

# WHAT'S YOUR NAME? WHO'S YOUR DADDY?<sup>1</sup>

By Jim Hochman

Lease negotiations aren't often brought up in rock 'n' roll trivia, but this column's title references an interesting lease negotiation point: security deposits. Often deferred in lease negotiations from the letter of intent, security deposits arise toward the end of the lease negotiation itself, often as a single TBD in the letter of intent. The letter of intent and lease draft cleverly postpone treatment of the issue well into the process, until the prospective tenant produces its financial statement. At that point, often in the third draft of the lease, the landlord has acquired leverage, because the tenant has likely committed to this lease, this space, and this transaction. Having invested precious time, most tenants are unable to abandon this deal and turn to the alternate properties it had under consideration and still occupy the space when they need it. Nicely

played, landlord, who now reviews the financials and insists on a hefty cash security deposit. I have seen this occur more than a few times. One landlord actually changed the deal terms, and on a 10-year lease term, moved the 10 months of abated rent from months 1-10 to months 61-70, asserting that the tenant's less than strong balance sheet caused the landlord to condition rent abatement on the tenant's payment of rent timely for all months 1-60.

While these parties paid close attention to the numbers, others on other deals might not be as vigilant. It is just as important, perhaps critical, to ask the question "Who is the tenant?" The following story illustrates this point.

I represented a foreign tenant leasing approximately 25,000 square feet of office space for its new U.S.

headquarters; a smaller headquarters deal, but a significant sized deal nonetheless. The parties went through various offers and counters on the size and nature of the security deposit, such as how many months of rent, whether the security deposit should be based on net or gross, burn-off if the tenant paid rent timely, and even a letter of credit whose size also "burned off" over time. I found it interesting though, that when my tenant client changed the name of the tenant entity from the well-known and well capitalized parent company to a newly formed wholly owned subsidiary limited liability company, there wasn't a ripple of notice or pushback from the landlord.

When I represent a landlord, I tend to look at the "what ifs," including damage to the space, or the occasional late or missed rent payment. I ask, "What if fortunes change? What if the tenant vacates the space in the midst of the lease term? Who pays the landlord's claims for lost rent, re-leasing the space, marketing expenses and lease commissions, or reimbursement for

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<sup>1</sup>From "Time of the Season" by The Zombies

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tenant improvement and abated rent?” Turning to my recent transaction, let’s project the worst: the tenant vacates after year one, leaving four years of term. The landlord abated five months of rent at the outset and spent significant funds on tenant improvements. From whom does the landlord recover? Whether he holds two or even three months of rent as a security deposit seems somewhat trivial, as the landlord’s losses from this one lease are significantly more than the so-called “heavily negotiated” security deposit.

Back to my clever title: “What’s Your Name, Who’s Your Daddy”? Is the parent entity (the one with the assets) liable on the lease as either the tenant or as guarantor? In my deal, the answer was no, no one asked, so the tenant did not offer.

What’s your Name, Who’s your parent company? Or to switch to another Zombies lyric. “Well no one told me about her... Please don’t bother trying to find her. She’s not there.”

So, what is my message today? Look at the big picture! Size of security deposit is one issue, but long-term viability of the tenant and the net worth of the party or parties responsible for the tenant performance and liability for tenant breach, are the real issues. ▾



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