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TENANT FINANCING - LANDLORD'S WAIVERS

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As we know, every businesses need **CAPITAL** to operate. They need capital to fixture, furnish, equip their Premises, buy inventory and pay employees. BUT in these challenging economic times, capital is not that readily available and where it is available, it comes with a high price tag.

Lenders want Security – in everything (all of the Tenant's assets, present and future).

But from a Landlord's point of view, having a Lender in the picture isn't so bad. Its like having a partner. Another entity, a financial institution, invested in the welfare of the Tenant.

TYPES OF SECURITY

Although Security may take different forms, the most prominent types of Security that impact a Landlord in Commercial Leases are:

- A. a General Security Agreement (a "GSA"); and
- B. Leasehold Mortgages.

A. Let's Start with a GSA

What is a GSA?

A GSA is a charge over the Tenant's personal property - furniture, fixtures, inventory and equipment. A typical GSA gives the Lender the right to seize and sell the charged property of the Borrower. However, many GSA's charge "all the Tenant's property and assets " and a lease is a form of asset so it is - knowingly or unknowingly – the GSA can also be in part a form of leasehold mortgage.

What does a Lender with a GSA need from the Landlord?

A Lender requiring a GSA from a tenant will need the Landlord to waive its right to distraint i.e. the landlord's right to seize and sell the tenant's assets for rent arrears.

Why do they need a Landlord's Waiver?

Lenders don't want to get into a priority battle with the Landlord's statutory lien over the same "Assets" as Landlord's usually get priority so an agreement with the Lender will give the lender priority on loan default.

The law is quite clear on this point (unique).

Prior to bankruptcy - as between a Lender and a Landlord - it's a race to the goods and Landlord's are usually "on the scene" faster and whoever gets there first – WINS.

Now, don't get so excited Landlords. It's not that easy. A proper distress takes time. Under the *Commercial Tenancies Act*, Landlords need to wait 5 days, get appraisals, find an "arm's-length" buyer and if the Lender learns that the Landlord has distrained, the Lender can petition the Tenant into bankruptcy and reverse the priorities.

But Lenders don't want that risk of losing their security since the bankruptcy route is:

- (1) costly;
- (2) the value of the assets may not cover the cost of bankruptcy and
- (3) the Lender is at risk of the Landlord not waiting the 5 days (risking an irregular distress) or not finding out about the distress until it's too late.

So to avoid these risks, Lenders ask for a waiver.

Why Would a Landlord Agree to Waive the Remedy of Distress?

- a. **Consideration** - If the Lease doesn't require the Landlord to sign a waiver, then it's within the Landlord's right to ask for CONSIDERATION in return. The Landlord is giving up a valuable remedy so it should not be couched as simply procedural (which Tenants like to try to convince Landlords that it is). We have negotiated successfully new or increased Security Deposits, Letters of Credit, Indemnities and the list goes on.
- b. **Practical** - the Landlord will be assisting a prospective or existing tenant to be a viable rent paying entity as without the loan the tenant may not be able to carry on business.

Ok, now that you as a Landlord have made peace with the notion of waiving your right to distrain – be careful.

What Should a Landlord Be concerned with in a Lender's form of Landlord's Waiver?

The standard Lender Waivers are loaded with traps. Here are some examples.

1. **NOTICE OF DEFAULT** – Lenders ask for notice of a tenant default and a period in which to remedy it so they don't lose the assets. It seems reasonable - but don't agree. You may not give your Tenant notice every time they default and a covenant to give the Lender notice may expose you to a claim for damages if you fail to do so. Often counsel will amend the Notice clause to provide for a notice of default but that failure to give it does not constitute a default by the Landlord so it becomes essentially a worthless covenant.
2. **ESTOPPEL RE LEASE** – Lenders often want the Landlord to confirm the lease terms and status. Landlords should be wary of unqualified statements that the Lease is not in default and should qualify them to "their knowledge".
3. **THE ASSETS** – make sure that leasehold improvements are carved out from the assets and that only the tenant's personal property is noted. If there are any items that could be fixtures and this part of the realty which should not be removed, then carve them out up front e.g. HVAC.
4. **POSSESSION** – Lenders need access to the Premises to seize, inventory and remove for sale or sell from the premises their goods. Seems reasonable but don't simply agree. Limit access and take control. The Landlord's goal is certainty. Give the Lenders the right to access for a specific purpose and within a fixed time frame and if they miss it, they lose it and they are deemed to have waived their rights. **REMEMBER** - Landlords need the ability to dispose of the assets and release the Premises in a timely manner – and who knows you may want the right to distrain.

5. **OCCUPATION RENT** – If the assets will require time for the lender to inventory and remove or sell from the premises, Landlords should negotiate Rent on a per diem basis. Lender’s access should not be for free.
6. **LEASE OBLIGATIONS** - Certainly the Lender should be responsible for the lease obligations arising during occupancy including, insurance, repair of damage it causes etc. but Landlords may also be able to negotiate the remediation of some prior defaults such as some rent arrears e.g. 1 – 2 months rent. It’s a tougher sell but we have achieved it and “if you don’t ask you don’t get”.
7. **LANDLORD RIGHT TO REDEEM THE SECURED ASSETS** - Landlords, should consider asking for the right to pay the distress value of the “Secured Assets” and get an assignment of the Lender’s Security. You may have a new tenant who will buy the goods or be incented by the right to use them **to sign a new lease with you** (like a restaurant or a fitness facility). The Lender saves the asset retrieval and disposal costs and you have just facilitated the re-letting of your premises.
8. **GET A RELEASE** – Have you ever found yourself in a position where the Tenant vacates the Premises but leaves it goods? Whose goods are they? What can you do with them? It’s a big problem. Deal with it – in the Agreement and get the Tenant’s consent to what has been negotiated with the lender.
9. **POSTPONE/SUBORDINATE v. WAIVE** – Too often Landlord’s are willing to waive without considering the option of postponing their distraint right. Remember that Landlords don’t need to WAIVE their rights to distraint. They can simply postpone the right in favor of the Lender. Consider the case of assets with a value of \$1 million and a secured lender owed \$500,000.00. But waiving your distraint right you may have lost your right to the proceeds remaining in those assets. If your tenant is in default and other creditors exist then arguably you may be hard-pressed to claim them. However, if you merely postponed your interest you may be able to seize the balance of the proceeds to apply to arrears of Rent.

B. Now Let’s Talk about Leasehold Mortgages

What is a Leasehold Mortgage?

Understand that the Lease can be an asset. If its terms are favorable in the marketplace and it’s assignable, it can be sold to a third party. A Leasehold Mortgage is simply a conveyance or transfer of that Asset as security for a loan or other obligation to a 3rd party. That is why it can also be caught under a GSA.

When is it Sought?

Where the location is a prime asset of the business or the lease terms have value – such as a long term with rents less than market as opposed to the value being merely in the personal property of the business, then if the loan goes into default, the Lender will want the opportunity to transfer the site to a buyer possibly with the personal property - although not necessarily.

What does a Lender with a Leasehold Mortgage need from the Landlord?

It needs the consent of the Landlord to the charge and an agreement on how it will operate on a tenant loan default.

Why do they need Landlord’s Consent to the Leasehold Mortgage?

Most Leases restrict the Tenant’s ability to Transfer the Lease and the Premises and therefore a Leasehold Mortgage requires Landlord’s consent. Typically the leasehold mortgage or agreement to provide it is conditional on landlord consent being given in order not to cause and immediate lease default for a transfer

without consent. Even if the lease is silent about leasehold mortgages - consent will still be required as it's a transfer of the lease.

Why Would a Landlord Agree to Consent to a Leasehold Mortgage?

The same reasons apply as for a GSA.

- a. **Consideration** - If the Lease doesn't require the Landlord to consent to a Leasehold Mortgage, then it's within the Landlord's right to ask for CONSIDERATION in return. The Landlord is giving up a valuable right of control of the lease should the tenant default.
- b. **Practical** - the Landlord will be assisting a prospective or existing tenant to be a viable rent paying entity since without the loan the tenant may not be able to carry on business.
- c. **A New Partner** – the Landlord has some comfort in knowing there is another player who has a vested interest in seeing that the tenant succeeds.
- d. **Another Party who can pay the Rent if Tenant Defaults** – if the Lender takes possession on default, it will have to pay an occupation rent as discussed below. Given this the Landlord is unlikely to have a new tenant ready to occupy and carry on business, it can continue the rental stream while it and the lender search for a new tenant to assume the lease.

What Should a Landlord be Concerned with in a Lender's form of Consent to Leasehold Mortgage or Tripartite Agreement b/w Lender, Borrower/Tenant and Landlord?

1. **LIMIT CONSENT** – Ensure that any Landlord consent is only a consent to the occurrence of the Leasehold Mortgage and not to the terms of the Security i.e. the landlord is not commenting on the suitability or enforceability or terms of the charge but rather, its merely consenting to its existence.
2. **NOTICE OF DEFAULT** –
 - (a) In the case of a Leasehold Mortgage, because the Security is the Lease, the Leasehold Mortgagee **NEEDS** notice of any default which may lead to a termination of the Lease. They will also need the right to **REINSTATE** the Lease if there is a default that they were unable to remedy. Those rights are reasonable but need to be properly created.
 - (b) The tenant will benefit some from the additional notice period unless its clear that your rights against the tenant are not affected by the consent and then it cannot re-instate the lease and can even be locked out of the premises if need be – but you need language to cover this.
 - (c) Notice of insolvency could lead to lender putting tenant into bankruptcy which means the landlord his now under the BIA and lease termination and distraint are not permitted.
 - (d) If you have not otherwise given a waiver of distraint, notice of default to the lender could defeat it as the lender now has an opportunity to seize the assets before you exercise your distraint unless the agreement limits the cure period to curing the default only.
3. **POSSESSION** – In a GSA, the Lender needs temporary possession to remove or dispose of the Secured Chattels. Here the right to possess is for the ultimate purpose of disposing of the Lease and maybe the business operations. In other words, finding a new tenant to take over the Lease. That takes time. Landlords need to make sure they have approval rights over any new tenant, their financial covenant and the use to be made of the Premises. That needs to be in the agreement.

4. **TRANSFERS** – make sure the lease must be in good standing before you have to consent to a transfer by the lender. Try not to re-negotiate the transfer terms in the lease./
5. **RENT AND LEASE OBLIGATIONS?** Unlike a GSA, in the case of a Leasehold Mortgage, the Landlord is perfectly within its rights to demand that ALL arrears be paid, ALL outstanding defaults be remedied, and that the Leasehold Mortgagee agrees to be bound by the terms of the Lease. Then comes the question of: But for how long? That is a matter of negotiation but again you must ask for it. The obligation should arise by the Lender sending a formal notice that it is exercising its right to possession and continue until it gives a similar notice otherwise.
6. **FREEHOLD MORTGAGEE CONSENT** – Consider whether you will need consent of the freehold mortgagee to a leasehold mortgage. Review your freehold mortgages. Any termination or transfer of the lease without their approval may be a default under your own loan. If it is needed then you have another party added to the scenario. The leasehold lender will also want this so as to ensure the prior lender can't terminate everyone.
7. **REMOVAL FROM TITLE** - get the lender to agree to remove the leasehold mortgage from title within 24 hours of vacating if it decides not to remain in possession and is walking away.
8. **RELEASE** – Inevitably the Lender will want to be released after a transfer or after it vacates possession. They see their position more akin to that of a Trustee in bankruptcy and like a Trustee, once it assigns or disclaims the Lease, it has no further obligations. The Landlord prefers to characterize the Lender as a simple assignee and assignees don't get released when they assign the Lease.

So those are two very valid business interests that need to be balanced.

(a) **Where the Lender is assigning the Lease**, for the Landlord to accept the release of the Landlord, it must be satisfied with the financial covenant of the new tenant. You can negotiate parameters so that there is no “**subjective**” test as to whether the Landlord is being reasonable like a minimum stated net worth test and perhaps you can get some additional security like an LC or Indemnity.

(b) **Where the Lender wants the right to simply return the Premises** to the Landlord and be released, it's a bit trickier. If the Lender has the right to give back the space and be released at any time, in essence the tenancy is just a temporary, month to month tenancy. For a Landlord that's terrible. You can't finance the property, you can't list the property you can't make any plans for the property until the lender decides what its doing. **That doesn't work.** So if the lender wants the right to give back the space and be released, Landlord needs to create parameters around that right. Not simply a notice period but rather a window within which the Lender can surrender the Lease and they miss that window, then they are on the hook for the balance of the Lease. In addition they have to repair any damage caused.

General Comments that Apply to All Forms of Security

There are certain concerns that apply in both the case of a GSA and a Leasehold Mortgage.

1. **WHERE'S THE MONEY GOING** - Since the Tenant is financing its Lease or chattels on the Premises, the Landlord should try to impose some restrictions. Firstly, on the quantum being borrowed and secondly, on how it's being used. [The money should be reinvested in the Tenant's business on the Premises and not some new unrelated venture.]
2. **DAMAGES** – Make sure the Lender is responsible for any damage it causes in removing the assets. Perhaps get a Security Deposit to protect this risk.

3. **TIME PERIODS** – If we all agree that certainty is what a Landlord is striving for, Landlords need to control the time periods in these agreements.
4. **ASSIGNABILITY** –Doing a deal with “the Royal Bank” as the “Lender” is one thing - but what if they assign their loan? Who are you dealing with now and more importantly how enforceable are all these covenants.
5. **AND FINALLY, COSTS** – Make sure you’ve dealt with the issue of the costs in negotiating these agreements – **they are not simple!**