

SNDA Toolbox: Ten Tips for the Health Care Tenant When Reviewing Subordination, Nondisturbance, and Attornment Agreements

Suzanne E. Hennessy (Murphy Austin Adams Schoenfeld LLP)

Catherine M. Oh (Murphy Austin Adams Schoenfeld LLP)

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Health care providers leasing office, medical office, or clinic space are often required by the terms of their leases to periodically sign a Subordination, Nondisturbance, and Attornment Agreement (SNDA) presented by Landlord's Lender. Lien priority is typically determined by timing order, and so a lease that is entered into prior to a Landlord's mortgage or deed of trust will have a higher priority. Lenders typically require that their mortgage be superior to all leases, but they do not necessarily want to terminate the lease through foreclosure since there is value in the income stream from the rents. The SNDA is a common instrument required by Lenders to address these concerns, and as further discussed below, is sometimes also required by Tenants.

The typical SNDA includes the following concepts: (1) Tenant subordinates its lease to the lien of Landlord's mortgage; (2) Tenant agrees to recognize Lender as its successor landlord post-foreclosure (commonly referred to as "attornment") and Lender agrees to perform the obligations of Landlord under the lease post-foreclosure; and (3) Lender agrees not to disturb Tenant's right of possession under the lease in the event Lender forecloses the mortgage following Landlord's default, so long as Tenant is not in default under the lease. These are typically short, but nevertheless important, tri-party agreements between Lender, Landlord, and Tenant that are recorded in the public records. This article highlights key issues to consider when representing the health care provider as Tenant when reviewing an SNDA:

1. Negotiate SNDA Requirements Before Signing the Lease. SNDA requirements are important to evaluate early on when negotiating a new lease agreement. Tenant should negotiate a liberal amount of time to review and comment on the SNDA and confirm that the SNDA provisions of the lease are otherwise reasonable. Moreover, the lease may or may not require that Tenant execute an SNDA at the time the lease is entered, but in certain circumstances a Tenant may want to pursue an SNDA even though Landlord is not obtaining new financing. If a Lender has already recorded a mortgage against the property at the time the lease is signed, the lease will automatically be subordinate to the mortgage. A Tenant in this position may require an SNDA at the outset when entering into the lease because (subject to specific state laws) without the nondisturbance provisions in the SNDA, Lender can "foreclose out" or terminate the junior lease upon foreclosure of the mortgage. This could be a devastating result, particularly if the lease covers highly improved medical office space that could then be leased by

the new landlord to a competitor or would be expensive to duplicate. An SNDA would also be important if the location of the leased premises was particularly strategic to the health care provider or if there were concerns about Landlord's financial strength and debt service abilities. But before insisting that an SNDA be required, the protections of an SNDA should be balanced against the hassles of entering into an SNDA when one would not otherwise be required, such as being subject to the additional covenants and limitations that are typically required in SNDAs and incurring additional legal fees.

2. Check the SNDA Terms Against the Lease Terms. Many Lenders attempt to rewrite certain lease terms in the SNDA. For instance, the SNDA may allow Lender substantial additional time to cure Landlord defaults beyond what Landlord is otherwise allowed in the lease, require Lender's consent for all assignments or subleases (even when consent for transfers to affiliates are not required by the lease), modify Tenant's rights in the event of casualty or condemnation, or require Tenant to waive offset rights, such as rent concessions or abatements. Tenant's starting position should be that Lender should not be able to renegotiate key lease provisions in the SNDA.

3. Review Lender Consent Requirements to Lease Amendments. A Lender's standard SNDA form typically requires Landlord and Tenant to obtain Lender's prior written consent for any amendment or modification of the lease. Tenant's response to such a provision may include a combination of the following: (i) limit consent to amendments or modifications that materially and adversely affect Lender; (ii) exclude any consent requirement for modifications that Landlord is allowed to make without Lender's consent under its loan documents or that are solely for the purpose of documenting rights expressly set forth in the lease (such as the exercise of renewal options) or confirming basic business terms (such as the final square footage of the premises or the commencement date of the term); (iii) require that Landlord, rather than Tenant, be responsible for obtaining Lender's consent under the SNDA since Landlord has the primary relationship with Lender and is obtaining all the benefits from the loan; and (iv) provide that Lender's failure to respond to a request for consent within a certain period of time is deemed Lender's approval of the requested item.

4. Beware of Lender Liability Carve-Outs. Typically, the most heavily negotiated provisions in the SNDA are the sections where Lender attempts to absolve itself from liability for prior Landlord defaults when it becomes the property owner after foreclosure (e.g., breaches of representations, maintenance failures). These provisions need to be reviewed carefully. Tenant should argue that, at a minimum, Lender, as the successor landlord, is liable for "continuing defaults" which exist at the time of foreclosure and of which Lender is aware. Other commonly negotiated limitations on Lender's obligations after foreclosure are discussed further below. (References in this article to Lender after the occurrence of a foreclosure include Lender or any other party who acquires title through foreclosure and becomes the successor landlord.)

5. Protect Construction Allowances. The exculpation provisions limiting Lender's liability after foreclosure often attempt to exclude Lender's liability for any tenant improvement obligations of Landlord. If the SNDA is signed in conjunction with a lease where Landlord is providing a significant tenant improvement allowance and all such funds have not yet been released to Tenant, this limitation needs to be deleted. Tenant should not face the possibility of a foreclosure occurring while tenant improvements are in process and not receiving the bargained-for allowance from Landlord's successor.

6. Get Credit for Prior Lease Payments. Lender's SNDA form typically provides that Lender will not be bound by any prior rent payments made more than one month in advance. Tenant will want to carve out from this requirement any advance rent or other payment required under the lease (such as security deposits and prepaid taxes or operating expenses) or any other advance payments actually received by Lender.

7. Focus on Lease Termination Provisions. The "no liability" provisions of the SNDA typically attempt to absolve Lender from being bound by any early lease termination. Many health care provider leases include

termination rights for compliance reasons. This provision should include a caveat that it does not prevent Tenant from terminating the lease pursuant to specific lease provisions or applicable law (e.g., condemnation).

8. Review Provisions on Payment of Rent to Lender. Most SNDAs require Landlord to agree that Tenant will pay rent directly to Lender upon notice of Landlord's default under the loan documents. Tenant should be able to rely solely on such notice without any obligation to inquire into the validity or appropriateness of any instructions to pay rent to Lender. Landlord should also be required to indemnify Tenant for any claims related to such payments made by Tenant and the parties should agree that all such payments are given full credit under the lease.

9. Do Not Forget the Little Things. Since most SNDAs require notice among the parties, make sure the SNDA includes an adequate notice provision with copies to appropriate Tenant parties. Be careful to limit circumstances in which Lender must be notified, and require that Landlord, not Tenant, be responsible for delivering any such notices. Also, many SNDAs include estoppel-like provisions that, if possible, should be deleted or moved to a separate estoppel certificate. If they cannot be deleted or moved, make sure any representations are made to "Tenant's knowledge" and define knowledge as the actual, not constructive, knowledge, without duty of inquiry, of a specific person or a class of people (e.g. property managers) so as not to draw in the implied knowledge of the entire health care system.

10. Remember That the SNDA Exists. Tenant should make sure it gets copies of any fully signed and recorded SNDA, which is an enforceable tri-party contract. Tenant should reflect the SNDA in its electronic lease file as Tenant may need to refer to the SNDA if there is a Landlord default or a need to notify Lender or obtain Lender's consent if the lease is being amended, assigned, or terminated.