability. A carefully crafted SNDA should include the following concepts from a lender's perspective:

### 1. Subordination.

The SNDA should subordinate the tenant's lease interest to the lender's deed of trust and the lien thereof. All lease rights should be subordinate to the provisions of the deed of trust rather than simply providing that the lien of the deed of trust is superior to the interest of the tenant under the lease. For example, the lender will want the disposition of insurance proceeds to be governed by the deed of trust and not by the lease.

### 2. Liability for Landlord Acts/Defaults.

The lender, if it becomes the successor landlord through foreclosure, should not liable to the tenant for acts or omissions of the prior landlord and should not be subject to lease offsets or defenses against the prior landlord. This often proves to be the largest point of contention and negotiation between the lender and tenant. Lenders will frequently agree to be liable prospectively under the lease (i.e. cure continuing defaults). Many tenants will further request that the lender agree to be liable for the prior landlord's defaults if the lender received notice of the default from the tenant. The problem from the lender's perspective is that even in spite of good faith efforts to cure the default, the lender may be unable to do so since it does not have possession of the property, may be stopped by the automatic stay if the borrower has declared bankruptcy or may for business reasons simply not want to cure the borrower's default. With regard to offsets, the lender will want to prevent tenants from offsetting common law tort damages against the lender as the successor landlord. Many tenants are successful in having lenders agree to specific contractual offsets if they are reasonable and are set forth in the lease.

### 3. Construction Obligations.

The lender should not agree to be bound to complete any of the landlord's construction obligations under the lease. In addition, the lender should not be subject to liability for latent or patent defects due to construction performed by the borrower.

### 4. Notice and Right to Cure.

The lender should receive notice of and an opportunity to cure a borrower default under the lease. The cure period should be in addition to the borrower's cure period so as to avoid any potential lender liability claims from the lender trying to act at the same time as the borrower.

### 5. Limit on Lender's Personal Liability.

The lender's full liability to the tenant should be limited to the lender's interest in the property. As the project size and value increases, this limitation offers less protection to the lender.

With careful negotiation, SNDAs can preserve the value of the lender's collateral while serving the needs of tenants by structuring in advance what the relationship will be between the lender and the tenant in the event of a borrower default under the lease or a foreclosure of the deed of trust.

## 6. Lease Amendments and Termination.

The lender should not be bound by lease amendments to which it did not consent. Tenants typically can convince lenders to limit the effect of this provision to material lease provisions such as rent, lease term, tenant improvement allowances, etc. This provision prevents the borrower and tenant from altering the material lease terms (and hence cash flow) without lender approval. Similarly, the tenant and borrower should not be permitted to agree to terminate the lease without the lender's prior written consent (as opposed to a lease termination contemplated by the terms of the lease).

# 7. Prepaid Rent/Security Deposits.

The lender should not be liable to the tenant for more than one month's prepaid rent. The lender will want to avoid a situation where upon foreclosure it is discovered that rent has been prepaid and the tenant therefore has the right to continue to occupy the premises for a period of time without paying rent to the lender as the new landlord. Similarly, the lender should not be liable to the tenant for security deposits the lender does receive from the borrower.

In short, with careful negotiation, SNDAs can preserve the value of the lender's collateral while serving the needs of tenants by structuring in advance what the relationship will be between the lender and the tenant in the event of a borrower default under the lease or a foreclosure of the deed of trust.

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