The Tenant, the Landlord and his Mortgage Lender: Is Three a Crowd?

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Revenues from an immovable property directly affect its market value and the owner's capacity to obtain financing, meaning to borrow the necessary capital to acquire the property, develop his project or finance his operations. The quality and credit worthiness of the tenants, and the content of the leases are therefore a determining factor for the lender who will be concerned in particular with the amount of the rent, the term of the lease and the payment guarantees offered by the tenant. Quite often, the lender will also be interested in obtaining tenant confirmations or additional commitments that are not already covered by the lease.

As for the tenant, he will want to protect his right to occupy the leased premises and avoid any risk of termination of the lease should the landlord be in default with his lender. Also, after concluding his lease, which is not always a walk in the park, the tenant will often be resistant to further other negotiations or concessions requested by the lender, an outsider who is not even a party to the lease and to whom the tenant is not accountable.

Therefore, the tenant and lender may sometimes have objectives that, at least on the surface, seem mutually exclusive. However, with a closer look, we can see that the divisive issues can be reduced and even eliminated. Let’s review some of the most common situations that can arise.

What is attornment?

You are the owner of an immovable property and you negotiate a lease with a tenant who requests the removal of the attornment clause. Can you grant this request without risk to yourself or to your lender? This clause provides that if your lender ever becomes the owner of the property, the tenant will be bound to your lender as landlord and new owner.

The attornment clause is necessary in other jurisdictions such as Ontario’s since under common law, when there is a change in the ownership of an immovable property, the tenant is not automatically bound to the new owner and he could, unless he consents to remaining a tenant, put an end to his lease.

In Quebec, however, under Article 1886 of the Civil Code of Québec, the tenant is bound by law to the new owner, who becomes his landlord. Therefore, a change in ownership does not give the tenant an opportunity to end his lease. The attornment clause is therefore not particularly useful and there is no risk in accepting to remove it.

What is the impact of subordination?

You are a tenant about to sign a lease for new premises for your company. The lease the owner proposes you sign stipulates that you accept to subordinate your rights to those of the owner's mortgage lender and that you agree to execute, upon request, any other
document required to confirm or implement this subordination. A decision to move your company to these premises is strategic for its expansion and you cannot run the risk of having the lease terminate prematurely. In this context, you must know how the subordination clause can impact your rights.

Generally, to subordinate means ranking the tenant's rights below the rights of the lender. This could also mean that further to the taking in payment of the immovable property by the lender, the latter could put an end to your lease. This risk of seeing your lease terminated justifies in itself your objection to the inclusion of the subordination clause in your lease. The lender, however, may have certain reservations if he does not have a subordination clause in his favour. This attitude of the lender may have more to do with habit rather than a firm knowledge that subordination does in fact provide a real advantage. In the case of the lender who has a mortgage at the time the lease is entered into, subordination is not an issue since the mortgage is registered before the lease. As for the lender who is granted a mortgage after the lease, he will have reviewed and approved the lease before granting the loan and he is less likely to need subordination.

In the end, although opinions may vary, a well-advised lender will understand that the absence of a subordination clause is not a problem for him in as much as he will always have the possibility to exercise the appropriate recourses under the lease should the tenant be in default.

Can a statement of estoppel be prejudicial to the tenant?

Most leases include a clause stipulating that upon the landlord's request, the tenant shall provide the mortgage lender with a written statement called estoppel. Estoppel is a legal rule that prevents the allegation or denial of a fact that is contrary to a previous statement. Accordingly, a statement of estoppel signed by a tenant gives the lender confirmation of certain facts relevant to the lease and the leased premises that is independent of that of its borrower, the landlord.

The statement of estoppel also prevents the tenant from reneging on the statement made. For example, if the tenant stated that the landlord has fulfilled all of his obligations under the lease, including the obligation to have some work done or to pay a rental incentive, the tenant cannot contradict this statement at a later date. It is easy to understand why the lender would be interested in obtaining from the tenant such a statement that will protect him should the representations and warranties of his borrower, the landlord, prove to be incorrect. However, we can understand the tenant who, while promising to sign the statement of estoppel in good faith and to the best of his knowledge, prefers not to waive his rights if the information should prove to be incorrect, through no fault of his own.

Why register a lease?

The registration of a lease ensures that the mortgage lender who has taken the property in payment cannot terminate the lease before it expires. Without registration, the lender who becomes owner could put an end to the lease twelve months later with a six-month notice.
Therefore, considering the importance of the protection offered by registration, the tenant should always register his lease especially since it is a simple and inexpensive procedure.

Moreover, the landlord cannot prevent the tenant from registering his lease in view of Article 2936 of the Civil Code of Québec, which states that any provision prohibiting the registration of a right admissible for registration is invalid.

Registration of a lease will not however protect a lease amendment agreement entered into at a later date, unless this agreement has also been registered. Therefore, if the lender takes the property in payment and only the lease has been registered, he will not be able to terminate this lease, but he may terminate the amendment agreement. The Quebec Court of Appeal has rendered a judgment to that effect in 2001 in the case of 2682982 Canada Inc. v. Compagnie 390 St-Jacques.

In 2004, the Court of Appeal rendered another significant decision on the effects of the registration of a lease. In Royal Trust Company v. Pinkerton Flowers Limited, attempts were made to terminate a lease after the sale of the property by mutual agreement as part of the exercise of a right by the mortgage lender. The lease had been registered after the mortgage but before the sale. The Court did not grant the termination of the lease because, among other things, the determining date was that of the registration of the sale and not the date of the registration of the mortgage. The lease being registered before the sale, it could not be terminated by the lender.

Is a non-disturbance agreement necessary?

Let us assume that you are the tenant we were referring to above and are looking for new premises for your company. You managed to sign your lease without a subordination clause, you registered your lease and are asking yourself if you should also obtain from the lender a non-disturbance agreement.

The non-disturbance agreement is to ensure the tenant that the mortgage lender cannot terminate the lease should he exercise a hypothecary right. However, as we have previously seen, the registration of your lease essentially does the same thing. In this case, the only reason to obtain such an agreement would be to have additional comfort with an existing lender whose mortgage was registered before your lease.

However, some tenants, especially major ones, are sometimes looking for more from the lender, in particular with regards to the payment of insurance proceeds and the obligation to reconstruct or not the building in case of loss. Here, your interest as a tenant is liable to be adverse to that of the lender. As tenant, you will be looking to obtain the lender's commitment to enable reconstruction with the insurance proceeds, while the lender will want to keep the option to reduce the debt with the insurance proceeds. In this regard, it must be understood that a lender will generally be unwilling to grant a credit in advance for the reconstruction without having had the opportunity to assess the solvency of the borrower (which could have changed), the profitability of the property, the economic context, etc. Should the creditor refuse to consent in advance to allow for reconstruction, you will have to consider other solutions such as the financing of the reconstruction with
another lender or the possibility for you to pay out the lender and be subrogated in his rights.

**The Credit Tenant Lease**

We cannot talk about the relationship among the tenant, the landlord and his mortgage lender without mentioning a more sophisticated financing method called the *Credit Tenant Lease* (CTL). A CTL is mainly considered where a property is leased to a single tenant that has a superior credit rating. Among the owner benefits, there is a very high loan-to-value ratio, a very low debt coverage ratio and a very competitive interest rate since the lender underwrites a loan on the basis of the tenant's credit rating. The transaction requires a triple net lease where the majority, if not all the risks related to the property are assumed by the tenant. The lender shall therefore demand that the lease include certain provisions not necessarily found in usual triple net leases. Among the most affected clauses, you will find those that address the right of the tenant to terminate the lease, the right to withhold or set off the rent, major repairs and damages in the case of loss or expropriation. We may have the opportunity to elaborate on CTLs in another article.

The threesome between the tenant, the landlord and his mortgage lender is inevitable. We must therefore understand the parties' objectives and the applicable rules, including those discussed in this article, to be able to propose acceptable solutions when there is disagreement. These solutions must balance out the tenant's desire to protect his lease and the mortgage lender's requirements which will be dictated by the type of financing sought by the owner.