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**SHORT, BUT *STILL* NOT SWEET:
THE LANDLORD SUBORDINATION AGREEMENT,
10 YEARS LATER**

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Article 1: Introduction: Ten years ago, I presented on the subject of the Landlord Subordination Agreement and its pitfalls. Some things have improved, but most have not and in one specific area, things have gotten worse. So once again, we need to examine Landlord Subordination Agreements. These agreements are tri-party agreements among a Landlord, a Tenant, and the Tenant Lender. The need for a Landlord Subordination Agreement arises when a Tenant wishes to use the personal property in which a Landlord already has a lien as collateral for a loan. Most Landlords are more interested in a successful Tenant at their project than in a first lien position in that Tenant's personal property and so will agree to subordinate their lien position. The complications arise because the form Landlord Subordination Agreements proposed by Tenant Lenders demand far more rights than a mere subordination and these demands place the Landlord in a untenable position with its Tenant. Recently, the SBA has decided to get involved and add another layer of inappropriate demands. In both cases, though, it is possible to negotiate the provisions and I have found more lenders expect it, although there are still some that are surprised.

Article 2: Negotiating Points: The easiest way for a Landlord to protect itself in negotiations is to require the Tenant Lender to use the Landlord's form Landlord Subordination Agreement and to refuse to depart from it in any way. I have attached my own such form as Exhibit "C." Oftentimes, though, the Tenant Lender will insist on using its own form. I have attached two examples of Tenant Lender forms as Exhibit "A" and Exhibit "B." If a Landlord is forced to use a Tenant Lender's form or to negotiate its own form, then it is important to keep the following points in mind:

- 2.1 Carefully Consider What Needs to be Included in the Description of the Collateral. Before signing a Landlord Subordination Agreement, a Landlord should consider if it is really willing to subordinate its lien in every piece of Collateral. Over the past 10 years, I have generally found the Tenant Lenders willing to accommodate these exceptions to the subordination. The bigger problem is making the Landlords think about this issue.
 - a. Most Tenant Lender Forms will Cover Everything. The following excerpts from the Tenant Lender forms that are attached as Exhibit "A" and Exhibit "B" both demonstrate the broad sweep of the description of the Collateral:

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| <p><u>Exhibit "A" (Tenant Lender's Form):</u> [T]he tangible and intangible personal property of such Company, including, without limitation, goods, inventory, machinery and equipment, together with all additions, substitutions, replacements and improvements to, and the products and proceeds of the foregoing (collectively, the "Collateral").... The Collateral may be stored, utilized and/or installed at the Premises and shall not be deemed a fixture or part of the real estate but shall at all times be considered personal property, whether or not any of the Collateral becomes so related to the real estate that an interest therein arises under real estate law.</p> |
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| <p><u>Exhibit "B" (Tenant Lender's Form):</u> "<u>Collateral</u>" means all of the following types of</p> |
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property, now owned and hereafter acquired by the Tenant: accounts, inventory, contract rights, letters of credit, chattel paper, instruments, notes, documents, documents of title, general intangibles, equipment, investment property, money, cash, cash equivalents, securities, deposit accounts, credits, books, records, account ledgers, data processing records, computer software, files (whether tangible or electronic data entry form), fixtures, and all other goods, merchandise or personal property, and all proceeds, accessions, replacements, and substitutions of any of the foregoing.

b. Considerations for Landlords.

- i. HVAC system. The lease will usually provide that the heating, ventilation, and air-conditioning (“HVAC”) system stays with the premises and is the property of Landlord, which means it is not available to the Tenant to grant as Collateral. However, in many cases, the Tenant buys the HVAC equipment and owns it until the end of the lease term, with leases varying in their specificity about what happens to the HVAC system at that time. In that situation, the status of the HVAC equipment is not as clear and there is a good chance of a dispute between the Landlord and the Tenant Lender. It is better to exclude the HVAC system from the description of the Collateral in which Landlord is subordinating its lien. A Landlord might also want to review the Tenant’s Pledge and Security Agreement and UCC-1 to make sure that the HVAC system is specifically excluded from the Tenant Lender’s description of its Collateral.
 - ii. Other building systems. The analysis that applies to the HVAC system can also apply to other building systems, especially if they are relatively easy to remove. While it is not likely that a Tenant Lender will try to remove wiring, it might remove an alarm system or certain parts of the plumbing or lighting system. If the Landlord wants to be sure that those items stay with the premises, the Landlord should exclude those items from the description of the Collateral in which Landlord is subordinating its lien and ensure they are not included in Tenant’s loan documents.
 - iii. Certain “big” fixtures. Certain Tenants, particularly restaurants, have significant built-in fixtures. These are difficult to remove without damaging the premises, are valuable if the Landlord wants to lease the premises to another restaurant, and are almost valueless once they are removed. Therefore, the Landlord, not the Tenant Lender, should try to keep the walk-in refrigerators and freezers, the vent-a-hood, and similar items. Again, if the Landlord wants to be sure that those items stay with the premises, the Landlord should exclude those items from the description of the Collateral in which Landlord is subordinating its lien and ensure they are not included in Tenant’s loan documents.
- c. Landlord Form. The form of Landlord’s Subordination Agreement attached as Exhibit “C” requires a specific description of the Collateral in which the Landlord is subordinating its lien on Schedule 1 and a specific description of what is

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