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Attorney: The Value and Potential Hazards of an SNDA for Commercial Tenants

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As is often the case with the leasing of new commercial space, it is likely that the tenant has made a significant outlay of capital in connection with the build-out and fit-up of its new location. As a result, a tenant will want to be assured that in the event the lender holding the mortgage on the property commences foreclosure proceedings, the tenant is able to continue to occupy the premises and operate its business throughout the foreclosure and afterwards. One of the most common ways for a tenant to remain in possession of its space despite landlord's financial difficulties is for the tenant to obtain a Subordination, Non-Disturbance and Attornment Agreement ("SNDA"). An SNDA is an agreement entered into between the tenant, landlord and landlord's lender. In its most basic form, an SNDA provides for the subordination of the tenant's leasehold interests in the property to the priority of the lien of the lender's mortgage, the lender's acknowledgment and agreement that it shall not disturb tenant's interests under the lease in the event the lender does foreclose its mortgage lien, and the tenant's acknowledgement and agreement to recognize the lender (or purchaser of the property at foreclosure sale if different from lender) as its new landlord under the lease.

If a tenant shall neglect to obtain an SNDA, the tenant is without any protection in the event the lender forecloses its mortgage lien and the lender (or any purchaser at foreclosure sale) will have the ability to terminate the lease agreement and evict the tenant from its space, whether or not tenant has complied with all terms of the lease agreement to date. In instances where a long-term lease agreement was entered into during a down market period, it is a strong likelihood that the rental rate being paid by the tenant under its lease agreement may be significantly lower than the current market rental rates at the time of foreclosure and as a result any purchaser of the property at foreclosure would be incentivized to terminate the lease agreement and replace it with a lease with a new tenant at the then higher market rates.

Alternatively, they can use a threat of lease termination against the tenant to force the tenant into a lease amendment which results in a new higher rental rate. Without an SNDA already in place a tenant will have no protection against these risks.

While an SNDA does provide valuable protections to a tenant, SNDAs are complex legal documents and could possibly have negative consequences to an unknowing tenant by inadvertently amending the terms of the tenant's lease agreement. Some ways in which an SNDA may negatively affect a lease agreement include (i) casualty - the SNDA may state that insurance proceeds can be used to pay down the lender's mortgage instead of being used to rebuild the tenant's premises and the tenant may not be able to continue its business in the damaged premises, (ii) the SNDA may include a provision that the foreclosing lender (or purchaser at foreclosure sale if different from lender) does not agree to undertake any of the landlord's obligations under the lease, which could be a significant issue if the lease provides that the landlord shall maintain the property, pay taxes or perform any

other material property management obligation, and (iii) condemnation proceeds - it is quite possible that the tenant has outlaid significant capital and resources in the construction and fit-out of its premises and if the SNDA provides that the lender's mortgage shall govern the disposition of condemnation awards then the tenant shall be at the mercy of the lender who may opt to use the condemnation awards to pay down the mortgage lien rather than restoring the tenant's premises. When appropriately drafted, an SNDA can be a valuable and beneficial document to the tenant, the landlord and the landlord's lender, but it can also contain significant hazards and risks to an unsuspecting tenant and therefore consultation with an experienced real estate attorney is strongly recommended at the time of lease negotiation or if the tenant is presented with an SNDA from a new mortgage lender providing financing to the landlord.

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