

Protecting Your Restaurant Against Landlord Defaults

By Anthony J. Vizzoni, Esq.

As a restaurant owner, you may have expended thousands, or even hundreds of thousands, of dollars in designing and building your dream restaurant. As you are in the restaurant business and not necessarily in the commercial real estate business, you may lease your restaurant location under a long-term lease arrangement with your landlord.

What happens, however, when despite the fact that your restaurant business is successful and you pay your rent in a timely manner each and every month, your landlord has financial difficulties resulting in his or her failure to honor their obligations to their lenders? If these financial difficulties on the part of the landlord lead to a mortgage foreclosure, you may be at risk of losing not only the leasehold interest, but also the benefit of all the improvements you've placed in the restaurant.

If your landlord finds himself in default with their lender, the lender may have the right to foreclose or terminate your leasehold interest. The lease itself may provide that the leasehold interest is subordinate to all the terms of the lender's mortgage on the landlord's property, thus permitting the

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lender to foreclose upon the leasehold interest. You may have even signed an estoppel certificate in favor of the lender which provides for subordination of the leasehold interest to the lender's debt. Thus, the lender, in exercising its right to foreclosure under a landlord default, can foreclose the rights of the tenant also. In such an event, not only will the leasehold interest be extinguished, but chances are that a prudent lender will also have a security interest in all the improvements, furnishings and fixtures located in the leased premises which could include all the improvements that you've installed, and paid for, in the business location.

Although one may wonder why the lender may choose to foreclose if the tenant is paying rent and honoring the terms of the lease, the landlord's lender may have other paramount interests in no longer having the restaurant as a tenant. For example, the restaurant's lease may be very old resulting in the tenant not paying market rent, or the tenant may be receiving significant rental credits as a result of the tenant improvements that the landlord agreed to credit back to the tenant in the form of rent, thereby resulting in less rent. The lender may also wish to lease to another food establishment with heavy name recognition for purposes of attracting other tenants, such as national tenants versus a local operator.



About the Author

Anthony Vizzoni serves as Of Counsel to the firm and has spent his entire career in real estate, both as a lawyer and real estate developer. Prior to joining the firm, he served as Corporate Counsel to the Vizzoni group, a well-respected real estate development firm.

As Corporate Counsel, he gained vast experience in all aspects of real estate law and a particular proficiency in handling transactions related to land acquisition and sales, real estate financing, commercial leasing and construction.

Anthony is also a member of the Becker Meisel Business Services Group and represents various tenants and landlords throughout New Jersey.

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Protecting Your Restaurant *continued...*

One tool available to the tenant to protect its business is a “Subordination, Non-Disturbance and Attornment” (SNDA) Agreement. As a condition to entering into the lease, the tenant should insist that the landlord and the landlord’s lender enter into an SNDA with the tenant. The SNDA Agreements will address the rights of all the parties in the event of a default by the landlord with its lender and, in so doing, if properly drafted, will preserve the tenant’s rights to the leased premises and the improvements installed therein, thus, avoiding devastating consequences for the restaurant tenant.

There are three separate and distinct components to the SNDA: subordination, non-disturbance and attornment. In addition to any subordination provisions that may be built into the landlord’s lease, most lenders require, as a condition to providing financing to commercial property owners, a specific subordination by tenants subordinating tenants’ rights under their leases to those of the lender. This is especially true if the tenant’s lease is in place prior to the lender’s mortgage on the landlord’s property so that the lender is aware of the tenant’s leasehold interest, be it by a recording of the lease or otherwise. In the SNDA, the tenant should agree to subordinate only to the lender’s interests to the lien of the mortgage, provided however, that the lender agrees not to join the tenant in any foreclosure action that will cause a termination of the tenant’s leasehold interest.

In securing the protections of non-disturbance under the SNDA, the tenant will be assured that, provided he is not in breach of the lease, the lender will not disturb his use and enjoyment of the leased premises should the lender become the property owner through a foreclosure action or other means. These protections as to non-disturbance will permit the tenant to continue to operate its restaurant business and enjoy use of the leased premises as if the original landlord was still in place. So, as to afford maximum protection to the tenant in this respect, the SNDA should be recorded of public record to put third-parties on notice.

The final element of the SNDA is attornment which simply means that, after the lender becomes the owner of the real property, the tenant will recognize the lender as the new landlord of the leased premises and the lender will continue to recognize the tenant’s interests in the leased premises. Attornment will protect the lender as the tenant confirms that the tenant will not exercise any rights to terminate the lease or vacate the leased premises simply due to the fact that the lender has become the new landlord. The tenant will be protected in that its interests in the leased premises will be preserved.

In sum, any restaurant owner leasing their restaurant location from a commercial property owner needs to give consideration to the effect that a breach between the property owner and its real estate lender may have on his leasehold interest. With the assistance of competent counsel, these issues should be addressed during the lease negotiation process and well in advance of the future tenant pouring significant monies into renovations or tenant fit-up improvements for the restaurant.

For more information about protecting your business as a restaurant tenant, contact Anthony J. Vizzoni at ajvizzoni@beckermeisel.com, or 973-422-1100.