

ESTOPPEL LETTERS & SUBORDINATION, NONDISTURBANCE &  
ATTORNMEN T AGREEMENTS

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In today's economic climate, a Lender must be more careful than ever when it makes a loan secured by rental real estate – real estate that derives a great deal of its value from the rent payments of the property's tenants. The Lender must have both assurance that the leases are not in default and a promise by the tenants to continue to pay their rent to the new owner after a foreclosure or other sale. For leases that are recorded in the public records, the Lender will also need to have an agreement by the tenant that the lease is subordinate to the mortgage.

If the Lender is taking a mortgage on a leasehold interest – if the borrower is a tenant and the Lender's security is the tenant's right to possession of real estate under a lease – then the Lender may need the consent of the borrower's landlord. Even if the landlord's consent is not needed, the Lender will need the landlord's assurance that the borrower's lease is not in default, the right to cure the borrower's defaults and to keep the lease from terminating, and the landlord's agreement that if the Lender or another person acquires the property in a foreclosure sale or a deed in lieu of foreclosure, then the landlord will recognize this person as the new tenant and the lease will remain in effect.

Most Lenders have forms that contain these and other important agreements by the borrower's tenants or its landlord, as the case may be. In these materials, we will examine these agreements, their negotiation, and the terms that are most crucial to the Lender.

**I. Estoppels From Borrower's Tenants**

A. The Nature of an Estoppel Letter

An estoppel is a letter or certificate signed by the tenant and directed to the Lender. In it, the tenant sets out the basic business terms of the lease, the status of any construction, and whether either party is in default.

The purpose of an estoppel letter or certificate is both (i) to provide assurance that the business terms of the lease have not been changed and that neither party is in default, and (ii) to bind the tenant to its representations about the lease and its interpretation and about the parties' performance prior to the date of the certificate.

B. Why an Estoppel Letter is Needed by a Mortgage Lender

Certainly, the Lender can and should obtain copies of the leases and review the major provisions in them. The Lender should also require that the borrower confirm to the Lender that the lease copies that the borrower has provided are complete and accurate and set out the parties' agreements and that neither party is in default. However, the borrower's interpretation of the lease and its status may not be the same as the tenant's, and some borrowers may not be completely forthcoming or may gloss over points that are very relevant to the cash flow provided by the leases.

To assure that what the borrower has told the Lender is accurate in the tenant's mind as well as in the borrower's mind, the Lender needs to obtain these same assurances from the tenant. In the estoppel letter or certificate, the tenant assures the Lender that what the borrower has told the Lender is accurate, and that there are no circumstances then known to the tenant that would jeopardize the rent payment stream.

Of course, not all leases are sufficiently important to the Lender for the Lender to require that the borrower go to the cost and effort of obtaining estoppel certificates. In loans on property with retail, office, or warehouse tenants, estoppel certificates are generally required other than with respect to the least important tenants. In loans on apartment buildings, estoppels are required less frequently.

C. The Certifications that a Lender Should Request in an Estoppel Letter

As a minimum, the Lender should require the following (for the following reasons):

- (i) Confirmation by the tenant of the term, rent, premises, security deposit, and other basic business terms of the lease – this will permit the Lender to confirm the accuracy of the lease schedule that has been provided by the borrower using the tenant's own numbers;
- (ii) Confirmation by the tenant that the lease is in effect, with no amendments other than those listed – this will permit the Lender to confirm that it has been provided with a copy of the correct lease and all of its amendments;
- (iii) Assurance by the tenant that all of the work landlord was to have performed has been completed, that the premises are in the required condition, and that landlord has paid all tenant allowances and paid all rent credits that are required under the lease – this permits the Lender to confirm that the borrower does not need additional funds to perform its lease obligations and that the amount of the rent payment stream is not subject to the risk that this work will not be performed, and if the Lender acquires the property by reason of a borrower default, it gives the Lender a defense to claims by the tenant that its landlord must put more money into its leased space;

- (iv) Confirmation by the tenant of the amount and date of the last rent payment it has made and that it has not pre-paid any rent for more than one month in advance – this permits the Lender to confirm that its future rent collateral has not been diminished by pre-payments;
- (v) Assurance by the tenant that it does not have a right to any offsets or deductions from the rent or any claims against landlord, that landlord is not in default, that it has given landlord no notices of default, and that there are no events or circumstances that, with notice or time to cure, would lead to or result in an event of default on the part of the landlord (or a right to terminate on the part of the tenant) – this permits the Lender not only to confirm that its lease collateral is not subject to imminent termination or offsets, but also, if the Lender acquires the property by reason of a borrower default, it provides the Lender with a defense against claims by the tenant with respect to any defaults that pre-date the estoppel certificate;
- (vi) Assurance by the tenant that the tenant is not in default under the lease, that it has received no notices of default from the landlord, and that there are no events or circumstances that, with notice or time to cure, would lead to or result in an event of default on the part of the tenant (or a right to terminate on the part of the landlord) – this permits the Lender to confirm that from the tenant’s point of view, the tenant has been complying with its obligations and the landlord does not have grounds to seek to terminate the lease by reason of the tenant’s acts or omissions;
- (vii) Confirmation by the tenant that it is not subleasing any part of its space and its rights have not been assigned – this permits the Lender to confirm that it is dealing with the occupant of the premises;
- (viii) Assurance that there are no rights to extend or other agreements with the landlord that are not expressly set out in the lease – this permits the landlord to confirm that the tenant does not believe that there are side agreements not set out in the lease; and
- (xii) Confirmation that the tenant has no right of first refusal or option to purchase the premises – this permits the Lender to confirm that the tenant will not later assert that these important rights were granted to the tenant.

This last assurance is very important to a Lender. An option to purchase the property for a particular price fixes the value of the property at that option price. In addition, if a tenant has right of first refusal that does not state that a foreclosure sale or transfer to a Lender is an exception to this right, then the Lender may have difficulty enforcing its normal mortgage rights and remedies.

Attached as Attachment A is a form estoppel certificate that includes the provisions discussed above as well as other useful terms. We have placed the basic information on the first page of this form because frequently, the estoppel certificates are completed by the borrower's property manager or the property manager of the owner that is selling to the borrower, and there is less chance that these property managers will insert incorrect information and more chance that the tenant will review this information for accuracy if the information is clearly set out on the initial page of the estoppel, not buried in the legal language.

Some Lenders require more detailed certifications from some tenants, particularly from tenants that are the only occupant of the property or whose payments represent the main part of the rent payment stream. For example, a Lender might ask the tenant to certify that the use of the premises has not involved the generation, storage, treatment, disposal or release of hazardous substances and that the premises are in compliance with all environmental and other laws. Most of these concerns should be covered by the tenant's confirmation that the tenant is in compliance with the lease. In the future, as new issues arise in commercial property ownership and leasing, landlords may also ask tenants to certify to additional and more complex matters.

Some Lenders also like to include affirmative agreements, such as an obligation to give the Lender notice of all defaults and to pay the rent to the Lender if the Lender exercises on its collateral rent assignment. However, these agreements are generally also part of the subordination, non-disturbance, and attornment agreement (the "SNDA"), so if an SNDA is being required, these agreements should not be duplicated in the Estoppel Certificate.

#### D. Negotiating Estoppel Letter Language with the Tenant

A tenant is not obligated to furnish its landlord's Lender with an estoppel certificate as a matter of law. This obligation must be imposed in the lease agreement itself. Indeed, the requirement that the tenant furnish an estoppel certificate on request is a basic provision of most commercial leases. The extent to which the tenant must certify matters to the Lender is also limited to the tenant's obligations under the lease. It is, of course, possible for a lease to include a list of required certifications, but many simply require that the tenant certify to the matters requested by the prospective Lender (or buyer), or, if the tenant negotiates the lease, to the reasonable matters requested.

The most basic issue that tenants raise in the negotiation of an estoppel certificate is whether they must certify to any matter absolutely – whether they may certify only “to the best of their knowledge” or “to their actual knowledge, without investigation.” As tenants are becoming more in demand and gaining bargaining position, tenants may also negotiate lease provisions that state that they will not be bound by the statements they make in their estoppel certificates if they later discover those statements to have been in error. Some language strong tenants may request in their lease or estoppel certificate might be the following: “Such instrument shall not have the effect of waiving, or estopping any party from asserting or otherwise depriving any party of the benefit of any

provision of this lease that provides a right to receive a refund of any overpayment,” or “If it is discovered by or disclosed to tenant after the date hereof that there existed on the date hereof any default, claim, or defense, or by reason thereof, rights of offset, not actually known to tenant on the date hereof, such default, claim, defense or rights of offset shall not be affected, waived or released by the issuance of this tenant Estoppel Certificate, and tenant shall not be estopped from asserting the same. . . .tenant shall not be estopped from denying the accuracy of this tenant Estoppel Certificate as between tenant and landlord, landlord’s affiliates or Lenders”. These provisions were quoted in the ABA, Real Property Probate & Trust section’s DIRT blog as forming part of some national retail tenant estoppel certificates recently.

These provisions strip an estoppel of all of the benefit that is to be provided to the Lender, and most Lenders will not accept an estoppel containing this language. However, inserting the phrase “to the best of our knowledge” or even “to our best knowledge without investigation” with respect to factual matters should give the Lender sufficient comfort except in the case of tenants whose rent payment stream forms the main part of the Lender’s security. Since these tenants are, in effect, the borrower, and particularly if the landlord is building or has built the improvements to the tenant’s unique specifications under a long term net lease, a Lender could demand that the tenant give a completely unconditional estoppel. Again, the provisions of the lease may govern in this case, and if the tenant has stipulated in the lease that tenant- protective language must be included in the estoppel, then the borrower may not be able to get its tenant to sign anything else, and the Lender will have to make a credit decision with respect to the matter.

Attachment B to these materials is a negotiated estoppel that reflects the changes that a reasonable Lender might agree to for a tenant whose rent payment stream is not the bulk of the Lender’s security.

E. Title Issues that Can Be Resolved by an Estoppel Letter

An SNDA is more useful in curing title issues than an estoppel certificate. However, an estoppel certificate can be helpful in establishing some matters to the title company’s satisfaction.

Under Louisiana’s Private Works Act, La. R.S. Section 9:4801 et seq., it is possible that a contractor will have the right to lien an owner’s interest in property for the full price payable under a construction contract signed by his tenant even if the tenant allowance is only a fraction of the contract price. If a tenant’s construction contract has been recorded and has not been terminated, the title company may refuse to remove the construction contract from the listed title exceptions even if the landlord was responsible for reimbursing the tenant for only a small part of the total cost and if this reimbursement has already been paid. The author has known a local agent for national company to take this position recently, and it is supported by the Private Works Act, particularly La. R.S. Section 9:4806. In a tenant estoppel, the Lender can ask the tenant to certify that all construction projects for which any allowance amounts were payable have been

completed and that all contractors and subcontractors were paid in full. The title company should be satisfied by this certification.

In addition, a properly drafted tenant estoppel will set out the commencement and termination date of this lease. If the memorandum or notice of lease of public record does not set out the exact commencement date or termination date, then a title company may wish to keep the lease as an exception indefinitely. The estoppel certificate should fix the commencement and termination dates, and if the property is sold or re-financed after the termination date set out in the estoppel certificate, the title company may be persuaded to take the estoppel certificate as partial evidence that the lease has come to an end.

## **II. Subordination, Non-Disturbance, and Attornment Agreements**

### **A. Lease and Mortgage Title Ranking Issues**

Louisiana is a strict recordation state. Both leases (which may be recorded by the recordation of a notice of the lease under La. R.S. Section 44:104) and mortgages must be recorded to bind third party purchasers of the property. The first recorded document will have priority over all subsequently recorded documents. However, parties are free to alter by contract the priority rights established by law. E.g., *Calcasieu Marine National Lender of Lake Charles v. Scarlett Investments*, 556 So.2d 911 (La. App. 3<sup>rd</sup> Cir. 1990). An agreement by the tenant in which it subordinates its rights under a recorded lease to the rights of a subsequently recorded mortgage is a contract that alters these priority rights and causes the mortgage to be superior to the lease.

In many states a purchaser that acquires property or a Lender that receives a mortgage on property with knowledge that is occupied by a tenant must take the property with the lease in place and cannot eject the tenant after the sale (or foreclosure sale in the case of a mortgage). However, Louisiana requires that the lease or a notice of it be recorded in the conveyance records of the parish in which the property is located in order to bind subsequent purchasers and mortgagees. If the lease is not recorded, then it will not have priority over the mortgage. If the Lender forecloses on its mortgage, the Lender can have tenants whose leases are unrecorded (as well as tenants whose recorded leases are subordinate to the mortgage) evicted from the property. E.g., *T.D. Bickham Corporation v. Hebert*, 432 So.2d. 228 (La. 1983). The tenant retains the right to sue its original landlord for damages since the original landlord has breached its obligation to keep the tenant in possession of the property, but the tenant has no claim against the buyer or purchaser at foreclosure sale.

If the lease or a notice of the lease that satisfies La. R.S. Section 44:104 is recorded, then the lease will survive a foreclosure or other sale of the property and will bind future purchasers. For this reason, most Lenders require that their mortgages on property that has commercial tenants be first priority mortgages that are prior in rank to all other recorded documents, including all commercial leases.

B. The Reasons the Tenant’s Lease Should Be Subordinate to the Lender’s Mortgage, and the Danger of Subordination

If a mortgage is recorded after a lease has been placed of public record, the lease will be prior in rank to the mortgage, and if the Lender forecloses, the lease will bind the purchaser at a foreclosure sale. Most Lenders want to be able to accept the tenants or not accept the tenants as they choose after a foreclosure sale. Equally important, Lenders wish to be able to take steps that are contrary to the lease – such as use insurance proceeds to pay the debt, and not to rebuild the leased premises even if rebuilding is required in the lease. Although property expropriation is not common, the Lender will also wish its rights to be recognized by an expropriating governmental authority before the authority compensates the tenant for its leasehold interest. To accomplish these results, the tenant must agree that its lease is subordinate in rank to the mortgage.

However, the subordination of a lease to a mortgage can have an unintended consequence. In the case of *T.D. Bickham Corporation v. Hebert*, 432 So.2d. 228 (La. 1983), the Louisiana Supreme Court upheld a foreclosing mortgagee’s right to disregard a lease that had been made subordinate to future mortgages by language in the lease; however, the court used very broad language to reach this result, holding as follows:

Although there are no Louisiana cases dealing with provisions that subordinate a lease to a future unspecified mortgage, prior cases have consistently held that leases, which are recorded subsequent to a mortgage, are cancelled and dissolved by the judicial sale of the property pursuant to a foreclosure on the mortgage. *Thompson v. Flathers*, 45 La. Ann. 120, 12 So. 245 (La.1893); *Sandel v. Douglas*, 27 La. Ann. 628 (1875); *Barelli v. Szymanski*, 14 La. Ann. 47 (Orl.App.1859).

432 So.2d at 230-31. Following *T.D. Bickham*, in *PJ’s Army Surplus & Co. v. G.D. & G.*, 635 So.2d 1271 (La. App. 5<sup>th</sup> Cir. 1994), the Louisiana appellate court held that a purchaser from a foreclosing creditor has the right to disregard a lease recorded prior to the sale and to obtain the eviction of the tenant, explaining as follows:

In our view, the judicial sale has the effect of canceling all rights in the property which are inferior to the right of the seizing creditor. This view is supported by the supreme court case *T.D. Bickham v. Hebert*, 432 So.2d 228 (La.1983). In *T.D. Bickham*, the court held that a lease provision that subordinated the lease to any future mortgage gave the third-party purchaser at the judicial sale from the mortgage foreclosure superior rights to the lessee. In so holding, the court relied on La.C.C.P. art 2372 and La.C.C.P. art 2376. La.C.C.P. art 2372 provides that the property sold at a judicial sale is sold subject to any real charge or lease which is “superior to” the rights of the seizing creditor.<sup>FN1</sup> La.C.C.P. art. 2376 provides that a judicial sale results in the cancellation and release of rights which are “inferior to” the right exercised by the seizing creditor.<sup>FN2</sup> The court stated, although not dispositive of the case before it, “under these two articles, a judicial sale cancels a right in property sold at a judicial sale which is inferior to the right of the seizing creditor.”

635 So.2d at 1218-19.

These cases do not state that merely that the foreclosure cancels the recordation of the lease and subsequent purchasers will take free of the lease as if it had not been recorded, although this is the actual result of each of these holdings, and this limited language would have been sufficient for the court to have accomplished this result. These cases use much broader language than was necessary to cancel the effects of the lease's recordation – they state that the lease itself is cancelled and terminated by the judicial foreclosure. Under the language of these cases, a tenant that wishes to terminate its lease can assert that a foreclosure sale gives it the right to walk away from the lease just as it gives the purchaser at foreclosure that right.

In this economic climate, even though Lenders wish the tenant leases to be subordinate to their mortgages, they probably do not want the tenants that produce the rent payment stream to walk away from the property. Consequently, they also need to require that the borrower have each tenant waive any right that the tenant may have to assert that the lease is terminated by reason of a judicial foreclosure.

C. The Additional Tenant Agreements Needed by the Mortgage Lender

Attached as Attachment C is a form of Subordination and Non-Disturbance Agreement that contains language that can be requested by a Lender.

In light of the language in the cases indicating that the tenant can claim that the lease is terminated as to both parties by a mortgage foreclosure, the Lender must include in its subordination agreement an agreement by the tenant that if the property is transferred by judicial foreclosure or dation en paiement (deed in lieu of foreclosure), the tenant will, at the request of the purchaser, attorn (that means pay its rent to) the purchaser and will otherwise honor its lease obligations in favor of the purchaser with the same effect as if the purchaser was its original landlord. As will be discussed below, the tenant is likely to ask that the Lender also agree to honor the lease and not seek to evict the tenant.

The Lender also needs to include a statement that it is not liable for defaults by the prior owner or obligated to pay money that the prior owner was to have paid or perform obligations that the prior owner was to have performed prior to the foreclosure. This should protect the Lender from suits for damages that the tenant may have against the mortgagor. This language is also designed to protect the Lender from having to pay tenant improvements amounts or perform other work in the leased space after a transfer to the Lender or other purchaser at a foreclosure sale. As discussed below, the tenant may have objections to this language.

The Lender should also include a provision in which the tenant agrees that the Lender has the right to subordinate its mortgage to the tenant's lease at any time.



If the lease and rents payable under the lease are also being assigned to the Lender as security, the SNDA should include a provision in which the tenant acknowledges this assignment and agrees to pay its rent to the Lender upon request by the Lender in accordance with La. R.S. Section 9:4401. It is a good practice to make the borrower a party to the SNDA so that it agrees that these direct payments to the Lender will satisfy the tenant's rent payment obligations.

Finally, the Lender should include a provision that obligates the tenant to send the Lender a copy of all default notices that it sends to the landlord. It may also wish to obligate the tenant to give the Lender an opportunity to cure the landlord's defaults if necessary to keep the lease from terminating. If the default cannot be cured without the Lender taking possession of the space, then the Lender will require that the tenant agree that the Lender will have the necessary time after it acquires possession of the leased space within which to cure the tenant's defaults. This provision permitting the Lender to cure the landlord's defaults may not be necessary in most small leases, but if the rent payment stream from the lease represents the bulk of the security for the property, then the Lender should seriously consider including these cure rights.

Most Lenders also include estoppels that duplicate the provisions of a separate estoppel certificate, though it is a better practice to include all Lender agreements in the same document.

The full SNDA should be recorded to bind all assignees of the tenant's interest, though if the lease is not recorded, then the SNDA should not be recorded.

#### D. The Tenant's Non-Disturbance Language

The reason that the agreement between the tenant and the Lender is called a "nondisturbance agreement" as well as a "subordination" agreement is the customary tenant requirement that the Lender include an agreement not to disturb the tenant in its possession of the premises during the term of the lease and for so long as the tenant is in full compliance with its obligations under the lease and is not in default beyond the notice and cure period stipulated in the Lease. The Lender will generally agree to a form of this language that states that this "non-disturbance" obligation will bind the Lender if it obtains possession of the premises by dation en payment or in the foreclosure sale. The tenant is likely to alter this language to provide that whoever acquires the premises in a foreclosure sale or a dation en paiement will be required to accept the tenant and honor its rights under the lease, regardless of whether the transferee is the Lender or a designee of Lender or an unrelated third party.

Most Lenders will agree to this non-disturbance and attornment language since it is necessarily coupled with the tenant's agreement to remain on the premises and pay its rent after a foreclosure sale.

E. Negotiating Subordination, Non-Disturbance, and Attornment Agreements

The tenant is also likely to contest the Lender's SNDA language stating that it must give the Lender notice of the tenant's defaults and an opportunity to cure these defaults, even if the cure period must be delayed until the Lender has had a chance to foreclose and obtain possession of the property. Most tenants will wish this cure period to be extended only for so long as the tenant is reasonably able to use and operate the property as contemplated in the lease. Even in the case of more "technical" defaults, few tenants will be willing to wait indefinitely for a keeper to be appointed and for the foreclosure to run its course. Consequently, most tenants will require that the duration of the cure period be limited in the SNDA.

However, if the property is a single tenant property, the lease is a long term net lease, and the landlord is either building the tenant's facility to its specifications or is paying for it by a tenant improvement allowance or in a sale/leaseback, the tenant should be willing to agree to refrain from terminating the lease by reason of a landlord default as long as the Lender is either in the process of curing the default or obtaining possession of the Property by foreclosure or other legal proceedings.

Most tenants will also object strongly to provisions that relieve the Lender or other foreclosure transferees from liability for landlord defaults that preceded the transfer to Lender or the other foreclosure transferee. A Lender may be willing to agree to cure physical defects in the premises that pre-date the foreclosure sale or dation en paiement, but few Lenders are willing to take on the prior owner's liability for damages or its obligation to apply insurance proceeds to repair damaged premises, to construct tenant improvements or to provide a tenant allowance.

This can pose a real issue for a tenant who is constructing tenant improvements in reliance on receiving reimbursement for these improvements. However, after a landlord has defaulted, the Lender will probably not be willing to advance more money on the property. The Lender will also probably not agree that the tenant may deduct the tenant allowance (or any other cost of curing landlord defaults) from the rent since the Lender will view this rent as the Lender's property. A deduction of this amount from the rent would effectively be a payment of this amount by the Lender. At this point, the tenant will turn to the landlord and either demand that the tenant improvement allowance be paid in frequent installments or require that the landlord provide a letter of credit or other security to assure that the amounts spent by the tenant for the improvements will be reimbursed.

Some tenants may also ask that the Lender assure that all insurance proceeds will be applied as required in the lease if the Lender acquires the property. If the tenant is a small one and the lease gives the landlord the right to terminate the lease and keep the insurance proceeds if the building in which the premises are located is damaged to a substantial extent, then the Lender may be able to agree to this request. However, most Lenders will not wish to be prohibited from applying insurance proceeds to the debt unless it also has the right to terminate the lease if the damage is serious.

Generally, in negotiating an SNDA, a Lender should require more from the long term tenant of a net leased property with tenant-specific improvements since in many cases, this tenant is the real borrower. Small tenants of office, retail, or warehouse space are not as important to the Lender's cash flow requirements, and deviations from the SNDA may be more acceptable.

### **III. Ground Landlord Agreements**

#### **A. The Rights of a Ground Landlord With Respect to a Leasehold Mortgage Lender**

Many commercial mortgages are secured not by the borrower's ownership interest in property, but are secured by the borrower's leasehold interest under a ground or other lease. Article 3286 of the Louisiana Civil Code expressly permits mortgages on "The Lessee's rights in a lease of an immovable with his rights in the buildings and other constructions on the immovable." Express statutory authority for the mortgage of a leasehold interest was necessary since a lease is technically a personal contract under Louisiana law, and a lease runs with the land only by virtue of statutes that expressly provide that the lease binds third parties such as future mortgagees or purchasers if the lease (or a notice of it) is recorded.

To provide adequate security, a ground or other lease should be for a term of at least 30 years and permit the property to be mortgaged and to be assigned freely. If the lease prohibits assignment or sublease, then it also prohibits mortgage under La. Civ. Code art. 2713 (as amended in 2005). Fortunately, La. Civ. Code art. 2713 also provides that if the lease is silent, the lessee has the free right to sublease, assign, or encumber its rights in the lease. The ground landlord's consent is required by law only if the lease prohibits sublease, assignment, or encumbrance.

Consequently, if a borrower grants a mortgage on property whose lease prohibits mortgages, whether by containing express language to this effect or by prohibiting subleases or assignments and not expressly permitting mortgages, then the ground landlord can assert that the granting of the leasehold mortgage is a default under the lease and justifies a default termination. If this underlying lease is terminated, then the Lender has lost its security. It is therefore very important that a leasehold mortgage Lender assure that its mortgage is not a default under the ground lease, that it has the ability to avoid default terminations by the landlord, and that it has the right to have the borrower's leasehold interest sold to satisfy the debt.

#### **B. The Consents and Estoppels That a Leasehold Mortgage Lender Needs from the Ground Landlord**

It is crucial that the mortgage Lender have the ground landlord provide the same estoppels and certifications that are customarily provided by a tenant of mortgaged

property. The areas that should be covered by these certifications and estoppels are generally the same as those set out in the estoppel certificate attached as Attachment A.

C. The Additional Ground Landlord Agreements That Are Crucial to a Leasehold Mortgage Lender

Of course, a leasehold mortgage Lender needs to review the lease that provides its security to be sure that it permits assignment and does not inhibit the rights of the tenant in a way that would diminish the value of the leasehold interest to a future purchaser. If the lease does not permit free mortgage or assignment, the Lender must impose the condition that the borrower provide it with the ground landlord's written consent to the mortgage of the leasehold interest to the Lender and to future assignments. Even if the lease is silent on or expressly permits assignments and encumbrances, the Lender (and title company) may want a separate express agreement to this effect from the ground landlord as well as an express agreement that the Lender or any other person that succeeds to the tenant's interest by foreclosure of the mortgage or other exercise of rights under the mortgage will also succeed to all of tenant's rights and will be treated by the ground landlord as the tenant under the lease.

As in the case of the agreements that a Lender wishes to obtain from a tenant of mortgaged property as discussed above, the leasehold mortgage Lender will want to have the ground landlord agree that the Lender or anyone that acquires the tenant's interest by reason of the mortgage will not be obligated to cure prior defaults by the borrower and will take the property, by foreclosure sale or otherwise, free of all prior (or existing) defaults.

The Lender also needs an express agreement by the ground landlord that it will receive a copy of all notices of default or other notices that the ground landlord sends to the borrower/tenant and the right to cure all defaults that can be cured without the possession of the property (such as the defaults in rent payments) within a period that extends beyond the period already provided to the borrower/tenant for the curing of defaults. The Lender will therefore ask the ground landlord to agree that it will not terminate the lease or exercise its default remedies if the Lender cures the borrower/tenant's default within this additional period.

Many defaults (such as maintenance or repair issues) cannot be cured unless the Lender takes possession of the property, so the Lender needs an agreement from the ground landlord that it will not terminate the lease with respect to this type of default if the Lender commences and prosecutes foreclosure proceedings or other proceedings necessary to gain control of the property, and after it gains control of the property, cures the default within a reasonable time to the extent that the default can be cured at that time (though this is inconsistent with a provision stating that a transferee of the borrower/tenant's rights is not liable for prior defaults).

Finally, but very important, the Lender should obtain an agreement from the ground landlord stating that if the lease terminates by rejection in bankruptcy or by any other means (particularly a default termination), the ground landlord will execute a new lease with the Lender or its designee under the same terms as the prior lease. This is not only an attempt to protect the Lender if the borrower/tenant seeks bankruptcy protection, but it should also be drafted as a means of giving a Lender the right to a new lease on the same terms as its mortgaged lease if it should elect not to cure a particular default – though most attorneys will advise a Lender to keep the old lease in effect by cure if necessary and not take the risk of having to sue the ground landlord to enforce its contractual obligation to provide a new lease.

The full ground landlord agreement must be recorded to bind future owners of the ground and their mortgagees.

#### D. Negotiating the Ground Landlord Agreement

Naturally, many ground landlords do not want to impair their rights under an existing lease just to permit their tenant to obtain a loan. If the lease does not require the ground landlord to enter into the Lender's required agreements, the Lender will have to negotiate these agreements with the ground landlord, then make a determination whether to go forward with the loan based on the assurances that it is able to obtain from the ground landlord. Of course, if these required agreements are already set out in the lease and are stated to run in favor of any mortgagee -- and a well drafted bankable ground lease will contain these provisions – then the Lender may not need new agreements (other than estoppels) from the ground landlord.

If the ground lease does not permit assignment without the ground landlord's consent, then it is crucial that the Lender obtain the ground landlord's consent to the mortgage and any assignment either to the Lender or its designee in a dation en paiement situation or to a purchaser in a foreclosure sale. These transfers should not be subject to the Lender's consent, although the ground landlord may wish any third party that obtains possession of the leasehold interest without its consent to be either the Lender or an affiliate of the Lender. The ground landlord may also ask that the Lender or other mortgage transferee deliver a written assumption of the tenant's obligations under the lease. The Lender should insist that if the transferee is the Lender or one of its affiliates, this assumption should be only be binding with respect to obligations to be performed during the ownership of the leasehold interest by the Lender or its affiliate and will not continue after a transfer of ownership to an unrelated third party.

Most Lenders will need the right to transfer the leasehold rights to an unrelated third party to realize on their security – and to be released from future liability under the lease once this transfer is completed. This second transfer and the release of the transferor may be an issue for the ground landlord, and the ground landlord may insist on having reasonable consent for this type of transfer. Many Lenders will accept a consent requirement with respect to a transfer to an unrelated third party as long as the ground landlord cannot withhold this consent unreasonably and as long as the Lender or its

designee will clearly be released from future liability under the lease by reason of this transfer. Though they have not been totally consistent with one another, Louisiana cases have indicated that there are few grounds that permit a landlord to withhold its consent to a sublease or assignment as long as the original tenant remains liable under the lease. E.g., *Caplan v. Latter & Blum, Inc.* 468 So.2d 1188 (La. 1985). This legal authority may provide comfort to the Lender that must provide the ground landlord with the right to consent to future transferees.

Most ground landlords will also object strongly to permitting the Lender to have an extended cure period. Many reasonable ground landlords can, however, be persuaded to agree to this provision as long as the Lender agrees to pay the rent and perform other obligations that can be performed by the payment of money during this period. Although some Lenders may demand a two or three month cure window during which it is not obligated to pay the rent, this is not popular with ground landlords and may not lead to successful negotiations. The obligation to continue to fund the rent during foreclosure proceedings is a risk that any Lender must consider in extending a loan secured by the mortgage of a leasehold interest.

Ground landlords also frequently object to provisions stating that the Lender or other mortgage transferee can take the leasehold interest without being obligated to cure prior borrower/tenant defaults. The cure of rent payment and other monetary defaults is generally more important to the ground landlord than the cure of other defaults, though ground landlords generally also want the property to be placed in the condition required in the lease after the Lender or its designee takes control of it. What is most important to the Lender is not being responsible for defaults that absolutely cannot be cured by a transferee – such as the borrower/owner’s bankruptcy or financial failure – and not being responsible for damages (other than for rent or the actual cost of repairs to the leased property) due by reason of the borrower/tenant’s default.

Finally, the ground landlord is likely to object to an obligation to enter into a new lease with the Lender or its designee after the termination of the mortgaged lease. The Lender can frequently get the ground landlord to agree to this right as long as the Lender tenders the replacement lease to the ground landlord within a certain period (perhaps 30 days after the termination of the mortgaged lease) and cures all monetary defaults under the mortgaged lease, including amounts that would have come due during the period between the termination of the original lease and the effective date of the new lease.

E. Dealing With the Ground Landlord’s Mortgage Lender or Underlying Landlord

The ground landlord will in most cases also have a mortgage on its ownership interest in the property. The Lender should require a non-disturbance agreement from this mortgagee in which the mortgagee agrees that if it or another party becomes the owner of the leased property by mortgage foreclosure or other enforcement proceeding, it will honor all of the ground landlord’s agreements in favor of the Lender. This agreement will be similar to the agreements that tenants request from Lenders.

If the ground landlord is not the owner of the property, but is a tenant from another owner, then the owner will need to agree that if the ground landlord's lease terminates, the owner will honor all of the ground landlord's obligations to the Lender.

The Lender and its title company must study the chain of title and be sure that all persons with rights in the property that are superior to the Lender's mortgage agree that they will not prevent the Lender from keeping its mortgage in place and if necessary, foreclosing and selling the mortgaged leasehold interest to pay the debt secured.

All agreements obtained from persons holding these superior interests should be recorded.

#### **IV. Agreements With Managers, Franchisors, and Other Contractors**

##### **A. Identifying the Agreements that the Mortgage Lender Needs to Keep in Effect to Operate the Mortgaged Property**

Agreements with managers, franchisors, and other contractors are not rights in the mortgaged property, and neither the Lender nor the managers, franchisors, or other contractors will be obligated to keep these contracts in effect if the Lender or its designee succeeds to the rights of the borrower. The Lender should therefore obtain a complete list of the contracts that are necessary for the operation of the property – for example, a hotel or restaurant may have little value if its franchise agreement or management agreement is terminated – and the Lender should obtain a collateral assignment of these essential contract rights as additional security for its debt.

##### **B. The Estoppels and Agreements that Should Be Requested by the Mortgage Lender and the Negotiation of these Estoppels and Agreements**

If a contract is important to the value of the mortgaged property, then the Lender should obtain the same agreements from the franchisors, managers, or other contractors under these contracts that it obtains from a tenant of the property – this means that it will need estoppels, perhaps consents to assignment to a transferee, and agreements to perform obligations in favor of the transferee even if there have been prior defaults under the contract. These agreements will be similar to the cure and attornment agreements required from tenants, and the parties' negotiation concerns will be resolved as discussed with respect to tenant estoppels and SNDAs.