

## Protecting Your Business: What Tenants Need to Know About Office Foreclosure Risks



Office building foreclosure risks are on the horizon. At the onset of the pandemic, many lenders provided short-term loan extensions while the world tried to wait things out, but many of these mortgages are now once again coming due. The rising interest rate environment and historically high vacancy rates have resulted in reduced office property valuations and are proving to be a precarious combination of factors for many owners.

As a result, some building owners are now financially underwater, facing interest rates that have doubled and likely the need to increase their equity stake (i.e. put more cash in) to reestablish loan to value ratios, or potentially default. While some lenders will work creatively to reach solutions with building owners or seek a new buyer, we are already seeing buildings go into foreclosure.

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## **What are the Risks to Office Tenants?**

If a building owner is facing financial difficulties, there's a risk that they may not be able to fulfill their obligations as the landlord, which may include payment of tenant improvement allowances, leasing commissions, or other concessions agreed to in the lease. This could leave tenants on the hook to cover significant transaction costs. Financial instability at a property could also lead to issues with maintenance, repairs, or other services that affect the tenant's ability to operate effectively.

## **How can Tenants be Protected?**

It's important to note that the specific lease provisions that are most appropriate will depend on the circumstances of the building, and tenants should always consider seeking legal advice to help in the lease negotiation process. ***Here are some important provisions to consider:***

**1) Subordination, Non-Disturbance, and Attornment (SNDA) Agreements** - If a property has a mortgage, a tenant's lease will likely be subordinate to the mortgage. This means if the landlord defaults, the lender has priority over the tenant's interest. A non-disturbance provision means the lender agrees not to disturb the tenant's leasehold interest in the event of foreclosure. Thus, the tenant's lease will remain in effect even if the property is foreclosed on. Attornment provides that the tenant will recognize the lender as the new landlord and will continue to pay rent and perform all other obligations under the lease. Absent a non-disturbance agreement from the lender in favor of the tenant, a tenant may not receive what the defaulting owner had promised – or worse, have its lease terminated by the lender.



**2) Offset Rights** - In the event of a landlord's default in the payment of a tenant improvement allowance, brokerage commissions, or other obligations, tenants could be out of luck. However, if an offset right has been negotiated, tenants can pay vendors directly and offset such amounts against rent. For example, let's say a landlord defaults on a \$100,000 payment to a general contractor hired by the tenant to build out the space. If the tenant has offset rights, they would pay the contractor directly and withhold the next \$100,000 worth of rent payments. While setoff provisions provide a great benefit to tenants, they can be very difficult to negotiate and achieve.

**3) Notice Provisions** - Office tenants should seek notice provisions that require the landlord to provide advance notice of foreclosure proceedings in order to have time to plan and take any other necessary actions to protect their interests.

**4) Building Maintenance Standards** - To mitigate the risk of a building falling into disrepair as a result of foreclosure, office tenants can negotiate lease provisions that require the landlord to maintain the building to a certain standard. If a building is taken over by a lender, the standards outlined in the lease must still be maintained.

It's imperative that these topics are negotiated before entering a binding lease. While the office sector is facing the most stress of any commercial real estate property type, opportunities for tenants abound. At TaTonka, we focus on diligently representing the interests of tenants in lease and renewal negotiations.

**Reach out to start the conversation  
about your next lease or renewal.**

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