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Landlord consent and waiver: What lenders need to know

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Lenders, already dealing with residential loan defaults, are bracing for an increase in commercial loan defaults as businesses report declining revenue. Some of these commercial defaults will involve loans made to tenants for the purpose of completing the leased premises for the tenant's occupancy. For example, suppose you are a lender who loaned a restaurant in the local lifestyle mall a substantial amount to complete the purchase and installation of the kitchen and related furnishings. With fewer people dining out, and the restaurant acknowledging a decline in revenues, you are naturally concerned over repossession in the event of a default. If you have not obtained a landlord consent and waiver when the loan was funded, you may end up in a dispute with the landlord over your right to repossess the kitchen equipment.

A consent and waiver is an agreement between a landlord and a third party in connection with the third party's loan to a tenant of the landlord. Without it, the lender's rights to repossess or sell the tenant's property held on the landlord's premises may be limited.

When fighting over the collateral, a lender will rely on its UCC filing with the state to establish its right to the collateral. The landlord will rely on its commercial lease and applicable state statutes. If there is no applicable statutory lien, sophisticated landlords may still have a lien based on the terms of its lease. For example, commercial leases often provide that alterations or improvements made to the leased premises remain the property of the landlord. Some leases go further and provide that the tenant upon execution of the lease grants the landlord a security interest in all of the tenant's property at the leased premises. The landlord consent and waiver reduces this potential conflict.

If a lender wants the right to remove the collateral without interference from the landlord, the landlord consent and waiver subordinates the landlord's lien rights and allows the lender to remove the collateral.

Lenders are often in a difficult position since commercial leases rarely obligate a landlord to execute a landlord consent and waiver. Tenants (as borrowers) often have little, if any, contractual leverage to compel a landlord to execute a landlord consent and waiver. The starting point for the lender is a review of the tenant's commercial lease.

If the lease provides little or no support for the tenant, lenders often condition the loan on the tenant's agreement to use its best efforts to secure the landlord consent and waiver. Lenders, however, should be prepared to negotiate the consent and waiver directly with the landlord.

In the end, a negotiated landlord consent and waiver should avoid potential disputes among the landlord, tenant and lender over the collateral. Below are some points for lenders to consider before entering into a landlord consent and waiver.

*Lease Review: Lenders should review the borrower's lease to determine the landlord's rights to the collateral.

*Collateral Description:Â Broadly describe the collateral.Â Refrain from being too specific since the collateral may be updated or replaced from time to time.

Proper Party:Â Be sure that the owner of the property signs the consent and waiver and not the property management company.Â The property management company may not have authority to bind the landlord.Â An on-line search of the applicable registry of deeds will disclose the correct legal entity.

*Access to the Premises:Â A lender needs access to the premises to remove or dispose of the collateral following a default.

*Notice of Lease Default: Â Require that the landlord provide written notice of any monetary default by the tenant under the lease.Â If the loan agreement so provides, a default under the lease may be an event of default under the loan.Â Be prepared to act.

*No Restoration Damages:Â Be sure the landlord waives and releases all claims for restoration damages to the leased premises.Â If the landlord is unwilling to do so, you should provide for a walk-through of the leased premises following removal and document the condition of the leased premises.Â Lenders should insist that the landlord apply any security deposit under the lease first to restoration costs and then to past due rent. Â

As you can see, the usual landlord consent and waiver has significant implications and should not be entered into without careful review. Â Next month, we will address these issues from the landlord's perspective.

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