

The Dynamics Of Collateral Access Agreement Negotiations

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As the economy emerges from the COVID-19 pandemic, there is likely to be an increase in secured loans made to companies in certain sectors looking to stabilize or expand their operations.

If the assets pledged as collateral are physically located on real property that is leased by the borrower, the lender will need to establish its rights to access and remove the collateral in order to ensure its ability to realize on the collateral in the event of a borrower default. As a result, the lender will typically require or request a collateral access agreement from the borrower's landlord as a condition of the loan.

Negotiations of collateral access agreements—which are also called landlord waivers, subordination and consent agreements, or something similar—vary widely.

The final terms depend on many factors, including (1) the negotiating leverage of the lender, landlord and borrower, (2) the overall relationship of the parties, (3) the experiences of the parties, especially related to previous bankruptcies and other distressed situations, and (4) applicable market conditions.

Understanding the priorities and perspectives of each party can be critical in achieving a successful result in negotiating these agreements.

The Relationship Between the Lease and the Collateral Access Agreement

The lender's ability to obtain a collateral access agreement from the landlord, as well as the lender's negotiating leverage regarding the terms of such an agreement if obtained, are strongly influenced by whether or not the lease has yet been entered into between the landlord and the tenant.

If the lease has not yet been signed, the lender can condition its approval of the new lease on delivery of a collateral access agreement with terms acceptable to it. If the lease has been signed, then the terms of the lease will be critical in determining the landlord's obligation, if any, to enter into a collateral access agreement with the lender.

Many leases do not require the landlord to deliver a collateral access agreement, although some leases do contain a requirement for the landlord to enter into a lien waiver or similarly titled agreement with the tenant's lender.

Even if the lease does not obligate the landlord to enter into a collateral access agreement or similar agreement, the landlord often agrees to do so as accommodation to its tenant. The landlord may make such an accommodation solely for relationship purposes, or at least in part because the related debt financing is beneficial to the tenant's financial condition and operations.

Defining the Collateral

The lender wants the collateral description in the collateral access agreement to match as closely as possible the description of collateral in the pledge from the tenant to the lender in the applicable loan documents.

However, the landlord usually wants to exclude any of the tenant's personal property at the site that has become a fixture pursuant to applicable law, although the lender often requires a further qualification so that any such fixture is still included if it is specifically financed collateral that may be attached to the improvements at the space.[1]

In part because of potential conflicts with mortgage loan documents over rights in fixtures, the landlord often seeks the consent of its mortgage lender regarding the terms of the collateral access agreement.[2]

Waiver or Subordination of Landlord's Interest in the Collateral

The lender typically wants the landlord to waive any right to claim any interest in the lender's collateral at the applicable site. The landlord's security interest in the tenant's personal property can be expressly set forth in the lease itself, and, in certain jurisdictions, the landlord has a common law or statutory security interest over tenant's personal property at the site, regardless of whether or not such a security interest is expressly described in the text of the lease.[3]

The landlord can also have the right to a judgment lien over personal property of the tenant in the event of default and nonpayment. The landlord sometimes agrees to a full waiver of any and all such security interests and rights, but it may agree only to subordinate its interests and rights to that of the lender. The lender generally acquiesces to such a demand because the lender's primary focus is on assuring the first priority of its security interest.[4]

With the landlord's subordination, the lender achieves this goal, and the landlord's subordinate position may still provide it with some amount of recovery in the event that the tenant defaults, the collateral is sold, and the amount realized exceeds the amount of the lender's debt.

Notice of Lease Default and Lender's Right to Cure

In addition to the landlord confirming that the tenant is not currently in default and the lease is in full force and effect, the lender wants to receive written notice from the landlord of any default by the tenant under the lease, as well as an opportunity—but not obligation—to cure any such default, preferably for some period of time beyond that provided in the lease for the tenant to effect a cure.

Although the terms of the loan documents may provide that the tenant is required to deliver any such notice to the lender, if the tenant fails to deliver such a notice, the lender could lose any opportunity it may have to cure the default and prevent (or at least delay) termination of the lease by the landlord.[5]

However, because such a notice requirement in the collateral access agreement would create an administrative burden for the landlord, the landlord sometimes agrees only to provide the lender with advance prior notice of any action by the landlord to terminate the lease due to a default. The landlord also sometimes limits the lender's cure period to the time provided in the lease to the tenant.[6]

Collateral Inspection and Removal

The lender typically wants the right to enter onto the premises from time to time in order to inspect the pledged collateral. The landlord usually wants prior notice of any such inspection, which the lender ordinarily agrees to, although the notice period is sometimes the subject of negotiation, as the lender wants to be able to move quickly should it believe that an assessment of the collateral is necessary.

Also, the landlord often wants to ensure that its personnel may accompany the lender during any entry on the premises. This is generally acceptable to the lender, although the lender often insists that the landlord's right is restricted to only the opportunity to have its personnel present, so that if the lender delivers the proper notice to the landlord regarding the entry, the lender can still enter upon the site even if the landlord's personnel choose or are unable to be present.

In addition, the landlord often wants to restrict the lender's period of entry, although the specifics of such a restriction can vary widely. For example, the landlord may want to limit the lender's access to business hours, in part to make it easier to have its personnel accompany the lender during the visit.

However, the landlord may require just the opposite—that any access must not be during business hours, in part to avoid negative optics for other tenants and their customers at the site.

In addition to the right to inspect the collateral from time to time as discussed above, the lender wants the right to access the premises and remove the pledged collateral in the event of either a default by tenant under the applicable loan documents, thus entitling the lender to exercise on the collateral, or in the event that the landlord takes possession of the premises for any reason, or has the right to take possession, including because of a tenant default under the lease following expiration of any applicable notice and cure periods.

In the event of such a loan document default, the lender delivers written notice to the landlord. In the event landlord takes possession of the premises or otherwise has the right to take possession, the landlord delivers written notice to the lender. Note that the landlord may want an additional provision requiring the lender to remove the collateral, or waive its right to do so, following such a notice from the landlord.

The time period afforded to the lender to remove and take possession of the pledged collateral is typically described as the disposition period. During the disposition period, the lender has the right to inspect and remove the collateral, although the landlord often prohibits the lender from conducting auctions or sales at the premises or from removing collateral from the premises at a time or in a manner that would interfere with the normal activities of any other tenants.

Also, although the lender generally wants the landlord to agree not to remove or disturb the collateral prior to either removal by the lender or expiration or waiver of the lender's rights to inspect and/or remove the collateral, the landlord may want the ability, after some defined period of time, to relocate the lender's collateral to other space on the property or even to off-site storage, in part to enable the landlord to potentially relet the space to a new tenant.

The cost and location of any such off-site storage is often a point of negotiation between the landlord and the lender. In addition, the lender often requires that if any injunction, bankruptcy stay or similar legal process prevents the lender from accessing the premises or realizing on its collateral, the disposition period will not commence or will be tolled, as the case may be, until such injunction or stay is lifted or removed, or similar process is completed.

Without such a provision, such an injunction, stay or similar process could render the lender's rights to remove the collateral partially or totally meaningless, if all or some portion of the disposition period occurs during the time that the lender is legally prevented from exercising its rights.

The landlord usually imposes conditions on the lender's entry onto the site to remove the collateral. Some collateral access agreements simply give the landlord the general right to impose additional reasonable conditions prior to lender's entry. The lender often resists such a general statement, out of fear that the lack of specific conditions could result in a later dispute with the landlord and delays in realizing on the collateral.

Specific conditions often imposed by landlords in the collateral access agreement include:

- The lender not interfering with the landlord's efforts to lease the premises to a replacement tenant;
- The lender agreeing to repair, or reimburse the landlord for the cost of repairing, any damage caused by the lender while at the site;
- The lender providing an indemnity in favor of the landlord for any loss or damage related to the entry and removal of the collateral;
- The lender either demonstrating significant creditworthiness or delivering evidence of liability insurance in favor of the lender and landlord covering lender's activities on the property;
- The lender being obligated to remove all its collateral (so that the lender does not only remove the valuable collateral and leave the rest for landlord to discard) and/or waive any lien it has on the collateral following the disposition period (although the lender will often object to waiving liens on collateral);
- Requirements regarding the period of entry and the ability of the landlord's personnel to be present during the lender's entry, similar to the requirements discussed above with respect to inspection of the collateral; and
- The lender paying the landlord an access fee. The access fee is often the subject of significant negotiations between the parties.

The amount of the fee is sometimes limited to the base rent due under the lease, but can also include additional amounts such as default and holdover charges. The fee is sometimes charged on a per diem basis for each day that the lender is on site, but in other agreements, the amount is charged for the entire disposition period, or for any full calendar month in which any of the disposition period occurs.

In addition, the landlord often wants some or all of the fee to be paid in advance, while the lender often wants to pay only after it has completed its removal of the collateral.

Finally, the lender can also try to include language confirming that it is only obligated to pay an access fee to the landlord if the landlord is not otherwise collecting rent from the tenant for the applicable period, and even requiring the landlord to refund to the lender the amount of any fees paid by the lender if the landlord later recovers applicable rent amounts from the tenant.

Lender's Right to Modify the Loan Agreement

The lender often wants the landlord to confirm that the lender and the tenant may modify any of the terms of the applicable loan documents without the landlord's consent and without notice to the landlord. The landlord generally agrees to such a provision, although it sometimes wants language added to the provision stating that any such modification cannot limit its rights or increase its obligations under the collateral access agreement.

Waiver of Special and Consequential Damages

Collateral access agreements typically include an express mutual waiver of special and consequential damages. Such a mutual waiver is far more likely to benefit the lender than the landlord in most circumstances, although it is typically agreed to by the landlord nonetheless.

Termination of Agreement

Generally, the lender wants the collateral access agreement to survive until all of the tenant's loan obligations have been paid in full. The parties sometimes also agree that the collateral access agreement terminates following expiration of the lender's disposition period. In any case, the parties usually want certain specific obligations to survive termination, such as indemnification clauses.

Also, the landlord often demands notice from the lender once the loan obligations have been satisfied, although the lender often agrees only to respond to a request from the landlord regarding the status of the loan obligations, thereby putting the initial burden on the landlord to make the inquiry.

[1] Whether personal property has become part of the real property is determined by the law of the jurisdiction where the real property is located. 35A Am Jur 2d Fixtures § 4. For a general discussion of fixtures, including criteria for determining whether personal property has become a fixture, see 35A Am Jur 2d Fixtures § 1 et. seq.

[2] A landlord sometimes also wants express exclusions for certain building items, such as HVAC systems, even though such items are clearly not owned by the tenant and may not overlap with the collateral description. However, adding such express exclusions to the collateral access agreement is typically acceptable to the lender.

[3] Whether such a security interest has priority over a perfected lender's security interest will vary by jurisdiction and specific circumstances. See 2 Powell on Real Property § 16A.01 (2021). Statutory or common law security interests are available to landlords in a number of jurisdictions, although they have been abolished in others. See 49 Am Jur 2d Landlord and Tenant § 783.

[4] Note that a full waiver is still better from the lender's perspective. With a subordinate perfected security interest, the landlord will have certain rights in the tenant's bankruptcy proceeding that the landlord can assert to the potential detriment of the lender.

[5] In a transaction where the lender has taken an express pledge of the tenant's leasehold interest, the lender often also requests the right to enter into a new direct lease with the landlord in the event the lease between the landlord and the tenant is terminated.

[6] The landlord may also want a provision requiring that the lender deliver notice of any loan default to the landlord, although in the authors' experience, such a provision is relatively rare in finalized collateral access agreements.

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