

THE ASSOCIATION OF THE BAR OF THE CITY OF NEW YORK

REAL PROPERTY COMMITTEE

MODEL INTERCREDITOR AND SUBORDINATION AGREEMENT

COMMENTARY

From time to time, unrelated lenders may find that they each want to have a security interest in the same real property. This could arise if real property is sold subject to an existing mortgage with purchase money financing provided by the seller. It could arise if an owner, with substantial equity in real property that is encumbered by a mortgage with a high prepayment penalty, wants to obtain additional financing secured by that real property. In any event, it is important for such lenders to have an agreement that governs their respective rights and responsibilities. The Real Property Committee of the Association of the Bar of the City of New York (the "Committee") has provided such a document.

The Committee has drafted a document that recognizes the superior interests of a first mortgagee and the fact that the prohibition against additional financing that is commonly contained in mortgages gives the first mortgagee a "veto" with respect to additional financing. That said, a subordinate mortgagee with leverage should use it to negotiate more rights for itself. For example, a subordinate mortgagee might try to obtain more notice of, and time to cure, a default under the first mortgage, or even a limitation on the amount secured by the first mortgage and a right to make its independent decision with respect to the collateral e.g., the application of insurance proceeds and condemnation awards, the release of collateral, and the execution of non-disturbance agreements with tenants.

One of the most important provisions in the document is the obligation of each mortgagee to provide the other with notice of default under its respective loan documents. However, failure to provide such notice does not affect the mortgagees' rights and obligations under the document. An express right to cure a default under the first mortgage loan documents, in at least the time period that the borrower has to cure the default, is given to the subordinate mortgagee, but the first mortgagee is not given a similar right. The Committee thought that such a right was vital to the subordinate mortgagee, and that a first mortgagee could easily obtain such a right if it wanted it. If the first mortgagee fails to give the subordinate mortgagee notice of a default, the subordinate mortgagee could de facto lose its right to cure unless it learns of the default from the borrower. The subordinate mortgagee can protect itself by having the very common requirement in its loan documents that the borrower give it notice of any default that it receives from the first mortgagee as soon as it receives such notice.

As part of a New York based bar association, the Committee has made New York the applicable law and provided New York acknowledgments. If the parties want another law to be applicable, or plan to record the document in another state, they should of course make appropriate changes.