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What is an HMA SNDA to every hotel owner, operator and lender anyway?

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Sherin and
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Subordination, non-disturbance and attornment agreement. It doesn't exactly role off the tongue, does it... What about the slightly less intimidating sounding acronym, "SNDA?" Surely, every hotel owner, operator and lender knows exactly what an SNDA is, right? In my experience, the answer is: definitely not. Hence, the topic of this month's article.

Let's start with the basics. The SNDA is a three-party agreement between the hotel lender, operator and owner. Anyone with an unleveraged hotel or a strictly owner-operated hotel can stop reading now. SNDAs may not be entirely foreign to commercial property owners, as SNDAs are commonly used whenever a third party (i.e., a tenant or a hotel operator) may be occupying or possessing a mortgaged premises. However, HMA SNDAs are vastly different from other types of SNDAs.

From the lender's perspective, the key letters in the acronym SNDA are "S" (which stands for subordination) and the "A" (which stands for attornment). Subordination means that the operator agrees to subordinate many, if not all, of its rights under the hotel management agreement ("HMA") to the lien securing the owner's lender's loan and the lender's rights under the loan documents. Attornment means that the operator will acknowledge that the owner's lender (or its success-in-interest) may step into the owner's shoes under the HMA, and the operator will continue performing under HMA, recognizing the lender as its new

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"boss." As the boss, the lender wants the sole right to decide, at some point after an uncured owner default, whether to keep the operator or not, and if so, for how long and on what terms and conditions. If the lender believes the operator adds value to the asset, it may want to keep the HMA in place. If, however, the lender believes that the operator is not cutting the mustard, or if the lender believes that the hotel is worth more if sold unencumbered by the HMA, the lender will want the ability to terminate the HMA following any uncured loan default. In addition, the SNDA may have estoppel provisions, to provide a lender with assurances from the operator that there are no uncured defaults or other problems under the HMA. Lenders may also use the SNDA to gain control over deposit accounts and other management rights, if the Lender believes such rights are necessary.

From the operator's perspective, the key letters in SNDA are "ND" (which stands for non-disturbance). Non-disturbance means that absent a default by the operator under the HMA, the operator may continue managing the hotel undisturbed by the lender during the term of the HMA, for the fees payable under the HMA, notwithstanding any owner loan default. Hotel operators rely on the fees payable under the HMA to meet many of their basic operating costs. In addition, many operators leverage their right to receive future fees under the HMA to their own lenders and pledge same as collateral. Thus, an HMA termination by the owner's lender may strain the operator's

cash flow and cause problems with the operator's lenders. Also, large operators (i.e., brands) compete with each other for market share. Why should an operator lose a valuable asset to a competitor simply because of the owner's loan default? Moreover, the operator agreed to enter into the HMA with a specific owner. Presumably, the operator conducted due diligence on the owner and found it acceptable. The SNDA asks the operator to "attorn" to a party it may know nothing about - and with whom it may not want to do business. Finally, at the most basic level, the operator needs to get paid amounts due under the HMA, and not end up violating applicable laws. If it is the owner's obligation to fund a payroll account, the operator can't afford to have the account attached or otherwise disturbed by the lender. Similarly, a termination of an HMA cannot violate the WARN Act (which may require 60-days advance notice to employees prior to a hotel closing or a mass layoff), a collective bargaining agreement or wage and hour laws. And, if the lender wants to retain the operator, the lender must agree to pay the operator, at the very least, for services rendered from and after the date that the lender takes possession or control of the hotel.

The operator and the owner's lender clearly have competing interests. Caution to an owner who believes that it can remain aloof. Many of the most critical terms of the SNDA are pre-negotiated between the owner and operator in the HMA, which usually has a "self-operative" SNDA provision. In addition, sophisticated third-party opera-

tors may attach their own "standard-form" standalone SNDA to the HMA, allowing the operator to require an SNDA in the pre-approved form. If the operator doesn't attach its form, then it still may have the right to negotiate "reasonable" changes to the lender's form. In either case, the owner must deal with complicated issues related to the SNDA at the time that the HMA and loan documents are each being negotiated, so that they are all in sync to properly reflect the understanding of the parties. Otherwise, the owner might find itself held hostage by the operator when it comes time to close a loan or get approval from its existing lender to an HMA.

How the competing business and legal interests of the owner, operator and lender are ultimately resolved varies greatly depending on the circumstances. A lender termination right may not be a big deal for an operator under a short-term HMA, as long as such termination does not create liability for the operator under the WARN Act, a collective bargaining agreement and/or state-specific employment laws. Different lenders and operators have their own unique sensitivities but often find themselves with unequal bargaining power. If you learn anything from this article it should be that the SNDA is a critically important document that requires a high level of care and attention by business decision-makers, as well as their legal counsel.

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