

Preparing for the Worst: Texas SNDAs get Lenders, Landlords and Tenants on the Same Page in the Event of Foreclosure, Texas Real Estate Business (Co-Author)

05.13.13

Subordination, Non-Disturbance and Attornment agreements (SNDAs) allow lenders, landlords and tenants to collectively plan for the worst case scenario — foreclosure. In the event of foreclosure and in the absence of an SNDA, state law will determine whether and under what circumstances a lease is extinguished and what rights and obligations survive foreclosure.

Though a fixture in Texas commercial real estate transactions, SNDAs are often overlooked or misunderstood by the parties responsible for their drafting and negotiation. SNDAs are typically three-party agreements between a lender, landlord and tenant that arise when a borrower seeks to finance or refinance commercial property that is leased to one or more tenants. The future rental stream will serve as the collateral for a lender's loan to the landlord/borrower, and as a result, a lender will require agreements from the tenant and landlord regarding the rights of the various parties, the priority of the lien and lease interests, and the consequences of foreclosure. This agreement will most often take the form of an SNDA, which generally consists of three main components: a subordination of the lease, non-disturbance of the tenancy and recognition of the new landlord, each of which are discussed below.

Subordination Subordination agreements contractually modify default lien priorities. A tenant's agreement to subordinate its lease to a landlord's mortgage results in the mortgage having a higher lien priority than the lease.

Non-Disturbance In exchange for an agreement to subordinate its lease, a tenant will often demand that a lender execute a non-disturbance agreement. A typical non-disturbance agreement offers a tenant comfort that the lender will not exercise its right to terminate the subordinate lease upon foreclosure (or otherwise disturb its tenancy), so long as the tenant is not in default (and perhaps so long as other conditions are met). Though such guaranties are theoretically important to tenants in every lease — where tenants have invested substantial funds in the improvement of leased property or would suffer significant damages if forced to relocate — it will be critical to have a non-disturbance provision that fully addresses the tenant's concerns.

Attornment In an attornment agreement, a tenant agrees to recognize the lender as its new landlord in the event of foreclosure of the landlord's property. In turn, the lender, as the new landlord, agrees to uphold certain landlord obligations under the lease. Importantly, the attornment agreement between the lender and the tenant creates privity of contract between the two parties, granting each party direct rights against the other under the lease post-foreclosure. As with non-disturbance and recognition provisions, parties may believe that attornment is a black and white matter — with tenants either agreeing or refusing to agree to attorn to a new owner post-foreclosure. However, the consequences of attornment provisions can vary greatly depending on how the provision is drafted. Although many leases contain general attornment clauses, as with the other issues addressed in a well-drafted SNDA, lenders are advised not to rely on generic lease provisions for the protections that direct attornment agreements can provide.

Lender Objectives A lender's key objective in negotiating an SNDA is the protection of its investment and preservation of its collateral, which is typically the future rental stream of the property. A landlord experiencing cash flow difficulties may be tempted to negotiate lease concessions with a tenant in exchange for lump sum advance payments of future rentals. If a tenant has paid a landlord for several months of rent in advance, a foreclosure purchaser might be surprised to learn that no rental stream would be available for several months. For this reason, lenders will frequently attempt to exclude some or all of the following from their assumed post-foreclosure liabilities or obligations: (i) liability for any act, omission, default or breach by any previous landlord or obligations accruing prior to the lender's ownership of the property; (ii) being subject to any offset, defense or claim which a tenant might be entitled to assert against any previous landlord; (iii) being bound by any payment of rent or other payments, made by a tenant to any previous landlord for more than one month in advance; (iv) being bound by any amendment or modification of the lease made after the SNDA, or by any consent or by

a previous landlord to any assignment or sublease of the lease; (v) liability for any deposit that a tenant may have given to any previous landlord which was not transferred to the lender; (vi) liability for any repairs, replacements, or allowances not performed or paid by any previous landlord if such performance or payment arose prior to the lender's ownership of the property; (vii) liability for payment of any leasing commissions, which became earned or payable prior to the lender's ownership of the property; and (viii) being bound by any right of first refusal or option to purchase any portion of the property. These types of provisions are among the handful of SNDA provisions that are guaranteed to require explanation and/or negotiation among the parties.

Tenant Objectives While most tenants seek assurance that their possession of the premises will not be disturbed after foreclosure, many tenants will also request additional guaranties that the new landlord will fully recognize all of the tenant's rights under the lease. Though these recognition rights are often confused with the concept of "non-disturbance" and used interchangeably therewith, a tenant's right to "recognition" is far broader (and thus objectionable to many lenders). In addition to requiring non-disturbance language in any lease provision discussing subordination or attornment, tenants can better ensure that their interests are protected by expanding the traditional non-disturbance language to include more complete recognition of the rights under the lease (i.e., expansion options, rights of first refusal, etc.).

Landlord Objectives Landlords have a vested interest in ensuring that an SNDA is executed as efficiently as possible. In most cases, the landlord will be responsible for its own attorneys' fees as well as those of the lender. Though many lenders will prefer to negotiate directly with tenants, some will require the landlord to play the role of mediator. Throughout the process, the landlord can add significant value by opening lines of communication and keeping the negotiations moving forward.

Developments Impacting SNDAs

While a detailed discussion of the Texas Assignment of Rents Act (TARA) and Real Estate Mortgage Investment Conduits (REMICs) is outside the scope of this article, the impact of these regulations on SNDAs should be recognized and addressed, if necessary, in negotiations.

TARA In 2011, Texas created a statutory process for creditors to take a security interest in rental streams produced by residential and commercial properties. This statutory scheme provides a uniform process for creating and perfecting a security interest in rents. As a result of TARA, many SNDAs now include provisions expressly addressing or waiving certain provisions and requirements of TARA (as codified in Chapter 64 of the Texas Property Code).

REMICs REMICS are widely-used structures utilized for securitizing residential and commercial mortgage loans. Where a REMIC holds a mortgage on leased property, there are certain additional restrictions on what a REMIC trustee or servicer can agree to perform (such as construction, unfunded obligations and radius restriction enforcement, to name a few).

Therefore, when addressing a loan involving a REMIC, the tenant should be aware that there may be fixed limits on the tenant's ability to negotiate recognition agreements because of the legal limitations imposed on REMICs due to their tax-advantaged structure