

# SUBLEASING PITFALLS AND STRATEGIES

By Jim Hochman and David Liebman, SIOR

As the pandemic continues to roil CRE markets and deals, there is one area that is seeing heightened activity: the availability of sublease space, particularly in the office sector, which has taken off at a record pace. As a direct result, the astute broker should consider some key subleasing issues and strategies. We identify several of these here with suggested ways to handle and use to your respective clients' advantage.

## **Right to and Conditions of Sublease:**

First and foremost, the tenant's right to sublease must be expressed in the lease. Coupled with that, the conditions under which the sublease is allowed should be detailed, including: information needed by the landlord in advance of landlord's decision whether or not to consent to the sublease (subtenant's name, use, financials, and form of sublease, including sublease rent and terms). In some cases, the tenant/sublandlord may have the right to share in the excess rent charged the subtenant, or perhaps a share net of sublease expenses such as marketing expenses, tenant improvement costs, and commissions.

## **Tenant's Payment of Rent/Creditworthiness and the Effect on Subtenant:**

As the pandemic took hold and governmental shelter-in-place orders proliferated, tenants' businesses faltered and many workers—especially those who are office-based—started working from home, resulting in many tenants not paying some or all of their

monthly rent, with or without rent deferral agreements in place. If a sublease is already in place, and the tenant/sublandlord stops paying rent, that could trigger lease default provisions, adversely impacting the subtenant's right of possession, among other negative consequences. In certain leases, a departure from occupying the space could impact co-tenancy provisions in other leases in a multi-tenant property. It might also activate a landlord's right of recapture, if one exists in the primary lease, and potentially terminate both the lease and sublease. Also, if tenant/sublandlord defaults on the primary lease, will the subtenant be protected if it keeps paying rent on the sublease space? Does the subtenant have the right to directly pay the primary landlord so that the subtenant isn't squeezed out of its possession rights or other rights under the sublease? These rights—usually contained in the sublease—may allow a landlord to accept subtenant's rents. In other words, the sublease should also be structured to protect the subtenant as well.

## **Tenant's Obligations Regarding Premises:**

A tenant may have existing obligations under the primary lease, such as restoration at the end of the lease term. If a subtenant is in possession of the premises under a legitimate sublease and the primary lease ends, what happens if the tenant-sublandlord—who already missed several months' rent payments—also fails to restore the premises as set forth and required in the primary lease? It is incumbent upon the subtenant, his broker, and attorney, to parse out all

primary lease obligations that arguably may fall into the subtenant's lap at some future date.

## **The Sublease As a Benefit To Tenant:**

Given potential pandemic-induced tenant challenges, financial or otherwise, from a strategy standpoint, consider whether a sublease might enhance a tenant's position vis-a-vis the landlord. If the landlord is concerned about a tenant's financial viability, a sublease could put the tenant in a better position, with an able subtenant to cover for any tenant-sublandlord missteps. However, to bring this concept full circle, one could argue that the subtenant must agree to attorn to the landlord in order to enhance the tenant's position.

These and many more issues make the sublease a challenging but potentially strategic tool for subtenants, tenants, and landlords and their experienced and knowledgeable SIOR advisors both in normal times and during our current pandemic as well. ▾

## MEET THE AUTHORS

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