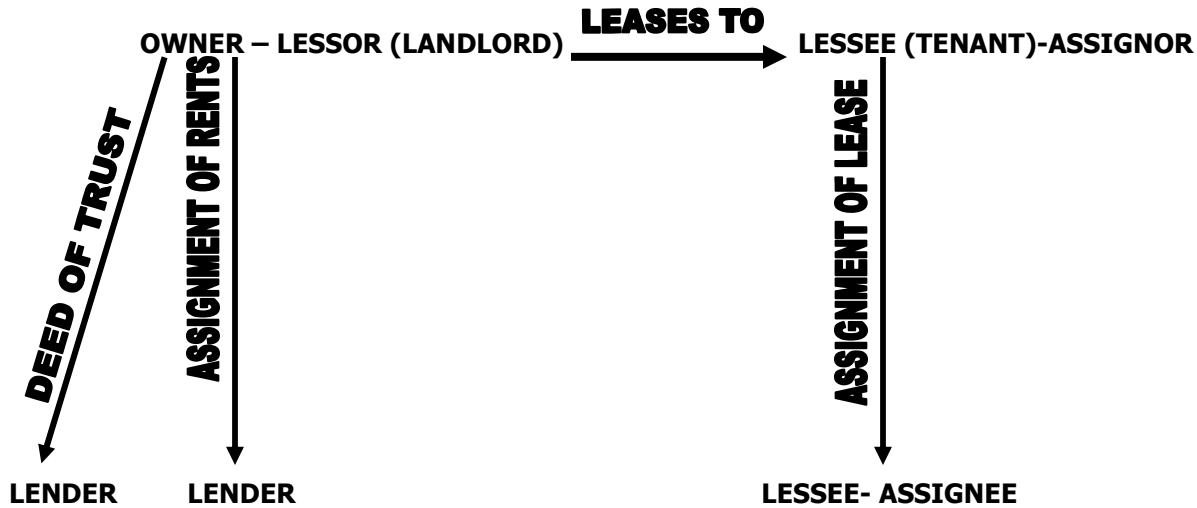


LEASES AND VARIOUS INTERESTS THEREIN – PRIMER FOR PARALEGALS AND UNDERWRITERS

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Things To Know:

1. Owner-lessor owns the fee simple title to the land.
2. Owner-lessor might (1) only grant (give) a lease to lessee or (2) only grant (give) a deed of trust or (3) both. Complex deals can involve both and an Assignment of Rents.
3. A lease for a total term of 3 years or less (counting options to renew) need not be recorded in order to be valid against someone later recording a deed, deed of trust, lien, or other lease from or against the owner-lessor. (G.S. 47-18(a)). A lease for more than 3 years (counting options to renew) must be recorded in order to be valid against such later interest holders.(G.S. 47-18(a)).
4. Often, the lease is too long and it will not be recorded. Instead, a short form memorandum of lease will be recorded. (G.S. 47-118 contains a form.) (If the lease also contains an option to purchase and the lease itself is not recorded when required (as noted above), the recorded memorandum of lease should be combined with the form memorandum of option to purchase in G.S. 47-119.)
5. A Deed, Deed of Trust, and Assignment of Rents from the owner to a party must be recorded in order to be valid against another purchaser for value or lien holder. (G.S. 47-18(a); G.S. 47-20).
6. In the above diagram, sometimes the lender will want not only a Deed of Trust, but the lender will also want an Assignment of Rents. (Sometimes this is titled, "Assignments of Rents and Leases", "Assignment of Lessor's Rights in Leases", etc.) This is an assignment of the owner- lessor's rights—the right to receive rent from the lessee (tenant) instead of the rent going from the lessee (tenant) to the owner-lessor. Under this assignment, the lender has to give written notice to the owner-lessor and lessee (tenant) to pay the rent to the lender instead of the rent going to the owner-lessor. The rent is applied to reduce the amount the owner-lessor owes the lender. (G.S. 47-20 should be noted for legal details.) This assignment is different from the assignment by the lessee (tenant) of the lessee's (tenant's) interest.
7. The lessee (tenant) can assign its interest in the lease and its interest is the right of possession. In such a case, the lessee (tenant) is the lessee-assignor and the assignee is the lessee-assignee. The assignment is usually recorded to protect the assignee against a subsequent assignment to another assignee by the lessee-assignor. The lessee (tenant) can assign its interest in the lease without the owner-lessor's consent unless the lease requires the consent of the owner-lessor; many leases do. The lessee (tenant) continues to be liable to the owner-lessor for the rent unless the assignment

by the lessee (tenant) to the lessee-assignee joined in by the owner-lessor (or another document also signed by the owner-lessor) releases the original lessee (tenant).

8. In lieu of an assignment by the lessee (tenant) of its interest, the lessee (tenant) can sublease the land to a sublessee. An assignment (see 7.) is a transfer of the *entire* leasehold interest. A sublease is a transfer of only a part of the term of the lease with the lessee (tenant) retaining a reversion of some portion of the term. (A transfer by the lessee (tenant) of part of the leased land only, but for the full term, is an "assignment pro-tanto.") This is discussed in *Webster's Real Estate Law In North Carolina* §12-14.

9. A usual order of events would be the following:

- 7-16-02 at 12:49pm: After owner-lessor acquires title, owner-lessor leases to lessee and the memorandum of lease is recorded first, in book 13807, page 136.
- 7-16-02 at 12:49pm: Owner-lessor grants (gives) a Deed of Trust to a trustee for lender recorded second in book 13807, page 167.
- 7-16-02 at 12:49pm: Owner-lessor grants (gives) an Assignment of Rents to that same lender recorded third in book 13807, page 186.
- 7-16-02 at 12:49pm: Lessee (tenant), lender (and sometimes the owner-lessor) sign (execute) a subordination, non-disturbance and attornment agreement (SNDA) recorded fourth in book 13807, page 196. The lessee (tenant) subordinates his rights to the lender's Deed of Trust. Without the SNDA, the lessee's lease would be ahead of the lender's Deed of Trust since the memorandum of lease was recorded ahead of the Deed of Trust. The lender agrees not to disturb the tenant by foreclosing and cutting off (extinguishing) the lease because the owner-lessor does not pay on his note secured by the Deed of Trust. The lessee (tenant) attorns (agrees to recognize the lender or other party as landlord if the lender or other party acquires title at foreclosure of the Deed of Trust). The attornment runs in favor of the lender or any other party purchasing at a foreclosure sale.

(Note that in the above example all documents were recorded within the same minute. When this happens, priority will be determined by the rule that if instruments are registered simultaneously, then the instruments shall be presumed to have priority as determined by: (1) the earliest document number set forth on the registered instrument and (2) the sequential book and page number set forth on the registered instrument if no document number is set forth on the registered instrument. The presumption created by this subsection is rebuttable. G.S. 47-18(a); G.S. 47-20(a).)

So an SNDA is a "win" for all. The lender's Deed of Trust has priority over the lessee's (tenant's) lease, but the lender agrees that if the Deed of Trust is foreclosed, the lease will not be wiped out as long as the lessee (tenant) pays the rent.

(NOTE: Sometimes an SNDA for a prior lease is not required by the lender. That is because the lease contains an "automatic subordination agreement" by the lessee. These must be scrutinized carefully. The reason is:

These clauses are of several varieties: (1) certain clauses actually constitute the subordination without any other action; (2) certain clauses actually constitute the subordination without any other action but provide that a confirmatory document specifically referencing the deed of trust to which the tenant or lessee is subordinating will be given upon request and (3) certain clauses only constitute an executory agreement to give a specific subordination upon request. Obviously, (1) or (2) is preferable to the lender relying upon the clause in the lease.

See E. Urban, G. Whitney, N. Ferguson, *North Carolina Real Estate* §21:21 (Thomson*West 2007 Supp.). G.S. 39-6.6 creates a clear set of rules for subordinations.)

- 10-10-02 at 1:00pm: The lessee assigns his rights to an assignee and this is recorded. The assignee steps into the original lessee's (tenant's) shoes as the new lessee (tenant). (This step happens less than the above steps.)

10. In a loan policy, the insured lender's Deed of Trust goes into Schedule A as the "insured mortgage." The lease memorandum and SNDA go into Schedule B-II pertaining to subordinate matters. The Assignment of Rents goes into Schedule B-II for information along with any UCC Financing Statement securing the same lender.

11. In an owner's policy, the lender's Deed of Trust goes into Schedule A if we are also issuing a loan policy. If we are only issuing an owner's policy, then the Deed of Trust goes in Schedule B of the owner's policy. The leases, SNDA's, and Assignment of Rents, and UCC Financing Statement securing the same lender go in Schedule B of the owner's policy whether or not there is a loan policy issued.

12. Sometimes the lender will record a UCC Financing Statement to cover fixtures, but the Deed of Trust usually covers fixtures. The UCC Financing Statement goes into Schedule B-II of a loan policy for information and into Schedule B of the owner's policy. However, a UCC Financing Statement will be filed in the register of deeds' office and in Raleigh with the Secretary of State when the UCC Financing Statement covers not only fixtures covered by the deed of trust, but also personal property on the premises.

13. At times, contemporaneous with the above recordings, the original lender will assign to another lender its various interests held pursuant to (1) a Deed of Trust, (2) an Assignment of Rents and (3) a UCC Financing Statement. (1) and (2) are usually assigned by one recorded document or separate recorded documents. The UCC Financing Statement assignment is usually assigned by a UCC Financing Statement Addendum that is recorded where the UCC Financing Statement is recorded. When such a new lender is involved, the new lender is shown as the insured in the loan policy, the Assignment of Deed of Trust is also shown in Schedule A of the loan policy right after the Deed of Trust, and the Assignment of the Assignment of Rents and the UCC Financing Statement Addendum are shown in Schedule B-II of the loan policy. The effective Date of Policy is the time of recording of the assignments. These documents are added to the appropriate places in the owner's policy. Any assignment should be placed in the same numbered item as the document assigned. Assignments should never be listed separately, unrelated to the document assigned.

14. If the title insurer is issuing a new commitment on a new transaction, and an old Deed of Trust to a prior lender and a related Assignment of Rents to a prior lender is reported in the attorney's preliminary opinion, require that both be cancelled in the same requirement. (It should be noted that if the note secured by the deed of trust is completely paid off and satisfied and the deed of trust is cancelled, but the assignment of rents is not cancelled—even though it should be—the title insurer can consider the assignment of rents "gone" since there is no debt secured. Second, if the deed of trust says that a cancellation of the deed of trust or a release of the land from the lien of the deed of trust also has the same effect on the assignment of rents, failure to obtain a cancellation of the assignment of rents or release of the land from the assignment of rents will be something that the title insurer can overlook. However, if the deed of trust says nothing about a release of the subject land from the deed of trust also acting as a release of land from the assignment of rents and there is no independent release of the land from the assignment of rents recorded, this can be a concern if the note has not been paid and satisfied.)