

SNDA: Often Encountered, Rarely Discussed

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Subordination, non-disturbance and attornment agreements (SNDAs) are often encountered by transactional real estate lawyers, but infrequently discussed.

An SNDA is an agreement among a tenant, the landlord's mortgage lender and, usually, the landlord. An SNDA provides that a tenant's lease will be subordinated to a mortgage on the landlord's property, and the mortgage lender will agree that if the mortgage goes into default and the lender forecloses its mortgage, the lease will continue (i.e., it will not be disturbed).

A lease will address subordination. It may simply provide that the lease is subordinate to all mortgages including future mortgages, or, for a tenant with sufficient bargaining power, it may condition such subordination upon the mortgagee agreeing not to disturb the lease upon foreclosure of the mortgage. An SNDA, if required by the lease, typically will be negotiated and completed with an existing mortgage lender at the same time the lease is negotiated and signed.

Future mortgages are more problematic. The landlord expects any future mortgagee to require that the lease be subordinated, and the tenant will be willing to do so if it receives non-disturbance, but the future mortgagee does not yet exist and the parties have to anticipate future SNDA terms. There is a good deal of negotiation and tension between landlord and tenant in this regard. After all, the landlord cannot promise the tenant anything the tenant demands, because doing so could well jeopardize the landlord's ability to consummate a future mortgage. Similarly, a tenant cannot simply agree to accept whatever a future lender dictates. Against this background, this article discusses the points of negotiation between tenants and lenders in an SNDA.

Tenants do not expect the basic economic terms of a lease to be effected by a foreclosure, and it would not be reasonable for an SNDA to modify such basic economic terms or impose new material terms. Lenders will agree that the SNDA should not change rent, renewal, expansion and termination options. On the other hand, lenders do not want to inherit issues arising from pre-existing defaults of the former landlord, and they want to ensure that the lease they inherit

was approved by the lender and has not changed without the lender's consent. The likelihood of pre-existing defaults is not hypothetical, considering that the foreclosed landlord most likely was in financial difficulties prior to foreclosure and quite possibly unable to meet its lease obligations to the tenant. Similarly, the possibility of the lease being amended without the lender's consent is not theoretical.

Accordingly, a lender will not be liable for failing to return a tenant's security deposit unless it was transferred to the lender, nor will a lender allow a tenant a credit for rent paid to a former landlord more than 30 days in advance. No lender is willing to allow a tenant an offset against rent arising out of the prior landlord's default. Lenders will not agree to be liable for pre-existing defaults of the former landlord. For example, the former landlord may have defaulted on repair and maintenance obligations prior to foreclosure. A foreclosing lender will not assume liability for resultant damages. However, if pushed, a lender should be responsible for repairs once the lender takes possession after foreclosure.

Most SNDAs absolve lenders from liability for completing or paying for tenant fit-up and pre-commencement date construction work that was the obligation of the prior landlord. This is a significant issue for a tenant that expects a landlord to complete initial work to prepare the premises for occupancy or to receive a monetary contribution from the landlord for initial tenant improvements. If the landlord loses the property by virtue of a foreclosure, and initial landlord work is not completed or the tenant is unable to be paid a construction allowance, the implications could be significant and the tenant will not be relieved of the responsibility for paying rent. Moreover, most leases will not afford the tenant a set-off right allowing the tenant to deduct the unpaid construction allowance or construction costs from rent, but even if such a right exists, the SNDA will cut it off upon foreclosure. One solution for the tenant is to obtain third-party assurances of payment, which will survive foreclosure. It is not unheard of for a tenant with significant bargaining power to obtain a guaranty or other security from a landlord such as a letter of credit to backstop the landlord's obligation in this regard.

If premises are damaged by fire or casualty, or there is a partial condemnation and condemnation proceeds are made available for repair and reconstruction, there is often a debate between the lender and tenant as to whether or not the lender will be obligated in the SNDA to release funds for repairs and reconstruction. The mortgage will often provide that the landlord's right to receive such proceeds for repairs and reconstruction is limited or leave the

lender with the option to allow or disallow disbursement of proceeds for repairs and reconstruction. The lease itself may provide that the landlord's obligation to complete repairs and reconstruction following a major casualty or partial condemnation is subject to the landlord receiving insurance proceeds or a condemnation award. It is arguable that a lender should stand in the shoes of the prior landlord. Thus, if the landlord and tenant agreed, in the lease, that the landlord would be obligated to complete repairs, without conditioning such obligation on the availability of insurance proceeds or a condemnation award, then the lender who has foreclosed and become the new landlord should be similarly obligated. On the other hand, if the landlord conditioned its repair obligation on the availability of insurance proceeds or a condemnation award, then it would be equitable for the lender to have the same rights should it succeed to the status of the landlord upon foreclosure.

Many SNDAs require the tenant to give the lender notice and an opportunity to cure a default by the landlord prior to exercising any remedies or, at least, exercising any right to terminate the lease. This is important to a lender to ensure that the lease does not disappear as a result of the landlord's default. The problem regarding notice and cure is that many such clauses provide that if possession of the premises is required for a lender to cure a default (for example, repairs), then the time period for curing will be extended by the period of time necessary for the lender to get possession. In practice, this means that the lender must complete its foreclosure, or at least have a receiver appointed with power to cure. For a tenant that has negotiated a termination right or other remedies, which termination right or remedies can be invoked in a relatively short period of time under the terms of the lease, being asked to extend the cure period in favor of a lender for what could be a very long period of time is a significant issue. We have seen lenders willing to back away from this position and settle on a stated period of time to cure, such as an additional 60 days. Whether limited to 60 days, or a longer period, a time limitation of some nature seems to be a reasonable compromise.

As noted, a lender needs to know that the lease it inherits was approved and has not changed. Accordingly, SNDAs provide that a lender that has not approved an amendment to the lease will not be bound by the amendment should the lender foreclose and become the successor landlord. This should not be objectionable to the tenant, but some SNDAs go further and make any such amendments void. If a tenant and landlord agree on an amendment, why should it not be binding between them, whether or not approved by the lender, provided the lender will not be bound by the amendment should the lender become the landlord after foreclosure?

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Most SNDAs provide that a lender or successor landlord has no personal liability and is absolved of liability after the lender or successor landlord has transferred the property to a third party. Most leases are non-recourse in any event, so the addition of a non-recourse provision for the benefit of the lender is not significant.

Many SNDAs provide that the tenant will pay rent to the lender on demand, prior to a foreclosure, pursuant to an assignment of rents between the lender and the landlord. Such clauses typically direct the tenant to disregard any objection or counter direction that might be asserted by the landlord. This should not be problematic for the tenant as long as the landlord joins in the execution of the SNDA, it is acknowledged that payment from the tenant to the lender will constitute rent payment as and when required under the lease, that the tenant can disregard any objection from the landlord and, for what it is worth, that the landlord will indemnify the tenant from any claims arising from the tenant's rent payment to the lender.

Lastly, some SNDAs include estoppel provisions. Provided the terms are consistent with the lease estoppel requirements, estoppel terms in an SNDA are not objectionable. However, better practice may be to keep estoppels and SNDAs separate, especially if the SNDA is recorded, because the typical estoppel will confirm business terms of the lease that the tenant, and, for that matter, landlord, do not wish to be made public.