



Client Alert

The current economic climate increases the risk of foreclosure of an office building. In a foreclosure, a commercial tenant could lose its right of possession unless the tenant has obtained the protection of an SNDA.

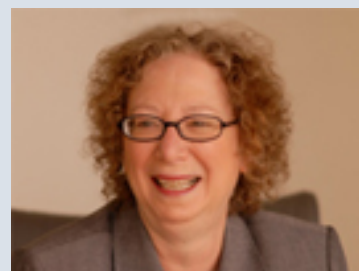
Subordination, Non-Disturbance and Attornment: What does it mean? Why do tenants care?

Tenants who become tired when reading complex and lengthy leases may be tempted to skip over a paragraph at the end of the document that starts with the words "Subordination, Non-disturbance, and Attornment" (SNDA). However, the SNDA language has taken on new importance in this economic environment in which it is no longer shocking to learn that a commercial landlord has walked away from its real estate project after defaulting on the mortgage.

When a landlord defaults on its mortgage, and there is a foreclosure sale, the tenant is at risk of losing its lease, even if it has installed expensive improvements at the property, developed goodwill at the location, and abided by all the terms of the lease.

This risk of loss is the result of being "junior" to the lender. And the tenant is always junior to the lender, either because the lender's deed of trust was recorded before the lease was signed or because the lease states that, even if the lease is signed before the deed of trust, the tenant agrees that the lease is subordinate (junior) to any existing or future lender's deed of trust on the property.

Because the tenant is junior to the lender, if the lender forecloses on the building, the lender or other



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purchaser at the foreclosure sale has a right to terminate the lease.

The way for a tenant to protect its lease from termination upon foreclosure is to obtain an SNDA. An SNDA is a three-party agreement entered into by a tenant, a landlord, and the landlord's lender. The SNDA obligates the lender, or purchaser at a foreclosure sale, to recognize the validity of the tenant's lease.

Why Does a Tenant Want an SNDA?

The lease will include a provision that requires the tenant to subordinate its lease to all existing and future loans. This gives the lender the option, after a foreclosure, to either recognize the lease or terminate it.

It doesn't matter if the tenant is a creditworthy tenant who complies with all of its lease obligations. If the tenant doesn't have an SNDA, the new owner has the right to terminate a "junior" lease as a result of a foreclosure sale.

In exchange for a tenant's agreement to subordinate its lease to the lender's deed of trust, the lease should say that the lender will agree that if there is a foreclosure the lender (or any third-party purchaser at the foreclosure sale) will not disturb the tenant's right of possession under the terms of the lease. In order for this "non-disturbance" protection to be enforceable against the lender, and a purchaser at a foreclosure sale, the lender has to sign the agreement.

Can the Tenant Obtain the SNDA?

Landlords often say they don't want to be obligated to get an SNDA for the tenant. However reasonable it is for the tenant to request an SNDA, the vast majority of landlords will not commit to obtaining an SNDA from the lender for the benefit of the tenant.

The best that most tenants get in a lease is a provision that the landlord will make commercially reasonable efforts to obtain an SNDA on the terms of the lender's standard form. Unless a tenant is taking a very significant portion of the building, that is the best the tenant can expect. The tenant should not get less than that, unless the tenant is leasing a very small portion of a building for a very short term.

Even with an SNDA, however, the tenant will bear some risk in the event of a foreclosure because of the terms and provisions of the SNDA.

What Does the SNDA Say?

In a standard SNDA, the tenant will agree to subordinate its lease to the lender's deed of trust (*subordination*) in exchange for the lender's agreement that, if there is a foreclosure, the lender or purchaser at the sale will recognize the tenant's lease and not disturb the tenant's possession (*non-disturbance*). Each will agree to recognize the other as the valid landlord and tenant under the lease (*attornment*).

Although the SNDA provides protection for the tenant, the SNDA also limits the obligations of the lender or a purchaser at a foreclosure sale when that party becomes the successor landlord. The most frequent modifications to the lease terms require the tenant to agree that if the lender or purchaser becomes the landlord, that party:

- is not obligated to return the tenant's security deposit (unless the lender or purchaser has received it, which is never the case)
- is not obligated to make any tenant improvements that have been agreed to in the lease
- is not liable for any existing defaults of the prior landlord.

While the lender may agree to some minor modifications to these provisions, there is not much flexibility in terms of the substance of these provisions. So a tenant should be aware that even if its lease remains in effect following a foreclosure, the tenant's security deposit is probably lost and any improvements that have not yet been made by the landlord will probably not be made. However, the tenant's right to possession will be undisturbed.

While an SNDA is very important to a tenant's continued right of possession, the tenant is best advised to undertake due diligence before signing the lease in order to have some knowledge as to the landlord's ability to continue to make the payments under its loan.

What Happens After the SNDA is Signed?

An SNDA is enforceable between the parties signing it (lender, landlord, tenant), whether or not it is recorded. However, a recorded SNDA provides greater protection because it puts any third-party buyer at a foreclosure sale on notice that the tenant's lease cannot be terminated by means of a foreclosure. To record the SNDA, the original signed and notarized document is sent to the county recorder's office.

About TroyGould

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