WeirFoulds LLP

The Financing Triangle: The Top Five Practical Considerations in Negotiating Tenant Financing Rights and "Landlord Waivers"

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When a typical franchisee in the food service industry seeks to open a business in a shopping centre, it usually obtains a commitment from its lender to provide financing for the purchase of the furnishings, fixtures, inventory and equipment. Normally, the lender requires the tenant to provide security over all of the items purchased, as well as over the business' receivables. More and more often, the lender also requires the tenant to obtain a waiver of rights from the tenant's landlord. But what if the landlord is paying a leasehold improvement allowance? What if the tenant's franchisor also wants rights in case of tenant default (in which case your already-complicated triangle becomes a square)? How do you draft a lease clause or waiver document that all of these parties will approve?

Consideration No. 1 There's a Conflict Here!

The landlord wants to preserve its rights and priority in the tenant's personal property, and also to make sure the leasehold improvements are not encumbered or removed the question of what is a "leasehold improvement", or a "fixture", or a "trade fixture" is a murky one. The tenant needs its financing, and has to sign a lease (otherwise, there's a chance both landlord and lender will refuse to fund) it is therefore trapped among the other three players. The lender seeks first right in the collateral for the loan (and that collateral may include items that the landlord considers "leasehold improvements"), as well as re-possession, removal and access rights. The franchisor also wants rights to take over the space and run the business. Now that we recognize the competing interests, the question is, how can these interests be reconciled in time to get the restaurant open for business?

Consideration No. 2 It's Mine! No, It's Mine!

The most important part of a financing clause or waiver document is the description of the property in which the landlord agrees to give up, waive, or postpone, its interest in favour of the lender's security therein. While the landlord will probably agree that the lender may have first right to unaffixed, movable chattels, "personal property", "equipment" and "trade fixtures" (because it wants the tenant to open and pay rent, hardly ever distrains anymore due to the change in the tax laws it can't distrain on fixtures anyway, and knows the lender can ultimately bankrupt the tenant), it's going to have an issue with "leasehold improvements". And what do these terms mean in any event? For example, is a walk-in freezer a "trade fixture" that is removable, or a "leasehold improvement" that becomes part of the property permanently?

Consideration No.3 The Limits and Scope of the Clause/Waiver

A sharp landlord will endeavour not to "waive" its rights, but rather to postpone them, and then only do so to a *bona fide* lender (chartered bank, insurance company, credit union, etc.). The tenant, however, might need flexibility in the source of its financing (individuals, shareholders, or any other non-traditional lenders (including the franchisor), and should ask for concession from the

landlord with respect to certain identifiable lenders, and for the right to be transferable for the purposes of sublease or assignment (and in general, sale of the business). For a franchisee, it's especially important to remember to obtain rights to transfer to the franchisor or a replacement franchisee.

Consideration No. 4 I Have to Get in There! Lender's Access Rights

Whether the lender has taken security over the goods, has retained ownership of them, or intends to the assume the premises under the provisions of a leasehold mortgage, it will require access to the premises in the event of a default by the tenant. In most financing clauses, a default by the tenant under either of the lease and the loan agreement gives rise to the lender's and landlord's rights.

The Landlord may require that, in the event of either type of default, the lender must pay any arrears of the tenant prior to obtaining access but the parties are more likely to settle on payment of a type of "occupation rent" by the lender. The landlord will certainly insist that the lender make good any damage caused by the lender or its agents in removing the goods from the premises (including damage to parts of the shopping centre other than the premises such as freight elevators, loading docks and shared walls), and will hold both the lender and the tenant responsible for such costs. In addition, the landlord will extract from the tenant its consent to the granting of such access, and its acknowledgement that the landlord need not inquire into the validity of the lender's claim, the lender's access, and the lender's removal of the collateral. This is not to say that the landlord will not also require the lender to satisfy the landlord that the lender has complied with all statutory and contractual requirements (such as the requirement to give notice) before granting access to the lender. A broadly-worded indemnity from the lender is also often sought by the landlord, even though other provisions of the lease (e.g., the tenant's obligation to insure the contents of the premises and the right of the landlord's insurer to subrogate against the tenant) may arguably address this issue. Any indemnity will usually be the subject of significant negotiation with the lender. Finally, if the landlord has terminated the lease, and the lender is entitled only to access to the premises for the purposes of removing the collateral, the landlord may permit access by the lender only for a certain period of time.

Consideration No. 5 Am I Missing Anyone?

A sharp landlord will require any indemnifier or guarantor under the lease to confirm its acceptance of the financing arrangement and rights given to the lender (including by signing any waiver or mortgage consent form directly) because such arrangements could, arguably, constitute a material' change in the risk assumed by the indemnifier. The tenant and lender are not likely to argue.

In addition, the franchisor may be asked to sign the waiver for the purpose of acknowledging that its rights (if it has any to take over the lease, or cure defaults) are subordinate to the rights of the lender. Some franchisors have standing agreements with major lenders to do just that.

In the case in which the financing is being obtained by an entity who is not the tenant (but is a related corporation or a subtenant), the recitals should make the transaction clear and the appropriate covenants or acknowledgments will likely be extracted by the landlord.

Wrap-up

Affording at least some consideration to these issues puts you, as tenant, landlord, lender or franchisor, well on the way to preparing a well-crafted financing clause that marries common sense and legal necessity. The ultimate goal of a financing clause or waiver is to provide the parties with some comfort and certainty that if "something goes wrong", the parties will have a written agreement to turn to hopefully without resorting to the complex web of priorities legislation, and the cloudy definitions of the common law.

But in the event the lender opts to pursue the bankruptcy of the borrower anyway

WeirFoulds LLP

www.weirfoulds.com

Toronto Office
4100 – 66 Wellington Street West
PO Box 35, TD Bank Tower
Toronto, ON M5K 1B7

Tel: 416.365.1110
Fax: 416.365.1876

Oakville Office
1320 Cornwall Rd., Suite 201
Oakville, ON L6J 7W5

Tel: 416.365.1110
Fax: 905.829.2035