

Real Estate Strategies

Protect Your Lease From Landlord \$\$\$ Problems

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YOUR COMPANY IS LOOKING FOR NEW SPACE, AND YOU AND YOUR TENANT REPRESENTATIVE HAVE NARROWED IT DOWN TO TWO ATTRACTIVE BUILDINGS WITH COMPETITIVE LEASE TERMS.

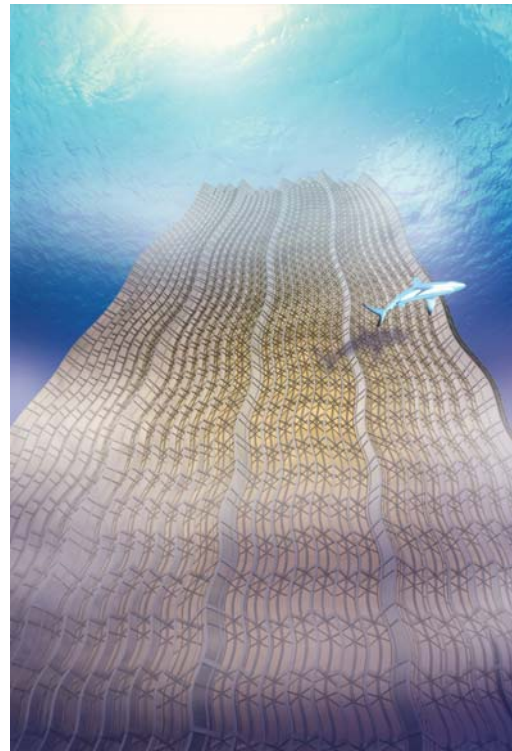
Your company is looking for new space, and you and your tenant representative have narrowed it down to two attractive buildings with competitive lease terms. Building 1 is a little cheaper, and has a better tenant improvement (work letter) on the table than Building 2. Your broker says take the space that costs more – Building 2. Why?

As an exclusive tenant rep with no loyalty to any building owner, he or she knows the market, and tells you that, “Building 1 is under water. (A tenant rep can also help if you’re stuck in the middle of a lease in a bankrupt building.)

Building 1 is a prototypical troubled property. If a building was purchased or refinanced at the peak of the market in the mid-2000s, its mortgage may exceed the present value of the property. The landlord may be having trouble paying the mortgage due to vacancies or the need to reduce rents to lure tenants.

Don’t consider leasing space in an “under water” property even if the lease terms are more attractive than comparable spaces. Run, do not walk away, from such offers.

It’s this simple: a landlord’s financial stress can interfere with things like maintaining basic building services and not being able to fund the promised tenant improvements (TI). Leasing at an underwater building is risky business – you may find yourself dealing with new people



constantly, including receivers, service companies, banks and eventually new owners.

If you like your building services “sunny side up,” choose a financially stable owner.

Tenant Protection in a Troubled Market.

But what happens if you're in the middle of negotiating for space and you learn that the landlord is in financial trouble – possibly insolvent?

Problems arise if the landlord has not funded TI's, isn't properly maintaining the property or worse yet, the property is foreclosed. Foreclosure brings uncertainty. How much uncertainty depends on who forecloses, such as a lender or an investor – each of whom has a different priority.

As a tenant, what are your protections? What rights do you have in relation to the landlord? What provisions should you attempt to have included in a lease? **Below is a quick rundown on tenant lease protections:**

SNDA (Subordination Non-Disturbance Agreement)

Tenant Rights: The SNDA is actually three agreements in one. The non-disturbance agreement protects the tenant by requiring that the lease stays in force so long as the tenant is not in default. Thus, if the building enters foreclosure, the tenant pays rent to the lender, not the landlord. The subordination portion permits the lender's lien to be superior, so in the event of a foreclosure, the lender can wipe out all junior liens. The lender also requires an attornment agreement which basically maintains the tenant's contractual obligations so that the current lease terms are binding on a lender or new landlord.

Offset Rights: In order to offset rent, the SNDA must allow the tenant to offset rent. The offset rights can be a valuable protection in the event the landlord does not fund the TI allowance or other financial obligations, however this slippery slope can be complicated if the tenant is still under a free rent period. In some states, the courts have ruled that if the landlord is not performing his obligations, then the landlord has constructively evicted the tenant. This allows the tenant to be relieved from the lease and move elsewhere. If the tenant stays in possession, however, he must pay rent.

Escrow Rights: Large tenants can require that the landlord escrow the tenant allowance funds or have an entity with unlimited liability guarantee the payment of the allowance. Whether or not the landlord is funding improvements, tenants should always perform due diligence to determine the landlord's financial position before entering into a lease.

Because of the intricacies of specific transactions, and state-to-state variations in tenant law, companies should retain a local legal counsel who specializes in commercial real estate law before making a binding lease commitment, and use a local ITRA non-conflicted tenant rep, whose fiduciary responsibility is to you, the tenant.

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