

Lease strategies

Options for landlords and tenants in a changing marketplace **Interviewed by Meredyth McKenzie**

Even after downsizing, many companies still find themselves stuck as tenants leasing more space than needed or with rents they can no longer afford to pay. These companies then run the risk of going into default on the lease or possible eviction from the space. They could also lose any security deposits or find themselves owing money as the result of the landlords' draw of letters of credit if they cannot keep promises under the lease.

It's a loss for the landlords, too, if the tenants default, since landlords of vacant spaces are not receiving the income needed to pay debt service owed to their lenders or to pay operating expenses for the property.

"Many tenants took on space needed at the outset of the lease without foresight that they would downsize in the current economic climate," says Juliana Stamato, real estate attorney with Theodora Oringher Miller & Richman PC. "Tenants then find themselves paying rent on space that is no longer needed or paying above market rent in the face of declining revenues."

Smart Business spoke with Stamato about the different options and strategies that tenants and landlords can utilize to cope with these challenges.

What options do tenants have if they are leasing too much space?

Tenants can consider moving out of the premises and assigning the entire lease to a new tenant or subletting some of the space. Tenants should review the lease to determine whether the lease permits assignments and subleasing. Most commercial leases require the landlord's consent for assignments and subleases, and many leases list criteria that must be satisfied in order to obtain the landlord's consent, such as establishing that the proposed new tenant has the financial strength to honor the lease obligations. Tenants will need to allow plenty of time for finding a new tenant or subtenant and obtaining the landlord's consent.

How can you find a tenant or subtenant for your space?

You should meet with your broker and explore current market conditions and



Juliana Stamato
Real estate attorney
Theodora Oringher Miller & Richman PC

possible candidates for the space. If you are paying above market rent, you will need to be prepared to lower the rent for your new tenant or subtenant and pay the difference to the landlord. You also need to assess the desirability of the space. For example, it may be difficult to find a new tenant or subtenant if your premises have highly specialized tenant improvements that need to be changed, if parking is an issue or if there is too little time remaining on the lease. Or perhaps the configuration of your leased premises doesn't work for subleasing. If you can't find a new tenant or subtenant, another option is to try to restructure or modify the lease.

What if you don't have excess space, but you are struggling to pay your rent?

You can propose to the landlord that the lease be restructured and modified to lower your rent.

If you are a tenant seeking a lease restructure, what are some things to consider?

You will need to develop a strategy for convincing the landlord that the landlord is better off keeping you as a tenant and restructuring or modifying the lease.

JULIANA STAMATO is a real estate attorney at Theodora Oringher Miller & Richman PC. She has extensive experience in leases and loans, including workouts. Reach her at (310) 788-3526 or jstamato@tocounsel.com.

You should be prepared to communicate honestly with the landlord about your financial position and plans and to share financial information. You should present the landlord with a business plan that demonstrates that you will be able to comply with the restructured or modified lease for the entire term.

If you are the landlord, how do you respond to a tenant's request for lease concessions?

You have to weigh the benefits of keeping the tenant with lease concessions against the costs of finding a new one. You have to consider the effects of a tenant bankruptcy, including the cap on damages that you can recover from a bankrupt tenant as well as brokers' commissions and tenant improvements for a new tenant. If you proceed with a lease restructure, you should first verify the tenant's financial condition and consider whether its business projections are realistic. You should consider increasing the security deposit, obtaining a letter of credit or a personal guaranty and extending the lease term. You can add a provision to the restructured lease that would allow you to recapture all of the rent and other concessions if the tenant should default. You also may want to require the tenant to pay your legal fees for the lease restructure so that your tenant does not drag out the negotiation process. And don't forget to check your loan documents to see if your lender has the right to approve the lease modification.

What steps can be taken to make sure both parties' needs are met when negotiating the lease restructure?

Circumstances vary. Typically the landlord will want a written agreement with the tenant at the outset, stating that the old lease terms will remain in effect until a lease amendment is signed. The tenant should work with an attorney early to ensure that the parties reach agreement on lease restructure as soon as possible and the modification terms adequately protect the tenant and give the tenant breathing room to continue its business in the space. <<

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