

## Examining the Use of SNDAs in the Hotel Industry

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With inflation reaching levels not seen in 40 years and interest rates on the rise, combined with reports that delinquency rates for lodging properties remain well above pre-pandemic levels, there is a persistent risk that a significant number of hotel properties will enter foreclosure in the next 12 months—especially in the face of continuing economic headwinds and the looming threat of a recession.

In this article, we examine the agreement—known as a Subordination, Non-Disturbance and Attornment Agreement (or SNDA)—typically used by hotel lenders, owners and managers to set forth their respective rights upon a foreclosure, and consider disputes that may arise when a party seeks to enforce its SNDA rights.

### What Is an SNDA?

An SNDA is originally a creature of commercial real estate lending involving a property with existing tenant(s). In that context, the SNDA was devised as a mechanism to establish privity of contract between a lender and a tenant—which parties otherwise, in contrast to a landlord and lender (through the loan documents) and a landlord and tenant (through the lease), have no contractual relationship—and set forth their respective rights upon a loan default.

As a condition to providing financing to the property owner/landlord, lenders require tenants to expressly agree to “subordinate” their leases to the lender’s mortgage or security interest position, and to “attorn” (i.e., recognize) the lender as the new landlord in the event of a foreclosure. This provides the lender with assurances both that its loan is of a higher priority than the tenant’s leasehold property interest, and that if the lender needs to foreclose on its loan, the rent stream from the lease will continue without interruption.

In exchange, the lender agrees that it will not “disturb” the tenant’s tenancy upon a foreclosure. In the absence of non-disturbance language, if the lease is subordinate to the lender’s lien, then upon a foreclosure the lender’s lien can also foreclose out all subordinate positions, including all leases. Tenants want to be assured that their leases will not be terminated by a lender in the event of foreclosure; otherwise, a tenant could be in full compliance with the lease yet lose its lease through no fault of its own.

### SNDAs in the Hotel Industry

A similar, if not exact, dynamic exists in the hotel business when the party possessing the property (the hotel manager) is not also the hotel owner, and thus has no contractual privity with the property lender. Borrowing from the real estate lending arena, the hotel industry has turned to SNDAs as a



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way to govern the respective rights of the hotel owner, hotel manager and owner’s lender in the event of a default under the loan documents.

As modified to the particulars of the hotel business, lenders typically require hotel managers to expressly agree to subordinate their rights under a hotel management agreement to the lender’s mortgage or security interest position, and to recognize the lender or a subsequent owner as the new hotel owner in the event of a foreclosure. The express subordination of the hotel manager’s property rights is not controversial, as it is generally understood that hotel managers—unlike leaseholders—have no direct property interest that may compete for priority with a lender’s secured interest. In addition, however, lenders often require that hotel managers agree to subordinate all of their right, title and interest under the hotel management agreement, including all rights of the hotel manager relating to the use of funds in the various hotel accounts. Such language permits the lender to exercise rights and remedies as to the use of hotel

funds immediately upon a loan default.

In terms of non-disturbance language benefitting the hotel manager, the hotel manager typically seeks a commitment from the lender that so long as the hotel manager performs as required under the hotel management agreement, they will remain the manager regardless of any loan defaults by the hotel owner or a foreclosure sale. This generally appears in language to the effect that the hotel management agreement will not be terminated by the lender or a subsequent owner acquiring the hotel through the foreclosure, and the hotel manager will be permitted to continue to operate the hotel under the hotel management agreement (or a replacement hotel management agreement of the same terms and length executed by the new owner) after a foreclosure. If the lender will not provide this level of protection, hotel managers often pursue other ways to protect their fee stream, including a termination fee to be paid by either the hotel owner or lender in the event of a termination due to a foreclosure or deed-in-lieu of foreclosure, or even a right of first refusal to purchase the hotel upon a loan default. At a minimum, hotel managers generally seek language that protects their right to manage the hotel during the period between the loan acceleration and the foreclosure sale.

Additionally, hotel managers often seek protection in the event the hotel management agreement is wrongfully terminated by the hotel owner, or if the hotel manager is otherwise wrongfully prevented from operating the hotel. This protection typically appears in the form of a provision stating that the hotel manager's rights under the hotel management agreement will be reinstated when the lender or a subsequent owner acquires the hotel through foreclosure, with a

requirement that any subsequent owner execute a replacement hotel management agreement of the same terms and length as that executed by the original hotel owner.

### What Disputes May Arise

As explained above, parties to an SNDA related to a hotel property—most particularly, the lender and hotel manager—bargain for specific protections. The lender requires certainty that its first lien priority remains unquestioned, seeks to ensure that it can keep close control of the hotel and its assets during the foreclosure process, and seeks to ensure that it or a subsequent owner can seamlessly step into the role of owner under a hotel management agreement while keeping all of the hotel manager's obligations in place. The hotel manager, in turn, seeks confirmation that they will receive the benefit of the bargain under the hotel management agreement even if the owner changes due to a foreclosure. While such protections may appear uncontroversial at the outset of the relationship, the parties' attitudes may have changed years later at the time of a foreclosure.

For one, hotel lenders may resist an expansive reading of the non-disturbance protections, as they may prefer to take the property unencumbered and not want to assume the hotel management agreement. They also may be reluctant to take on the responsibility of ensuring that any subsequent owner assumes the management agreement as a condition of purchasing the hotel. This may lead to creative efforts by a lender—by employing a deed-in-lieu or other process—to accomplish its objectives while circumventing the non-disturbance language of the SNDA. There may also be questions of whether such provisions, which seek to impose obligations on third-party future purchasers to assume or enter

into a hotel management agreement as a condition to purchasing a hotel, are legally enforceable or, conversely, unlawful restraints on trade, and whether a hotel manager can specifically enforce such a provision or is left with a claim for money damages.

Conversely, a hotel manager understandably may resist allowing the hotel lender to dictate the management of the hotel, including the use of hotel funds, which rights may conflict with the hotel's manager's broad discretion under the hotel management agreement to operate the hotel. A hotel manager may, in good faith, believe the hotel lender's directives are contrary to the hotel's best interests.

While each situation will be different, there is little doubt that the enforcement and reliability of SNDAs will be tested if a wave of hotel foreclosures comes to pass. Industry participants would be well-advised to closely review their SNDAs and be strategic as they prepare for any eventuality, and to closely consider these issues in connection with any new deals that they are negotiating.

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