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Landlord's Waiver or Subordination to Tenant's Lender's Security Interest

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Most commercial real estate lease forms (and most states' laws) grant the landlord a lien on the tenant's personal property located at the leased premises in the event of an uncured default by the tenant under the lease. In situations where a tenant (as borrower) enters into a loan transaction with a third-party lender and uses the loan proceeds to acquire personal property to be kept at the leased premises (such as equipment or inventory), most lenders will want priority rights to the same in the event that the tenant/borrower defaults under the loan. In order to protect the lender's security interest in such equipment or inventory, tenants commonly provide the landlord with the tenant's lender's standard form of "Waiver (or Subordination) and Consent Agreement" (whereby the landlord waives or subordinates the landlord's lien on the tenant's personal property that is secured by the loan) and request that the landlord execute such agreement. Without such waiver or subordination agreement from the landlord, in the event of a default under the lease, the landlord might preempt the lender's rights in such property.

Because waiving or subordinating the landlord's lien on the tenant's personal property will reduce the landlord's remedies upon a tenant default under the lease (and most lender's standard forms of Waiver (or Subordination) and Consent Agreement fail to capture many issues that could be important to a landlord), landlords should carefully review and evaluate the lender's form Waiver (or Subordination) and Consent Agreement and consider the issues described in this article before agreeing to sign the lender's form.

Waive or Subordinate?

From the landlord's perspective, subordinating the landlord's lien on the tenant's personal property is preferable to a complete waiver of the lien. Most lenders will be indifferent to whether the landlord agrees to a waiver or subordination as long as the lender receives a first security interest in any of the tenant's personal property that is located at the leased premises. Landlords should include language in the Waiver (or Subordination) and Consent Agreement that allows the landlord to proceed against the personal property of the tenant or enforce other rights against the tenant following a final judgment against the tenant by the landlord. Landlords should, however, be willing to agree that such rights of the landlord remain subject to the terms of the Waiver (or Subordination) and Consent Agreement and such lien obtained by the landlord shall be expressly subordinate to the lender's lien as may be described in the Waiver (or Subordination) and Consent Agreement.

Lender's Access, Interference, Obligations and Waiver

The Waiver (or Subordination) and Consent Agreement will likely provide the tenant's lender with the right to enter the leased premises and remove the tenant's personal property or trade fixtures to which the lender has rights. The landlord should require that the lender agree to minimize interference with operations of the landlord and the landlord's other tenants at the site, and require that such removal occur before the expiration of the lease term (or within a very short time period after termination of the term). The landlord should also add that if the subject personal property is not removed within such time period, then the tenant and the tenant's lender shall be deemed to have waived any rights either party may have had to the subject personal property and provide that the landlord may thereafter remove such property from the leased premises. If the tenant's lender has

rights to access the collateral after the expiration or termination of the term of the lease, the Waiver (or Subordination) and Consent Agreement should require the tenant's lender to pay the landlord an occupancy fee in an amount at least equivalent to the scheduled base and additional rental provided for in the lease. Similarly, the tenant's lender should agree to assume the tenant's responsibilities under the lease which arise during such period of occupancy (e.g., provide evidence of insurance to the landlord). Also, the tenant's lender should agree that the leased premises shall remain available for inspection by the landlord (and prospective tenants) and the tenant's lender shall cooperate with the landlord's reasonable efforts to re-lease the leased premises.

Liquidation Sales

The Waiver (or Subordination) and Consent Agreement should include language confirming that neither the tenant nor the tenant's lender may conduct any public or liquidation sale at the leased premises without prior written approval of the landlord. If the landlord consents to a public or liquidation sale at the leased premises, the tenant's lender should be required to notify the landlord first and to hold such auction or sale in a manner that would not unduly disrupt the landlord's or any other tenant's use of the site.

Notification, Removal and Indemnification

Before the tenant's lender can exercise its right to any security interest in the tenant's collateral located at the leased premises, landlords should require the tenant's lender to notify the landlord that the tenant has defaulted under its agreement with the lender and require the tenant's lender to exercise reasonable care in affecting the prompt removal of the personal property from the leased premises.

Landlords will want to:

- Have the right to have a representative present at the time of the removal of any of the collateral.
- Add a provision to the Waiver (or Subordination) and Consent Agreement that will make the tenant's lender responsible for any damage to the leased premises resulting from the tenant's lender's activities (including damage caused by or in the process of the lender's removal of the collateral).
- Add a provision to the Waiver (or Subordination) and Consent Agreement that will require the tenant's lender to indemnify, defend and hold the landlord harmless from and against any and all claims, damages, and the like resulting from the tenant's lender's activities on or about the leased premises pursuant to the Waiver (or Subordination) and Consent Agreement or asserted by the tenant against the landlord as a result of the tenant's lender's activities pursuant to the Waiver (or Subordination) and Consent Agreement.

Notify Lender of Tenant's Default

Landlords should avoid absolute obligations to notify the tenant's lender of a default by the tenant under the lease. A reasonable compromise is an agreement to use "reasonable efforts" to notify the tenant's lender if the tenant defaults under the lease. However, landlords should add a provision to the Waiver (or Subordination) and Consent Agreement confirming that failure of the landlord to notify the tenant's lender shall not result in the imposition of liability against the landlord. It would also be reasonable for the landlord to allow the tenant's lender a limited time period to cure or cause the tenant to cure any such default.

Tenant's Continued Liability

Landlords should make sure that the Waiver (or Subordination) and Consent Agreement includes a provision that the tenant will continue to remain liable for the performance of the tenant's lease obligations (including obligations concerning removal of the tenant's personal property).

Tenant's Default Under the Lease

The Waiver (or Subordination) and Consent Agreement should include a provision that any default by the tenant under the tenant's agreement with the tenant's lender, which results in a removal of the tenant's property from the leased premises or otherwise impairs the tenant's ability to fulfill its lease obligations, shall constitute a default under the lease.

Termination of the Agreement

Landlords should add a provision to the Waiver (or Subordination) and Consent Agreement confirming that the Waiver (or Subordination) and Consent Agreement, and all obligations of the landlord thereunder, terminate upon the release and satisfaction of the loan agreement between the tenant and the tenant's lender.

Confirm Rights

The Waiver (or Subordination) and Consent Agreement should include a provision allowing the tenant and the landlord to amend the lease without the prior consent of the tenant's lender.

Limit Landlord's Liability

Landlords should limit redress for any claims against the landlord under the Waiver (or Subordination) and Consent Agreement to the extent of the landlord's interest in the property to which the leased premises is a part.

Conclusion

Most tenant's lenders initially offer to landlords one-sided forms of Waiver (or Subordination) and Consent Agreements and do not address many common landlord concerns. Landlords will be well served to evaluate the issues described in this article thoroughly before agreeing to waive or subordinate their interest in the tenant's personal property to the tenant's lender's security interest. Armed with the suggestions in this article, landlords now have ideas that they can consider as they review, evaluate and negotiate the Waiver (or Subordination) and Consent Agreement. With these ideas, landlords should be able to better balance the parties' respective rights and obligations and achieve a mutually agreeable and practical solution.

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