

Real Estate Law Alert

The Subordination, Non-Disturbance and Attornment Agreement

The Subordination, Non-Disturbance and Attornment Agreement ("SNDA") is often misunderstood by landlords and tenants in a lease transaction, and consequently is frequently disregarded. The failure to obtain a SNDA for the benefit of a tenant may result in an unanticipated early termination of a lease. In the face of current economic uncertainty, it is helpful to review the importance to a tenant of obtaining a SNDA from existing mortgagees of a landlord/property owner.

Typically, a landlord lease contains a provision which states that the lease is automatically subordinate to any existing and future mortgages placed upon landlord's property. By consenting to this provision without negotiation, a tenant has effectively agreed that if the subject mortgage is foreclosed the mortgagee is not required to recognize the lease and tenant's corresponding right to occupy the premises.

It may seem counterintuitive that a lender would consider terminating a lease upon foreclosure and forfeiting the associated income stream, but if the rent due under the lease is below-market at the time of foreclosure, or if the tenant occupies a small space or a portion of a floor, or the successor landlord desires to use the space itself or for other purposes it may be in the best interest of the successor landlord to extinguish the lease. If the lender is not bound by a nondisturbance obligation, the lender has all of the flexibility and bargaining power.

It is therefore to the advantage of any tenant and especially a tenant who has made a substantial investment in its tenant improvements, to have the right to secure a SNDA from all existing mortgagees of the property and a commitment by the landlord to obtain such agreement from future mortgagees as a condition to granting subordination to future mortgagees.

The following is a realistic list of revisions to a lender's form SNDA:

1. A tenant will be required to deliver a notice of default to a lender and grant a lender an opportunity to cure a

landlord default. Lenders frequently attempt to obtain a cure period which commences after a landlord's cure period has expired, and if not capable of remedy without lender obtaining title to the property, continues indefinitely, provided lender is diligently pursuing such cure. A tenant should offer to give lender a simultaneous notice and cure period with that of landlord in order to avoid further delay in exercising tenant's remedies.

2. Frequently, a lender requires a tenant to obtain lender's consent prior to amending the lease. It is fair for a tenant to qualify the necessity of a lender's consent to only material amendments or in an effort to define material, to only those amendments to use, term or rent. In addition, a lender's consent should not be unreasonably withheld, conditioned or delayed and in some cases a definite time limit may be agreed upon within which a lender must consent to or reject the amendment.

3. A lender may require a tenant to obtain lender's consent before a tenant may terminate the lease. The highly-negotiated terms of the lease should control tenant's rights to terminate.

4. A lender may require a tenant to obtain lender's consent to an assignment of the Lease. A tenant should avoid entering into an additional contractual obligation with landlord's lender with respect to assignment. Presumably, landlord's consent to an assignment will be required under the lease, which consent generally is not to be unreasonably withheld. Arguably, such language enables a landlord to withhold its consent, if its lender, acting reasonably, does not consent to the assignment.

5. Generally, a lender succeeding to the interest of landlord will seek to avoid being bound by certain lease provisions. Typically, a SNDA states that a mortgagee will not be:

- (i) liable for any act or omission of any prior landlord.
- (ii) liable for return of any security deposit.
- (iii) subject to any offsets or defenses which tenant might have against any prior landlord.

Real Estate Law Alert (continued)

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(iv) bound by any representation or warranty made by any prior landlord.

(v) bound to complete any construction which any prior landlord is obligated to perform.

(vi) bound by any rent or additional rent which tenant paid for more than the current month to any prior landlord.

The following qualifications to the above list should be negotiated:

(i) "except as to continuing defaults."

(ii) "except to the extent the same was transferred to such successor-in-interest."

(iii) "except as to continuing defaults." A tenant with bargaining power should also retain the right to set-off its out-of-pocket costs in effectuating a cure for a past landlord default, if the cure is underway or completed as of the date mortgagee succeeds to landlord's interest under the lease.

(iv) "other than those which are set forth in the lease." Landlord's representations and warranties are a critical component to any lease. If a tenant subsequently determines that a warranty regarding compliance with

laws, zoning, environmental, etc. is not valid, a tenant should be entitled to enforce its remedies under the lease.

(v) This should be omitted whenever possible. There might be substantial tenant improvement work which is not completed and from which all other economic provisions of the lease were derived. In addition, this clause may be interpreted to apply to a landlord's casualty, repair and maintenance obligations which a tenant has the right to expect that its landlord (or successor) will perform in accordance with the lease terms.

(vi) "except if such payments were required under the Lease." A tenant should not be required to forfeit prepaid minimum rent or estimated common area expenses or tax payments which it was contractually obligated to make.

6. Generally a SNDA requires a tenant to pay rent directly to a lender should a lender notify a tenant that landlord is in default of its mortgage obligations. A tenant should confirm that the SNDA contains landlord's release of tenant from any claims arising out of tenant's direct payments to lender and that landlord is a party to the SNDA, thereby enabling tenant to enforce this release, if necessary. Without the release, a tenant may find itself in the middle of two competing claims for rent payments and risk being in default of its lease and/or the SNDA.

Finally, tenant's counsel should require the SNDA to be fully executed and delivered to Tenant at lease execution and properly recorded on the appropriate land records. With the SNDA secured, tenant's counsel has properly protected its client from an unexpected and unwanted early lease termination.

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