

Real Insights on Real Estate: How to Review an SNDA

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How to Review an SNDA Welcome to another “Carlton Fields Real Insights on Real Estate” podcast. Today we’re going to talk about an issue that is often glossed over in real estate transactions -- the subordination, non-disturbance and attornment agreement and how to review it from the perspective of a lender. Joining us to discuss the SNDA and the real estate business is David Adams. David is an attorney who represents national, regional, and community lenders in a wide variety of regulatory and financial matters. He has extensive experience in the areas of the regulation of financial institutions; the acquisition and sale of business entities, and the financing of

various transactions.

When reviewing an SNDA from the lender's perspective, a reviewer's goal in negotiating an SNDA is to try to limit the lender's lease obligations as much as possible, while conversely the tenant endeavors to protect as many of the rights it negotiated in the lease agreement. And, although the lender will generally agree not to disturb the tenant's possession of the premises if the tenant is not in default, the list below indicates the most important items that lenders want outside counsel to review in any SNDA form, and which should be negotiated by tenant. Of course, before diving into the details of any SNDA it is important to make sure that the SNDA (and to a lesser extent the subject lease) actually does the three things in its name: (1) subordination; (2) non-disturbance; and (3) attornment. Sometimes the lender will leave off the non-disturbance portion of the agreement, as the lender is only interested in the subordination and attornment. The purpose of the subordination and attornment agreement is to protect the lender in the event of a default under the mortgage and/or foreclosure of the mortgage so that the lender has the ability to collect rents (often through a rent receiver), and if foreclosed, permit the lender or purchaser at the foreclosure to take possession of the property and step into the shoes of the landlord under the lease.

1. Subordination. A subordination is a contractual agreement by the tenant that its leasehold interest in the collateral property, or portion thereof, is subordinate either to the mortgage or to the lien of the mortgage. This distinction is important because if a tenant subordinates to the mortgage itself, then the tenant will be bound by the terms of the mortgage, which may be contrary to the terms of the lease. Alternatively, if a tenant subordinates only to the lien of the mortgage, then only the tenant's possession is subordinated, and thus the lease provisions will control, subject to any provisions set forth in the SNDA.

2. Non-disturbance. Non-disturbance, as the word implies, is a contractual agreement by the lender not to disturb tenant's possession of the premises under the lease in the event of a foreclosure. At its most basic level, a tenant should require a non-disturbance agreement from a lender in any situation in which the tenant is agreeing to subordinate the lease to the lien of the loan. Tenants are also well advised to seek a non-disturbance agreement unilaterally from any existing lender when the tenant is entering the lease, since the lease automatically would be subordinate to the lien of the loan by virtue of being chronologically behind the lien. Lenders are generally willing to grant non-disturbance to a non-defaulting tenant in return for contractual subordination of the lease to the lien of the loan.

3. Attornment. Simply put, in the context of an SNDA, an attornment is the technical process by which the tenant agrees to recognize the lender, or the foreclosure transferee if not the lender, as the new landlord under the lease after the foreclosure is completed. It is this process that creates the direct privity of contract between the lender or other foreclosure transferee and the tenant under the lease. In addition to the three items above, there are several other items that lenders should pay very close attention to in both the lease and the SNDA review process. When a lender is reviewing a lease or an SNDA, the reviewer should keep in mind that the review is not only for things that may affect a borrower's ability to pay the loan, but also for obligations a lender may step into if – and when – it becomes a landlord. Just like there can be

different lease forms, there is no one-size-fits-all approach to reviewing an SNDA. Below are some questions that a lender should ask when reviewing leases to understand what obligations the lender may step into if and when it steps into the shoes of a borrower/landlord. **Is the lease complete?** Ensuring that all of the documents were actually signed, signed by the correct tenant legal entity, and that the lease relates to the correct premises are preliminary steps, but are important items to confirm. Further, the lender should confirm that all copies of leases include all exhibits and amendments. These could affect the financial terms of the lease, the length of the lease, and other important financial matters. **What is the lease term?** When does the lease expire and what extension/renewal rights does the tenant have? If tenant has a renewal option, purchase option or other option, the lender should confirm that borrower/landlord has sufficient notice of tenant's intent to exercise or not exercise its renewal option so that the borrower/landlord still has enough time to re-let the space without risk of interruption in rent. **What is the rent?** Together with verifying the rent in the borrower/landlord-provided rent roll, the lender will want to understand whether there are any free rent periods. The lender will also want to understand whether there are any significant exclusions from operating expenses or taxes that form part of the additional rent. Commercial leases will often contain a provision allowing a tenant the right to "abate" rent: to stop paying all or a portion of rent for a period of time. The tenant may also have a "self-help" right: the right of the tenant to cure the landlord's default and offset the costs against rent. A lender will want to understand the tenant's right to self-help and set-off, especially if the borrower/landlord is not maintaining the property. **Are there tenant improvement obligations?** Where a building is under construction, or as a tenant inducement, the borrower/landlord may have obligations under the lease to pay for construction or improvements. The lender should ensure that it understands the costs of these obligations, the tenant's remedies for late delivery, and whether the lender would be liable for the borrower's/landlord's failure to provide a tenant improvement allowance. **What are the termination rights?** Lenders concern themselves about the effect that a tenant's termination right may have on a borrower's ability to meet debt service obligations. Tenant termination rights could arise from several provisions in a lease: landlord's breach of a restrictive use covenant; landlord's failure to complete leasehold improvements timely; landlord's failure to make major repairs; or landlord's failure to restore the demised premises soon enough after a casualty. The lender should also review the landlord's termination rights as this will help assess the flexibility a lender may have upon enforcing a lease if it steps into the shoes of the borrower/landlord. Further, the lender should understand cure rights for a landlord default that may help to preserve a favorable lease. **Is there a "go dark" or "co-tenancy" provision?** The lender should understand landlord's rights if a tenant closes its doors and ceases operations. Although the tenant will typically be required to continue paying rent if it goes dark, the collectability of rent may be in doubt. Another question a lender should ask is what impact does a "going dark" provision have on other tenants in a multi-tenant property should the tenant exercise this right. If it is an anchor tenant, the other tenants may rely heavily on the anchor being open so as to generate traffic in the property and business. The lender should also determine whether the lease contains a "co-tenancy" provision. These provisions allow a tenant to exercise specified remedies if certain conditions regarding the presence and operation of

other tenants in the building are not met. The lender should understand the impact a co-tenancy provision could have on the entire property if any one tenant's closure or failure occurs within the property. **What are the landlord's obligations to rebuild or restore?** The obligation to rebuild or restore after a casualty usually falls on the landlord's shoulders. This can be an extremely expensive undertaking for a landlord, especially if insurance coverage is inadequate. Another related area is understanding when and how the lease allows a Tenant to abate rent after a casualty. An insurance review cannot be understated. While many of the items will happen if the appropriate number of angels dance on the appropriate pin head, insurance claims ways occur at the worst possible moments. If a reviewer does nothing else, it should complete a thorough insurance review. **Are there rights of first refusal or first offer?** These tenant rights can limit a landlord's ability to lease vacant space. In multi-tenant buildings, tenants with these rights may be entitled to notice when other spaces become available in the building and a landlord may not be able to offer vacant spaces to desirable tenants without first offering it to existing tenants holding these rights. **Is the lease self-subordinating or is there a requirement for a subordination, non-disturbance and attornment agreement (SNDA)?** The SNDA subordinates a lease to the lender's security interest in the property. This subordination is usually given by tenants in exchange for a promise by the lender not to disturb the leasehold rights of the tenant in the event of foreclosure as long as the tenant is not in default of its lease. As mentioned above, a key provision for lenders in the SNDA is "attornment," which provides that in the case of a foreclosure, the tenant will attorn to (recognize) the lender (or the buyer at a foreclosure sale) as the new landlord under the lease with all the same rights of the prior landlord. A lender will want to be sure that any tenant that has an interest in the property that is earlier than a new mortgage is obligated in its lease to provide an SNDA in connection with the new mortgage. **Is the tenant obligated to provide an estoppel certificate?** Many leases provide that either landlord or tenant will execute an estoppel certificate upon request of the other. The estoppel gives a lender notice of existing issues in the landlord-tenant relationship and any defaults by either party that might need to be cured. A lender should confirm whether the leases require tenants to provide estoppel certificates. The lender should review the estoppel certificate to be sure there are no unexpected issues with the property or the relationship between landlord and tenant that would prove costly to resolve by the landlord, or later by the lender if a foreclosure becomes necessary. In most cases a SNDA will be an ancillary document in a financing or leasing transaction. Normally, the need for a SNDA will arise as one of a lender's closing conditions for funding a loan. Certain tenants may also request a SNDA as a closing condition or post-closing obligation to be satisfied by its landlord in a leasing transaction, but this is less common. Since a SNDA will not be one of the primary documents in a loan transaction, there is sometimes a tendency for the landlord and lender to treat it as an innocuous "checklist" item and wait until late in the transaction to circulate the lender's form to any tenants. But commercial tenants should not let the attitude of their landlord or its lender towards SNDAs, or any last minute rush, fool them. The stakes are high and tenants should carefully review the terms of a SNDA with counsel before signing. The above items highlight just a few of the commercial lease provisions that lenders should look for when reviewing leases not only for items that may affect the borrower's ability to pay the loan but also for obligations on the lender if – and

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