

REAL ESTATE
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Tenant Focus: Advanced Leasing Issues



Carla Calobrisi



Bruce Rosen

Why Tenants should require an SNDA

Or risk some disturbing results.

Introduction. We all know that lease forms are heavily weighted in favor of landlords. Through negotiation, experienced real estate lawyers attempt to lessen the impact on the tenant of some of the more onerous provisions and bring the landlord/tenant relationship into a better balanced position.

One such onerous provision is the so-called “automatic subordination” provision.

What is an automatic subordination clause. Ordinarily, if a landlord uses its property for collateral for a loan after the tenant’s lease was entered into, the lender must agree to honor the tenant’s lease (and all other leases that are in effect prior to the date of the lender’s mortgage or deed of trust. Lenders, however, are concerned about the possibility of taking over a building (after a landlord defaulted), and being stuck (from their perspective) with a lot of leases which may be at below-market rents. Even if the leases are paying market rents, a lender may want the flexibility to demolish or repurpose the building. To do that the lender must have the right to terminate the then existing leases. An “automatic subordination clause” helps to give the landlord’s lender that right.

“An automatic subordination clause” provides that the tenant’s leasehold interest will be subordinate to the lender’s interest in the property, without any further action by the tenant. As a consequence, if a landlord defaults on a loan, the landlord’s lender may elect to terminate the lease and the tenant would not have any recourse. In most cases, the tenant will not even receive a refund of its security deposit. An automatic subordination does not mean that in all cases, the lender would terminate the lease, but it does give the lender the right to.



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DC: (202) 868-2755
MD: (240) 252-3386

NY: (646) 820-3013
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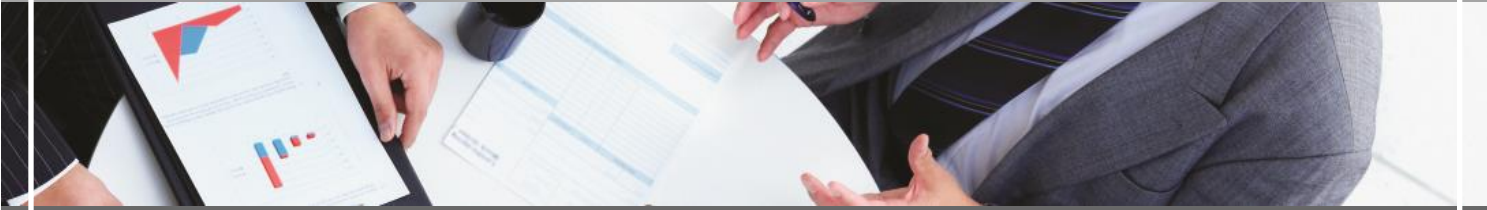
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Attornment. The automatic subordination provision may also provide that upon the lender's notice to the tenant, the tenant will be required to make future rent payments directly to the lender. This is known as "attornment" and is usually not a risk for tenants. Some leases, however, go on to limit the obligations of a lender who takes over from a landlord (e.g., the lender might not be liable for pre-existing landlord default), so tenants should focus on any such provisions.

SNDAs. While tenants may not object to recognizing the lender as the landlord and paying rents to that new party, tenants should obviously object to the possibility of being evicted through no fault of their own. To avoid that result, whenever possible, tenants should require the landlord to obtain a Subordination, Non Disturbance and Attornment Agreement ("**SNDA**") from its current and future lenders.

How Does an SNDA protect a tenant? We've talked about the "S" (subordination), and the "A" (attornment). Now let's focus on the "ND" part of SNDAs. The SNDA represents a "mutual understanding" between the tenant and the lender. In exchange for the tenant's agreement to subordinate its interest to the lender (subordination) and to recognize the lender as the landlord (attornment) the SNDA requires the lender *not to disturb the tenancy* if the lender becomes the landlord (non-disturbance). This means if the lender becomes the landlord and the tenant is not in default under the lease, then the successor-landlord will recognize the tenant's right to stay in the premises. Further, tenants with bargaining power or leverage may even be able to persuade a lender to agree to cure the prior landlord's defaults including honoring the tenant's security deposit and paying any unpaid tenant improvement allowance, however, this last covenant is not easy to obtain (and may require the landlord to escrow the security deposit and improvement allowance with the lender). Whether a tenant has such leverage typically depends on how much of the building the tenant's lease is for, how long of a term the lease is, and other factors such as the tenant's market reputation.





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Lender is not a party to the Lease. Remember, since the lender is not a party to the lease, even if the lease states that the lender will not disturb the tenant, it would be an unenforceable provision as to the lender. Only the SNDA protects the tenant's leasehold interest in case the landlord defaults under its loan and the lender takes over the ownership and operation of the property.

One last point. Finally, if at all possible, be sure to get a fully executed SNDA on or before the full execution of the lease. Often the SNDA form is agreed to by the parties, but obtaining a fully executed SNDA after a lease is signed by the tenant may be difficult as the tenant no longer has any leverage.



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Bruce Rosen is the founder and Managing Member of Real Estate Counselors. He represents owners and developers, national and local companies, lenders and tenants. Prior to founding REC, Mr. Rosen was with the law firm of Akin, Gump, Strauss, Hauer & Feld, in Washington DC. Carla Calobrisi has practiced real estate law for over twenty five years, spending the last twelve years as Associate General Counsel at Booz Allen Hamilton Inc. Ms. Calobrisi has negotiated leases for over one million square feet of space.

