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Why is a "Financeable Lease" Crucial to Your Loan?

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Commercial property owners know all too well the impact that the worst economic downturn since the Great Depression has had on access to credit. While interest rate cuts have given some owners an opportunity to purchase new properties or tap existing properties' equity for operating capital, lower rates don't necessarily mean it will be easy to obtain financing. In considering loans secured by multi-tenant income-producing property, such as an office building or shopping center, lenders have become more sensitive to the quality of the lease agreements you have with your tenants.

Lenders are focusing increasingly on "financeable leases"—leases that ensure consistent cash flow and have terms that would protect them from liability in the event that they have to foreclose on the property and step in as the new owner. Tenants, on the other hand, are concerned primarily with making sure that no matter what happens with the ownership of the property, as long as they are operating in accordance with the lease, their rights will not be altered in any way and they will be allowed to remain in their space after a foreclosure. This puts you in the middle, as both the lender and tenant are looking to you to ensure that their financial interests are protected. Satisfying both parties' competing concerns involves a thorough review of your leases with the lender, and negotiation of two crucial items—the tenant estoppel certificate and the subordination, non-disturbance, and attornment agreement (SNDA). If not handled properly, this review and negotiation can cause major problems between you and your tenants, and it could cost you your loan.

In analyzing whether a lease is financeable, a lender will consider a number of factors. Fundamentally, it will want to determine whether the lease provisions are enforceable in accordance with their terms and applicable laws (are the parties and the leased premises clearly identified, can the lease term be extended, what are the conditions to extension, etc.). In addition, the lender will want to ensure the creditworthiness of the tenant, as well as the ability to review the tenant's financial situation on a regular basis. Credit enhancements, such as security deposits and personal guarantees of the tenant's obligations, are also important. The lender will look at whether the rentals reserved under the lease will be adequate to service the loan debt, and will generally want to limit the landlord's obligations to the tenant (no setoffs against rent, limited rent abatement during and obligations to repair after a casualty event, restrictions on use of tenant improvement allowances, etc.). The lender may insist on other protections, such as the extension of the lease term beyond the loan maturity date; notice of lease defaults delivered directly to the lender; and limitation of the landlord's liability to its interest in the property.

In addition, your lender will require a signed estoppel certificate from each tenant (or, if there are too many tenants of varying sizes, from certain designated "major" tenants), to confirm that each tenant's lease is enforceable and that there are no uncured defaults. Typically, the lender will draft the certificate and require the tenant to confirm items such as the actual commencement date of the lease term and the square footage of the space; that the lease is in full force and effect, and that the tenant is currently paying all costs associated with the space; that the tenant has not paid any other amounts to the owner other than the

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security deposit and rent; that the owner has not defaulted under the lease; and that the tenant has no claims or defenses against enforcement of the lease. To prevent resistance from your tenant during loan negotiations, your lease should obligate the tenant to sign an estoppel promptly upon request.

Your lender will also require that each tenant sign an SNDA, to ensure stable occupancy and rental payments in the face of a loan default and subsequent foreclosure of the loan by the lender. The SNDA is a three-part agreement in which the lender and tenant acknowledge:

1. that the lease is subordinate to the lender's mortgage;

2. that so long as the tenant is not in default of the lease, it will not be affected by the owner's loan default and subsequent foreclosure; and

3. that in the event the lender or a new owner steps into the shoes of the original owner, the tenant will acknowledge the new owner as its landlord under the lease.

SNDAs may also include lease default notice and cure provisions for the lender, to the extent that they are not all contained in the lease. In addition to requiring execution of estoppel certificates, an effective financeable lease will also require that the tenant sign an SNDA when requested.

Lenders are much more likely to approve loans secured by projects involving financeable leases that provide them with adequate financial and liability protection. Owners of multi-tenant properties should consider these issues carefully when negotiating leases with new tenants or renegotiating leases with existing tenants.