

BRYAN CAVE

# Legal and Practical Commercial Leasing Issues For Real Estate Lenders

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# Overview of Commercial Leasing Issues

- Commercial Leases
  - Distinctions Between Credit Tenant Leases vs. Other Commercial Leases
- Process of What to Review and Focus on with Standard Commercial Leases
- Ground Leases
  - Pad or Parcel Ground Leases Between Borrower and Ground Tenant
  - Borrower as Ground Tenant
    - Distinction Between Ground Lease Assignment and Leasehold Mortgage

# Approach to Reviewing Commercial Leases

- Key Commercial Lease Provisions for Lenders
  - Payment of Rent –
    - Rent Abatement
    - Rent “Subsidy”
    - Free Rent Period(s)
  - Lease Term – Any renewal or extension options during loan term
  - “Go Dark” Provisions
  - Purchase Option or “ROFO”
  - Leased Premises Expansion Rights
  - Future Lease “Incentive” or Other “Partial Refund” Payments by the Owner to the Tenant

# Approach to Reviewing Commercial Leases

## Part 2

- Funding for Construction of Tenant Improvements
  - Payment by Owner with Reimbursement Obligations of Tenant
  - Payment by Tenant with Reimbursement Obligations of Owner
- Development, Leasing or Below Market Rent Restrictions
  - Development Agreement Requirements
  - Fair Housing Requirements
  - Letter of Credit for Infrastructure Improvements

# Approach to Reviewing Ground Leases

- Is Borrower Ground Tenant or is Borrower the Fee Owner and Ground Lessor?
  - If Borrower is Ground Tenant –
    - Reasons for Using Leasehold DOT vs. Lease Assignment
    - Reasons for Ground Lessor Consent and Estoppel
- Elements of Ground Lessor Consent and Estoppel
  - Approval of Leasehold DOT and Agreement for Mortgage Protections
    - Including Notice and Cure Rights; Time to Foreclose if Necessary for Cure
  - Termination Issues, Both Pre- and Post-Bankruptcy
    - These are Legal Rights Which Cannot be Waived, so Must be Addressed to Permit Continuation of Lease Between Lender and Ground Lessor
  - Rights Regarding Lien Against Fee Interest
    - Prohibition or Requirement for Acknowledgment to Consent and Estoppel by Fee Lender

# Approach to Reviewing Ground Leases

## Part 2

- If Borrower is the Fee Owner and Ground Lessor
  - Reasons for ARNDA vs. SNDA
    - ARNDA Creates a More Interactive Relationship to Preserve the Ground Lease, Which Often is the Key to Property Success
- Elements of ARNDA
  - Contains Standard SNDA Provisions
  - Addresses Broader Tax Obligations, Insurance Obligations and Other Construction or Quasi-Ownership Rights Inherent in Ground Lease
  - Includes Additional Ground Tenant Protections, Including Bankruptcy Related Protections Similar to Ground Lessor Consent and Estoppel, Development and Construction Obligations, etc.

# Lease Subordination Issues – Overview

## Subordination, Non-Disturbance and Attornment (“SNDA”)

- SNDA provisions usually control the rights and remedies of the foreclosing lender (new landlord) and the tenants.
- Subordination: If a mortgage or deed of trust predates a lease, then the lease would be terminated upon foreclosure. In most jurisdictions, if the lease is prior in time to the mortgage or deed of trust, there would not be termination upon foreclosure. SNDAs can alter the priorities.
- Sometimes a lease contains a subordination provision which entitles foreclosing lender to terminate at its election upon foreclosure. These are often contained in loans where the originating lender required it as a condition for a loan. SNDAs signed by tenants often contain subordination provisions.
  - Inadequate because it does not typically address all issues, but also does not create a “privity” relationship between Lender and Tenant

# Lease Subordination Issues – Overview (cont.)

## Attornment v. Non-Disturbance

- Attornment provisions provide a benefit to the foreclosing lender (new landlord). Requires tenant to abide by lease to the benefit of the foreclosing lender.
- Non-Disturbance provisions are obligations imposed on the foreclosing lender in which the lender agrees that it will not terminate lease upon foreclosure. Law usually requires that the lender actually sign and not binding on lender is just signed by borrower and tenant.



# Lease Subordination Issues – Part 2

- Lease Subordinations or SNDA
  - “Subordination” is the Least Important Element of an SNDA
    - Really do not Want a True Subordination Because the Purpose of the Agreement is to *Preserve* the Lease, Not Wipe it Out
  - Non-Disturbance and Attornment Provisions are the Key Elements
- Frame of Mind – View SNDA as Addressing Three Relationships Between the Lender and the Tenant
  - “Pre-Default” Relationship (Both Lease or Loan)
  - “Post-Default” Relationship (Both Lease or Loan)
  - “Post-Foreclosure or Deed-in-Lieu” Relationship

# Lease Subordination Issues – Part 3

- SNDA - “Pre-Default” Relationship (Both Lease or Loan)
  - No Assignment or Subleasing Beyond Lease Terms
  - No Obligations for Lender Until Assumption of Ownership
  - Respective Obligations for Insurance and Application of Proceeds
- SNDA - “Post-Default” Relationship (Both Lease or Loan)
  - Limitations on Lease Modifications
  - Limitations on Pre-Paid Rents
  - Exculpation for Environmental and Construction Obligations
    - No Liens on Property Permitted; No Obligation to Finance Construction
  - Notice and Cure Rights
- SNDA - “Post-Foreclosure or Deed-in-Lieu” Relationship
  - Limitation for Lessee Against Lender to Lender’s “Rights in the Property” – No Personal Recourse
  - Express Release of Liability After Transfer of Title
  - Limitations for Trailing Liability – Only Responsible for Matters for Which Lender Received Prior Notice and Cure Opportunity

# Lease Subordination Issues – Part 4

- Schoolcraft Issues for Insurance and Condemnation Proceeds
  - Must Apply Proceeds to Restoration Regardless of Loan Document Requirements
- “Non-Negotiable” Issues
  - Exculpation from “Special Obligations”
    - Unique Payment Refunds
    - Environmental Responsibilities
    - Construction and Expansion Obligations
  - Restrictions on Option and ROFO Rights in Favor of Tenants
    - Only Exercise Upon Repayment of Loan and not Triggered by Foreclosure or Deed-in-Lieu
  - Termination of Lender’s Liability After Post-Foreclosure Transfer

# Acquisition Phase

## Special Use Permits/Requirements; Maintenance and Management Agreements; CC&Rs and Trailing Security Interests

- Need to determine if notices of termination or continuation are required, length of any notice periods, exercising rights under assignments and pledge agreements, etc.
- Explore means of securing/obtaining rights to additional pledged collateral, such as LCs for tenants, deposits, bond proceeds, reserve accounts, tax refunds, etc.
- Investigate any potential property or use violations under local ordinances and have corrected, if possible, prior to transition.
- Receivership Transition –
  - Lender can Control Terms of Receivership and Selection of Receiver – This is Key Decision Which Will Either Create or Avoid Problems During Receivership Pending Foreclosure
    - Problems can arise if a Receiver consents to a lease extension or modification during the term of the receivership. Lender should closely monitor leasing activity during receivership and raise objections to the court if needed.
    - Courts and Title Companies Still Hesitant to Grant Receiver Right to Sell Property Prior to Foreclosure – Usually will Require Borrower Consent

# Summary; Final Thoughts

- Commercial Leases are Key to Success or Failure of Project
- Critical to Understand Lease Terms and How They Relate to Lender's Rights and Obligations Under Loan Documents
- Many Provisions of Ground Lease or Commercial Lease Can Be Treated by Negotiation in ARNDA or SNDA
  - Remember the “Non-Negotiable” Items, Which are not Numerous
- Pending and Following Foreclosure, the SNDA and ARNDA Will Continue to Control Relationship Between Lender and Tenant

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